5. The Degree of Central Bank Involvement in Financial Supervision: The BCFA Index

At this point, we should also consider the nature of the institutions involved in the supervision responsibilities. Any supervisory regime have to provide a link between the supervision and the central bank, given the potential relationships between monetary stability and financial stability[68]. It has been correctly pointed out[69] that, irrespective of what role, if any, assigned to the central bank with respect to the prudential supervision, it is universally the case that the central bank must be the authority for the stability of the payment system, liquidity assistance to markets and solvent institutions, and systemic stability[70]. The debate of the optimal characteristics of this link is particular important in the European Union, where monetary policy is separated from financial supervision[71]. Therefore we must ask what role the central bank plays in the various national institutional structures[72]. Focusing on the degree of involvement the central bank has in financial supervision as a whole can be immediately explained with the specific nature of that institution with respect to the others, since in every country it is the authority responsible for monetary policy and for the stability of the payment system.

So, to highlight that role, we introduced an index of the central bank's involvement in financial supervision: the Central Bank as Financial Authority Index (CBFA Index)[73]. For each country, and given the three main possible financial sectors (banking, securities and insurance) the index is[74]:

1 = the central bank has responsibility in no sector[75];
2 = the central bank has responsibility in one sector;
3 = the central bank has responsibility in two sectors;
4 = the central bank has responsibility in all three sectors.

Therefore, each national supervisory regime can be identified with at least two characteristics: the degree of concentration of powers (FAC Index) and the degree di involvement of the central bank in that distribution of powers (CBFA Index) (Table 3).

68 See Garcia Herrero and Del Rio (2003). On the role of central bank in banking supervision see Goodhart and Schoenmaker (1995), Haubrich (1996), Peek, Rosengren and Tootle (1999), Abrams and Taylor (2001)

69 Llewellyn (2001).

70 On note 66, we have defined these functions as payment system management and liquidity management.

71 See Schoenmaker (2003), Padoa Schioppa (2003), Goodhart and Schoenmaker (1995), Eijffinger (2001), Vives (2001), Goodhart, Schoenmaker and Dsgupta (2003).

72 See Oosterloo and de Haan (2003).

73 See Masciandaro (2003).

74 Alternatively, the different levels of central bank involvement can be measured using the identical scale of the FAC Index (labelled CBFA Two Index): 1 = the central bank has responsibility in no sector; 3 = the central bank has responsibility in one sector; 5 = the central bank has responsibility in two sectors; 7 = the central bank has responsibility in all three sectors. Obviously – Annex II, Table 17 - the econometric performances of the two indices (CBFA and CBFA Two) are equal.

75 Following the classification introduced in note 66 and used in note 73, we consider without supervision responsibility each central involved only in the payment system management and the liquidity management (and consequently in the crisis procedures).

TABLE 3: CBFA INDEX & FAC INDEX IN 69 COUNTRIES (year 2002)

	Countries	CBFA INDEX	FAC INDEX
1	Albania	2	1
2	Argentina	2	1
3	Australia	1	6
4	Austria	1	7
5	Belarus	2	1
6	Belgium	1	5
7	Bosnia	2	0
8	Brazil	3	2
9	Bulgaria	2	1
10	Canada	1	3
11	Chile	1	3
12	Colombia	1	3
13	Croatia	2	1
14	Cyprus	2	1
15	Czech Republic	2	1
16	Denmark	1	7
17	Ecuador	1	3
18	Egypt	2	1
19	Estonia	1	7
20	Finland	1	5
21	France	3	1
22	Georgia	2	1
23	Germany	1	7
24	Greece	2	1
25	Hong Kong	2	1
26	Hungary	1	7
27	Iceland	1	7
28	India	2	0
29	Ireland	4	7
30	Israel	2	2
31	Italy	3	2
32	Jamaica	2	3
33	Japan	1	7
34	Jordan	2	1
35	Latvia	1	7
36	Lithuania	2	1

