A World of Financial Models: The French Touch in Deregulation, 1980-2009

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September 15th, 2008. Lehman Brothers files for bankruptcy. The Anglo-American model of finance collapses. This is a "Big Bang" for the global financial markets. The months following saw a rush to rebuild the premises of the financial markets and set the stage for a regulatory revolution. The G-20 meetings have offered some first steps towards a global compromise.

Change. This word, perhaps overused in other contexts, is insufficient to describe the revolution that is taking place in the organization of American finance. But, apart from the media buzz and the populist rhetoric of politicians, can we expect the Anglo-American organization of finance to change that dramatically? Will the G-20 lead to global convergence on new terms? Warren Buffet, referring to the current financial crisis, has famously said: "when the tide goes out, you see who has been swimming naked." The American and British banks in general seemed to have left their swimsuits on the beach and to have dived into the ocean of risk-taking, and of complex financial products. Current estimates place the assets of banks at around \$1.2 trillion, and the liabilities at \$2.5 to 4.9 trillion. This gap illustrates the magnitude of the risks taken by banks. The French banks, operating in a transformed French deregulated and market-based political economy, seem to have remained dressed while swimming in the

waves.

Understanding how the French model of finance has evolved and how far it has changed in reaction to external factors will allow us to understand the dynamics of change in financial systems. This article will argue that financial systems do change, and sometimes radically, but they do not abandon their national or regional specificities. The result of external pressures leads to transformed systems, which is not always an alignment on dominant market practices. Behind the convergence of "best practices," different sets of values and institutions will produce different models. Underlying cultural and institutional frameworks mediate the changes, and distinct settings produce distinct outcomes.

Looking at the French case, I will show how global pressures and the competition with the US and Great Britain have radically transformed French finance. I will also examine the nature of the pressures of European harmonization. They have influenced the evolution of the French model by integrating it in the Single Market. But the deregulation of France had its limits. Specific features mediated the external pressures and produced a transformed yet distinct French model, which kept a flexible but robust approach to financial regulation. The excesses of the Anglo-Saxon model were avoided. The tides change, but what people wear or do not wear in the

water does not change that quickly. They need time to remake themselves, and they remake themselves differently.

This article will argue that the limits to French convergence towards the Anglo-American model of finance are the result of two key features: a specific culture of French elites and their relationship with the state, and the universal bank structure of the French financial system.

Why should we look at France for guidance in understanding change in financial models? The French case is enlightening because it is a particularly hard case for convergence, as it was historically very regulated. The French financial system started in the 1980s as what Zysman calls a “credit-based price administered” system (1983). Today, it is a market-based system. This dramatic transformation illustrates the power of the markets in forcing change. But when we look at the details of the new system, France did not converge entirely towards an Anglo-American financial system. It created its own system, with a balanced approach to markets.

Lehman Brothers Collapse, Bankers face a bleak future.

The culture and the institutions of France constrained the global and regional pressures to reinvent a different model.

The Transformation of French Finance: Deregulation from the 1980s to the 2000s

French finance was transformed and deregulated from the mid-1980s to the 2000s. It has adapted to globalization. The financing of the French economy evolved from being credit-based to market-based. The regulatory framework is more flexible and allows financial institutions to take more risks. This seeming convergence towards a liberal model was a “little big bang” (Cerny 1989), and as Schmidt reminds us, the French system, compared to Great Britain and the US, is the country that has changed the most (1996). However, France remains distinct in the regulation of its transformed model, and the convergence towards the Anglo-Saxon model remains partial. The underlying values and approach to regulation remain distinct. This contradiction between the power of external factors in changing France and the survival of a distinct model is puzzling. In this section, the transformation of France and its distinct outcome are briefly exposed.

Changes in French Finance (1980s-2009)

France in 1980 was a credit-based system with government-administered prices, in contrast to the British and American models, which were market-based and allocated resources by competitively establishing prices (Zysman 1983, 18). The financing of the economy was based on credit, and financial markets were secondary and accessible only for a particular set of large companies for operations controlled by the state (Zysman 1983, 123). France was an “overdraft economy,” a “political economy that has become dependent on the allocation of credit by institutional lenders (Loriaux 1991, 9). This system was based commercial banks that accompanied firms with long-term financing.

