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Round Table III: "The Evolution of Bank-Firm Relationship in the Enlarged Europe"

Opening Remarks

This conference rightly emphasizes how much the authorities and the financial and business community of the new member countries have become full players in the EU financial integration process. The enlargement dimension is a recent addition to the single financial market discussions. It is not only a public policy determination, but also the outcome of decisions by several large EU banks to place their Central European activities at the center of their value creation strategies.

Let us remember that when Commissioner Monti launched the Action Plan in January 1999, the accession process was only a few months old – and encompassed only five of the ten central European countries that presently are or are going to be EU members. Since then, the FSAP and enlargement processes have been running very much in parallel, and on quite unrelated tracks. The FSAP was not perceived to be relevant for the candidate countries. Their obligations were determined by the adoption of the pre-FSAP "acquis communautaire". And little if no consideration was paid to the implications of the FSAP for the future of their recently restructured financial markets.

With the joint effect of EU membership and the enactment of the FSAP legislation, the new member countries are going to be integrated into the world's second largest financial market. This carries two major benefits for them: first, they become part of distribution channels of financial products and techniques developed in the most advanced markets; second, they gain access to substantially enhanced risk sharing and capital allocation capabilities. Both aspects could overhaul the way finance supports their real economy.

In previous panels, we have discussed which types of financial intermediaries or which financial center will benefit most from the single financial market. When the question is cast instead in terms of users of financial services, the reply is a straightforward one: the users domiciled in the new member countries are going to benefit the most from the single financial market. The reasoning is quite simple: because they are currently penalized by small and shallow financial markets, they are going to benefit most, in differential terms, from access to a large and deep financial market.

In the new member countries, the main beneficiary would be the underleveraged corporate sector which consists largely of young small and medium-sized enterprises. Even though access to finance for the small and medium-size enterprises has always been one of the chief "political" objectives of the financial sector action plan, it was certainly unanticipated in 1999 that the main beneficiaries could become residents of candidate countries.

If you wish to follow me on this scenario, I would suggest we discuss in this session the extent to which the new member states and market participants have embraced, in their policy work and business planning respectively, the single financial market perspective – that is to find innovative solutions to make finance flow to the corporate sector and to offer consumers the most suitable financial products.

In other terms, I wish to put to you a question formulated as follows: "*Are we making the most of the possibilities offered by the single financial market to improve access to financial services in the new member states? Or there is need for a new impetus coming from authorities and market participants*?"

Sitting in Washington I do not have a clear sense of these developments. But my impression is that the transition to this new mode of thinking has not fully occurred yet. Authorities are still under the spell of the compulsory adoption of the pre-FSAP acquis communautaire that did not allow for room for adaptation to local conditions. And, with the financial system now privatized and controlled in large part by strong European institutions, their attention has moved to other policy areas with more pressing needs. On the other hand, market participants are intent on realizing the large operating and financial gains that are available under current legislation. And institutions without a local presence may not feel the urge to devise remote-based entry strategies into what are and always will be small markets.

We are fortunate to have on this panel two bankers that several years ago have had the vision to take a significant stake in the development of sound banking business in several New Europe countries -- at a time when this move was still seen as adventurous (and some analysts may still be unconvinced…). We have a visionary financial entrepreneur from Poland. We have a successful entrepreneur from Italy. And we have a very fine analyst of enlargement issues.

To make the most of the vast range of experiences available on the panel, I would put to each of you the following four issues for discussion.

<u>Question #1 on "Does Finance Make Entry Possible?"</u>:

What are the prospects today for a potentially promising business concept, such as for instance Italy's FastWeb whose founder is represented on this panel, to secure start-up and expansion financing, if domiciled and operating in a new member country?

Where are there gaps? In the business sector? In the financial market? On the advisory side? On the legal side?

Question #2 on "Can A Strong Capital Market Emerge?":

New member countries differ from the EU-15 in two important structural aspects. One, bank-based finance prevails over market-based finance. Two, concentration in banking is about 50% higher than in EU-15.

Could domestic capital market institutions develop independently from incumbent banks? Could governance arrangement be enforced to protect consumers when incumbent banks increase their involvement in market-based financing? And through which channels? Market discipline, regulations, self-discipline?

Question #3 on "Is Incrementalism The Only Way Forward?":

Would banks be willing to collaborate to prepare a common approach, on the basis of recent experiences for instance in Germany and in Italy, to help raise finance for new member countries SMEs through multi-country securitization structures?

Could such a prospect create political incentives to accelerate domestic capital market reforms (to accelerate legal reform, to push for accounting and auditing improvements, to enforce stronger disclosure norms)? Are coordination problems hampering this process?

Question #4 on "Where Are The Sources Of Change?":

Are domestic authorities considering the full implications of the single financial market for the future of their domestic financial systems? Are they prepared to accept more cross-border delivery of financial services to the benefit of the consumer (and to the possible, relative, detriment of domestic institutions)? Are they conducting strategic consultations with market participants – both resident and non-resident?

Conversely, can sufficient common ground be found among market participants to play a more active role in designing the next round of market reforms (after the rounds led by the WB/IMF and EU respectively)? Are they starting to invest in independent policy analysis and advocacy? Are there institutions capable to distill a common view and to engage with authorities?