37	Luxembourg	1	5
38	Macedonia	2	1
39	Malaysia	3	3
40	Malta	1	7
41	Mauritius	2	3
42	Mexico	1	5
43	Moldova	2	1
44	Netherlands	3	2
45	New Zealand	2	1
46	Norway	1	7
47	Pakistan	3	4
48	Peru	1	3
49	Philippines	3	2
50	Poland	1	1
51	Portugal	3	2
52	Romania	2	1
53	Russia	2	1
54	Singapore	4	7
55	Slovak Republic	2	2
56	Slovenia	2	1
57	South Africa	2	3
58	South Korea	1	7
59	Spain	3	1
60	Sri Lanka	2	1
61	Sweden	1	7
62	Switzerland	1	5
63	Thailand	2	1
64	Trinidad e Tobago	2	1
65	Tunisia	2	1
66	Turkey	1	1
67	UK	1	7
69	Ukraine	2	1
69	USA	2	0

The analyses on the degree of financial supervision consolidation and on the level of central bank involvement let us to have a general picture on the supervisory regimes around the world. Figure 3 shows the levels of both indices for the 69 countries. Dividing the chart into four areas by drawing a line corresponding to half the maximum possible value (3.5 for the FAC Index and 1.5 for the CBFA Index), we delineate four possible supervisory models based on the possible combinations of a high or low level of concentration of powers with a high or low level of central bank involvement.

FIGURE 3: FAC INDEX and CBFA INDEX IN 69 COUNTRIES (year 2002)