France in 2007 was very different. The financial system was transformed. Michel Barnier, in the Cornell International Affairs Review, explained that France “has passed from one era to another, from a closed-in and regulated world to a world open to exchange and to competition” (2007, 6). The financing of the economy is based on the financial

“The French have reacted to the global challenges of regulation by retaining a strong but flexible role for regulation.”

markets and the issuance of bonds and stock, rather than by bank loans. The French firms finance themselves essentially on the financial markets, and this behavior is similar to the actors on the American liberal market (Culpepper 2006, 50). The capital raised on the stock exchanges in France went from being negligible in France in the early 1980s to being the main source of financing of French firms.

The French banks are now freed from the full control of the state. They are able to engage in many risky operations. French banks propose complex financial products. They are global actors that compete with American financial institutions (Padoa-Schioppa 2004, 55). The French financial players are important and competitive in an increasingly integrated world (Larosière 2007, 13). French banks are strongly involved in the securities markets and organize many deals. In 2006, BNP Paribas organized 63 operations, accounting for 108 billion euros. The financial sector in 2007 represented five percent of the GNP (Lagarde 2008).

The French market is also very open to international banks. The American banks have been advisors on more than 60 percent of the investment banking deals originated in France in 2006, and four of the five largest deal winners in France were American: Goldman Sachs, Merrill Lynch, Morgan Stanley, Citigroup (Larosière 2007, 21). This French evolution is recognition that in a world where the financial

assets have been “soaring,” to reach 3.5 times the world GDP in 2006, to enhance efficiency, you have to take advantage of these assets rather than use only the capital-consuming national credit-based financing (SIFMA 2008, 5).

Similarly to the US, the over-the-counter (OTC) market has expanded significantly. Michel Prada, former chairman of the French securities regulator, underlined the importance of the unregulated OTC market in France. Many new complex financial products are traded on this market on which no regulator has jurisdiction.¹ The French credit default swap (CDS) market is very important, as well as the market for securitized products, such as collateralized debt obligations (CDO) and other similar products (FBF 2009, 9). There is an externalization of risks from the banks balance sheets, and we have dissemination of risk in the hands of many actors on the markets.²

The French financial markets follow the international rules established by the Basel Committee on Banking Supervision (Kapstein 1994, 103). The recent Basel II framework and its refinement of the capital adequacy requirements and improved risk management is an illustration of how the French financial supervision has converged (Larosière 2007, 23; Artus and Virard 2008, 81). The Basel Committee is a work in constant progress, and different sub-committees meet constantly, leading the French model to evolve and converge with the other financial centers.³ The international accounting standards are slowly harmonizing thanks to the international financial reporting standards (IFRS). The cooperation of the national securities regulators in the framework of the International Organization of Securities Commissions (IOSCO) leads to an increase in convergence of the international regulations (Schmidt 2002, 37). The IOSCO Technical Committee, chaired by the Frenchman Michel Prada (who explains this in his article in the Cornell International Affairs Review), led to the establishment of a set of international

standards for securities transactions.⁴ French markets seem to have converged significantly. This contrast between the 1980s and the 2007 is the result of a series of deregulatory reforms enacted by successive governments that for reasons of space we cannot go over here (See Loriaux, Abdelal, Hancké, La Serre and others).

The Distinctiveness of French Finance in a Globalizing world

France, although it has changed and converged towards a liberal model, remains distinct (Culpepper, Hall and Palier 2006, 16). What characterizes this distinctiveness? France is not quite a liberal market economy (LME) as underlined by Culpepper (2006, 63). Indeed, Hancké reminds us that “the French political economy retains, even after capital markets have become more flexible, specifically French characteristics” (2001, 334). The underlying values of French finance and of French regulation remain distinct and maintain a robust regulation in a new framework.

The French regulators remain *tâtilon* and look at details. Indeed, they keep a culture of control and inspection that is very detailed, and looks not only at the processes that the bankers follow when they do a market operation, but they pay special attention to the products themselves and the evaluation of the risk of the product. Prada emphasizes this aspect of French regulators, and underlines the common sense approach that is taken by the regulators, which, he implied, contrasted with a more ideological approach in other countries that believed that the market actors were inherently right and that detailed controls were not required.⁵ A member of the Commission Bancaire, the French banking supervisor, emphasized this French characteristic with respect to the approach to the supervision of the prudential ratios of French banks.⁶ The French have reacted to the global challenges of regulation by retaining a strong but flexible role for regulation.

