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About the Author

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Abstract

The deepest financial crisis to strike the global economy since the Great Depression has unceremoniously called into question the very foundations of the Western economic model. The liberalisation of capital flows and the growing internationalisation of financial markets outpaced global regulatory and supervisory efforts. The repercussions of the financial crisis have given new dynamism to the reform of financial regulation both globally and within the European Union (EU). The Eurozone, by way of its own failings, has emerged as a stronger conceptual and legitimate entity since the onset of the crisis, but to what extent does this equate to a greater external role, in particular in the reform of international financial regulation? This paper argues that the Eurozone is currently not in a position to play an important role in the reform of international financial regulation, as it is a weak actor in the context of the EU financial architecture, which is still largely characterised by differing national regimes, a prevailing influence from the UK and fragmented external representation. The key finding from this study is that internal tensions in the EU are at the very heart of the Eurozone's difficulties in playing a role in the reform of international financial regulation. Surmounting these tensions is a pre-requisite for the Eurozone if it is to overcome its structural weakness in international financial politics. However, the implications of such evolutions to the Eurozone, as an entity, and to European integration are far-reaching.

List of Abbreviations

BCBS	Basel Committee on Banking Supervision
CEBS	Committee of European Banking Services
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CESR	Committee of European Securities Regulators
CRA	Credit Rating Agencies
CRD IV	Capital Requirements Directive IV
EBA	European Banking Authority
EC	European Communities
ECB	European Central Bank
ECOFIN	Council of Economic and Financial Affairs
EFC	Economic and Financial Committee
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
EIOPA	European Insurance and Occupational Pensions Authority
EMU	Economic and Monetary Union
EP	European Parliament
ESA	European Supervisory Authorities
ESCB	European System of Central Banks
ESFS	European System of Financial Supervision
ESM	European Stability Mechanism
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
EURIMF	European Representatives to the IMF
FSA	Financial Services Authority
FSAP	Financial Services Action Plan
FSB	Financial Stability Board
IMF	International Monetary Fund
MiFID	Markets in Financial Instruments Directive
MoU	Memorandum of Understanding
NCBs	National Central Banks
SCIMF	Sub-Committee on the International Monetary Fund
TEU	Treaty on European Union

Introduction

"Great empires rarely succumb to outside attack. But they often crumble under the weight of internal dissent."[1]

In its first ten years of existence the Eurozone was hailed as a success, the Euro had become the world's second reserve currency, and never before had such an experiment been attempted. The apparent success of the Euro and the Eurozone appears somewhat naïve in light of the serious flaws that the banking crisis and the subsequent sovereign debt crisis have exposed. "The Eurozone crisis is much more than a sovereign debt crisis. It calls into question the whole architecture of economic policy, from monetary policy to macroeconomic surveillance."[2] Reforms to the regulatory and supervisory framework have, in spite of differences, been pursued in order to ensure the future stability of the financial system in Europe. Concurrently financial regulation on a global scale is also undergoing a phase of evolution.

This piece of work does not intend to analyse the specific reforms proposed to international financial regulation or to the international financial architecture. Instead, the objective of this paper is to gain a greater understanding of the consequences that internal governance reforms could have on the external voice of the Eurozone in light of the financial crisis. It will be argued that despite the emergence of the Eurozone as a stronger conceptual entity in the eyes of markets and global partners, it is currently unable to assume a strong external role for two crucial reasons. Firstly, it is a weak actor in the context of the financial architecture within the EU due to institutional inconsistencies and the dominance of the UK and the City in EU financial regulation and, secondly, it suffers from a very fragmented system of external representation.

It is important first to clarify the definition of financial regulation. The 'de Larosière Group' defines regulation as "the set of rules and standards that govern financial institutions".[3] This paper favours a more 'old-fashioned' understanding of financial regulation, "understood as a cluster of interrelated policies designed to ensure the proper functioning and integrity of financial systems", including public regulation, supervision of banks, leverage and liquidity issues, risk management and crisis

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[1] D. Gros, "The decline and fall of the euro?", *Centre for European Policy Studies (CEPS)*, Brussels, 2012, retrieved 29 March 2012, http://www.ceps.be/book/decline-and-fall-euro.
[2] "Eurozone Crisis: Debts, Institutions and Growth", *CEPII*, Paris, 2010, retrieved 30 April 2012, http://www.cepii.fr/anglaisgraph/publications/lettre/pdf/2010/let300ang.pdf.
[3] European Commission, *The High-Level Group on Financial Supervision in the EU: De Larosière Report*, Final Report, Brussels, 25 February 2009, p. 13.

management.[4] This wider definition of financial regulation allows a richer study of the efforts undertaken to reform it on the international level.

The nature of the research subject and the fact that the financial architecture in the EU and Eurozone are constantly evolving places limits on the scope of the analysis. The paper does not take into account the developments from the recent European Council meetings of June 2012, which suggest the European Central Bank (ECB) will become the supervisory body of the Eurozone.[5] This paper will instead focus on the reforms that have already taken place in the EU, the European System of Financial Supervision (ESFS), and the proposed reforms of the UK, after which the external dimension will be analysed, specifically the interaction of the Eurozone with the International Monetary Fund (IMF) during the sovereign debt crisis.

The Eurozone, Regulation, Supervision and Crisis Management

Before examining the recent reforms and their impact on the Eurozone's ability to play a role in the reform of international financial regulation, it is important to understand the origins of the problems that the Eurozone is facing. Two factors appear to be important in light of the current crisis: the division between economic and monetary policy in the Eurozone and the pursuit of capital movement liberalisation.

Firstly, in the institutional setup of the Economic and Monetary Union (EMU) a "divorced economic logic is fully adopted", meaning that "according to traditional monetary theory, from an institutional point of view, monetary policy can be divorced from *economic* policy".[6] Monetary policy was therefore centralised and the economic policy remained the domain of national governments albeit with some coordination at the Council of Economic and Financial Affairs (ECOFIN). The institutional setup of the EMU, as described in the TEU, clearly stated in article 105(5) that "the ESCB [European System of Central Banks] shall *contribute* to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the Financial system" [emphasis

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[4] N. Véron, "Financial Reform after the crisis: An Early Assessment", *Bruegel*, Brussels, 2012, p. 2, retrieved 27 April 2012, http://www.bruegel.org/publications/publication-detail/publication/680-financial-reform-after-the-crisis-an-early-assessment/.

[5] S. Evans, "EU Summit: Was Merkel the winner after all?", *BBC News Online,* 2 July 2012, retrieved 30 July 2012, http://www.bbc.co.uk/news/world-europe-18673218.

[6] G. Caravelis, *European Monetary Union*, Avebury, Ashgate, 1994, p. 17.

added].[7] Therefore, prudential supervision, and implicitly systemic risk, is not treated by the TEU due to this divorced economic logic between monetary and economic policy.

Secondly, the "complete liberalisation of capital transactions and full integration of banking and other financial markets" was inherent in the definition of monetary union supplied by Jacques Delors.[8] The initial definition of monetary union envisaged a complete liberalisation in financial markets. Lest it not be forgotten that "the *sine qua non* of monetary union for Germany would be full capital movements".[9] This logic of liberalisation continues to be seen in the EU financial market, for example the European passport for banking created by the Second Banking Directive (89/646/EEC). It allowed banks to provide cross-border services more easily, but also created an inherent conflict of interest between the home country, which could supervise a pan-European financial institution, and the host country's responsibility for financial stability.

"Since 2000 the single financial market has been characterized by a 'new' degree of consensus over opening and integrating financial markets", which was made apparent by the Financial Services Action Plan (FSAP) and the 'Lamfalussy Process', both of which emerged from the Lisbon European Council of 2000.[10] The 'Lamfalussy Process' explicitly advocated the benefits of more open, transparent and liberalised financial markets. It can, therefore, be seen as a continuation of the philosophy of financial market liberalisation that had prevailed in the EU since the introduction of capital movement liberalisation.

Despite this, the 'Lamfalussy Process' did try to create the framework for the national supervisors and financial authorities to interact closely with each other.[11] At level 3 of the Four-Level Approach[12] proposed by the 'Lamfalussy Process' (see Annex for more detail), each of the Committees is made up of high-level representatives of

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[7] European Union, "Treaty of the European Union of 7 February 1992", *Official Journal of the European Union*, C191E, 29 July 1992, article 105(5).

