Preface

After decades of neglect, financial regulation and supervision have moved to the forefront of policy making. Practitioners, academics, officials and politicians have engaged in a public debate much in the same way as they did for monetary policy since the 1950s.

Several factors have contributed to the rise in interest in public policy aspects of financial activity. The first is the reappearance of financial *instability*. After many decades of tranquillity, a series of banking and financial crises have hit—from the 1980s onwards—a number of industrial and emerging economies as well as the global financial system. This called for extensive use of taxpayers' money and raised questions about the adequacy of the regulatory framework that had been designed in the aftermath of the financial crises of the 1930s.

A second factor is the phenomenal *expansion* of finance relative to the real economy, an expansion due to the rise in wealth, the widening split between savings and investment, the institutionalisation of saving, and the swelling of public sector deficits. The financial sector, which has traditionally been among those where public intervention was most pervasive, grew to such an extent that its regulation climbed to the top of political priorities.

A third factor were the advancements in *technology*, which made it possible to circumvent many regulatory barriers and segmentations erected to safeguard financial stability and reduce competition. Real time, remote, or intra-day finance and the development of trading outside formally organised markets have rapidly subverted the basis on which traditional regulatory instruments rested.

Financial *innovation*, partly driven by new technologies in the processing and transmission of information, was a fourth factor. A wave of new products, new market infrastructures, new trading and settlement systems, and new risk management practices completely transformed the financial industry. Regulation and supervision could not ignore the progressive blurring of the segmentation between the three traditional fields of finance: banking, securities, and insurance.

A fifth factor was the *globalisation* of finance, whereby financial transactions were less and less conducted in the closed world of nation states and increasingly implicated more than one country, one currency, one regulatory and legal system, and one supervisor.

A sixth and final factor was the change in the mission and institutional profile of *central banks*. Less than fifteen years ago, most central banks were still agencies charged with the defence of all public interests associated with the currency and the financial system, under rather strict dependence on the executive branch of the government. Since then, they have turned into independent institutions, strongly focused on the pursuit of price stability, and often deprived of the function of supervising and regulating banks.

While none of the factors above is exclusively, or even predominantly, European, two further specific developments made the aforementioned factors particularly relevant for Europe. Such developments were the creation of a single market for banking and financial services in 1986-93 and the adoption of a single currency for most EU countries in 1999. The EU became an exceptionally fertile ground to nurture a debate on fundamental issues of financial regulation. An entirely new legislation had to be drafted and negotiated. Definitions for basic components of the financial system (such as a bank, a market, settlement, etc.) had to be formulated. The charter of a new central bank had to written, in which all the aspects of central banking, including the involvement in financial stability, had to be reconsidered.

The essays collected in this book result from my involvement in the developments summarised above. With one exception, they were all written after the start the euro, when I was serving in the European Central Bank. Only some of them are devoted to issues specifically arising from the adoption of the euro. Most address issues which are not specifically European. Yet, the reflections they present owe a great deal to the intellectual stimulus provided by the adoption of a single currency in Europe. Indeed, the unprecedented event of creating a Monetary Union out of a set of still largely independent states, which—among other things—retain ample regulatory and supervisory powers in the field of finance, requires by itself considerable thought about regulatory and supervisory issues in new and consistent terms.

Whatever merits this book may have, credit for them goes to Charles Goodhart in the first place. Charles encouraged me to organise my thoughts and to present them in three lectures at the London School of Economics. He has been a most stimulating partner in a number of discussions, seminars, and conferences in which commonality of interests, similarities in intellectual approach and fruitful occasional disagreement enriched and filtered my thoughts. He then invited me to collect the lectures and other essays in a book, advised me on the selection and wrote the introduction. I owe a great deal to his intellectual finesse, solid judgement, and generosity.

In the preparation of the book, but also very much in relation to some of the essays (notably Chapters 2, 4, 5, 7 and 8), Jukka Vesala has been a skilful, competent and very efficient assistant. The same is true for Andrea Enria with respect to Chapters 1 and 2. The two of them and Mauro Grande have been stimulating partners in innumerable discussions about the issues treated in this book. Ariana Mongelli has carefully reviewed the drafts to ensure consistency in the language and to remove the traces of non-native English. Claudia Ferrari has patiently and skilfully managed the manuscript. To all of them, as well as to many staff members of the European Central Bank, who have actively joined internal discussions at various occasions, I express my gratitude. Opinions and errors are only mine. Finally, I would also like to express my appreciation to the Oxford University Press, for again being interested in publishing my output.