Perhaps the strongest illustration that France remained distinctive in its regulation of

the financial markets is that the financial crisis hit French banks as a consequence of American excesses, rather than as a consequence of French excesses. Although it did uncover some excessive risk-taking and some failures in risk management, most of the losses came from products that were originated outside of France and that were brought in by banks that were diversifying their portfolios.⁷

Although France changed from its early 1980s political economy, it did not abandon its specificities, and still has robust regulations of its financial markets. This is a puzzling outcome. Given the power that external forces have had in changing the French political economy in general and in particular the organization of its financial markets, it is puzzling that France kept a distinct approach to the regulation of its new model. The new system is a deregulated market-financed system, with the government out of the markets, and fairly light regulations that give an important level of freedom and flexibility to financial actors to innovate. The composition of the French financial markets and their regulation is in general similar to the American or British markets. However, this is not a blind convergence towards the American or the British approach to the regulation of the financial markets. The notion of self-regulation has not permeated the French system. So there is a limit to convergence theories and to the victory of markets.

Global Changes and Their Impact on Financial Systems

In the last few decades, at the global level, technological changes and innovations have strongly impacted the organization of the financial industry. This led to a series of changes towards the deregulation of the financial sector and a new approach to finance. These global changes also led to a heightened competition both between financial institutions and between financial centers, leading to interjurisdictional competition (Vaillancourt 2007). These global factors influenced all countries. They

influenced France in particular and made a reform of its financial system necessary. France liberalized starting in the 1980s (Loriaux 1991). The deregulation of the financial markets continued in the 1990s and 2000s, and the role of the state in the financial system was redefined (Culpepper 2006). As a result of these global pressures, France partially converged towards a deregulated model and took the state out of the markets.

Technological Innovations

Technological changes have been quite important in the last decades, and they have promoted competition. Technology has been seen as a factor that would force convergence between national political economies towards a set of 'best practices' required by the new technologies.

The most important technological changes have been the information, communication and technological innovations (OECD 2008, 14). These technological changes were dramatic (Comte-Sponville 2004, 199). These technological changes are primarily developments in electronic communication, telecommunication, transportation and data processing.

Competition technology has promoted vicious competition in financial markets

New information and communications technologies also led to "dematerialization." This term characterizes the process by which securities ownership, which used to be in the form of physical certificates, was converted into electronic records.

These technological innovations allowed financial institutions to get around a lot of regulations. Regulations that separated different activities in the financial markets quickly became obsolete. Non-bank financial institutions became competitors of banks for certain products. Banks needed deregulation to have a level playing field in which they could compete fairly. As a result, new technologies and innovations led to the process of conglomeration (Padoa-Schioppa 2004, 57). This led to the creation of bigger financial institutions that had the ability to give all sorts of financial products.

The financial actors took advantage of these technological changes and innovated, creating new financial products and new ways of dealing with risk. In turn, these innovations impacted the financial system and increased deregulation.

Innovations in Financial Products

There have been many innovations in the financial markets. New financial products were produced by the "Quants" and sold on the markets. The "Quant era" started in the mid-1980s, when these math and physics PhDs created and priced new investment structures (Salmon 2009). These innovations offered higher remunerations, and what was believed to be lower risk. They changed the composition of the markets, in particular by increasing the size of the global unregulated over-the-counter (OTC) market, on which complex financial products were exchanged between financial institutions.

The process of securitization is perhaps the most important of these innovations. Securitization has two meanings: the increased reliance on securities to finance an economy or a process by which complex financial products are created by packaging different vanilla products together. It is the second meaning which is referred to here. Guy Moszkowski underlines the importance of the securitization process, which consists of "putting together a pool of assets that provide

a regular cash flow, tranching it, and selling different layers of risk to different investors.”⁸ Other innovations such as the CDS, CDO and others also were developed.

The outcome of the combination of innovations and of this set of incentives was a global environment in which regulations were more relaxed and financial institutions were more daring. France did not escape this general trend.⁹ The impact of technological evolution and innovation on the financial services industry is not new. Already in the Middle-Ages, the invention of letters of credit between Flemish and Italian markets was a little revolution in finance. The difference today is the suddenness and amplitude of these technological changes and innovations, which are transforming the value scales, distances, time and production processes (Lencquesaing 2007, 7). Since the 1970s, the flows of investments have changed radically and changed the relationship between the state and the markets to the advantage of the markets (Ohmae 1991, 161). These technological changes and innovations in financial products cannot be tamed by the regulators, and this led to a global environment in which deregulation was seen as the desired outcome (Calomiris 2000, 247; Stiglitz 2003, 255).