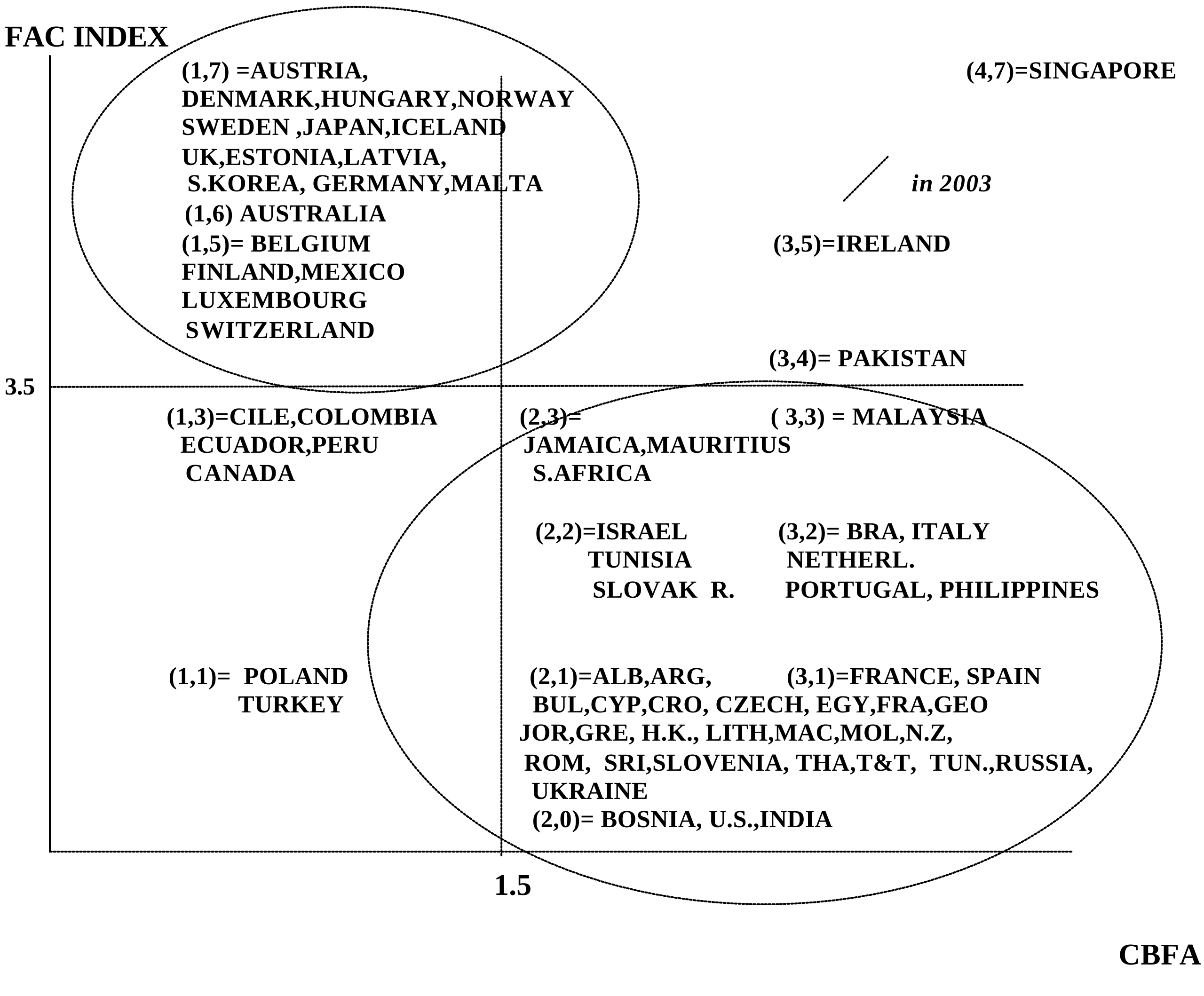

Figure 3 shows that the two most frequent models are polarized: on the one hand, countries with a high concentration of powers with low central bank involvement (*Single Financial Authority Regime*), with 19 countries; on the other, countries with a low concentration of powers with high central bank involvement (*Central Bank Dominated Multiple Supervisors Regime*), with 41 Countries.

The polarization phenomena is more evident in the European Union case. For the actual EU State members, we have on the one hand, countries with a high concentration of powers with low central bank involvement (Single Financial Authority Regime), with 8 countries; on the other, countries with a low concentration of powers with high central bank involvement (Central Bank Dominated Multiple Supervisors Regime), with 6 countries. The Ireland is the exception, with a regime characterized by both a high degree of consolidation and a high level of central bank involvement. Furthermore, if we consider the hypothetical European Union of 27 member states, again we see a huge polarization of the supervisory models: on the one hand the Single Financial Authorities Regime (12 countries), on the other the Central Bank Dominated Multiple Supervisors Regime (11 countries); excluding Ireland, the three remaining countries are characterized by both a low degree of consolidation and a low level of central bank involvement

The descriptive evidence of these two alternative model helps to improve - and to correct too- the idea that actually, given the blurring process in the financial landscape, there are two kinds of prevalent supervisory approach: the integration of financial stability supervision and banking supervision under the roof of the central bank; the integration of the supervision of all financial market intermediaries in an integrated supervisory body[76]. In reality, the consolidation of supervision seems to be more evident in the case of Single Financial Authorities Regime, while in the case of Central Bank Dominated Multiple Supervisors Regime the approach seems to be more consistent to a “leader-followers” framework.

In other words, using the political delegation approach, the descriptive analysis signals at least two results. First, in the financial supervision arena, the policy makers around the world choose to delegate this policy, rather than implement it directly. Second, the political choice on how many agencies have to be involve in supervision is strictly intertwined with the role of central bank: the degree of supervision consolidation seems to be inversely correlated with the central bank involvement. How to explain – before to test it econometrically – these stylised facts? It has been argued[77] that the reason of the trade off between the supervision consolidation and the central bank involvement is because of a fear that the safety net – central bank function of lender of last resort – might be spread to a wider set of institutions than just banks if the central bank is also involved in supervising insurance and securities trading firms (*blurring hazard effect*). Furthermore, a political economy explanation could be add to this economic interpretation: in the country in which the central bank is deeply involved in supervision, the policy makers could fear the creation of a too much powerful bureaucratic agency, and therefore they prefer to have more supervision agencies, and consequently a less consolidated supervisory regime (*monopolistic bureau effect*).

[76] Grunbichler and Darlap (2003).
[77] Llewellyn (2001).