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European States and Financial Systems: A Biased Relationship

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In the summer of 2007, the financial systems of European countries were hit full force by a crisis of great magnitude. They were, by their behavior, the protagonists of this crisis and the first surviving victims of the central banks and States. Certain financial systems stood up to the crisis better than others, but all experienced dysfunctions that clearly showed the limits of the forms of governance and the forms of public intervention that characterized them. The banking system and the financial markets are both components of a financial system; the former is subject to European control and regulation, while the latter are free because they are supposed to regulate themselves.

Public intervention in the banking sector takes three main forms: prudential regulation, especially with the Basel II ratio for adequacy of a bank's own funds for their exposure to risk¹; insuring deposits, the goal of which is to ensure a minimum level of protection for depositors and savers in order to avoid a run on banks²; and control and supervision of banks by public authorities, which ensures that the rules are applied properly.³ Intervention by central banks, through their monetary policy and as lenders of last resort, constitutes the fourth means of regulating the banking system, and the main form of intervention in financial markets. Central banks intervene in order to ensure the stability of financial systems. The financial crisis has shown that traditional modes of public intervention in the financial system are ineffective and insufficient. Before analyzing the principles and limits of these forms of public intervention, we are going to

¹ The crisis revealed several weaknesses in the Basel II system: little consideration of the risk of liquidity, the procyclical nature of banks, the failure of internal controls to function, etc.

² The member States of the European Union are required (by Directive 94/19/EC) to set up a system to guarantee deposits that ensures, in a short time, a payment to depositors that is calculated according to a minimum harmonized level of 20,000 euros. Following the crisis, the European Union raised the minimum level of the guarantee to 50,000 euros beginning on June 30, 2009 and harmonization at a level of 100,000 euros beginning on December 31, 2011.

³ The crisis showed clearly the insufficiency of supervision. Reforms of existing systems were undertaken at the national and European levels. The European System of Financial Supervisors coordinates a network of national supervisors with European institutions for controlling banks, insurance, and stock exchanges.

examine cases of exceptional intervention and support to banks by public powers during the crisis. Then, in conclusion, we will compare these forms of public intervention with the current state of financial systems.

1. For an exceptional financial crisis, exceptional public intervention

At the start of this crisis, called the crisis of “subprimes,” at the beginning of 2007, was a fall in the market value of securities backed by American subprime mortgage loans, real estate loans made to borrowers with little solvency who were excluded from the credit market. This fall followed the realization of the lack of solvency of subprime lenders, including the American company New Century Financial, which declared bankruptcy on April 2, 2007. Banks that held these securities in their assets would then become aware of the illiquidity of these securities. They would declare their losses and raise their conditions for doubtful debt on the American real estate market. In June 2007, the fifth largest American investment bank, Bear Stearns, bailed out two of its hedge funds that were exposed to American subprime loans. It was followed in August 2007 by BNP Paribas, which announced the suspension of trading of three of its investment funds that were exposed to subprime loans, and by the German bank IKB Deutsche Industriebank AG, which, holding securities backed by subprime loans called “toxic” securities, was saved from bankruptcy by its mother house, the public bank KfW. The end of 2007 would be characterized by a succession of announcements of losses produced by depreciations of toxic securities.⁴ On September 13, 2007, Northern Rock, the fifth largest British real estate lender, asked the Bank of England for an emergency loan; on October 24, Merrill Lynch announced major losses, and would be followed by UBS and Citigroup banks. These different events led to great tension and a loss of confidence on the part of the markets, especially money markets. European banks faced problems with financing, a contraction of interbank loans, and a rise in the rates for interbank borrowing. Faced with the deterioration of their balance sheets, banks sought to get out of debt and to ration the credit they offered. Over the course of 2008, most banks saw their situation worsen, and systemic risk reached its height in September. On September 7, the American Treasury took control of the mortgage credit agencies Freddie Mac and Fannie Mae; on September 15, Lehman Brothers, the fourth largest American investment bank, went bankrupt, and Bank of America announced that it was buying Merrill Lynch; on September 16, the world’s largest insurance company AIG was nationalized by the Fed and the American government. Starting in October 2008, the world financial crisis entered a second phase. It grew worse; the danger of a systemic crisis became greater, and the world’s large economies

⁴ According to an IMF study, losses and depreciation of assets of French banks make up 3% of the world total counted in mid-2009. According to Bloomberg data, among the top 25 with the greatest losses and depreciations are 11 American banks, with at the top of the list Citigroup, Wachovia, Bank of America, and JP Morgan, for a total of \$600 billion; 4 British banks with a total of \$166 billion; 2 Swiss banks, 3 German banks, 2 Dutch banks, 1 Spanish bank, and 2 French banks (Société générale and BNP Paribas) with a total of \$39 billion in losses.

saw a recession for more than two years. Beginning in the summer of 2010, the financial crisis, which caused a swelling of debt and public deficits, was transformed into a sovereign debt crisis. Before the crisis, the situation of public finances in the countries of the euro zone was globally satisfactory; with the crisis, public deficits grew (Mathieu and Sterdyniak, 2011). Budget imbalances grew worse because of, on one hand, injections of public funds into the financial sector, and on the other hand, the fall in revenue caused by the economic recession (see the chapter by Philippe Bance below). The financial markets then decided that this deterioration of public debt increased the risk of insolvency for States. They revised sharply upward the risk premiums on the sovereign debt of several European states, especially those on Ireland, Greece, Portugal, Spain, and Italy. There followed the establishment of restrictive policies, a sharp reduction of public spending, and strengthening of the supervision of budgetary policies, accompanied by the establishment of a temporary financial aid system for member States that were having trouble getting access to financing on the markets. The behavior of the markets turned against banks, their main actors. Banks that held sovereign debt had to face a devaluation of their assets and an increased risk of losses. According to the European Central Bank (ECB), this risk must be relativized. In the case of French banks, for example, their exposure to sovereign debt of the countries of southern Europe makes up 38% of their own funds (Tier 1), and they hold 8% of the Greek sovereign debt.