Competition has also been a crucial factor in deregulation, but again, for reasons of space, these elements developed elsewhere will be left out of this article.

Regional Market Pressures: Globalization with a Political Face

The French financial markets deregulation is also a European story. This section shows how the European Commission, as a consequence of its political strategies to achieve European harmonization, played a role in accelerating and coordinating the deregulation movement that member states initiated. It was difficult for the European Commission to impose a common regulatory framework that would have forced member

states to abandon their national specificities. Given its structural weakness, it had to rely on political strategies to harmonize the markets. These strategies reinforced the global pressures for deregulation. The Commission forged winning coalitions by using the differences in objectives between those who wanted liberalization as an end in itself and those who saw it as a necessary intermediate goal for long term political integration. The Commission unified them around the shared objective of harmonization and was able to pass its directives. Because of this strategy, the directives came down on the side of global markets. The Commission also used competition between national regulatory systems to promote harmonization outside of the legislative process. This strategy of promoting interjurisdictional competition and using market forces as a tool to harmonize reinforced the deregulatory pressures on France.

The European Union as an Actor for Harmonization and Deregulation

The European Union is an important actor in the regulatory arena. Through the policies of the European Commission, it has had a role in furthering harmonization and deregulation of the national regulatory frameworks. Schmidt goes even farther and argues that “Europeanization has represented a strong force for change, stronger than globalization” (2002, 14). Although this process was already started at the national levels in most member states by the time harmonization and deregulation of the financial services industry became a European Union policy, the actions of the European Union have had a significant role in accelerating and coordinating the national reforms. It served as a “locus of coordination of market reforms” (Jabko 2006, 58).

To respond to the new challenges in financial supervision, in particular the internationalization of the financial groups who increasingly operate on a cross-border

basis, the European Union has furthered cooperation and coordination between national regulators. There are three supervisory committees, which are part of the level 3 of the Lamfalussy process, and have the objective to promote supervisory convergence. They are the Committee of European Banking Supervisors (CEBS), the Committee of European Securities Regulators (CESR), and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS). These committees play a very important role in harmonizing the rules of supervision of the member states (SIFMA 2008, 28). They are a place of cooperation and coordination between national supervisors, who keep different approaches.¹⁰ This evolution in the Commission's approach to legislating on financial regulation and the development of these committees added more pressures on France to converge towards a deregulated model.

Harmonization on Market Terms and the Weakness of the Commission

The European Commission has improved the harmonization of the frameworks for financial regulation in the member states. This was a difficult task given the structure of the European Union and the ambition of the objectives. Indeed, the ability of the Commission to force member states to agree to its policies was limited and harmonization is inherently difficult as states have to change their systems and sometimes lose their specific competitive advantages. As a consequence of the tension between the ambitious objectives and the limited means to achieve them, the Commission could not simply craft a framework for financial regulation and impose it to the member states. Competition and deregulation seemed like the only options to achieve harmonization.

It is difficult to impose reforms that create losers, as the losers face clear costs and mobilize in a stronger form than the winners. Indeed, the gains for the winners would be

on a longer time horizon and more diffuse. If there is a central authority that can easily coerce the losers to accept their faith, then the collective good can be attained. But when there is no central coercive authority, as at the EC level, then implementing the common interest becomes harder. The problem becomes more difficult when the winners and the losers are not only sub-sectors of the financial services industry or specific firms, but member states themselves, as may be the case in the transformation of the financial system as a whole.

As a consequence of the difficulty of harmonization, the Commission cannot provide its own framework and impose it. It has to rely on compromise, and the easiest compromise is to deregulate, rather than change the regulation models of all member states to one tightly regulated model.

Deregulation as a Result of a Coalition-Making Strategy for Harmonization

In this context of difficult harmonization, the European Commission has elaborated a political strategy to build a winning coalition of actors capable of bringing reforms and passing directives. This strategy was based on bringing together groups that did not share the same vision on liberalization. It managed to bring together these "strange bed fellows" by playing on the ambiguity of the final objectives these groups pursued. The neo-liberal Anglo-Saxons wanted to have the European Union as a free-market zone with no barriers, and with a deregulated financial system. The continental groups saw financial market integration on deregulated terms as an intermediate objective which would enable the emergence of a political Europe. These different groups formed a coalition that allowed the European Commission success in harmonization and deregulation. This strategy increased the pressures on France to deregulate.

