Let me begin by belabouring the obvious. The proposition that important benefits would arise from greater financial integration in Europe has solid theoretical support (though only in the long run, as pointed out by Baron Lamfalussy in a recent presentation (1)). Requested by the European Commission to give quantitative flesh to this accepted qualitative wisdom, a research centre, London Economics, recently produced a report (2) (quoted by many but, I am afraid, read by few) attempting to measure the macroeconomic impact of financial integration. It is an excellent report, both for the wealth of information it provides, and for its econometric ingenuity. Without discussing numbers, it may be useful to spell out how the wondrous results that are predicted are expected to come about.

Trading costs, measured as percentage effective bid-ask spreads, are the prime, and indeed the only mover; costs other than the spread are not part of the analysis. It is estimated that in an equity market with a capitalization equal to the sum of European regional markets, such costs would fall substantially (by up to more than 80 per cent. for some countries). This would lower the average cost of capital in Europe by some 37 basis points and by 10 more due to an unspecified reduction in clearance and settlement costs: whence higher investment, higher GDP and all the rest. But how would such a fully integrated single securities market come into existence? Its benchmarks are: freedom of access for issuers, investors, intermediaries and infrastructure suppliers irrespective of their location; and "a seamless web of market supervision which guarantees stringent and effective…enforcement of commonly agreed provisions". Its more precise essence is however a single Europe-wide trading platform or, at least, a set of interlinked platforms where all European companies are listed and where - it is assumed - all other differences would disappear.

The benchmark features and this specific condition are a heterogeneous set. Their realization requires not only the top-down interventions envisaged by the FSAP as necessary to establish a "seamless web" of commonly agreed provisions, but also a bottom-up initiative that can only originate from the market. It may even be argued that the latter could set the path for the former and present European law-makers and regulators with relevant faits accomplis. It is, after all, the first commandment of the City of London that "markets are created and developed by market participants not by rules and regulations" (3). Let me pause and consider what market participants could do, without waiting for rules and regulations, to enhance the creation of the single pool of liquidity required by the London Economics report, and what they actually have done. The two relevant cases here are exchanges and clearing and settlement.

2. Exchanges are nowadays private entities in the whole of Europe. Mergers, take-overs, the setting up of common platforms have of course important regulatory implications, but are in the end private decisions, though the existence of common provisions would make such decisions easier. Consider the consequences that the mere announcement of a merger between the LSE and DB had some time ago. First, I am convinced, it was the prospect of that merger that prompted a French political initiative at the Ecowin and eventually the creation of the Lamfalussy Committee. Second, British and German regulators began to meet in order to solve the regulatory problems posed by the project. Third, the mere threat of a London-Frankfurt axis provided impetus to Euronext, the establishment of which, again, required a strict cooperation of the French, Belgian and Dutch regulatory authorities. Why IX floundered is a different story, which is not for me to tell. My point is that sometimes, when the market takes the lead, l'intendence suivra. But, at the moment, nothing seems to move.

On the contrary, continental exchanges seem to be strengthening the walls of their citadels, each with its own vertical post-trade structure: which brings me to a second issue which would clearly require a bottom-up approach.

Two points emerged clearly in the hearings with the industry of the Lamfalussy Committee: first the inefficiencies in the cross-border clearing and settlement of securities transactions are a source of high costs and represent a major obstacle to market integration (nobody, to my recollection, mentioned bid-ask spreads);
second, that was a problem for the private sector, more than for the authorities to solve. This is clearly said in the Giovannini Report\(^4\): though "the need for EU legislation...cannot be ruled out entirely", and without aiming at full system mergers, "there is a consensus...that the EU clearing and settlement landscape could be significantly improved by market-led convergence...across national systems". I doubt that this is happening, at least with the required speed. The G30 report\(^5\) notes that, while "it would be reasonable to expect markets to respond to [the] challenges", in fact "incentives within the individual clearing and settlement entities tend to support incremental change that strengthens the local franchise, rather than initiatives to facilitate greater competitiveness...that could adversely affect the value of the local franchise".