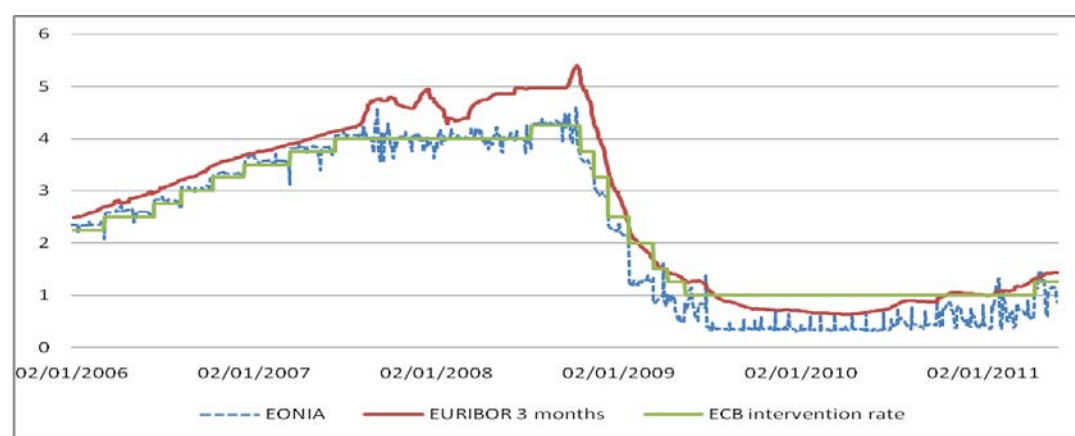
Beginning in August 2007 and throughout 2008, central banks and States intervened massively to save financial systems. Banks, facing a high risk of insolvency, had to increase their solvency ratio, either by reducing their assets, especially outstanding bills for credit given, or by increasing their own funds by recapitalization. Moreover, they also had to continue refinancing themselves in order to meet their commitments. The general context of uncertainty and distrust led to a crisis of liquidity, which required refinancing of banks and led to a restriction of credit. It also contributed to a sharp fall of financial markets, which led to a rise in the cost of recapitalizing banks on the stock market. Facing the risk of financial systems freezing and the financial crisis turning into an economic crisis, public powers decided to support financial systems. In Europe, this support occurred in two stages, reserved support until September 2008, then solid and committed support by the ECB and certain States, which did not prevent a severe economic recession.

At the beginning of the crisis, central banks tried to contain it by injecting exceptional liquidity into the interbank market in order to restore a climate of confidence among banks. When this initiative proved to be insufficient, the Fed quickly adopted measures of “conventional” monetary policy that consisted of lowering its intervention rates. The ECB adopted these measures in October 2008, lowering its intervention rate from 4.25% to 1%, which led to the lowering of reference rates on the interbank market (Figure 1). At the end of 2008, central banks faced a market crisis; they then put in place “unconventional” measures that consisted of meeting all of banks’ needs for liquidity, providing liquidity in cash, extending the duration of refinancing operations, enlarging the list of eligible assets, but also buying secured bonds and government

bonds.⁵ The goal pursued by central banks was to increase massively the amount of money in the economy and reinvigorate the markets by buying securities directly and substituting themselves for banks to finance the economy (Loisel and Mésonnier, 2009).

The primary mission of the ECB is the stability of the prices of goods and services (ECB, 2011). To ensure the success of this mission, it sets its intervention rate and, by open market operations, stabilizes the daily interbank rate (EONIA) at a level close to this intervention rate.⁶ In a normal economic situation, refinancing operations and required reserves are the two pillars of the monetary policy of the ECB, which, by combining them, stabilizes the interbank rate very close to the intervention rate.⁷

Figure 1: Interest rates in the Euro area, 2006-2011



Source: EcoWin.

⁵ The Fed instituted these measures in December 2008, then the Bank of England in January 2009 and the ECB in June 2009.

⁶ To carry out its monetary policy, the ECB uses six tools: short-term refinancing operations (Main Refinancing Operations, or MROs), required reserves, longer term refinancing operations (LTROs), fine tuning operations, permanent facilities (every day, banks can borrow from or lend to the central bank an unlimited amount at a rate +/-1% of the intervention rate for 24 hours), and collateral (each time a bank refinances itself with the ECB, it must mobilize assets that will serve as collateral).

⁷ The ECB offers banks variable rate loans for seven days. The minimum rate for the loan is the intervention rate. The ECB sets the total amount loaned, the benchmark, according to the amount of liquidity it deems necessary for the economy, so that banks can meet their obligations for reserves. Credit establishments of the euro zone are compelled to form required reserves (the current reserve rate is 2% of deposits) for accounts opened with national central banks. The reserves are formed for a period of four weeks and are paid.