[8] D. Gros & N. Thygesen, *European Monetary Integration from the European Monetary System to Economic and Monetary Union*, Harlow, Adison Wesley Longman Limited, 1998, 2nd edn., p. 403.

[9] M. Chang, *Monetary Integration in the European Union*, Houndmills, Palgrave Macmillan, 2009, p. 35.

[10] H. Macartney & M. Moran, "Banking and Financial Market Regulation and Supervision", in K. Dyson (ed.), *The Euro at 10*, Oxford, Oxford University Press, 2008, p. 327.

[11] C. McCreevy, "The New Global Regulatory Agenda in Financial Services", *International Finance*, vol. 9, no. 3, 2006, p. 386.

[12] The Four-Level Approach proposed a new system to speed up the regulatory process and supervisory convergence.

relevant supervisory bodies who would be able to coordinate and promote a consistent interpretation of EU directives as well as attempt to converge supervisory practices. Nonetheless, in the light of the financial crisis this attempt seems to have failed. The Committees comprised an inordinate number of members, totalling over 50 in the Committee of European Banking Services (CEBS) alone. [13] The Memo-randums of Understanding (MoU) signed in 2005 and 2008 on cooperation in situations of financial crisis were quickly ignored in the case of the failure of Dexia and Fortis. At this time, crisis resolution was entirely the responsibility of national treasuries and thus carried out on an *ad hoc* basis, given the fact that the MoUs never alluded to an *ex ante* burden sharing arrangement.[14]

The process of deregulation within the EU financial market started with free capital movements and was continued by the introduction of the European passport for banking and the FSAP. Simultaneously, the introduction of the 'Lamfalussy Process' sought to ensure greater flexibility in the regulatory process and enhanced cooperation between national regulators and supervisors. Despite some positive steps forward, the crisis has revealed a number of institutional flaws that were present in the EU and consequently in the Eurozone since its creation. In hindsight, it seems startling that a greater amount of attention of regulation and supervision was not given to the Eurozone level. The initiatives mentioned above were situated at the EU level, although there now appears to be greater systemic risk given that there is only one currency connecting the financial systems of Eurozone countries.

European System of Financial Supervision

Since the start of the crisis there have been, on a global level, policy initiatives to correct the "embarrassing blind spots in the pre-crisis understanding of the financial system",[15] notably the creation and adoption of authorities mandated to survey and contribute to the stability of the overall financial system. The EU and its Member States have been no different in this regard. In 2009, the Commission proposed a set of institutional reforms after the findings of the de Larosière Report produced by the High-Level Group on Financial Supervision in the EU, which were subsequently

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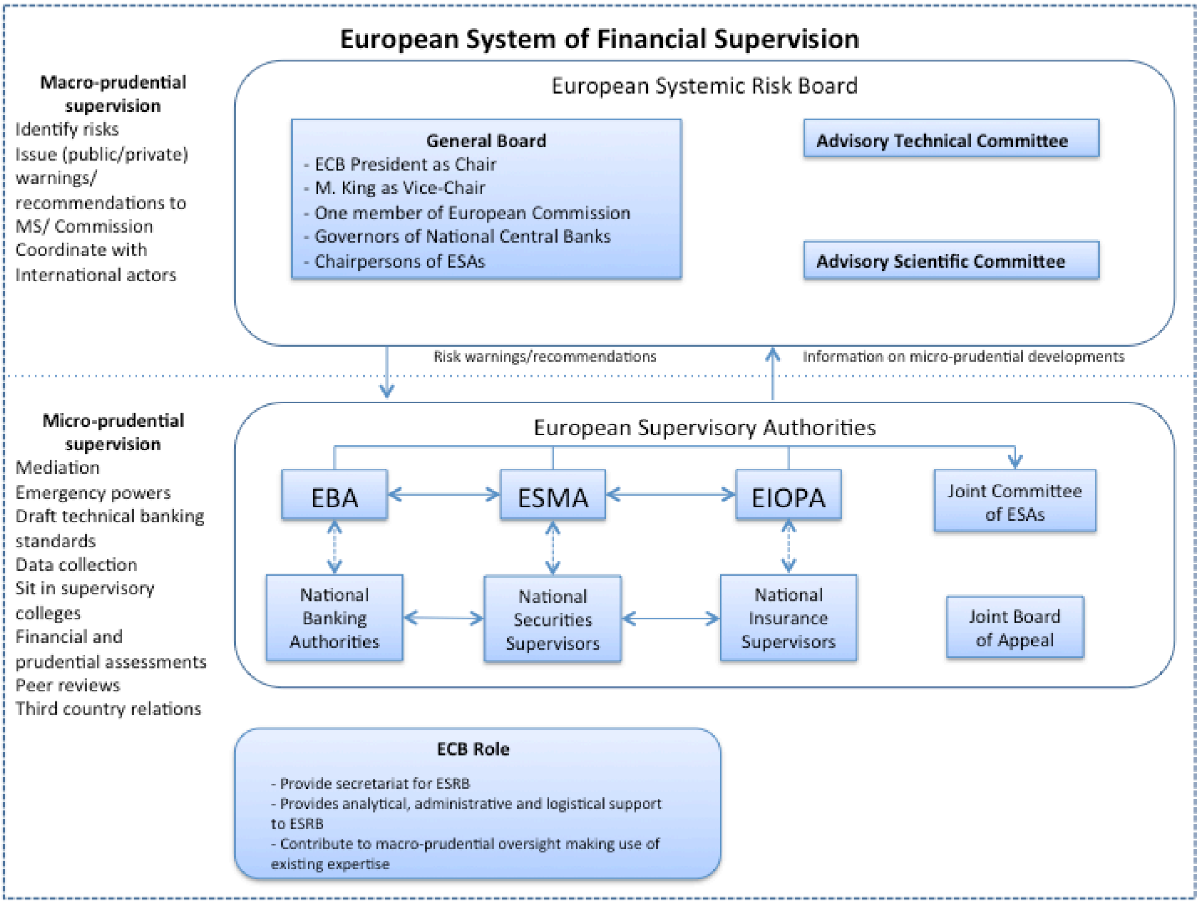
[13] N. Véron, "Is Europe ready for a Banking Crisis?", *Bruegel*, Brussels, 2007, p. 4, retrieved 03 October 2011, http://www.bruegel.org/publications/publication-detail/publication/234-is-europe-ready- for- a-major-banking-crisis/.

[14] J. Pisani-Ferry & A. Sapir, "Banking Crisis Management in the EU: an early assessment", *Economic Policy*, vol. 25, no. 62, 2010, p. 346.

[15] Véron, "Financial Reform after the crisis", *op.cit.*, p. 11.

adopted in November 2010 in several regulations.[16] The new supervisory package sets out a two-pillar process that intertwines micro- and macro-prudential supervision. The overall structure is known as the European System of Financial Supervision and displayed in Figure 1.

Figure 1: New European Supervisory Framework



Source: based on D. Green, "International Financial Regulation", in N. Bayne & S. Woolcock (eds.), *The New Economic Diplomacy*, Farnham, Ashgate, 2011, 3rd edn., p. 267.

The European Systemic Risk Board (ESRB)

The acknowledgement and the attempt to create a European authority to survey systemic risk in the EU's financial system represents an important step forward. The ESRB is primarily focused on macro-prudential risk, but it has been mandated to work closely with the European Supervisory Authorities (ESAs). Consequently, there is a 'cross composition' of the ESRB, which is very beneficial on initial examination. By including the ECB, it makes use of its already established advisory capacities to

[16] Council of the European Union, "Regulation No 1092/2010", "No 1093/2010", "No 1094/2010", "No 1095/2010", "No 1096/2010", *Official Journal of the European Union*, L331, 24 November 2010.

systemic risk and allows the presence of an institution of the Eurozone. The inclusion of the National Central Banks (NCBs) and the ESAs is also important, as the ESRB will rely on information only available to these authorities in order to make an assessment of the overall stability of the financial system. From this point of view, the EU-level body is well designed as it is very inclusive of all the important actors.