To achieve a winning coalition to liberalize finance was not a given, and this

strategy was a tool to succeed in a difficult mission. The promoters of Europe managed to bring different actors with different interest together. Harmonization meant deregulation to a certain extent, and the loss of many powers of the state over the financial markets. The natural coalition that supported this objective was formed by the neoliberal actors, the international business groups, and the states that would benefit from more deregulation. But this coalition was a minority, even within the Commission's bureaucracy. The promoters of Europe used the long-term objectives of European integration shared by many actors in order to bring them to compromise on liberalization as a necessary moment to further integration. They argued that the deregulation and liberalization was only an "intermediate" goal that was necessary to make the ideal of a united Europe a reality. Liberalization, then, became a difficult but necessary medicine to swallow.

Meeting of the European Commission in Brussels, Belgium

This strategy did indeed succeed in bringing together "strange bedfellows" that did not share common long term objectives. The winning coalitions that were forged allowed the European Union to coordinate deregulation of member states and to harmonize through a series of directives. These directives, because of the composition of the coalition, liberalized the markets and have put an additional pressure on France to deregulate.

A Strategy of Interjurisdictional Competition and Deregulation

Harmonization of the financial sector, past a certain level of relatively consensual convergence, becomes harder when the resilient aspects of the national models are concerned. The European general interest was in stronger contradiction with the national interests of certain member states. The capacity of the European Union to broker compromises and to forge winning coalitions to produce legislation was further constrained when the regulations they tried to harmonize the resilient regulations. As the harmonization process reached some core aspects of national models and the implications for the competitiveness of financial centers get bigger, the Commission turned to the promotion of interjurisdictional competition as the central tool for harmonization. This strategy of competition, in context of mutual recognition of financial regulations across the European Union put in place by the 1992 plan, led to important pressures on national financial centers to deregulate in order to stay competitive. These pressures did not come specifically from directives that legally required deregulation, but rather from market forces. This also increased the pressures on France to deregulate.

This strategy of promoting competition played by the European Commission is the product of the constraints of its weakness, but also of the ideas that came to dominate the Commission in charge of these policies. This strategy has increased the reliance on market pressures to force convergence of national regulatory frameworks for financial services and have let competition define the general interest. This competition leads to deregulation, and harmonization around minimum regulatory requirements. Therefore, politics at the European Union level play a crucial role in French deregulation. Global European Union factors have put strong pressures on France to deregulate its financial system.

A Distinct French Outcome: Elite Culture and Universal Banks

The French model remains distinct. It kept a robust regulatory system, with regulatory agencies that had a *tâtilion* approach to controlling the market operations of financial institutions. The regulatory agencies did not become captured by the markets, as they did in other countries. French banks did not engage in as much risk-taking as their Anglo-Saxon counterpart. Although France has evolved towards a market-based financial system, its approach to regulation was not identical to the neo-liberal approach that dominated other financial centers subject to similar external pressures, in particular London and New York. Given the global pressures from technological and financial innovations, given the regional political pressures that accompanied and reinforced convergence, why is the French outcome distinct? This puzzle can be explained by the specific culture shared by the cohesive French elite. It has strong ties with the state and some sense of the general interest, or at least of the interest of the state, which they equate with the general interest. The organization of the French elite constrained the market pressures and led to this distinct outcome. The specific institutional setup of the main actors on the financial markets, the French universal banks, also played a role in constraining the external pressures. The universal banks produced a specific culture of risk-taking, and its business model, based on long term relationships with its clients, did not require as much deregulation. These factors shaped the way these external pressures impacted the French model. The convergence towards one global model of finance is not the necessary outcome of these external pressures.¹¹

A Cohesive French Elite and Its Approach to the State and Regulation

The distinct French outcome is the product of the relations between the elite and the state.¹² The elite are cohesive and go

back and forth between civil service, politics, finance, regulation and the industry. They are socialized by similar educations and career paths. This produced a distinct world view which constrained the external deregulatory pressures. French elite culture and cohesiveness is an important factor to explain why France has a distinct regulatory model. "Deregulation does not mean no rules, just different rules," as Schmidt (2002, 20) reminds us. And the characteristics of these different rules are partly determined by features of the nation, such as the organization of the elite. The cultural setting of France shapes the elite, which are predisposed to leave power in the hands of the state and to give it a strong role in the regulation of finance. This produces a suspicion towards the ideas according to which markets can self regulate and banks will control their risks.