Between August 2007 and September 2008, the ECB's policy consisted of injecting liquidity daily according to the demand in the banking sector while maintaining the total amount of liquidity at a globally constant level. This policy increased the cost of liquidity, since banks were refinancing themselves at rates that were on average above the intervention rate. Since the ECB's main goal was to control inflationary tendencies, it did not lower its intervention rate during the first year of the crisis. The results of its behavior were greater volatility of the daily interbank rate, the EONIA, and a rise in three month interbank rates, the EURIBOR 3 months, reflecting a high level of distrust on the interbank markets (Figure 1). With the aggravation of the crisis beginning in September 2008, the ECB changed its policy radically. It participated in the concerted lowering of rates (minus 50 base points) carried out jointly by the Fed, the Bank of Canada, the Bank of England, the Bank of Sweden, and the Swiss National Bank, and it lowered its rates 325 base points in seven months (to 1% in May 2009). It gave banks the possibility of borrowing at any maturity at a fixed rate (the intervention rate), and in currency other than the euro, the liquidity they needed (the benchmark or maximum amount that the ECB is willing to loan was temporarily eliminated and replaced by full allotment). In these conditions, banks preferred borrowing liquidity from the ECB rather than depending on other banks of whose solvency they were uncertain. The excess liquidity drew down interbank rates, which stayed close to or lower than intervention rates until April 2011 (the intervention rate went to 1.25%). In May 2010, the financial crisis entered a third phase, becoming a crisis of sovereign debt. The ECB maintained its "unconventional" operations in order to reduce the effects of the crisis on the markets.

Intervention by States took different forms depending on countries (see the chapter by Luc Bernier below). It was essentially aid for refinancing in the form of guarantees and lines of credit, aid for capitalization, and aid for undoing assets (Plane and Pujals, 2009). Between September 2008 and February 2009, close to 40% of increases in the capital of euro zone banks was due to injections of capital by public powers. In France, the government created the State Company for Public Participation (SPPE) to allow the recapitalization of banks to a ceiling of 40 billion euros.

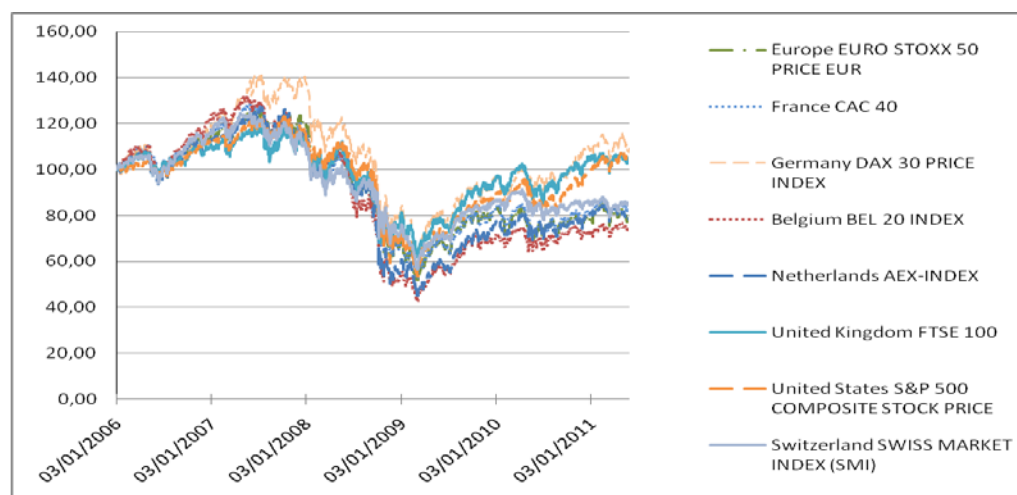
On October 10, 2008, the heads of State and of government of the G7 oriented the action of States around three axes: suspension of the application of international accounting norms (questioning the principle of valuation by the market price, Fair Value); recapitalization of banks, even State participation in the capital of banks; and a

commitment not to let any bank "of systemic importance" go bankrupt, to provide a public guarantee of interbank loans and re-regulation.⁸

At the European level, member States gave themselves three mechanisms that were supposed to guarantee European financial stability (Noyer, 2011). In May 2010, they created, for a period of three years, a European Financial Stability Facility (EFSF). In March 2011, the size of the fund was raised to an effective amount of 400 billion euros. They also approved the establishment beginning in 2013 of a European Stability Mechanism (ESM) provided with a loan capacity of 500 billion euros that would make possible exceptional intervention on the primary markets for sovereign debt. Finally, beginning in July 2013, there will be not issuing of eurobonds but integration of normalized and identical collective action clauses (CACs) into all contracts for issuing of government bonds in the euro zone for longer than one year of collective action. How were these different forms of public intervention received by the financial systems? Did they reach their goal of reassuring the markets? In view of the panic that hit the financial markets again in the summer of 2011, it seems that the goal was not reached.

Between the summer of 2007 and the beginning of 2009, the stock markets collapsed, before starting to move upward again, showing a certain level of confidence in the measures taken by the central banks and States. In May 2011, the stock markets of Germany, the United Kingdom, and the United States regained their 2006 levels, while those of Ireland, Greece, Portugal, and Italy had lost more than 50% (Figures 2 and 3).