However, the instruments given to the ESRB are rather limited, and in fact "it lacks instruments to address systemic risk".[17] "As response to potential systemic risks, the ESRB may issue warnings and recommendations on how to mitigate those risks."[18] Recommendations can also be made to the European Commission regarding a certain piece of legislation, meaning that the ESRB can impact EU law in this domain. According to article 18 of Regulation No. 1092/2010, the ESRB can make its warnings and recommendations public.[19] Much in the same way that NCBs can release information into the public domain with the objective of influencing markets or financial institutions, the ESRB has the same possibility. Nevertheless, these tools are not legally binding on the addressees. Instead, there is an "act and explain mechanism", which the ESRB optimistically believes will make "it difficult for the addressees to simply ignore them [the warnings and recommendations of the ESRB]".[20] The fact that it was agreed to make the warnings non-binding indicates that "De Larosière's quasi-supranational vision of financial supervision" will remain just that, a vision, and the well-established soft law approach will continue to prevail.[21]

Furthermore, the ESRB relies on the national authorities of each Member State to implement its recommendations. One problem that becomes apparent with this approach is that national authorities may well have very different views as to which macro-prudential instruments to use and how to use them. The UK, France, Belgium, and other jurisdictions have set about creating their own macro-prudential authorities; in the UK the Financial Policy Committee, in France the Financial Regulation and Systemic Risk Council and in Belgium the Committee for Systemic Risks and System-relevant Financial Institutions. The name attributed to each

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[17] Deutsche Bank Research, "Financial Supervision in the EU", *EU Monitor 84*, 2011, p. 7.
[18] F. Dierick, P. Lennartsdotter & P. Del Favero, "The ESRB at work", *Macro-prudential Commentaries*, European Systemic Risk Board, no. 1, 2012, p. 1.
[19] Council of the European Union, "Regulation No 1092/2010 of the European Parliament and of the Council on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board", *Official Journal of the European Union*, L331, 24 November 2010, p. 10.
[20] Dierick, Lennartsdotter & Del Favero, *op.cit.*, p. 4.
[21] D. Hodson, *Governing the Euro Area in Good Times and Bad*, Oxford, Oxford University Press, 2011, p. 34.

institution is indicative of the diversity in conception and roles conceived for these authorities.[22] As long as the ESRB does not have its own macro-prudential tool-kit and has to rely on the national authorities, it will face a tough challenge of coordination and harmonisation.

Finally, the ESRB is also charged with "[c]oordinating its actions with those of international financial organisations, particularly the IMF and the FSB [Financial Stability Board] as well as relevant bodies in third countries on matters related to macro-prudential oversight".[23]

Therefore, there is an explicit external dimension given to the ESRB in its mission statement. Given that it is only a year old, it is difficult to judge at this stage the actual external presence that the ESRB will be able to maintain, taking into account that it is reliant on the ECB to ensure its secretariat. Nevertheless, in the context of the global financial architecture, this should be seen in a positive light if the macro-prudential authority coordinating European macro-prudential stability is interacting with those on the international scene.

The European Supervisory Authorities

The ESAs are made up of three separate bodies that take over the roles of the level 3 Committees of the Four-Level Approach proposed by the 'Lamfalussy Process'. These Committees are now called the European Banking Authority (EBA), the European Securities and Market Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA). The first distinction is that the ESAs have a legal personality unlike the previous Committees. They are mandated to take a pan-European approach and must ensure "that a single set of harmonised rules and consistent supervisory practices are applied by national authorities".[24] The aim of a 'single European rulebook' represents a significant step towards achieving a consistent set of harmonised standards across the EU in supervisory and regulatory practices. In order to achieve this goal, the ESAs are mandated with wider reaching powers than the previous Committees. Firstly, they can draft binding technical standards as defined by EU financial legislation. For example, the ESMA currently has powers in several pieces of legislation, such as the Markets in Financial Instruments Directive (MiFID), the Transparency Directive, the Market Abuse Directive, the

[22] Véron, "Financial Reform after the crisis", *op.cit.*, p. 11.
[23] Council of the European Union, "Regulation No 1092/2010", *op.cit.*, p. 6.
[24] Deutsche Bank Research, *op.cit.*, p. 9.

Settlement Finality Directive, and the Alternative Investment Fund Managers Directive. As the Commission has the sole right of initiative, the ESAs will prepare the substance of such technical standards, but the Commission must adopt them. In areas where they cannot issue legally binding technical standards, they will nevertheless set guidelines, the difference being that a national authority must explain its reasons for non-compliance.[25]

While the technically binding standards on all EU Member States are a significant step forward, with the exception of the ESMA and credit rating agencies, the ESAs do not have any direct supervisory power.[26] The supervision of financial institutions remains a purely national pursuit. There is no European level supervision, which is disappointing, given that the negative effects of the crisis were compounded by differences between home and host country's supervision. Admittedly, Article 21 of Regulation 1095/2010 confers upon, in this case, the ESMA, the power to participate in Colleges of Supervisors, which consult on cross-border groups. However, in paragraph 1 of this article its remit is defined as: "The Authority shall *contribute* to *promoting* and *monitoring* the efficient, effective and consistent functioning of the colleges of supervisors" [emphasis added].[27] This does not give the impression of a powerful new body that will direct cross-border supervision.

Yet again there is an exception to this 'soft touch approach', in that the ESMA can, according to Article 19, settle disagreements between competent authorities in cross-border situations with a binding effect to uphold consistency with Union law. The ESAs also have the ability, in emergency cases when declared by the Council, to adopt a decision, which requires the competent national authority to take action.[28] This being said, there is a caveat in the form of article 38. This safeguard clause prevents ESMA from adopting a decision that could impact on the fiscal responsibilities of Member States. It seems that this article is an attempt, on the part of Member States, to protect their national interests and to prevent the establishment of a fully-fledged European supervisory body.

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[25] "A Guide to Understanding ESMA", *European Securities and Markets Authority*, 2011, p. 5, retrieved 14 March 2012, http://www.esma.europa.eu/system/files/2011_009.pdf.
[26] Deutsche Bank Research, *op.cit.*, p. 10.
[27] Council of the European Union, "Regulation No 1095/2010 of the European Parliament and of the Council establishing a European Supervisory Authority (European Securities and Markets Authority)", *Official Journal of the European Union*, L331, 24 November 2010, p. 101.
[28] *Ibid.*, p. 100.

The jury, so to speak, is still out on the new supervisory framework in the EU. The conceptual aspects of linking both micro- and macro-prudential supervision are appealing, and there is certainly an effort to ensure greater coordination between supervisory bodies who have been given greater powers with which to achieve these aims. The establishment of the 'single European rulebook' is another move in the right direction. The ESRB and the ESAs have also been charged with an external dimension. However, the reliance on national authorities for the success of the ESFS is all too apparent. In the matter of improving European supervision to prevent further crises, the EU has taken an 'incremental step' forward rather than a 'giant leap'. The irony of the situation is that the ESA regulations recognise the limits of the previous structures for European supervisory coordination, but do not manage to address them with a truly pan-European supervisory body.[29]

Burden Sharing

"[S]ome day in the future our successors will find that, however good, the improvements our generation makes in the structure, regulation and supervision of the financial system, will let them down."[30] Therefore, it is necessary to consider at this point what crisis management and resolution frameworks are in place with a particular focus on the burden sharing aspect. The Commission, on 6 June 2012, published a legislative proposal for bank recovery and resolution.[31] The proposal, unambitiously but realistically, follows the same logic as the agreed new supervisory framework in the sense that it "proposes a minimum harmonised set of tools and powers" but "Member States would be able to introduce additional tools at national level [...] to deal with crises".[32]

An innovative idea is the use of a resolution college that would be able to "coordinate preparatory and resolution measures among national authorities to ensure optimal solutions at Union level".[33] The national resolution authority that is responsible for the parent financial institution would supervise the resolution college.

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[29] *Ibid.*, p. 85.

[30] P. Tucker, "The Crisis Management Menu", in R. Ayadi, F. Lierman & M. Balling (eds.), *Crisis Management at Cross-roads*, Vienna, SUERF, 2010, p. 13.