We thus have two important cases in which the market solution, being marred by oligopolistic inefficiencies, does not deliver the optimum. Thus, let us by all means "formally embed[...]"] the first commandment "in the most authoritative manner in Community legislation", as required by the City of London: but do not expect that market participants, left to themselves can always produce an efficient solution irrespective of the existing entrenched interests.

3. It is certainly not the task of legislation and regulation to create and organize markets. Nor can legislation and regulation be the magic wand that removes a persistent home bias: according to a recent study\(^6\), in the period 1995-2000 the investment vehicles of households’ assets in EU countries, far from converging, have, if anything, become even more country specific. As this may be due also to the specificity of financial regulation, the proper task of Community top-down initiatives, such as those listed in the FSAP, should be that of establishing the necessary (though far from sufficient) conditions for growing integration.

I do not intend to discuss specific pieces of level 1 legislation (to use the Lamfalussy jargon) now under discussion, being aware, as I said, that there are contentious issues, on which feelings are high on both sides of the Channel. I prefer to consider what has been and what can be achieved with the suggestions of the Committee of Wise Men as implemented by the Stockholm Council.

The Lamfalussy report was success story. Unlike other reports filling the shelves of the Commission offices, it was accepted with surprising speed at the political level, it was digested, though with some difficulty, by the European Parliament and it was warmly welcomed by the industry and market participants. I may be wrong, but I now have the feeling that we have entered a season of disenchantment with the past fashion. Neither the recent report of the City of London nor that of Eurofi\(^7\) spend much time on the Lamfalussy procedure. In a recent paper, professors Gérard Herting and Ruben Lee\(^8\) predict that the Lamfalussy process will not work, and that, as a result, there will eventually be a European Securities Commission focusing on corporate disclosure issues. There are recurrent noises to the effect that the new European constitution being written by the Convention should include a provision providing a legal basis for a single European securities regulatory authority.

How warranted is this perceivable scepticism? We can readily agree that, so far, the Lamfalussy approach has not delivered much in terms of new legislation. But can we infer from this that the glass is empty, or are instead observers and scholars missing some important development which the process has at least potentially set in motion? I wish to argue that the true seeds of change are to be found in the level 3 tasks attributed to CESR, though it is far from certain that CESR will find the will and the ability to exploit this opportunity. Before discussing this, however, let me take a quick look at what is happening at level 2.

4. When it proposed the introduction of level 2 legislation the Lamfalussy committee had two objectives in mind: speeding the process of primary legislation by removing a host of technical implementing measures from the table; allowing a quick adaptation of such measures to the changing needs of the market. It is not clear to what extent the first objective has been achieved, considering that the Council and especially Parliament have tended to take a rather narrow view of what is to be left to technical implementation. The introduction by Parliament of a tight sunset clause to the possibility of updating and adapting the implementing measures outside the co-decision process has severely limited the scope of the second objective.

The adoption of the implementing measures for the market abuse directive will be the first test for the newly created Securities Committee working in its comitology capacity, so we do not know yet whether the Committee will work fast, and especially whether it will avoid the same squabbles that have often paralysed the Council. The Committee is given a relatively short time to decide: but, if it votes against the Commission's proposals or is unable to deliver an opinion, the draft measures are submitted to the Council, which votes within three months. It may well happen (indeed it has happened even before the Lamfalussy method) that the consensus reached at the level of national securities commission vanishes at the level of national (political) representatives.

CESR has worked much harder. In its capacity of an advisory group assisting the Commission, it has drafted proposals for the implementing measures of the market abuse directive, is giving advice on the prospectus directive, is responding to the Commission's consultation on the ISD. It will, I hope, be recognized that the work of CESR is being accompanied by intensive consultation with the interested parties.
The cake prepared at level 2 has not yet been eaten, so it is too early to judge. But one thing is for sure. The institutional metamorphosis of a cosy club of regulators - as essentially FESCO was - into a committee with institutional dignity in the European law making process (with an acronym that lends itself to a slightly megalomaniac pronunciation) is by itself an important step.

5. Potentially, but so far only potentially, level 3 may become the most relevant area of CESR work, because uncoordinated and variegated implementation of the directives in national legislation and regulation is a major obstacle to the development of a single market for financial services.