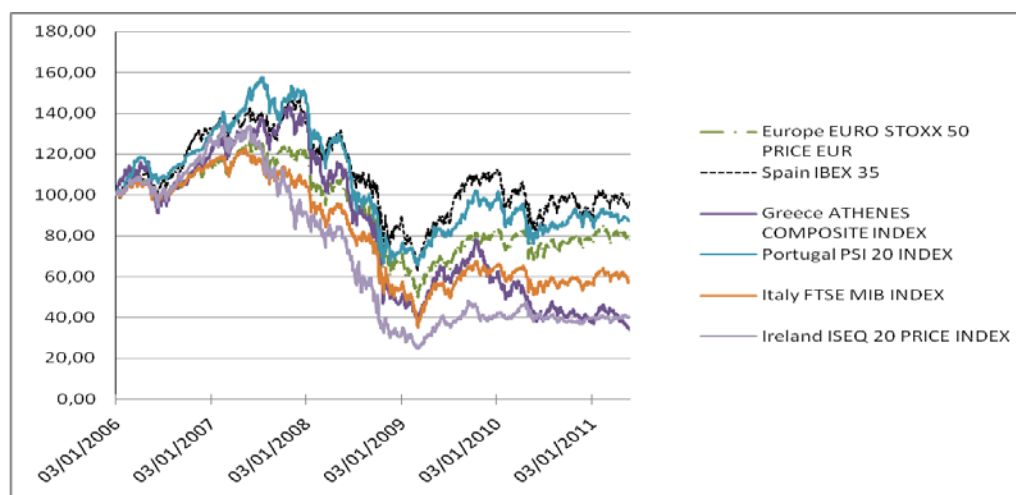
Figure 2: Evolution of indices shares from January 2006 to may 2011



Source: Telekurs.

⁸ On October 20, 2010, the European Commission presented its European outline project for the management of crises in the financial system.

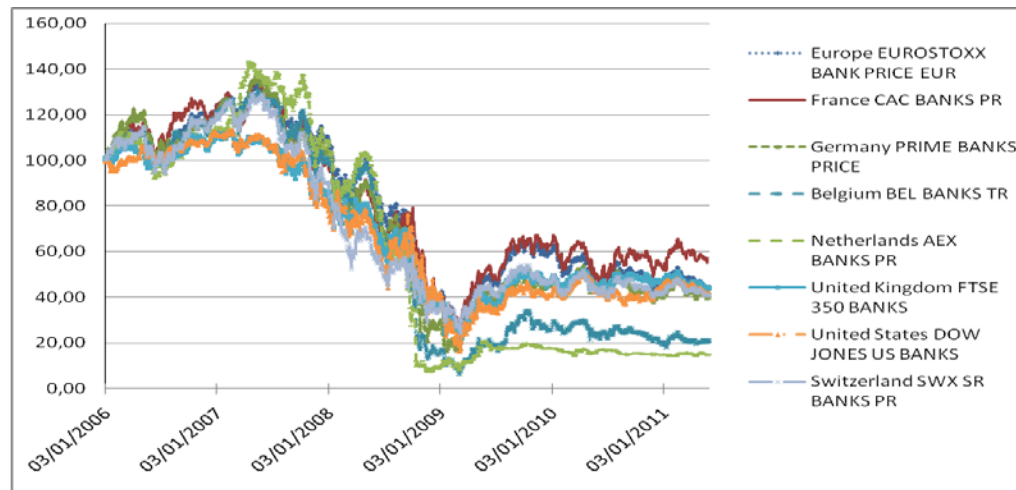
Figure 3: Evolution of indices shares from January 2006 to may 2011



Source: Telekurs.

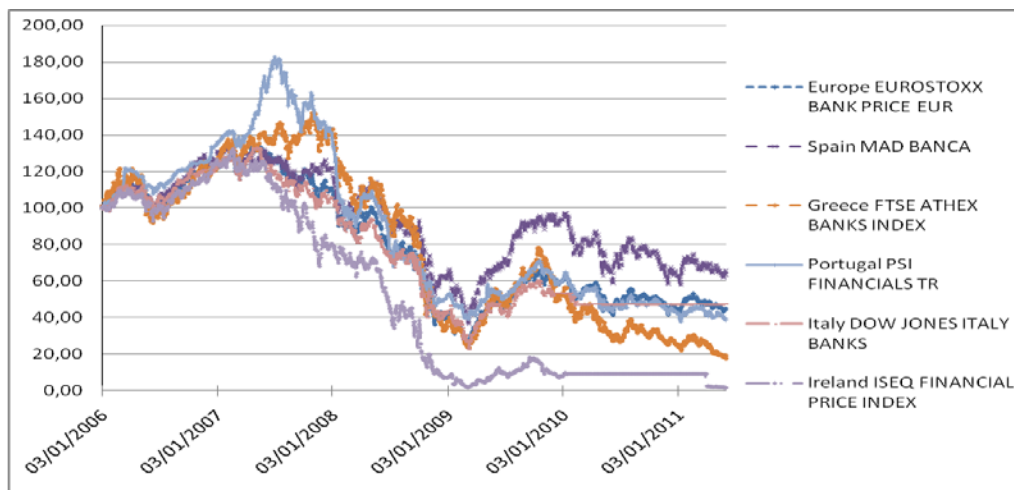
This sharp fall of stock markets is explained in part by the fall of bank shares. Since 2009, shares of Dutch, Belgian, and Irish banks recorded losses in value of more than 80% (Figures 4 and 5). In 2011, the stock market worth of bank values remained well below their 2006 levels.