[31] European Commission, *Proposal for establishing a framework for the recovery and resolution of credit institutions and investment firms,* COM(2012) 280 final, Brussels, 6 June 2012.

[32] European Commission, *Bank recovery and resolution proposal: Frequently Asked Questions,* MEMO/12/416, retrieved 20 June 2012, http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/12/416&format=HTML&aged=0&language=EN&guiLanguage=en.

[33] European Commission, *Proposal for framework for recovery of credit institutions*, *op.cit.*, p. 15.

The idea would be that the group resolution authorities would have the power to decide on how to resolve the group situation, including group liquidity management, which "may be suboptimal and the survival of the group could be hampered by supervisory ring-fencing", and *ex ante* planning for possible group resolution plans.[34] The EBA would play a central role as a member of each resolution college and "perform a binding mediation role".[35] However, the binding mediation role of the EBA would be subject to article 38 of its founding directive, the safeguard clause, meaning that it could not take a binding decision that would impose on the fiscal responsibilities of the Member States.[36] In this respect, the power of the EBA within the resolution colleges is somewhat limited.

One notable actor since the crisis is the ECB. It has *de facto* been involved in burden sharing. When interbank markets had dried up of liquidity, the ECB was quick to respond to this by supplying liquidity to the market. "Under the programme, Eurosystem interventions are carried out in the euro area [...] to ensure depth and liquidity in dysfunctional market segments".[37] This intervention fed institutions head-quartered both within and outside of the Eurozone through the liquidity their subsidiaries or branches obtained. As a result, the ECB performed the role of liquidity support to the European banking system. There are several implications that arise from what happened. First, the interventions were generally accepted to be a success,[38] which implies that the institutional structure of this institution was apt for tackling cross-border problems. The relative success of an institution mandated at the Eurozone level raises very searching questions for the Eurozone itself on how to proceed in the future with regards to financial stability and crisis management. The crisis has shown that the Eurozone may well act as a shield against wild currency fluctuations. Conversely, systemic risk would seem to be much higher amongst Eurozone states than non-Eurozone states.

Crisis management and resolution are still rooted in the national context albeit with greater coordination amongst national resolution authorities. The Commission openly

[34] European Central Bank, "The New EU Framework for Financial Crisis Management and Resolution", *ECB Monthly Bulletin*, July 2011, p. 91.
[35] European Commission, *Proposal for framework for recovery of credit institutions, op.cit.*, p. 7.
[36] Council of the European Union, "No 1093/2010 the European Parliament and of the Council establishing a European Supervisory Authority (European Banking Authority)", *Official Journal of the European Union*, L331, 24 November 2010, p. 38.
[37] D. Schoenmaker, "Banking Supervision and Resolution: the European Dimension", *DSF Policy Paper Series*, no. 19, 2012, p. 3.
[38] *Ibid.*

acknowledges that a single European resolution fund is necessary but accepts that in the absence of a single European supervisor and with differing insolvency regimes it is at present 'unworkable'.[39] Academics and practitioners have made suggestions of a Eurozone resolution fund as the precursor to an EU-wide fund.[40] While this may be a reasonable option both for the Eurozone's future stability and in terms of the politically sensitive issue of a Europe-wide fund or authority, it does raise questions as to the future relationship between the Eurozone countries and the 'outs', and has implications for the internal financial market.

Before the crisis, a burden-sharing mechanism for sovereign debt would have been unthinkable, yet it is now in place in the Eurozone. In the words of the Vice-President of the ECB: "Crises make us reconsider things that we would have seen as beyond the feasibility horizon."[41] The Eurozone has emerged as a stronger conceptual entity since the crisis. The internal financial market has been pursued clearly on a EU27-level, and the reforms to supervision and regulation have also revolved around the EU as a whole with a marked absence of the Eurozone as an actor. The structure of regulation and supervision within the EU has been sub-optimal as shown by the recent events of the crisis. The reforms that have been proposed have not corrected all the inconsistencies that have existed since the liberalisation of capital movements. To sum up, there is still a dilemma between an integrated European financial market and the reluctance to relinquish national control of supervision and crisis resolution. This disparity affects the Eurozone in its ability to put forward a truly unified model towards initiatives such as the FSB's resolution regimes.

The internal institutional developments are inextricably linked to the external role of the Eurozone. In the current system it is still difficult to see how the Eurozone can export its model as an example for international financial regulatory reform as long as these inconsistencies persist.

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[39] European Commission, *Bank recovery and resolution proposal: Frequently Asked Questions*, *op.cit.*

[40] Schoenmaker, "Banking Supervision and Resolution", *op.cit.*, and V. Constâncio, Vice-President of the ECB, "A European Solution for crisis management and banking resolution", *ECB Conference of Banking Resolution*, Stockholm, 14 November 2011, retrieved 30 April 2012, http://www.ecb.int/press/key/date/2011/html/sp111114.en.html.

[41] Constâncio, *op.cit.*

The City, the UK and EU Financial Regulation

A Change of Mantra?

The impact of the UK and the City on EU financial regulation, and by extension the Eurozone, is well known. The MiFID, for example, "required all countries to be like the UK, in permitting systemic internalizing".[42] Yet the financial crisis has questioned whether the 'soft touch' approach so fervently pursued by UK authorities and others around the globe was, in fact, the correct one. The following section will examine the recent developments in the UK, allowing an insight into the impact on the Eurozone going forward.

Major reviews of the financial regulatory system have taken place at both the EU level, the de Larosière Report (February 2009), and at the national level in the UK, the Turner Review (March 2009).[43] It is not an understatement to say that both of these reviews have had a far-reaching impact on the regulatory and supervisory architecture within Europe and in the UK. Lord Turner, at the publication of his report, stated, "'soft-touch' regulation has been consigned to the dust-bin of history".[44] It would appear that there has been an important change of mind-set that has taken place amongst British authorities.

The de Larosière Report and the Turner Review show many similarities in their findings. They agree on the major causes of the financial crisis,[45] both call for a review of the pro-cyclical effects that result from 'BASEL II Accords' and both urge "a fundamental review of CRAs [Credit Rating Agencies] economic model should be conducted".[46] Apart from some differences in the forward-looking recommendations made by each report, it could be considered that a "technocratic cross-Channel consensus on the causes of the financial crisis and the lessons to be learned" has emerged from the two reports.[47]

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[42] S. Booth *et al.*, "Continental Shift: Safeguarding the UK's financial trade in a changing Europe", *Open Europe,* 2011, p. 11, retrieved 01 April 2012, http://www.openeurope.org.uk/Content/Documents/PDFs/continentalshift.pdf.
[43] Financial Services Authority, *The Turner Review*, London, FSA, March 2009.
[44] S. Schifferes, "Can Banking Regulation go global?", *BBC News Online*, 2009, retrieved 20 April 2012, http://news.bbc.co.uk/2/hi/business/7950758.stm.
[45] Financial Services Authority, *op.cit.*, p. 11; and European Commission, *De Larosière Report*, *op.cit.*, p. 7.
[46] European Commission, *De Larosière Report*, *op.cit.*, p. 19.
[47] P. Whyte, "Anglo-Saxons and hedge funds: Culprits or scapegoats?", *Centre for European Reform (CER)*, London, 2009, retrieved 25 February 2012, http://centreforeuropeanreform.blogspot.com/2009/08/anglo-saxons-and-hedge-funds-culprits.html.

A technocratic consensus may be admirable, but policy issues, which before the crisis were the restricted domain of technicians and practitioners, have received greater attention from elected officials. If the technocratic consensus is not reflected in the political rhetoric or decision-making due to elected officials responding to domestic audiences' concerns, policy-making could be pushed in unfavourable directions. This, to a large extent, has been the case in the formation of the new EU financial regulatory and supervisory framework. The UK was able to impose certain restrictions on the progress of the new framework. The European Council welcomed the de Larosière Report in March 2009, although it quickly gave in to "opposition from the UK [...] against giving the ECB a say over financial stability beyond the euro area".[48] Thus, the limits of the role of the ECB in financial stability have been shaped by an entity that is not actually part of the Eurozone. Furthermore, the "sine qua non of any British agreement" to a new financial framework was the explicit exclusion of any fiscal burden sharing for financial institutions that may be in trouble.[49]

The political actions of the UK have left a deep imprint on the whole of the new European financial framework. The City is one of the biggest financial centres for euro-denominated international transactions and the UK is a key driver in financial policy, both of which are external to the Eurozone. There is a paradoxical point in that the UK has significant influence on the financial system of the Eurozone whilst at the same time it is strongly opposed to joining it.