According to the Lamfalussy report, at level 3 CESR should produce consistent guidelines for national administrative regulations, issue joint interpretative recommendations and set common standards, compare and review regulatory practices, conduct peer reviews of administrative regulation and regulatory practices in Member States. The Stockholm Council endorsed these indications.

Though CESR level 3 recommendations and standards are not legally binding, the Committee could exercise appropriate pressures on its members by asking them to comply or explain. For this to be possible, CESR should have the means, and above all the strength, to conduct regular reviews of its members’ compliance. The same is true for the other major level 3 mission: insuring “more consistent and timely implementation of Community legislation in Member States” in national regulation and in the regulators’ practice, as requested by the Stockholm Council in order to to encourage the free movement of services.

These new tasks assigned to CESR are somewhat delicate because they imply some intrusion in the domestic regulatory activities of its members. No procedure to deal with them has yet been set in place. In comparison with international organizations (such as the IMF or the OECD) that conduct independent assessments in various areas, the technical structure of CESR is still weak. More importantly, will CESR members accept to submit to a peer review? It is perhaps telling that the requirement of "peer reviews" present in the Stockholm Council resolution has disappeared in the CESR chart.

The market appears to be discovering the relevance of level 3. In the recent consultation on the implementing measures for the prospectus directive there was a widespread request that some level-2 detailed prescriptions be downgraded to level-3 recommendations: a sensible request in some cases, provided that the greater flexibility thus obtained is reconciled with a consistent implementation of the legislation. But market participants could do more to persuade CESR members to submit to collective constraints if they were more active in signalling the inconsistencies between the words of legislation and of recommendations and the deeds of regulatory practices.

In the end, developing and strengthening level 3 work could provide a feasible, sensible and gradual solution to the problems that periodically prompt the proposal of a pan-European regulatory authority. As has been noted by two legal scholars(9), "it is striking that, whereas in the area of financial services the idea is mooted of a European financial services authority, one may discern a trend in Community law to move precisely in the opposite direction, away from centralised control". Before engaging into the less obvious option of a single European authority (with a Treaty amendment), they add, one should first consider "whether greater cooperation between national authorities combined with the enactment of the Commission's proposals... together with the implementation of the proposals of the Lamfalussy Committee would suffice". I agree; but I add that it is up, to CESR and its members to prove that this flexible but by no means simple model can work.

6. One last, and concluding, word on a more general issue. Underlying the debate on European financial integration I often detect the elements of a philosophical - at times theological - dispute: one between the harmonisers and , if you allow me the term, the mutual recognisers.

There are of course good arguments on both sides. It is true on the one hand, that, as has been said by my eminent colleague Sir Howard Davies, imposing "a one-size fits all approach... simply does not reflect the reality of the difference from one member state to another": the different degree of evolution of markets in different Member States, their different legal regimes, the different role played by self-regulatory organizations are all relevant obstacles to an attempt to establish uniformity. It is also true, on the other hand, that insufficient harmonisation has often provided Member States with the opportunity to introduce additional requirements serving the purpose of insulating the domestic market from competition, while consistent implementation of laws and standards is necessary in order to remove the existing obstacles to the single market. (It is perhaps useful to remember in this context that in the United States securities laws, unlike the company law, soon acquired a federal status).

I think it would be unwise to exasperate the ideological differences between the two views. Remembering that harmonisation, mutual recognition, non-discrimination and free movement are all concurrent and complementary tools for the building of the internal market(10), I am inclined to take a middle-of-the-road view on this issue, based on the following lines. First, we must accept that the process towards a single European
financial market requires gradually raising the level of harmonisation, even without specifying to the millimetre the size that should fit all. Second, this process can only be gradual. Third, the more uniform model to which this will lead will not necessarily be that prevailing in one jurisdiction, to which all others should conform. Fourth, and as a result, everybody should be ready to contribute to a workable solution, even at some cost for short-term national and sectoral interests: a more level playing field will in the end provide a better opportunity for the fittest to survive.


10. See O’Keeffe and Carey in note 9 above.