Q&A

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The challenge of the public and private investment in the EU

Latest forecasts by the European Commission paint a positive picture for investment. After a sharp fall in 2020, total investment are clearly recovering. However, we should not be overoptimistic in believing the picture will stay like this for long easily. The road ahead of us is hard and full of obstacles.

As we move forward, a number of economic and financial factors may induce the financing conditions to be not as easy as they are today. Private businesses will have to face deteriorated balance sheets, due to losses absorption and consequent higher leverage ratios, and therefore will tend to cut or delay investments. Governments' fiscal space will shrink, as they will be confronted to unprecedentedly high level of public debts and (hopefully new) fiscal rules will come back in the picture.

This potential adverse scenario will come at a time where the European Union will be mostly in need of investment. By 2030, the EU should reduce its greenhouse gas emissions by 55% (with respect to 1990 level), should have at least 40% of renewable sources in its energy mix and should increase its energy efficiency by 36%. According to the Commission estimate, the EU would need to invest approximately €595bn per year to achieve that (€470bn per year for the ecological transition and €125bn per year for the digital one).

The above-mentioned objectives are valuable in themselves, but they also have geopolitical and social implications. The digital transformation is vital to make sure Europe stays at the technological frontier, and not dependent on foreign countries. Furthermore, medium to long-term growth depends on today's level of investment. If private investments remain at a standstill, this will hamper future growth potential and EU's economy risks entering in a vicious circle. Lower growth potential would make fiscal rules imposed to governments tighter, leaving them less space to spend and forcing them to cut on investments, thus sustaining growth even less. In the meantime, higher rates of bankruptcies would generate higher levels of unemployment, making social expenditure more important and generating even more pressure on public productive investments. In addition, this rise in unemployment would produce a loss of human capital and hence hampering even more the economy's growth potential, and so on and so forth. Overall, this ultimately poses a serious risk for the tenure of our institutions and for democracy.

We need to act fast and we need to act now.

National public budgets cannot bridge this huge investment gap on their own. Although there now seems to be growing support for the idea that green, digital and social investments should be favourably treated for the purposes of the constraints of the Stability and Growth Pact - which clearly cannot come back as it was pre-crisis - the issue of substantial indebtedness of the Member States is there, and poses an evident economic constraint. Therefore, it is clear that the public initiative will have to be accompanied by even more substantial private funding.

Despite the numerous reforms initiated or even completed in the last decade, European financial markets are not yet ready for this challenge. European finance is still largely segmented along national lines, with savers and investors depending heavily on national banking systems. The problem of nationwide fragmentation of the banking sector is not new on the European political agenda. The Banking Union was a response to this problem. Unfortunately, after a strong initial impulse having achieved an efficient first pillar (supervision) and an important but still improvable second pillar (resolution), Banking Union now lacks momentum and remains incomplete. Yet, the completion of the Banking Union is key for tomorrow's challenges.

Moving towards a true single banking market through cross-border restructuring is above all a matter of strategic autonomy. Genuine Pan-European banking groups could operate more effectively, raise their profitability thanks to scale effects and better face up to foreign competition. At the macro level, Banking Union would decisively enhance private risk sharing within Europe and, in conjunction with parallel progresses towards a Capital Markets Union, would enable a better channelling of our abundant savings toward the important targets of the EU in terms of digitalisation and green transformation of our economies.

The project of the Banking Union can be brought forward only within an holistic approach. However, some work-streams should be prioritised in light of their greater urgency in relative terms and the more essential role they play to complete the Banking Union. I am referring to the introduction of a European insurance scheme on deposits and to the crisis management framework. Such reforms are strictly interlinked and are pivotal in limiting market fragmentation and creating a true level playing field across the euro area.

As for the former, the reason for its prioritisation is straightforward. In order to accomplish a real Banking Union, depositors across the Euro Area need to be sure that they can rely on the same safety net. Such a result will be ensured only by an insurance scheme on deposit providing full loss-coverage. Any work plan on the completion of the Banking Union must explicitly acknowledge this element as the end goal, and indicate a clear-cut timeline to achieve such goal. Hybrid solution are acceptable only a first step towards a fully mutualised mechanism, with clear loss-absorbing features and a pre-defined timeline.

The adequacy of the EU banks' crisis management framework is the other main issue that should be addressed quickly. Everyone recognizes that the creation of the Single Resolution Mechanism represented a big step towards facilitating the orderly resolution of significant institutions with minimal or no taxpayer involvement. However further improvements should be discussed also in line of the considerations made both in the European and international fora on the shortcomings of the current framework. In this regard, one of the main issue is whether the BRRD framework is suitable for handling the crisis of small and medium-sized banks. The experience of recent years does not appear to be encouraging. Indeed, most medium-sized banks (not to say smaller ones) are not equipped to tap capital markets to issue MREL-eligible instruments. It is therefore of utmost importance to introduce a harmonised framework for the crisis management for these institutions.

This would ideally be achieved via the implementation of a European framework for an orderly liquidation regime of banks failing the public interest test, financed by the national deposit guarantee schemes. The positive example of the Federal Deposit Insurance Corporation (FDIC) is often mentioned in this regard. However, it should be beard in mind that FDIC not only manages orderly liquidation or preventive measures. One of the key success factors of the FDIC is the possibility of combining resolution and deposit guarantee functions for all US banks. A European insurance scheme on deposits is the only element that can ensure consistency between the responsibility of the crisis management and the level where costs are borne. This is the reason why these two reforms are strictly interconnected.

A common insurance scheme on deposits is also the essential element to move beyond home/host issues. On this issue, we should start from the effective implementation of cross-border liquidity waivers within the Union, as prescribed by the European legislation. Moreover, some additional efforts should be done as regard the extension of intra-group capital and liquidity waivers. So far, the main obstacle to these waivers was exactly the absence of and European insurance scheme on deposit, since this created a discrepancy between the place where the resolution decisions are made and the place where the material disbursement of the funds takes place. This once again proves how important it is to start from the third pillar of the banking union to find a solution to the other problems.

A stronger and integrated banking system is key to contribute to the financing of the digital and green transformation of our economies.