The UK: A Unilateral Approach

The banking and sovereign debt crises have highlighted the need for solidarity and collective action within the EU. Despite the technocratic agreement on the causes of the crisis and the way forward, there is still a different political rhetoric being pursued by the UK and the EU when it comes to the new financial framework for after the crisis. The UK resisted increasing the supranational nature of financial regulation and supervision in the EU. This does not imply that the UK has stood by the use of 'soft touch' regulation. On the contrary, the UK could be considered to be "at the strict end of the EU spectrum".[50] In 2011 all political parties accepted the results

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48 Hodson, *op.cit.*, p. 34.

49 G. Glöckler, "Euro area governance and the Financial Crisis: new quality or flash-in-the-pan?", in R. Liddle (ed.), *After the crisis: A new socio-economic settlement for the EU*, London, Policy Network, 2009, p. 58.

50 P. Whyte, "Financial Regulation: Britain the perennial outlier", *Centre for European Reform (CER)*, London, 2011, retrieved 20 April 2012, http://centreforeuropeanreform.blogspot.com/2011/06/financial-regulation-britain-perennial.html.

of a report delivered by an Independent Commission on Banking.[51] While the results of the so-called Vickers Report testify to the move away from 'soft touch' regulation to a stricter approach to financial regulation, this is not necessarily the problem that the UK poses for the EU or the Eurozone. The unilateral action of the UK has provoked difficult questions as to the future of the single market and the relationship that the UK maintains with the EU and the Eurozone.

There are two controversial suggestions, namely ring-fencing measures for UK banks and tough capital requirements on banks. The former would mean that banks "will be required to establish a separate legal entity within their corporate structure to provide retail and commercial banking services in the UK".[52] The idea behind this proposal is to allow retail services to be insulated from riskier banking activities. In terms of ensuring greater stability for the financial sector in the UK, this idea could yield positive results, although there would be secondary effects on the state of competition within the UK retail banking sector and therefore on the single market. Banks, which operate primarily in other countries with different regulatory procedures, would be forced to adapt their structures if they wanted to enter the UK banking market. The ring-fencing idea, if only applied in the UK, could have dissuasive effects on new entrants to the UK retail banking market. The case could even be made that the UK is pursuing a form of financial protectionism.

Véron persuasively argues that although the controversial proposal of ring-fencing may appear to contradict the principles of the single market for financial services, the institutions and effective centralised regulation are not currently in place for a single market. "As long as these do not exist [...] the single banking market must remain a fiction."[53] He suggests that the Vickers Report has, in fact, provided a valuable public service to the EU by identifying this contradiction. Despite the fact that he may well be correct with these comments, should the ring-fencing proposal not be considered in another light? The UK, by accepting the suggestions of the

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[51] G. Parker & S. Goff, "UK Government to accept Vickers Report 'in full'", *Financial Times*, 18 December 2011, retrieved 30 April 2012, http://www.ft.com/intl/cms/s/0/1f90fcf2-296d-11e1-a066-00144feabdc0.html#axzz272tDCX9U.

[52] B. Reynolds, "The Vickers Report and the Future of UK Banking", *Harvard Law School Forum*, 2012, retrieved 21 April 2012, http://blogs.law.harvard.edu/corpgov/2012/03/29/the-vickers-report-and-the-future-of-uk-banking.

[53] N. Véron, "Some progress in the banking reform debate", *Bruegel*, Brussels, 2011, retrieved 03 April 2012, http://www.bruegel.org/publications/publication-detail/publication/526-some-progress-in-the-banking-reform-debate.

Vickers Report, is prolonging the fragmentation of the EU single market for financial services.

The impact of the UK idea of ring-fencing would not only be a backwards step away from a single financial market, but would also put pressure on the EU approach. In January 2012, Commissioner Barnier announced that a High-level Expert Group would be established.[54] It has the specific mandate to consider structural reforms in the EU banking sector, with particular attention given to the ring-fencing proposed by the Vickers Report and the Volcker Rule.[55] Although their findings will not be published until late 2012, if they were to suggest an EU-wide ring-fencing, the impact on the universal banking model that dominates on the European continent will be significant. There would be a fundamental shift in the structure of banks in each country. Granted this is hypothetical, and the findings of the High-level Group may well be very different, the underlying point is clear: The UK, by acting first in accordance with its own interests, will have a significant impact on the whole of the EU's banking sector. Furthermore, what is adopted in the EU will have ramifications on the international level, as international financial institutions will have to make adjustments to meet the regulatory requirements in the EU if they wish to continue to operate in the large EU financial market.

The second controversial suggestion made by the Vickers Report refers to greater capital requirements on UK banks in order to improve loss-absorbency. It puts forward that the ratio of equity to risk-weighted assets should be at least 10% for banks in the UK, which is higher than those proposed under 'BASEL III' (generally 8-9.5%).[56] The Commission has simultaneously put forward proposals in the form of the Capital Requirements Directive IV (CRD IV) to implement 'BASEL III'. However, these proposals contain "minimal flexibility for Member States to impose lower or higher capital requirements".[57]

By recommending higher capital ratios, the UK is effectively wishing to introduce measures that would propagate different national regimes within the EU. One of the main criticisms to emerge from the crisis has been the range of different national regulatory and supervisory regimes that are present in the supposed EU single financial market. As Whyte notes, "far from narrowing, the Channel looks as wide as

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[54] European Commission, *High-level Expert Group on reforming the structure of the EU banking sector: mandate*, MEMO/12/129, Brussels, 22 February 2012, p. 1.
[55] *Ibid.*
[56] Reynolds, *op.cit.*
[57] *Ibid.*

ever", despite the fact that the UK has abandoned its 'soft touch' approach.[58] The unilateral posture of the UK in response to the financial crisis shows little change from its actions before the crisis, albeit now being at the other end of the spectrum.

The UK is often referred to as the awkward partner in the EU. The examples analysed in this section have reinforced the image of a country wanting to pursue its national interest in the field of financial regulation while resisting the 'control of Brussels'. However, "it is no longer clear that this Janus-faced position is tenable".[59] The UK has implicitly acknowledged, both in the Turner Review and the Vickers Report, the problems posed by the financial trilemma of having integrated financial markets and a stable financial system, whilst still maintaining national supervision.[60] By advocating for a possible ring-fencing of the UK retail banking system and preventing a truly European supervision, it could be suggested that the UK has chosen a stable financial system and national supervision, at the expense of integrated financial markets. This may be suitable for the UK but what of the Eurozone countries and its future members, who have opted for a higher level of economic integration with the introduction of a single currency? It is less likely that the survival and future stability of the Eurozone can be achieved with the same choices. An integrated financial market is a crucial aspect of a currency union. Financial stability is also highly desirable for the success of a currency union, meaning that national supervision would seem to be the odd one out. There is a risk that the Eurozone's choice will be made by default by the UK.

As Schoenmaker rightly states, the UK is the informal leader in financial services and must be taken into account, just as France has an informal leadership in agriculture.[61] The problem lies in the fact that the UK seems to act only for its national interest. A sovereign state cannot be criticised for acting to protect its own national interest, as

[58] P. Whyte, "Britain, the City and the EU: A triangle of suspicion", *Centre for European Reform (CER)*, London, 2011, retrieved 15 April 2012, http://www.cer.org.uk/insights/britain-city-and-eu-triangle-suspicion.
[59] P. Whyte, "Financial Regulation: Will British Euroscepticism collide with European populism?", *Centre for European Reform (CER)*, London, 2011, retrieved 01 April 2012, http://centreforeuropeanreform.blogspot.com/2010/05/financial-regulation-will-british.html.
[60] "The financial trilemma states that (1) financial stability, (2) financial integration and (3) national financial policies are incompatible. Any two of the three objectives can be combined but not all three; one has to give. As international economic integration progresses, the policy domain of nation states has to be exercised over a much narrower domain and global federalism will increase (e.g. in the area of trade policy). The alternative is to keep the nation state fully alive at the expense of further integration." Source: D. Schoenmaker, "The financial trilemma", *Economics Letters*, vol. 111, no. 1, 2011, p. 57.
[61] Schoenmaker, *Banking Supervision and Resolution*, *op.cit.*, p. 12.

this is each state's right to do so. For example, Germany could be argued to be pursuing its own national interest in the way it shaped the so-called 'Fiscal Compact'. However, the UK can be reproached for not acting with greater coordination with its partners. The financial crisis has highlighted that financial markets, on a global scale, and those of the EU Member States, and to an even greater extent the Eurozone are, despite some fragmentation, inextricably linked. This has effectively placed limits on the sovereignty of a state to act without considering others, especially in the context of the EU. A choice will need to be made by the UK with regards to the role that it wishes to pursue in the EU.