The fact that the leaders of the banks, of the state, and of the regulators all went to the same schools and were socialized in a world view that emphasizes the service of the state, explains this particular approach to finance in France. Furthermore, because these networks between bankers and regulators are so strong, there is a special relation between them. They have access to each other and as a result, regulation is not viewed with as much suspicion as in other countries. These networks also allow the state to influence at the margins the policies of the banks. Indeed, the public officials have a direct access to the CEOs of the banks on a personal basis (Zysman 1983, 115). This passage in the civil service helps define the world view of the elites and this can explain the distance with the Anglo-Saxon doctrines by which the markets are capable of self-regulation, and that the state should completely exit the markets and let the financial actors forge their own tools of regulation. The approach to risk and regulation of the leadership of the banks is then defined in part by this particular career path. Firms tend to behave in accordance to a management culture, practices, and political

ties that are maintained (Schmidt 2002, 35). Schmidt summarizes the particularity of the French elite in the following way: "" (2002, 30). The shared suspicion of the French elite towards the markets and their relationship with the state explain the resilience of a French model of financial regulation in a context of deregulatory pressures usually understood as ineluctably forcing full convergence.

Universal Banks

The French financial system is based on the universal banking model. Universal banks are the main actors on the French markets. Specialized financial institutions are secondary. The universal banking model is based on having different financial services grouped together in one bank. Banks have a portfolio of activities split between retail banking, investment banking and asset management. Some universal banks give more importance to one line of business or to another, so certain universal banks are more present in retail banking or in market activities. But overall, this model, with a balance between its two main activities of retail and markets, offers a particular risk management culture and give priority to long term relationships with customers and this leads to a robust financial system (Paris Europlace 2009, 12).

Investment banking and corporate finance activities were mainly developed inside the universal banking framework. These activities were therefore regulated by the same regulators as commercial banks. As a result, the French BFIs were regulated by the AMF for their securities activities, and by the Commission Bancaire for the respect of prudential ratios by the bank as a whole.¹³ Therefore the operations on markets were structurally regulated. During the 1990s and 2000s, when the importance of markets increased in the financing of the economy relative to credit, the importance of the investment banking departments grew, but they grew inside the framework of the universal banks.¹⁴ Therefore, these activities remained regulated, even if the regulations

were flexible.

In contrast, the evolution of finance in the US was marked by the Glass-Steagall Act of 1933 (Calomiris 2000, 334). Commercial banks and investment banks were separated. The commercial banks were very highly regulated. The investment banks were not strongly regulated. The logic for this was that their market operations were mainly between institutional investors or firms, who understood the risks they were taking. It was not deemed necessary for the state to be involved in the protection of these actors. They were not the "widow and the orphan," and the state was not going to protect them. As a result, the investment banks were not regulated by the Fed, which controls prudential ratios. When the investment banks became more central to the economy, the regulations remained light. The regulatory distinction between the SEC and the Fed and the inability of the Fed to control the risk levels of investment banks did not enable the regulators to understand the systemic risks involved with the increase in proprietary trading of the investment banks. This problem was already evoked in a report led by Glen Hubbard, John Thornton and Hal Scott (2006).

Consequences of the Universal Banks on French Financial Regulation

The economic crisis of 2009 has not dampened France's national pride.

Institutions shape the policy and institutional preferences of economic actors. Market pressures on firms are very different from one country to another (Schmidt 2002, 31). The universal bank characteristic of the French financial system is important to consider as an institution shaping the preferences of financial actors for the regulatory framework. Indeed, the French universal banks prioritize the long-term relationships with their clients (Paris Europlace 2009, 12). They can adopt this strategy because they are relatively less dependent on the short-term market pressures and are not required to do deals all the time to survive. This is allowed by the “cushion” provided by the recurrent profits from the commercial banking activities which can mitigate losses.¹⁵ The long term horizon constrains the BFI from selling to clients products that are too complex and with hidden risks, at high prices. Indeed, if its services are not appropriate (for example if the products are oversold or if their risk levels are misevaluated), the long term relationship is compromised. They take a particular responsibility in the products they offer to their clients. They are not solely in the deal-making perspective. This means that they offer less original solutions. This long term relationship enables the universal bank to be less aggressive and less risk-taking (McCoy, Frieder and Hedges 1994, 18).¹⁶ Furthermore, the shareholders are not as focused on short-term profit. This is a characteristic of the French model (Fioretos 2001, 221; Culpepper, Hall and Palier 2006, 16).