Figure 4: Evolution of indices of the banking sector from January 2006 to may 2011



Source: Telekurs.

Figure 5: Evolution of indices of the banking sector from January 2006 to may 2011



Source: Telekurs.

The financial and economic crisis was deepened by the increase in the correlation between the banking sector and the economy as a whole, which had the important result of spreading the financial crisis to the economy as a whole. At the European level, the correlation between yields of the economy as a whole and those of the banking sector rose to 0.95 in May 2007, before the onset of the crisis, and with a correlation of 0.92 in May 2011, it has remained at a high level, which continues to cause risk for the European economy. The development of the correlation between the banking sector and the economy as a whole varies depending on the European country. On one hand, countries like Greece, Portugal, and Spain saw a strong increase in the correlation between their banking sectors and their economies as a whole, making them more vulnerable when facing a breakdown of this sector. On the other hand, the other European countries saw their correlation either maintain the same level as before the crisis, which is especially the case for France, or decline, which was the case for Italy, Ireland, the Netherlands, Belgium, and Germany.⁹ Some people might think that these countries would be less affected in case of new breakdowns in their banking system, but this would be to forget too quickly the strong dependence among European banking systems. This dependence was notably favored by the establishment of a common system of regulation, which rather than preventing crises, contributes to their appearance by pushing banks to behave the same way toward risk.

⁹ The correlation was calculated between the indices representing the stock markets and those for the banking sector in each country and for the euro zone, for two periods: January 2006-March 2007 and April 2007-May 2011.

2. The financial crisis: the result of outdated traditional means of public intervention

Aware of the central role played by banking systems in economies, public authorities subject them to regulations and controls. By their transforming activity, banks have structural fragility: they are exposed to the risk of illiquidity of their loans while facing liquid deposits. A first means of public intervention seeks to limit this transformation ahead of time. This is the international prudential regulations decreed by the Basel Committee, which require banks to hold enough capital in proportion to the risks they take. The Basel II prudential ratio in effect since 2007 requires banks to have their own funds making up at least 8% of the total of three weighted risks (credit, market, and operational). The goal announced by the Committee when this ratio was created was to push banks to set up performing models to measure risks and to improve their internal control systems. This goal has not been reached: on the contrary, the Basel II system bears part of the responsibility for the crisis, for at least four reasons.

While the transforming activity of banks' financial commitments naturally exposes them to risks concerning liquidity, these risks are not taken into account in the prudential ratio. The present crisis began by a crisis of liquidity, which then exacerbated credit, market, and operational risks. Banks owe it to themselves to respect a simple short-term liquidity ratio that guarantees that liquid assets for a month must at least cover liabilities due for a month. This ratio is calculated on the basis of assets and liabilities on the balance sheet; it does not include the possibility that in a context of uncertainty and tension on the markets, assets can quickly become illiquid, thus increasing banks' exposure to risks to liquidity.

The establishment of the Basel II solvency ratios was accompanied by new accounting rules that applied to businesses and banks listed on the markets and imposed on them the principle of valuation of their balance sheet at market value (Fair Value). The combination of this principle, which serves as a reference for calculating solvency ratios, and new prudential rules favored procyclical behavior by banks. In periods of market euphoria, the more the value of assets increases, the more banks will lend and take risks; on the other hand, when markets go down, the value of assets collapses, banks reduce their activity and increase their own funds.

It is true that the Basel II system was implemented only shortly before the crisis, but banks, especially European banks, had anticipated the move from the Basel I ratio to the Basel II ratio. They quickly developed very complex "advanced" models that calculate the three great risks independently of each other but above all allowed them to

follow weaker requirements for their own funds. Banks saw prudential regulation not as a way of regulation encouraging them to know better their exposure to risks in order to limit potential losses but as a constraint that, by forcing them to immobilize part of their own funds, harmed their profitability. They then resorted to financial innovations in order to "take out" of their balance sheets risky assets and transfer them to investors who were only slightly subject (like insurers) or not subject at all (shadow banking) to prudential regulation. During the period of market euphoria, banks had "forgotten" the low-quality assets that they had transferred to other establishments. With the crisis, they were faced with a massive return of assets to degrade on their balance sheets.

Finally, the crisis has shown the deficiencies of internal control or self-control of risk by banks, which is one of the pillars of Basel II. Within banks, the establishment of a culture of risk control, an internal organization separating operational activities and activities to control these same activities, and models for quantification and evaluation of risk based in large majority on Value at Risk, VaR, did not prevent either excessive risk-taking by some banks or the danger of a systemic crisis. The Basel II Committee and the supervisory authorities delegated to banks their control functions without giving themselves sufficient means to evaluate the tools and procedures for risk management established by each bank. They overestimated banks' ability to establish effective internal controls.

The crisis clearly showed the insufficiencies of prudential regulation, but it also revealed the failures and limits of supervision, which is to say, of the national public institutions responsible for ensuring that financial establishments comply with the rules defined by regulators. Before the crisis, each country had several supervisory authorities without there existing, within each country but also between countries, any coordination between different authorities. Following the crisis, it seems obvious that supervision must be macroprudential, and European if not international (Dabrowski, 2010).

