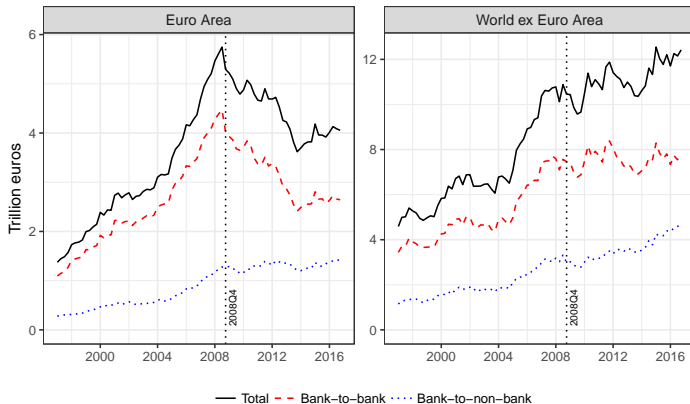




The intra and extra EU cross border financial services (in)activity: Europe's Cinderella?

Remarks by Mathias Hoffmann (University of Zurich)

Crossborder-banking flows by borrowing sector



...

Interbank vs. deep banking integration

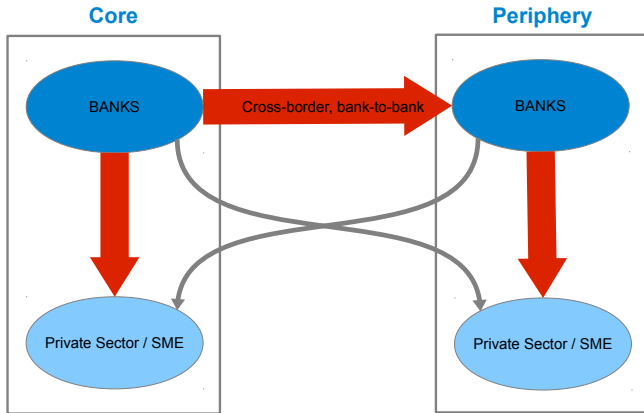


Figure: Source: Hoffmann, Maslov, Sørensen, CEPR DP 13691

Europe's flawed banking integration: getting all the costs without any of the benefits

- ⇒ Interbank integration...
 - ... leaves domestic real sector fully exposed to local banking sector shocks
 - ... while increasing exposure to external banking shocks
- ⇒ Breakdown in interbank integration during the global financial crisis exacerbated macroeconomic asymmetries and contributed to the failure of risk sharing mechanisms between member countries.
- ⇒ What is needed is deep (bank-to-real sector) integration (cross-border lending or cross-border branching)

Banking integration gone wrong: real effects

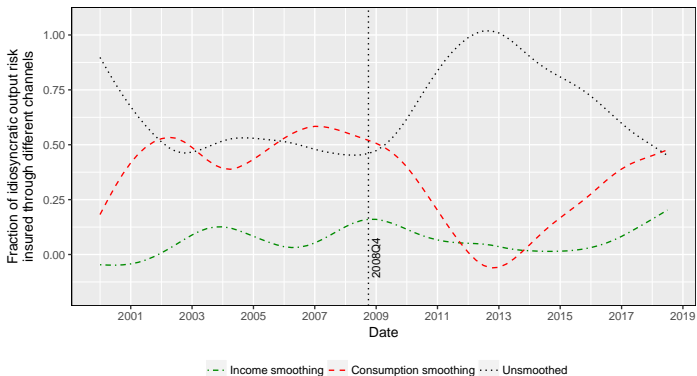


Figure: The decline in macroeconomic risk sharing during the Eurozone crisis (source: Hoffmann et al., IMF Economic Review, July 2019)

Some lessons from the United States

Situation in the U.S. until the 1980s similar to Europe today.

- ⇒ Interbank market fully integrated between states.
- ⇒ Virtually no deep integration, though. Cross-border direct lending and cross-border branching were prohibited by state laws.
- ⇒ Dismantling of these barriers during the 1980s led to big cross-border mergers and eventually to cross-border branching.
- ⇒ Academic literature documents positive effects for access to finance of SMEs, higher growth, improved and more robust interstate risk sharing.

How to move forward?

Barriers to entry in Europe today are not *de iure*, but exist *de facto*:

- ... regulatory fragmentation (supervision, resolution mechanisms, deposit insurance)
- ... political economy ('national champions', role of public and regional banks)

What to do about it?

A truly complete banking union: common supervisory mechanism and resolution mechanisms also for non-systemic institutions, common deposit insurance

Encourage cross-border mergers, e.g. by lower risk weights for geographically diversified holdings of loans

Common credit registries, harmonization of bankruptcy laws ...