ECB Executive Board member Jörg Asmussen called, at the start of April 2012, for greater integration in financial policy at the Eurozone level.[62] This would include establishing its own system to monitor financial institutions and a common fund for collapses, if further integration is not possible at the EU27-level. While Commission officials have been hesitant about any action that could fragment the single market and create a messier institutional setup,[63] "[u]ltimately, monetary union cannot be sustainable without fiscal union and banking union".[64] It is, of course, economically preferable to include the City and the UK in the future process of financial integration and elaborating financial regulation, but there is a real risk that this will not happen. Such an occurrence would pose fundamental questions on the dichotomy between the governance of the EU Member States and the Eurozone members.

The continuing fragmentation of the EU in the area of financial services is a cause of concern. This is primarily because, without greater coordination and harmonisation of the different domestic markets, the EU could commit the same errors and suffer further financial crises that are exacerbated by the different national regimes. The role of the UK as a driver of direction, external to the Eurozone, is crucial. It can prevent the Eurozone from establishing the necessary financial regulation to ensure its future stability and prosperity. As long as financial regulation remains at the EU27-level, the UK will always have a large impact on the Eurozone.

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[62] A. Barker, "Eurozone weighs union on bank regulation", *Financial Times*, 3 April 2012, retrieved 29 April 2012, http://www.ft.com/intl/cms/s/0/f03ab0bc-7d84-11e1-81a5-00144feab49a.html#axzz1tK5CSUdS.

[63] *Ibid*.

[64] N. Véron, "Banking Union or Financial repression? Europe has yet to choose", *VOXEU*, 26 April 2012, retrieved 5 May 2012, http://www.voxeu.org/index.php?q=node/7916.

Academics and practitioners alike have alluded to putting a 'European stamp' on the reforms of the global regulatory architecture, but this is a misnomer.[65] There is neither a European model nor a Eurozone model to speak of because it has been contorted by the UK and the City. Instead, it represents the limits of their willingness to move towards a closer supranational framework. As long as the UK is able to shape financial regulation, the EU or the Eurozone will struggle to put a 'European stamp' on the reform of international financial regulation that represents The Eurozone and the EU's collective interest rather than simply those of the UK or the City.

A Fragmented External Representation

"The coordination of the global financial regulatory reform agenda during the crisis has been mostly the joint preserve of the IMF and FSB."[66] A brief glance at Table 1 underlines the fact that the representation of the EU and the Eurozone in international fora is not uniform. This section will analyse the interaction between the Eurozone and the IMF in the sovereign debt crisis in order to understand whether fragmented representation poses a problem in reality.

Table 1: EU External Representation in Practice

	ECB	**Eurogroup**	**EU Presidency**	**Commission**	**ESAs or ESRB**	**EU Member States**
OECD	Partial		Quasi-member	Quasi-member		19
IMF	Observer		Delegated			27
Financial Stability Board	Member			Member		6
BCBS	Observer			Observer	Observer	9
G7 Finance Ministers & Central Bank Governors	Quasi-member	Quasi-member		Partial		4
G20 Finance Ministers & Central Bank Governors	Member		Member	Attending		5
G20 Heads of States or Government			Member	Member		6

Source: based on G. Glöckler & Z. Truchlewski, "From polyphony to harmony? The external representation of EMU", in J. Lieb, N. Ondarza & D. Schwarzer (eds.), *The European Union in International Fora*, Baden-Baden, Nomos, 2011, p. 119 (fifth column added by author).

The IMF, which has since the onset of the crisis reaffirmed its role on the international scene, granted observer status to the ECB. The ECB is allowed to speak on issues

[65] Glöckler, *op.cit.*, p. 61.
[66] Véron, "Financial Reform after the crisis", *op.cit.*, p. 5.

pertaining to monetary policy and exchange-rate policy, while the Executive Board member who is holding the Presidency would speak on issues of particular relevance to the EMU.[67] This pragmatic solution allowed for the ECB, as the only central bank having observer status, to represent the monetary policy of the Eurozone, and did not necessitate a change to the Statutes of the IMF.

In the case of the IMF, "the most frequent mode of coordination/concertation is the EU format rather than the Euro area one".[68] Only France, Germany and the UK have their own seat on the IMF Executive Board, while other Member States are split amongst mixed constituencies, in which the EU Member State does not always hold the Executive Board seat but must share it with non-EU countries. Two bodies exist to facilitate coordination: the Economic and Financial Committee's Sub-Committee on the International Monetary Fund (SCIMF) and the group of EU representatives to the IMF (EURIMF). It is important to note, that coordination in these bodies is taking place at the EU level. There is no clear indication, except for monetary and exchange-rate policy, that the Eurozone makes significant efforts at the IMF to establish a common position on issues relating to financial regulation, supervision or fiscal policies. While this is understandable given that the competences are internally set along EU lines, it could hinder the realisation of a common Eurozone position on such issues.

Before the financial crisis, it was unthinkable that any European no less Eurozone country, would have recourse to IMF funds. Yet this has been the case for three Eurozone states at the time of writing,[69] Greece, Ireland and Portugal, whilst Cyprus has requested external financial aid. At the start of 2010, the gravity of the situation faced by Greece and the Eurozone became clear and statements from politicians pledging support were no longer enough to calm government bond interest rates.

> A statement issued by EU heads of state or government on 11 February 2010 promised to draw on the 'expertise' of the IMF (Heads of state or government of the European Union 2010), but widening interest rate differentials between Greek and German government bonds suggested that markets remained unconvinced about the EU's ability to do without the Fund's financial resources.[70]

After hostility towards the involvement of the IMF's financial resources, fearing that this could be a show of weakness of Europe to manage the Eurozone, Member

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[67] Agreed at the Vienna European Council, *Presidency Conclusions*, Vienna, 11-12 December 1998.
[68] Glöckler & Truchlewski, *op.cit.*, p. 120.
[69] This paper was submitted for publication in August 2012.
[70] Hodson, *op.cit.*, p. 105.

States agreed at the March 2010 European Council to involve the IMF in any rescue plan.[71] It was not, however, until 2 May 2010 that an eventual package for Greece was agreed upon. The Greek loans were given three months after the EU governments initially tried to rectify the situation without the resources of the IMF.

The month of May also saw the announcement of an EU-IMF initiative to provide support to Eurozone states in difficulty.[72] Ireland was the first Eurozone member to make use of this facility in November 2010, followed by Portugal in May 2011. Ireland, at the time, also received bilateral loans from the UK, Denmark and Sweden, which were separate from the European Financial Stability Fund (EFSF) created by the Eurozone members. The other financial instrument that was created simultaneously was the European financial stabilisation mechanism (EFSM).

Several points need to be highlighted regarding the involvement of the IMF. A noticeable problem during the sovereign debt crisis was the initial time delays between the EU acknowledging the need to make use of the 'Fund's expertise' and the eventual agreement of aid for Greece. For the Greek deal there was a delay of around three months. "The EU's prevarication over the Greek fiscal crisis nonetheless weakened the former's bargaining position in relation to the Fund."[73] The other two rescue packages were agreed in a shorter time period of around one month. There have been various arguments put forward by academics as regards the reasoning behind such delays. One argument blames the poor coordination methods without having a single voice externally or at the IMF for the Eurozone. The other line of argumentation denounces deep-seated divergences between Member States as the source of the EU's procrastination, stating that a single chair at the IMF would have done little to overcome these differences.[74]

A combination of these two arguments is more credible rather than viewing each one as mutually exclusive. The deep-seated divergences in the policy response required were in part a cause of the EU's prevarication. It is undoubtedly hard for Eurozone and EU governments to overcome differences of opinion that would have a lasting effect on the EU. At the same time, improving coordination methods would have helped in finding a common position and expressing it externally.