It has also shown the limits of the deposit insurance schemes chosen by national public powers to protect not only national depositors but also those who live in other countries. In the European Union, countries must meet a common directive, the Deposit Guarantee Schemes Directive (DGD), which defines the fundamental principles of deposit insurance but allows States a certain autonomy in choosing their scheme. From this results a diversity of schemes in terms of types of deposits covered, ways of joining, calculating rates, the amount covered, settling bankruptcies, and the status of the deposit insurer, which is especially favorable for the development of moral risk and opting out (Eisenbeis and Kaufman, 2008). Joining the deposit insurance scheme should be mandatory for all financial establishments that have deposits of parties needing protection, such as individuals and small businesses, to limit opting out. When

joining is voluntary, a bank that takes extraordinary risks will join the deposit insurance, thus guaranteeing for itself the insurer's support in case of difficulties, while a low-risk bank will not. The problem of moral risk arises when beneficiaries of protection take exaggerated risks because they are protected, or think they are, against losses, or believe that the authorities will intervene to prevent any bank failure.

Central banks, the last mechanism for public intervention, have also shown some failings in the crisis. They use intervention rates, the very short-term interest rates that they offer banks to refinance themselves, to reach their goal of stability of prices and to influence conditions of the credit supply. They are the lenders of last resort; they provide liquidity to banks that are at risk of default because they are unable to finance themselves on the interbank market or because they are insolvent but too big to fail. They support a failing bank in order to keep its failure from spreading to the entire system and producing a systemic crisis. The guarantee of automatic support from central banks can encourage moral risk in the financial system, since it favors banks taking high risks when granting credit or taking a position on the markets (Cukierman, 2011).

Central banks must favor targeted injections of liquidity to limit the use of liquidity for simple goals of speculation (Ewerhart and Valla, 2008). Regulating liquidity would be one way among others to reduce the pressure put on central banks in favor of liquidity injections in periods of crisis (Rochet, 2008).

3. After the financial crisis: better regulated European financial systems?

The Basel Committee, mandated by the governments of the G20 to draw the lessons of the crisis, defined a new prudential framework that should be respected by credit institutions in 2019 at the latest and that introduces, in addition to the Basel II solvency ratio, a "leverage" ratio, two liquidity ratios, and resistance tests.¹⁰ Banks should strengthen the character of their own funds in order to cover all risks and control the leverage effect.¹¹ The second pillar of Basel II already requires banks to supervise their

¹⁰ The reader can consult <http://www.bis.org/bcbs/basel3/b3summarytable.pdf> for a synthesis of the Basel III prudential reforms.

¹¹ The new norm anticipates an improvement in the quality of the "hard core" or Tier 1 of banks' own funds (capital provided by shareholders, increased by profits held in reserve), which will go from 2% to 4.5% with a "countercyclical" cushion of 2.5%. Tier 1 should therefore make up a minimum of 4.5% of weighted risks of banks and, in times of strong economic growth, it will be a maximum of 7% of weighted risks.

indebtedness by the "leverage ratio" that measures the size of banks' commitments in relation to the size of their balance sheets. With Basel III, this ratio should be integrated into Pillar 1, and should therefore be integrated into the calculation of requirements for their own funds. In 2015 at best, if pressure by the banking lobby does not succeed in preventing the imposition of new ratios, banks will have to respect two ratios of liquidity, one for the short term (one month), the Liquidity Coverage Ratio (LCR), the other for the long term (one year), the Net Stable Funding Ratio (NSFR), to limit their exposure to liquidity risks.¹² The short-term liquidity ratio already exists; what is new is the application of the coefficient for weighting to assets and liabilities according to their degree of liquidity. Assets are all the more liquid as their issuers are solvent. To calculate the liquidity risk, banks will therefore have to evaluate the solvency of their issuers, either by using internal rating tools or by using external ratings by private rating agencies as references.

The committee persists in giving a central role to rating agencies in the evaluation of borrowers' solvency, when the agencies did not anticipate the losses by banks. They only modified their ratings after banks and States announced their difficulties. By their behavior, private rating agencies encourage panic on financial markets.

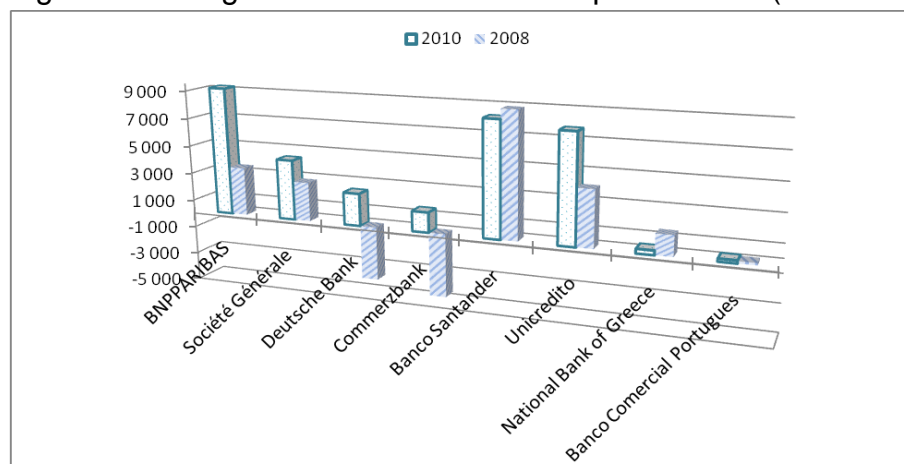
While the crisis showed clearly the weaknesses of means of public intervention in financial systems, the public authorities were more than prudent in their reforms. Will the modifications made to Basel II make it possible to avoid other crises? The answer seems obvious. Before the liquidity crisis of 2007, banks were already following the "leverage" and short-term liquidity ratios, which did not prevent them from becoming overexposed to risk; they met the solvency ratios of Basel II, but clearly either they underestimated their risks or their risk evaluation models were incorrect, or their levels of their own funds were insufficient for a situation of systemic risk. The new prudential rules, like the old ones, will apply only to banks; what about regulation of activities of other actors in financial systems, such as institutional investors, who bear part of the responsibility for the crisis? Nothing, or not much. What about regulation of financial markets, especially Over The Counter markets where complex and opaque products with high risk are negotiated? Nothing. Banks can therefore innovate, take risks again, and transfer them, especially to localized entities in countries other than their country of origin.

