

CONSIDERATIONS ON THE PROSPECTS OF THE INTEGRATION OF THE EUROPEAN FINANCIAL MARKETS IN THE CONTEXT OF THE GLOBAL CRISIS

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In recent years, as the efforts linked to the elimination of the capital movements control between countries have intensified, the preoccupations concerning the explanation of the financial integration concept have multiplied, in their turn. An integrated financial market is necessary particularly to the distribution of liquidity between the institutions in the euro zone, and, implicitly, for the enforcement of a common monetary policy. Thus, the problem of the integration of the financial market, respectively of the monetary one, appears as a premise for a homogenous transmission of the financial policy impulses all throughout the euro zone. The financial integration is defined in conformity with the law of a single price. According to this definition, in case the markets are integrated, the financial assets bearing identical characteristics should have the same price, regardless of their geographic origin.

Keywords: financial market, financial stability, euro zone, single currency

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1. Introduction

The level and rate of integration of the European financial markets have been remarkable in recent years. In the last decade, there was a high level of market integration, both on the monetary and on the bonds markets, especially in the euro zone. In addition to that, there was the integration of the capital markets in EU, although the progress was impeded by a lack of integration within the clearance and reimbursement infrastructure.

From a conceptual point of view, we can distinguish between the vertical integration and the horizontal integration of the financial market. We can speak about a vertical integration, due to the fact that the telecommunications determine an increase in the interdependence between the monetary markets and the currencies, on the one hand, and between the option markets and the markets of short-term financial instruments, on the other hand. Systematically, the investors arbitrate between the different compartments of the financial market, with a view to obtain the best ratio cost/benefit. The horizontal integration of the financial market recorded in the last decades a spectacular progress, especially due to the elimination of the obstacles between the national financial markets, progress that was interrupted by the recent financial crisis that has affected the whole world.³²⁵ As far as the EU markets are concerned, they are in different stages of the financial integration process. The financial integration process advanced during 2008 and a

³²⁵ Corina, Weidinger Sosodean, *Euro și piețele financiare internaționale*, Editura Mirton, Timisoara, 2005, p.174.

new impetus may derive from the implementation of the Markets in Financial Instruments Directive (MIFID), the Single Euro Payments Area (SEPA), as well as the adoption of the single currency in an increasingly large number of the member states.

The question of the integration of the European financial markets may be approached starting from the very slogan of the European Union that is “unity in diversity”. EU gives the possibility of uniting several countries, each of them having things to learn from the other ones, this union covering various domains, including the financial markets of the member states. The integration of the European financial markets is a question relating to competitiveness. It is difficult, especially under the current circumstances, to talk about a single market, even if this is to be desired; yet, it is true that we can talk about several niches of a single European market. Besides this, there is an atrocious competition in different sectors and fields of activity, with a strong impact on the European financial markets (the capital market, the bank market, the insurance market, etc.).³²⁶ Nevertheless, at present and also as a future prospect, in what regards the less developed countries in Central and Eastern Europe, their access to an integrated European financial market is rather difficult, situation determined also by economic and financial indicators which differ a lot from one country to another. But, with the help of structural funds coming from and financed by the European Union, people are trying to direct the financial markets of these countries towards an integrated European financial market.

In addition to that, under the circumstances of the financial crisis with effects on the entire European economic system, it is intended to create a single system of supervision of the financial sector, which could lead almost instantaneously to the process of financial integration of the member states. This unique supervision system was not thought of beforehand by the founders of the integration idea, nevertheless it proves to be very useful, given the effects of the financial crisis. Thus, will come into being the European System of Financial Supervisors means to ensure an objective and real monitoring of the financial institutions activating in at least two member countries. The system would enable the setting up of new European authorities in the banking field, in the field of insurances, of securities and of occupational pensions, meant to supervise and to coordinate the activities of the national supervision authorities.

