CHAPTER EIGHTEEN

HOW FAR IS BASEL FROM GENEVA?
INTERNATIONAL REGULATOR CONVERGENCE AND
THE ELIMINATION OF BARRIERS TO INTERNATIONAL
FINANCIAL INTEGRATION

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Abstract

This chapter discusses the twin questions of legal diversity and legal harmonization from the perspective of international financial integration, i.e. the internationalization of securities markets, banking markets, cross-border bank mergers and other types of direct investment in the financial sector. It addresses the increasing antagonism between domestic legal and regulatory institutions and international financial operations and explores the role of legal convergence in facilitating linkages between national financial systems. In that respect, one of the most remarkable recent developments has been the proliferation of common international standards and codes of best practice in prudential regulation, securities regulation, accounting and other areas relating to international finance, which aim to introduce a minimum level of consistency among national systems and practices. One of the central aims of this chapter is to examine this process of ‘soft’ legal convergence and discuss how it relates to the economic effects of regulatory diversity on international finance. The chapter begins by presenting the conceptual elements of international financial integration, what we mean by that and what its basic components are in the various markets that comprise the international financial system.

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Against this context, the chapter summarizes a large amount of empirical evidence that quantifies the internationalization of global securities markets in debt and equities, bank lending and foreign direct investment in the financial sector and highlights the remaining pockets of incomplete financial integration. Several economic causes of incomplete financial globalization are examined but particular emphasis is put on the legal obstacles and barriers that may inhibit the flow of capital across national borders. The remaining parts of the chapter discuss the international policies and legal instruments that aim to remove these remaining legal barriers, particularly the structural impediments raised by the economic effects of legal diversity and over-regulation.

I. Introduction

International trade economists and legal economists have long observed the collateral economic effects of domestic laws and regulations on international trade in goods and services.1 By affecting the cost of production and market entry of products and providers of services, the economic cost of regulatory diversity in the form of differences in national laws, regulations and administrative practices influences the conditions of commercial competition and potentially increases the cost of doing business internationally. This is now a familiar concept.

According to the Organization of Economic Cooperation and Development, ‘... it is increasingly evident that domestic regulation may represent a significant source of residual trade barriers.’2 The message is similar in a 2003 World Bank study where it is suggested that ‘... although regulatory autonomy is required to enable domestic rules to respond to local conditions, there may be times when such autonomy leads to trade friction, either unintentionally or as disguised protectionism.’3

Moving from trade in goods and services to the field of international finance, the sources of legal impediments to international capital flows and trade in financial services are traditionally classified as direct or indirect depending on whether the adverse effects of the pertinent rules on cross-border transactions are express and intentional or indirect and inadvertent.4

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4 Aaditya Matoo & Pierre Sauve, supra note 3; Sydney Key, Trade Liberalization and Prudential