¹² The goal of this ratio (outstanding one-year stable assets must be at least equal to outstanding one-year stable liabilities) is to force banks to hold assets of one year maturity that are easily negotiable in order to withstand thirty days of crisis.

Public powers quickly revised downward their requirements for regulation of financial systems under pressure from the banking lobby, but also because of banks' rapid return to profitability. In 2010, the earnings of the twelve largest European banks grew by 8.6%, and their Tier 1 solvency ratios were between 8.5% and 15.3% (Noyer, 2011).

2010 was marked by a return to profitability of European banks, including those in the European countries most affected by the economic crisis. Between 2008 and 2010, the profits of the two largest French banks increased, by more than 160% for BNP Paribas and more than 50% for Société Générale (Figure 6).

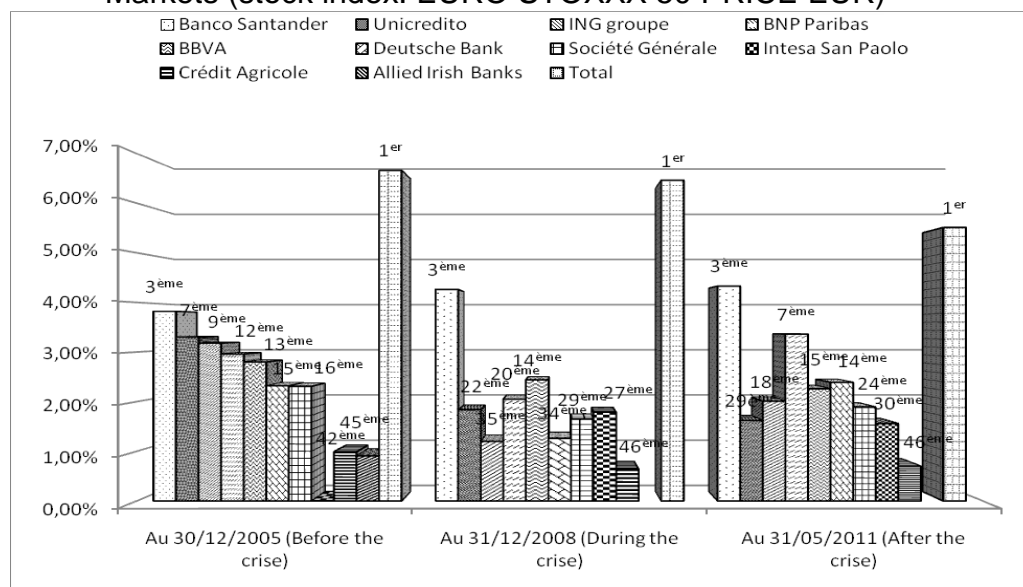
Figure 6: Changes in Net Results of European Banks (in thousand of euros)



Source: According to Telekurs.

European banks remain flagship values on the stock markets of the euro zone. After the crisis, 9 European banks appear among the 50 most liquid European values by the European stock index EURO STOXX 50 PRICE EUR (Figure 7). Despite the crisis, the supremacy of some banks remains unquestioned, and this in spite of the fact that their countries of origin are still affected by the economic crisis. The Spanish bank Banco Santander has maintained its third place on the European stock index and seen its weight increase after the crisis.

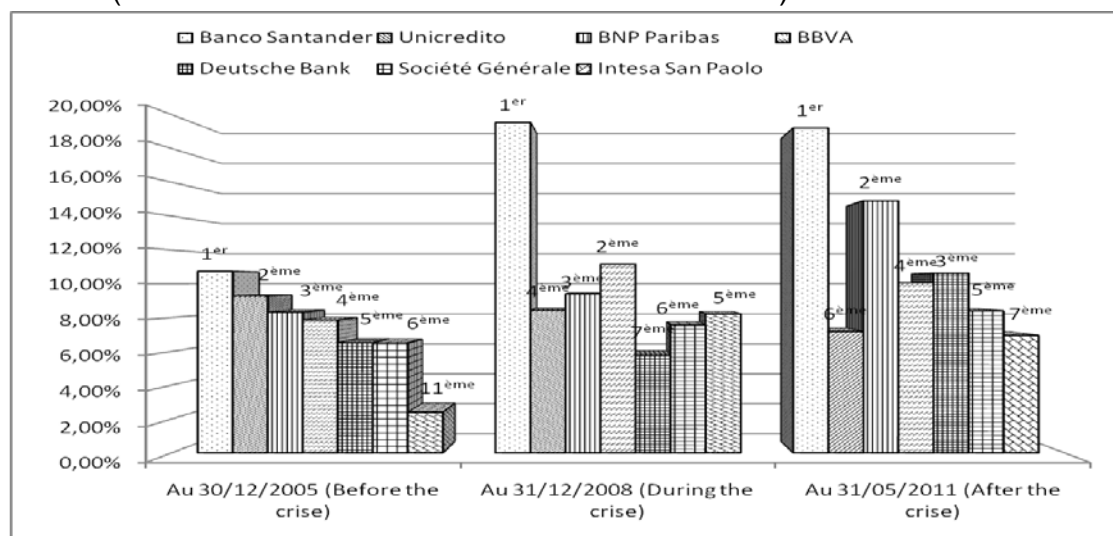
Figure 7: Changes in Weight and Position of European Banks on European Stock Markets (stock index: EURO STOXX 50 PRICE EUR)