Among the advantages of the European financial markets integration, we can mention the enhancement of the potential of economic growth. Thus, as the financial system is becoming more integrated, especially in the euro zone, the gross domestic product (GDP) is also growing. At the same time, a more integrated and larger financial system enables the economic agents, among others, to better exploit the economies of scale and the economies of scope, while the population can benefit from the access to a greater variety of financial products – such as the mortgage loans – at relatively low costs. At the same time, the existence of the integrated financial markets bears major implications upon the mission of ensuring the financial stability both in the euro zone, and all throughout EU. Thus, the financial integration can have positive effects on the financial stability, taking into account the fact that more and more integrated financial markets will be able to ensure the necessary conditions for an easier absorption of the financial shocks. The Eurosystem's mission to promote the good functioning of the payment systems is based on the integration phenomenon, this mission holding a fundamental role in ensuring a safe and efficient functioning of the clearance and reimbursement systems of the securities operations.³²⁷ But, according to the Report of the European Central Bank from April 2009, the financial integration process is threatened by the unrest characterizing this year. The basic question under scrutiny is whether and to what extent the financial unrest starting in the middle of 2007 has led or can lead to a suppression of the financial markets within the national

³²⁶ Ciampolini, M., Rhode, B., *Money market integration: a market perspective*, ECB Conference „The operational Framework of the Eurosystem and Financial Markets”, Frankfurt, 5-6 May, 2000.

³²⁷ Garganas, N., *International role of the euro*, Conference of the European Commission, „Europe, the Mediterranean and the Euro”, February, 2003, p.3.

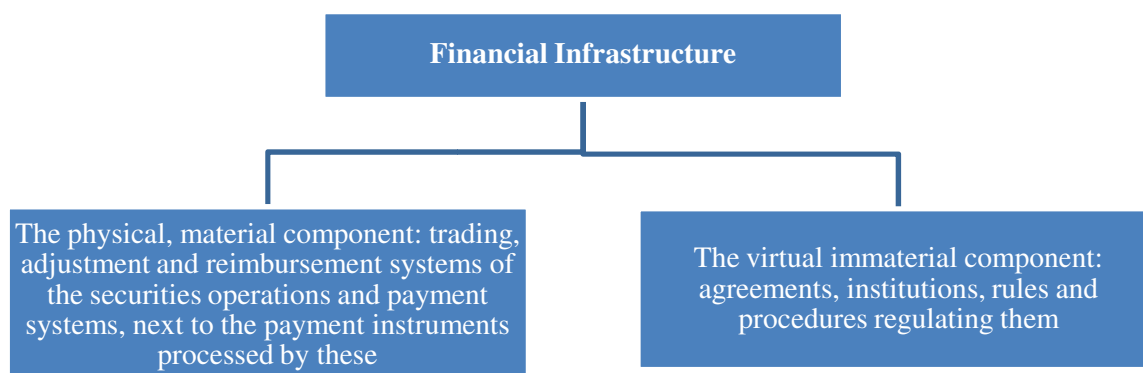
borders and, by way of consequence, to an inversion of the European financial integration process.

2. Specific of the European Financial Markets

The EU financial integration is a continuous, dynamic process, contributing to the efficient transmission of the monetary policy impulses all throughout the euro zone, at the same time, stimulating the member countries to rally to the communitarian financial standards.

Thus, the infrastructure of the European securities markets comprises all the arrangements and facilities connected to the issue, the listing, the trading, the clearance and the reimbursement of the transactions with securities and derivatives, as it is highlighted in figure no 1.