As a result, the policy preferences of the French banks are not necessarily full deregulation and freedom to engage in excessively risky operations, as excessive risk is not required for survival. The competition, although intense, remains at a reasonable level, as banks have a set of loyal clients, and a recurrent source of profits from commercial banking. This produces a stable system.¹⁷

There is a specific culture of risk management that comes from the universal

bank model. Indeed, the top management of a French bank is comprised of bankers that are commercial bankers first. As we have seen, they often spend time in the public service, which participates in shaping their world view and their understanding of risk. But in their career paths they also are often commercial bankers first, and have an approach of bankers, not investment bankers, towards risk. And the commercial banking culture is more risk-averse and less regulation-averse. The top management moves back and forth between commercial banking and investment banking. Therefore even the heads of investment banking activities of the bank share to some extent this common culture.

The institutional organization of the French universal banks also constrained the possibility for the interests of the investment bankers to reach the level of policymakers. Indeed, when the bank is lobbying the state, it represents the interests of the bank in general, not just the interest of the investment bank department. And the final position of the banks is set by the President of the bank who, as shown earlier has an approach to risk defined by his experience as a banker. Therefore, banks are not likely to ask for significantly more deregulation.

Conclusion

In finance, the global changes brought by technological and financial innovations and competitive pressures are real. They are necessary. They are driven by the search for efficiency and by globalization. It is a necessity to optimize the usage of savings and capital to finance growth, to finance emerging countries, to finance the new economy under the pressure of new constraints, such as the environment or longer life expectancies. These changes impact the world; they lead to partial convergence of different national financial systems and regulatory frameworks, and are ineluctable. France has experienced these pressures and deregulated its financial system.

Yet other external forces also played a key role in French deregulation. The European Union has accompanied, accelerated, and coordinated the convergence of European regulations. The legislation pushed by the European Commission was clearly on the side of the markets, and reinforced the pressures on member states to abandon their control of finance. The political strategy of forging winning coalitions to pass legislation reinforced the deregulatory characteristics of the European directives. The political strategy of relying on market forces to further harmonize through competition between national regulatory systems also reinforced the deregulation pressures. Change is not just the result of the impersonal forces of globalization. Politics, in this case politics of the European Union, also play a role in deregulation.

Given these pressures, France changed. But it also remains distinct. It keeps its own values and approach to regulation. Its modern, market-centered, flexible, deregulated financial system has not fully converged towards the Anglo-Saxon, self-regulation approach. French regulation remains balanced and robust. It combines protection of the investor against systemic risk and market efficiency. It is an example of "smart regulation."

Why has it kept its specific approach to regulation in its transformed market-based system? Why has it not fully converged towards the dominant liberal system? This article has argued that domestic factors constrained the power of the markets. The culture of the French elite is permeated by the state. The elite are socialized in a specific world view which emphasizes the general interest and the need for state sovereignty, and views the markets with suspicion. The way the elite thinks of the market and the state refined the policies chosen to modify the French financial system. The organization of the French universal banks, with their diverse portfolio of activities balanced between market operations and commercial banking, has also shaped these external pressures, through a specific culture of risk and a business model which relies on long term relations with the corporate clients.

The French model survives, transformed. It has experienced an *Aufhebung*, a sublation, rather than a negation. The French model is both *preserved* and *changed* and has evolved to take advantage of new opportunities in a globalized world. How much will this model, and its nuanced approach to markets and regulation, influence the post-financial crisis global framework? This French case based on its traditions and values demonstrated its ability to adapt to the market needs and to the pressures of European and global convergences. The current financial crisis triggered a process by which the assumptions behind the current dominant framework will be revisited. A new framework will have to be more globally accepted and based on values that maintain confidence on markets, responsibilities, transparency, balance between innovation and investor protection, and balance between organized market and OTC market. In this perspective the French case demonstrated an interesting compromise, which may be a valuable input for the creation of a new global framework launched by the G-20 in April and September 2009.