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[71] S. Ishmael, "Germany warms to IMF aid for Greece", *Financial Times*, 18 March 2010, retrieved 27 April 2012, http://ftalphaville.ft.com/thecut/2010/03/18/179731/germany-warms-to-imf-aid-for-greece.
[72] Hodson, *op.cit.*, p. 107.
[73] *Ibid.*, p. 106.
[74] *Ibid.*

The problem lies in the fact that "the markets and Europe's global partners increasingly perceived the Euro area as an entity in itself and consequently expected governments to assume responsibility for the stability and smooth functioning of the Euro area".[75] This perception does not accommodate heterogeneous preferences. The Eurozone needs, therefore, to ensure that it can better overcome its differences, otherwise it will continually be weakened in negotiations, as was the case with the IMF. If important financial actors, markets, and other international partners now consider the Eurozone a single entity, then logically it would be beneficial to reflect this in the policy responses and the actions of the Eurozone towards these actors.

However, the Eurozone was able to determine some of the modalities of the Greek rescue package. Reports at the time suggested that the IMF approached the subject of debt restructuring, which was emphatically rejected by European policymakers.[76] The Commission and the ECB also managed to obtain a key role in the monitoring process as part of the so-called Troika (together with the IMF). Then, in March 2011, European policymakers began a discordant debate as to whether a partial or full debt restructuring was necessary for Greece.[77] The end result was, in fact, a partial debt restructuring that took place in March 2012. Two interesting points emerge from these events. Firstly, they illustrate the point that the Eurozone, by resisting the IMF's suggestions about debt restructuring initially, did have some influence on the IMF. The Eurozone, despite its fragmented structure that is plagued by heterogeneous preferences, was thus able to prevent the IMF from getting its way initially. Conversely, the fact that there was a need for a debt restructuring two years after the IMF had raised the idea highlights the mistaken policy decisions taken in the Eurozone. This example serves to illustrate the issue of the Eurozone's credibility and its failings. Not only has it proven that the Eurozone has made misguided policy decisions, but also that its speed of policymaking has been slow. "[T]he crisis showed that events can unfold in the blink of an eye, putting strong pressure on actors and

[75] D. Schwarzer, "A consolidated representation of interests in the context of Europe's relative economic decline: drivers and obstacles", in J. Lieb, N. Ondarza & D. Schwarzer (eds.), *The European Union in International Fora*, Baden-Baden, Nomos, 2011, p. 150.
[76] A. Sakoui & K. Hope, "Market weighs up the possibility of Greek debt restructuring", *Financial Times*, 20 April 2010, retrieved 08 February 2012, http://www.ft.com/intl/cms/s/0/cd267574-4c13-11df-a217-00144feab49a.html#axzz1tK5CSUdS.
[77] D. Lachmann, "Partial debt restructuring will not work", *Financial Times*, 30 May 2011, retrieved 08 February 2012, http://www.ft.com/intl/cms/s/0/6da0ef64-8aea-11e0-b2f1-00144feab49a.html#axzz1tK5CSUdS.

their capacity to take decisions and implement them."[78] The capacity of the Eurozone to take decisions, based on the evidence, has to be questioned.

The final remark about the intervention of the IMF in the Eurozone concerns the role that the Commission obtained. The IMF usually seeks an agreement with the relevant monetary and fiscal authorities, but in this case that includes the Commission and some Member States. The Commission has also been asked by the Eurozone states to report on the implementation of adjustment measures and the aid packages. The *ad hoc* cooperation between the Commission and the IMF was given a more permanent basis following the announcement of the joint EU-IMF initiative in May 2010. Thus, "it is supposed to operate jointly with the IMF, so interaction within the Euro area may become an ongoing feature".[79] As a result, the Commission has become a key actor in the Troika and the sovereign debt crisis, although it maintains a rather anomalous position vis-à-vis the IMF.

The Commission is not a member of the IMF, it does not have observer status, yet it is working very closely with the Fund to ensure the successful resolution of the sovereign debt crisis. This is problematic, as one of the European institutions that is working the closest at the moment with the IMF is non-existent at the Executive Board, the main decision-making body of the Fund. Even the ECB, which has observer status, is not privy to the decision-making processes of the Executive Body. In view of the disjointed position of the Commission with regards to the IMF, it is hard to see how a clear position can be communicated, given the number of different European voices to which the IMF is subjected. The anomalous position of the Commission reinforces the need to reform the external representation in order to address the problems outlined in this section.

In conclusion, the Eurozone's external representation is plagued by fragmentation and disjointed access in international bodies. In practice this has proven somewhat problematic. Admittedly there are examples of Eurozone influence in initial negotiations with the IMF, and the cooperation between EU institutions and the IMF has turned the Eurozone into its partner. It remains to be seen what effect this will have on the relationship and the influence that the Eurozone can exercise in the future. However, the Eurozone's, and the EU's, external representation is still marred by complexity and numerous different actors. The Eurozone is increasingly being

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[78] Glöckler & Truchlewski, *op.cit.*, p. 129.
[79] Schwarzer, *op.cit.*, p. 150.

treated and viewed as a single entity by international markets and partners, but this has yet to be reflected in its external representation.

"The crisis has accelerated the transition from a western-dominated financial world toward a more globally-balanced one."[80] The pressure is likely to keep increasing on the EU and the Eurozone to rectify the myriad of its external representation in order to better reflect the reality of global economics. "A cacophony from the European side in discussions would condemn the EU to a spectator role."[81] The analysis presented in this section indicates that despite the Eurozone becoming an informal partner of institutions like the IMF, the formal representation in the Fund and in general is still fragmented. The way in which the Eurozone acts, as a collection of actors, and the way it is treated, increasingly as a single entity, are inconsistent and restrict its ability to interact effectively in international fora, thus limiting its external role.

Conclusion

"EU members need to come out with a clear view of what kind of coordination device they want to invent. There are several routes forward, but failing to select one could contribute to marginalizing the Eurozone in the global economy".[82]

The purpose of this study was to examine the capacity of the Eurozone to play a role in the reform of international financial regulation. Throughout this paper the analysis has largely shown the Eurozone to be an institutionally constrained actor.

The single market for financial services and financial regulation has been pursued at the EU27-level. The UK has had a dominant influence on the direction of financial regulation before the crisis, and it would appear that this is still the case in response to the crisis. The examination of the new ESFS has illustrated that the problem of differing national regimes has not been overcome. The ESFS propagates this situation by avoiding a powerful European supervisory or crisis management system. Due to the institutional setup that is present in the EU financial system as a whole, the Eurozone struggles to be an important actor despite the fact that the Member States' national systems are heavily interdependent. The disparity between the Eurozone and the EU on an internal level is an impediment for the development of a

80 Véron, "Financial Reform after the crisis", *op.cit.*, p. 9.
81 Glöckler, *op.cit.*, p. 61.
82 "Eurozone Crisis: Debts, Institutions and Growth", *op.cit.*

'Eurozone approach'. As there is no approach to export, the impact on international reform is thus likely to be relatively low.

The above-mentioned internal problems are reflected in the external representation of the Eurozone. In the IMF, one of the institutions that has been largely responsible for global regulatory reform, the division of constituencies initially makes coordination amongst Member States difficult. In addition, coordination attempts among Member States seems to be solely focused at the EU27-level with the absence of the Eurozone. The actions of the Eurozone states, during the sovereign debt crisis, have also revealed the weakness of the Eurozone to act collectively in an external environment, and long delays in taking action were witnessed. The evidence tends to confirm the hypothesis stated in the introduction, which took a pessimistic stance on the role of the Eurozone in the reform of international financial regulation.