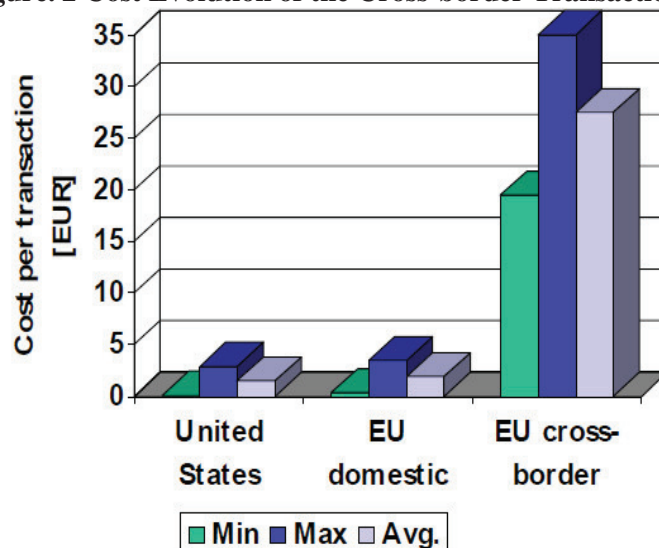
Figure 1. The European Financial Infrastructure



The infrastructure in the euro zone and EU is still extremely fragmented and pursues the accomplishment of three extremely important objectives: efficiency, integration and safety.

The limited integration of the infrastructure of the capital market leads to significantly high post-trading costs for the cross border securities transactions within EU (Figure no.2), thus causing the reduction of the economies' potential, as well as the impossibility to create equitable competitive conditions.

Figure. 2 Cost Evolution of the Cross-border Transactions



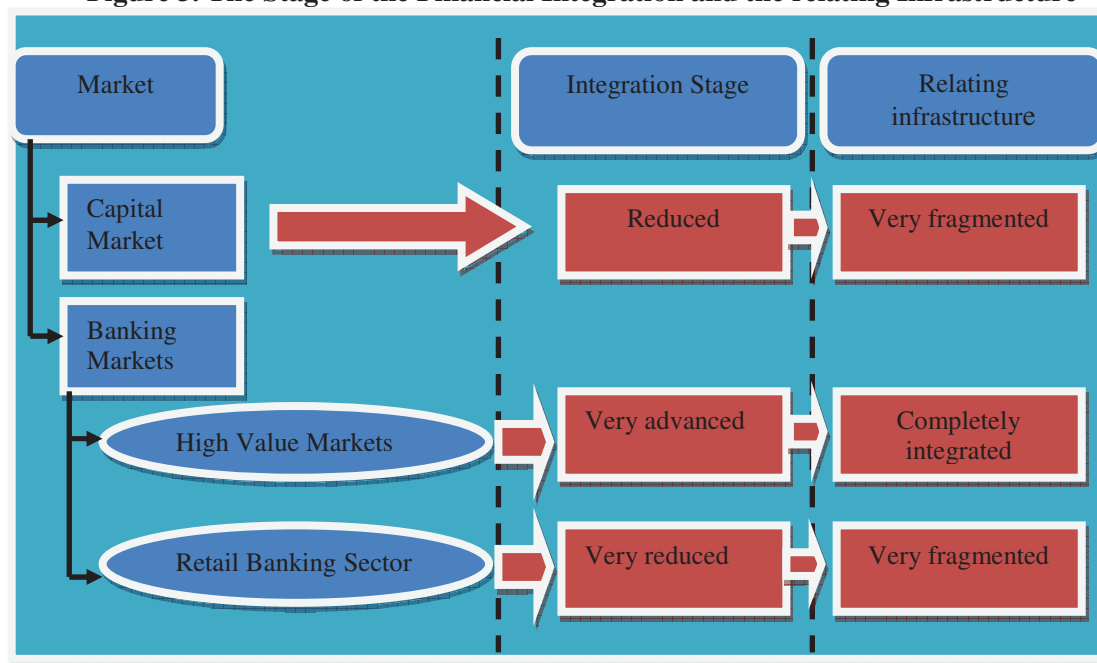
The European banking financial policies and institutions are situated within its regulating,

institutional, functional and operational dimensions and, to this purpose, are open to the economic integration, and also to the political one.