Endnotes

- 1 Interview with Michel Prada (AMF), Paris, January 7th 2009.
- 2 Interview with René de La Serre (CCF), Paris, January 8th 2009.
- 3 Interview with Stephan Boivin (Commission Bancaire), Paris, January 15th 2009.
- 4 Interview with Michel Prada (AMF), Paris, January 7th 2009.
- 5 Interview with Michel Prada (AMF), Paris, January 7th 2009.
- 6 Interview with Stéphane Boivin (Commission Bancaire), Paris, January 15th 2009.
- 7 Interview with Anne Marion-Bouchacourt (Société Générale), Paris, January 15th 2009.
- 8 Interview with Guy Moszkowski (Merrill Lynch), New York, February 7th 2009.
- 9 Interview with Michel Prada (AMF), Paris, January 7th 2009.
- 10 Interview with Michel Prada (AMF), Paris, January 7th 2009.
- 11 For more writings on the resilient aspects of national models, see Berger and Dore (1996), Boyer (1996), Garrett (1998), Culpepper, Hall and Palier (2006), Hall and Soskice (2001), Moran (1991), Pierson (1996), Pontusson (2005), Schmidt (2002), Streeck (1997), Trachtman (1993), Vitols (1997), S. Vogel (1996), Wade (1996).
- 12 For writings on the French elite system, see Armstrong (1973), Bauer and Bertin-Mouroit (1997), Bourdieu (1989), Crozier (1964), Hancké (2001), Mandras and Suleiman (1995), Rouban (2002), Schmidt (1996), Suleiman (1978), Ziegler (1997).
- 13 Interview with Stéphane Boivin (Commission Bancaire), Paris, January 15th 2009.
- 14 Interview with Arnaud de Bresson (Paris Europlace), Paris, January 14th 2009.
- 15 Interview with Philippe Morel (BCG), Paris, January 8th 2009.
- 16 For more writings on universal banking, see Calomiris and Hubbard (1990), Calomiris and Pornrojngangkool (2006), Kashyap and Stein (1995), Rajan (1992).
- 17 Interview with René de La Serre, Paris, January 8th 2009.

Appendix 2: Interviews

Andolina, Robert. Visiting Senior Lecturer of Finance, Johnson School, Cornell. Former Managing Director, Lehman Brothers. Ithaca, November 15th 2009.

Boivin, Stéphane. Service Affaires Internationales, Commission Bancaire. Paris, January 15th 2009.

Bresson (de), Arnaud. Managing Director, Paris Europlace. Paris, January 14th 2009.

Brouwer (de), Frederic. Head of legal for Europe, competition and group legal function, Société Générale. Paris, January 13th 2009.

Graber, Dominique. Head of European Public Affairs, BNP Paribas. Paris, January 6th 2009.

Grunenwald, Bertrand. Managing Director, Leonardo & Co. Former Managing Director, Rothschild & Cie. Paris, January 12th 2009.

Jabko, Nicolas. Senior Research Fellow, Institut d'Etudes Politiques de Paris. Paris, January 7th 2009.

La Serre, René (de). Advisor to the Compagnie Financière Edmond de Rothschild Banque. Former Vice President and General Director, Crédit Commercial de France (CCF). Former Chairman, Conseil des Marchés Financiers (French securities regulator). Paris, January 8th 2009.

Lencquesaing (de), Edouard-François. Director, Netmanagers. Member of the Board of Directors, Euro CCP. Former Member of the Executive Committee, CCF. Former Director, SWIFT and SICOVAM. Paris, January 6th 2009.

Marion-Bouchacourt, Anne. Member of the Executive Committee, Société Générale. Paris, January 15th 2009.

Morel, Philippe. Senior partner and Managing Director, The Boston Consulting Group (BCG). Paris, January 8th 2009.

Moszkowski, Guy. Managing Director and analyst covering investment banks, Merrill Lynch. New York, February 7th 2009.

Prada, Michel. Former Chairman, Autorité des Marchés Financiers (2003-2008). Paris, January 7th 2009.

Remay, Vincent. Director-Deputy CEO Senior Advisor, NYSE Euronext. Paris, January 8th 2009.

Segonzac, Patrick (de). Former Member of the Executive Committee, CCF. Bomy, France, June 25th 2007.

Villeneuve, André. Chairman, LIFFE. Chairman, City of London EU Advisory Group. Paris, July 3rd 2008.

Wolstencroft, Tracy. Partner and Managing Director, Goldman Sachs. New York, January 6th 2009.

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