However, it should be considered that recent developments suggest a *potentially* greater role for the Eurozone as an entity in the future. The sovereign debt crisis dictated that the Eurozone became a partner of the IMF, while the ECB has obtained a central role in the newly created macro-prudential supervisory authority, the ESRB. The Eurozone has emerged from the crisis as a stronger conceptual entity with calls to pursue further financial policy integration at this level. Therefore, there is evidence suggesting a more optimistic evaluation of the Eurozone's role in the reform of international financial regulation in the future; emphasis placed on the word 'future', as this is not a certain notion.

This more optimistic viewpoint of the Eurozone's role raises more searching questions with regards to its future relationship within the EU, with those states that are not currently in the Eurozone and those opposed to joining it. The notion of a Eurozone resolution fund, or pushing for greater financial regulation integration at the Eurozone level, if not possible at the EU-level, have been alluded to in this work. This could reinforce the dichotomy between the Eurozone Member States and the non-Eurozone states, especially in terms of governance structures. Additionally, this will have implications towards the single market for financial services. An even wider governance gap could be created, leaving place to a 'variable geometry' or 'multi-speed Europe' that is difficult to reconcile with a single market for financial services.

Considering the possibility of greater financial policy integration in the context of external representation of the Eurozone, the argument for a reformed and more unified external representation would become even more compelling. The question would then be: In what format should a more unified external representation be pursued? Should it be through stronger coordination methods or with the creation of a single external representative for the Eurozone? In the case of the IMF, would this mean a single Eurozone seat on the Executive Board? From an external point of view, a single Eurozone seat would dramatically change the structure and the voting power of constituencies on the Executive Board. From the internal point of view, the occupier of such a chair would be very controversial. From which institution would the occupier of the single seat be selected? Should it be the ECB, the Commission, or even from one of the Eurozone Member States? Even if there was an agreement on how to choose the new holder of the single chair, it is hard to believe that the holder would have the same ability to take important binding decisions, as would a national Executive Board member. The formation of common positions then becomes even more important. The fact of having a single currency does not imply that Eurozone countries all share the same view on the Fund's projects in Africa, for example.[83]

This hypothetical line of reasoning usefully serves to illustrate the point that the current reform processes in the financial regulation in the EU are of critical importance. The *halfway-house* nature of the regulatory and supervisory reforms sparked calls for further Eurozone integration, which in turn would have wide-reaching ramifications on the EU and, further afield, in the international system. The effect of such changes cannot be underestimated, as they would touch upon the very essence of the EU and the Eurozone.

This paper opened with a quote describing the fall of great empires due to internal tensions. It has been shown that internal tensions in the EU are at the very heart of the Eurozone's difficulties in playing a role in the reform of international financial regulation. Surmounting these tensions is not only a pre-requisite for the Eurozone to overcome its structural disadvantage in international financial politics, but it is also vital in guaranteeing its future stability.

[83] Schwarzer, *op.cit.*, p. 154.

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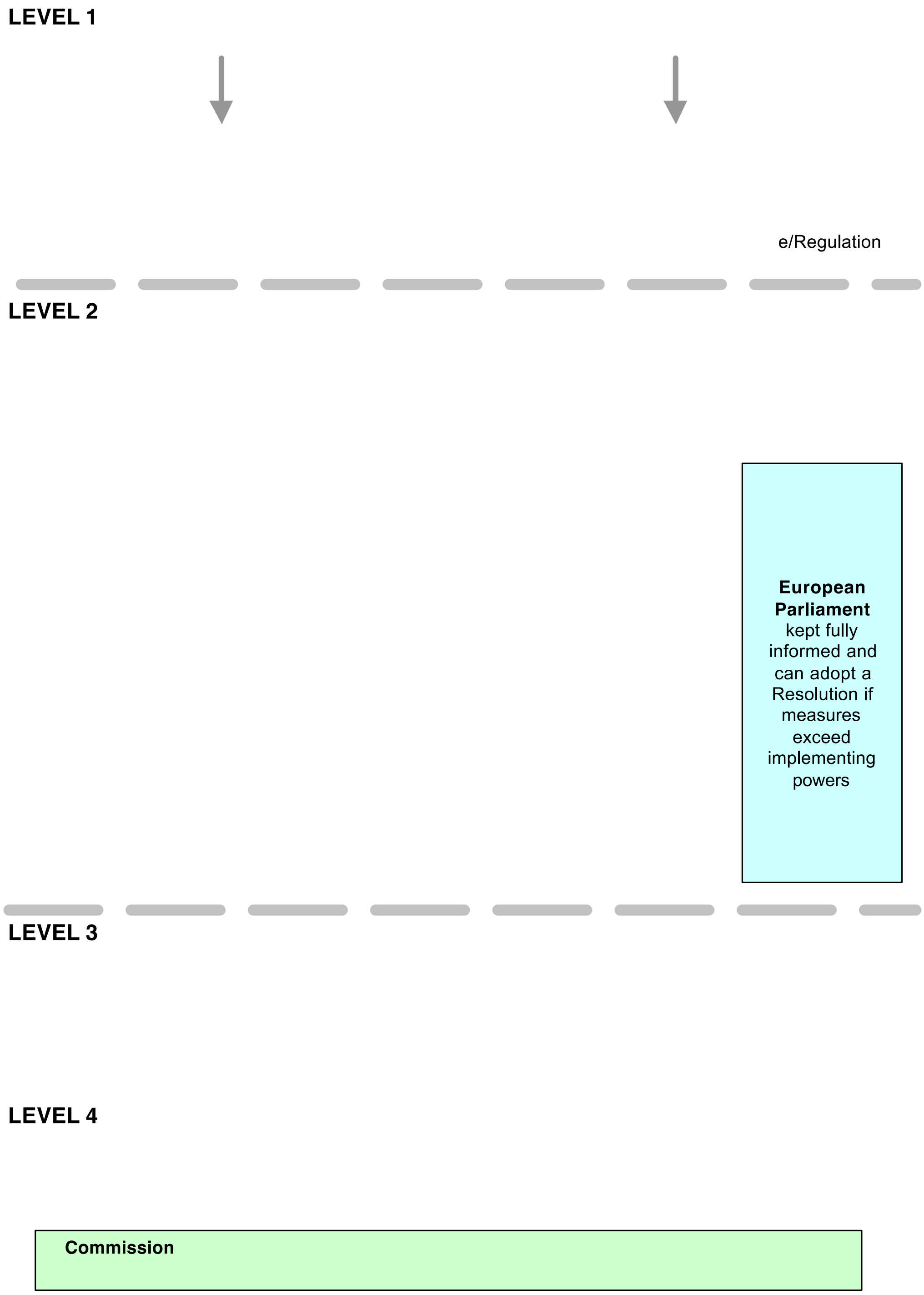
Annex

New Four-Level Approach Proposed by the 'Lamfalussy Process'



Source: European Commission, *The Committee of Wise Men on the Regulation of European Securities Markets,* Final Report, Brussels, 15 February 2001, p. 6.

The 'Lamfalussy Process', as it became known, refers to the Committee of Wise Men presided over by Alexandre Lamfalussy charged with examining the state of the EU financial market. The final report was delivered on 15 February 2001 and was "convinced that regulatory reform is required if the European Union's objectives are to be fulfilled", specifically relating to the European Securities Market.[84] It recommended, therefore, a new four level approach "to speed up the regulatory process and to foster supervisory convergence in the EU".[85] The report advocated that "only framework directives need to be approved by Parliament and Council before technical details are 'filled-in' by a Committee composed of national regulators".[86] Thus, the Committee of European Securities Regulators (CESR) was created. The Committee's role was to:

- Improve coordination amongst national securities regulators and develop an effective operational mechanisms to enhance day-to-day supervision
- Act as an advisory group to assist the Commission
- Try to ensure more consistent and quicker implementation of Community legislation in Member States

The report also recommended that, if successful, this new structure should be extended to banking and insurances services. This duly happened in March 2005, when a directive was adopted to create the Committee of European Banking Services (CEBS) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).

[84] European Commission, *The Committee of Wise Men, op.cit.,* p. 18.
[85] D. Schoenmaker, "Central Banks and Financial Authorities: What Prospects?", in D. Masciandaro (ed.), *Handbook of Central Banking and Financial Authorities in Europe*, Cheltenham, Edward Elgar, 2005, p. 427.
[86] Macartney & Moran, *op.cit.*, p. 328.

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