The foundation of the Economic and Monetary Union (EMU) of the euro zone is a result of the European integration dynamics, a phenomenon that can be retraced all throughout Europe's modern history, both in terms of idea and concept, and of action and organization. The integrationist attempts within the European area are obvious, the determining factor being often the military one, disguised in political and sometimes state clothes; the novelty, the originality of this new attempt of European integration consists in the fact that the determining factor is the political one, bearing often initiating characteristics, a factor turned into an instrument and objectified through material, trading, financial and social elements; all of these are engendered and, at the same time, pushed forward by an immaterial, invisible, ineffable force, the currency, that is the primary constituents of the „human construction”, the needs.³²⁸

The financial markets integration is highly advanced in the euro zone, facilitating the allocation of the savings towards the most profitable investment opportunities and enabling the participants to partially diversify the risks of the asymmetrical shocks. The euro has obviously accelerated the integration, particularly of the *monetary market*. Furthermore, the measures adopted through the *Financial Services Action Plan* significantly intensified the integration of the government securities market, yet less in the case of the corporate securities market. However, in the *retail field*, (Figure no 3), especially in the banking sector, the market segmentation remains rather stressed, the cross border loans from the banks from the euro zone towards the nonbanking financial sector remaining under 5% from the total of the loans there existing a persistent dispersion between countries, in what concerns the level of the interest rates of the financial institutions, at least in the case of certain categories of instruments, this fact determining ECB to support the foundation of a *common area of the payment system*.

Figure 3. The Stage of the Financial Integration and the relating Infrastructure



The analyses conducted throughout the research have revealed the similarity of the transmission

³²⁸ Lommatzsch, K., Tober, S., Monetary Policy aspects of the enlargement of the euro area, Deutsche Bank Working Paper, No.4, August, 2002.

channels of the monetary policy, the channel of the interest rate having a prevailing role in all the countries, while the channel of the bank loan is characterized by a less prevailing role.

Yet, the national financial structures still continue to present significant differences ; for instance, the role of the debt securities and of the shares in financing the private sector and the types of vehicles (pension funds, insurance funds and mutual funds) used in order to orient the long-term economies, still differing in the countries in the euro zone.

As a result of the high degree of trade integration, particularly the intra-industrial and financial one, as well as of the high degree of convergence of the macroeconomic policies in the euro zone, the business cycles tend to be significantly synchronized. The cross border correlations of the business cycle, particularly of the industrial productions, were rather high in the case of many countries in the euro zone in the previous period, under the circumstances in which the business cycles tended to be rather synchronized all throughout the world. Furthermore, the dispersion of the growth rates of the real GDP in the euro zone has remained very close to the historical average, which suggests the absence of major asymmetrical shocks. In the case of the new member states, the business cycles are less correlated within the group and within the euro zone, which also points out to the high degree of production variability. Due to the continuity of the trade integration and of the flows of the direct foreign investments in these countries, we may consider that the synchronization level will increase.³²⁹

3. The impact of the crisis on the European financial markets

In only a few months, the effects of the financial crisis have changed everything - from the oil prices to the nature of the market economy itself. It is obvious that the changes surpass the limits of the economic and financial sector and will inevitably affect the EU institutional architecture. It remains to be seen whether these times of economic incertitude will cement the relations between the member countries or will result into a process of European disintegration.

If we look first at the empty half of the glass, the prospects are not very encouraging. In an initial stage, the European governments responded to the challenges entailed by the crisis in a reactive and uncoordinated manner. First of all, Ireland unilaterally assumed a generous offer of guaranteeing the deposit money, this way encouraging the clients from other countries to transfer their money to the Irish banks. As a response, several other countries felt they were obliged to resort to similar measures, this transforming into a measure against the other banks, at the European level. The financial markets reacted worse at the meeting of the only member states that are part of G8 (France, Germany, Italy and Great Britain), especially since this meeting did not end with an ambitious action plan. As usual, in such cases, out of electoral reasons, the national governments point their finger to Brussels. But what expectations can we have from EU if, at the moment of conceiving the single currency, the member countries decided it was better not to constitute centralized economic and fiscal institutions?