Source: According to Telekurs.

Spanish and French banks have reinforced their position in the banking system of the euro zone. At the end of May 2011, Banco Santander and BBVA for Spain and BNP Paribas and Société générale for France were the most liquid values of the banking sector represented by the European "bank" shares index EUROSTOXX BANK PRICE EUR (Figure 8).

Figure 8: Changes in Weight and Position of European Banks in the European Banking Sector (stock index: EUROSTOXX BANK PRICE EUR)



Source: According to Telekurs.

Between December 2005 and December 2008, some European banks increased their own funds and thus either maintained their position on the index representing the banking sector of the euro zone or improved their position. The number of shares increased by 42.96% for Société générale, 27.82% for Banco Santander, and 154.97% for Intesa San Paolo. The increasing concentration of the European banking sector was one of the results of the financial crisis. The reduction in the number of banks making up the EUROSTOXX BANK PRICE EUR index reflects this increased concentration: of 47 banks forming the index at the end of 2005, only 34 remained in May 2011. High concentration of banking is a source of instability, not only because it is a high risk factor in financing banks, but also because it increases the degree of dependence of an economy on a limited number of banking and financial groups, and the principle of "too big to fail" is strengthened.

The Spanish, French, and Dutch banking sectors quickly recovered their place in their countries' economies, while others, such as those of Belgium, Germany, Italy, Greece, and Portugal, saw decreases in their respective weight. In May 2011, Banco Santander and ING Groupe were among the most liquid values of the Spanish and Dutch economies, while banks like Commerzbank, KBC Groupe, and National Bank of Greece did not manage to recover their position from before the crisis (represented here by the reference stock index of each of the countries, Table 1).

Table 1: Changes in Weight of European Banks on the Stock Markets of their Countries (weight as % of the reference shares index)

<i>Countries</i>	<i>Banks</i>			
France (CAC40)	BNP Paribas	6.63 %	4.44 %	7.11 %
	Société générale	5.48 %	3.55 %	3.79 %
	Crédit agricole	2.18 %	1.51 %	1.40 %
Germany (Dax30)	Deutsche Bank	6.58 %	3.77 %	6.14 %
	Commerzbank	2.49 %	1.05 %	0.56 %
Spain (IBEX35)	Banco Santander	16.97 %	16.73 %	17.63 %
	BBVA	12.44 %	10.06 %	9.29 %
	Banco Popular	3.05 %	2.33 %	1.44 %
Belgium (BEL20 Index)	KBC Group	14.37 %	4.69 %	5.75 %
	Dexia	10.66 %	2.01 %	4.33 %
Netherlands (AEX Index)	ING Groupe	14.33 %	6.33 %	11.23 %
Greece (ATHENES COMPOSITE Index)	National Bank of Greece	12.11 %	13.16 %	8.70 %
	EFG Eurobank Ergas	8.53 %	6.00 %	4.17 %
	Alpha Bank	7.19 %	5.47 %	4.19 %
	Bank of Piraeus	3.89 %	4.14 %	2.96 %
Portugal (PSI 20 Index)	BCP	14.49 %	7.70 %	8.32 %
	BES	7.79 %	6.70 %	5.67 %
	Banco BPI	5.60 %	3.28 %	1.72 %
Italy (FTSE MIB Index)	Unicredito	17.4 %	8.52 %	8.49 %
	Intesa Sanpaolo	4.76 %	12.38 %	6.92 %
	UBI Banca	1.84 %	3.31 %	1.39 %

Source: According to Telekurs.

Since October 2008, more and more coordinated and global public intervention has constituted a systemic change, since it replaced provisionally the State and central banks at the heart of the financial system. The only positive effect of the crisis has been to remind everyone that the State is the guarantor of the financial system's continuity. Without the intervention of the State, the stability of the financial system is threatened. The crisis has also served as a reminder that the relationship between the State and the financial system is biased: the financial system wants and expects the State to intervene when it is going through a crisis, but it does not accept a restrictive regulatory framework. The State, aware of the central role of the financial system and in particular

of banks in the management of the common good that money constitutes, is willing to support them financially without forcing them in exchange to limit activities that are too risky and may put the existence of this common good in danger. The financial markets react favorably to State financial support for the banking system, even if it leads to an increase in public deficits. On the other hand, they demand higher remuneration for government securities of States that have large public debts. Today, market discipline has become the reference; to be able to finance themselves on the markets, States must reduce their public debts, which involves their disengagement from social and industrial systems (see especially the chapters by Cathy Zadra-Veil, Hugues Jennequin, and David Flacher).

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