To put it differently, we may assume that EU will reduce the external assistance for the developing countries. Why fighting poverty somewhere else, when at home unemployment is advancing at high speed? Likewise, given the reluctance of countries like Great Britain, Ireland and Spain towards the intra-EU migration of the labour force, we can anticipate that the extension will not be a to list topic too soon. Actually, it did not really meet with too much enthusiasm even before the crisis. In spite of these, a recent report of the European Commission declares that the last enlargement waves were successful, in terms of policy, demonstrating with numbers that the countries in the ex-Soviet block recorded an important increase in their living standard, thing which was not accomplished - and this is equally important - at the expense of the older members. Dwelling on the full half of the glass, there are at least two other reasons for optimism. The first one lies in the relative stability of the single currency. At least, the states in the euro

³²⁹ International Monetary Fund, Annual Report, Washington DC, 2003, p.34-36.

zone felt safer, having the ballast of a currency of a continental scale. Of course, in the euro zone there are also problems, but not as dramatic, if we compare them to the situation in Island, Russia or Ukraine. Let us imagine that instead of euro we still had the Spanish pesetas, the French, Belgian and Luxembourgish franc, the German and Finnish mark, the Italian and Irish lira etc. They would have obviously reacted differently to the convulsions of the financial markets and not always in favour of the state in question. The relative stability of the euro has surprised many people, so in Denmark and Great Britain there have been debates concerning the costs for being outside the euro zone. According to the Euro barometer, the single currency is seen as one of the most positive aspects of the European integration, next to the free movement of capital of persons. These evolutions may cause structural changes in the financial administration at the EU level, as the euro has a central bank without also having a centralized financial system, the supervision being reserved to the national governments.³³⁰ There are already top-level discussions regarding the facilitation of the entry conditions in the euro zone, so that the aspiring states may adopt more rapidly the single currency. The second reason is related to the fact that the crisis effects have proved the necessity of a coordinated intervention at the EU level, which may be the beginning of changes in the institutional architecture of the Union. Although the solidarity between the EU countries seemed to be weak in certain cases, for the moment, at least, there is an understanding between the governments not to embark upon actions that might affect the neighbours. After what happened, „thanks to” the world financial crisis, it became clear that there was need for a more stable EU presidency, with a long-term mandate. Certainly, depending on the direction of the „financial storms” that ravish the world, things can still change, inclining the balance to either side. Yet, up to now, the prevailing conclusion is that the European leaders have been capable of learning rather rapidly the lesson of the benefits taken from a common economic cooperation.

The financial monetary integration of Europe, within the euro zone, generates multiple effects. In the terms of macroeconomic stability, the euro zone and the newly enlarged EU promotes a context oriented towards stability, which may provide the best conditions for sustainable economic growth and occupation. The results of the euro zone in achieving the nominal and real convergence are relevant and approach the criteria of an optimal monetary euro zone, having a major role in obtaining these results, role it continues to have.

4. Conclusions

Concerning the future, the change processes put into motion, under the current circumstances of the market and of the single currency, combined with the structural changes in the economic world, lead to changes in the economic conditions. These changes finally lead to a high degree of economic diversity and regional specialization, which, on condition that these may be caused by market forces, may enhance richness in the euro zone, taken as a whole. The redistribution between the advanced regions and the less advanced ones may generate certain challenges for the regional policies, at a national and at the EU level.

Automatic fiscal stabilizers can contribute to the economic stability, through their regulating impact on the aggregate demand. Taking into consideration the lack of a central mechanism of cross border budgetary transfer, it is vital that these stabilizers should be capable to operate freely. The adopted measures, through the structural policies, in the euro zone countries, have led to the increase in flexibility of the labour and product markets, with positive results and future additional benefits. While sometimes these imply short-term costs and incertitude, especially when the measures are not implemented in a decisive way, to a large scale, the positive impact of the well-structured reforms on production and the occupation is highly significant.

³³⁰ Prasad, E., Rogoff, K., Wei, S., Kose, M., *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence*, International Monetary Fund, March, 2003.

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