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The Chance for a Golden Age, the Risk of Never-Ending Turbulence

Keynote speech, session on Finance for Growth

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1. Premise

The title and theme of this workshop could not be more apt or timely. Truly we must wonder “Where are we going?” This is a question that we must always pose, in order to reassert our identity and not lose our vision. To Europe in particular, the question serves first and foremost to reflect upon itself. Is Europe a mere “geographical expression” or a community of values that can serve to guide us to the future through the turmoil of the present? Will the refugee emergency find us united in handling and governing it? I consider the “State of the Union” speech by the President of the Commission, Jean-Claude Juncker, as crucial also in reaffirming our Continent’s responsibility for coping with the exodus from the southern and southeastern shores of the Mediterranean.

I believe that Europe – despite a host doubts and uncertainties – is a single entity, and not just economically. And that the closer it comes to being a unit politically as well, the greater will be its chances of solving its problems.

2. The background

The European Union, unlike the “Old World” of Europe, is a relatively young political area, faced in recent years first with a dramatic economic-financial crisis and then with a sovereign debt crisis that spotlighted a series of inefficiencies and weak points in the entire system. The process of building the Union, we have seen, has not gone beyond the design of a techno-structure and has failed to advance the great democratic-political

project of the founding fathers. Sometimes, it was imagined that we could achieve integration through rules and norms rather than through shared ideals.

"And yet it moves …" – in the words of a famous Italian, and European, Galileo Galilei.

The response of European institutions, not perhaps as swift or strong as that of other economies – first of all the United States, of course – has nevertheless been useful in producing the signs of recovery that are now beginning to emerge.

In these last couple of years we have learned to acknowledge the presence of a renewed European Union that has put the focus on its own past deviations and recognized that we all need *more Europe* provided that it is a *good Europe*.

Doubts remain. Alongside Mario Draghi's "whatever it takes" and the ECB's massive quantitative easing, we have a supervisory structure that stiffens the capital requirements on banks, giving priority to stability over growth. The EU, with the so-called Juncker Plan, proposes an extraordinary investment programme to mobilize €315 billion for the productive economy, and at the same time the EU, de facto, in its capital requirement provisions, penalizes infrastructural investment. The Europe that launches the Capital Markets Union, which we consider to be a worthy and ambitious programme for rapid implementation, is the same Europe that is planning a Financial Transaction Tax, which in certain circumstances would annul the effects of the construction of a single financial and investment market.

Yet there is no doubt that the awareness of these limits has spread, as the efforts to overcome them have multiplied. There has been a notable change of pace in the new legislature.

We welcome the decision to concentrate on a few key matters – such as the investment plan, as noted, and the Capital Markets Union – and to proceed to "stabilize" European rules both through impact assessments of existing (and often overlapping) financial rules (see for instance the recent parliamentary report "Stocktaking and challenges of the EU Financial Services Regulation") and through the setting of standards and guidelines for policy and regulation to attain predetermined objectives while holding costs and negative externalities to a minimum ("better regulation"). Every policy needs a *pars destruens* to stimulate reflection on any errors, as well as the *pars costruens* to move in the prescribed way from new bases. PWC, on behalf of the City of London, has calculated that in the next few years the difference between adverse regulation and a regulation recognizing the needs of the financial services industry in Europe could amount to as much as 1.9 per cent annual growth of the industry, 0.6 percentage points of GDP growth, and 2.3 million jobs in the financial sector (11 in the overall economy). This represents potential growth that we cannot afford to forgo; this analysis means that good finance can contribute very substantially to the real economy.

The watchword for Europe (and for Italy) can only be "investment"

Among the devastating "cultural" consequences of the crisis, we have registered excessive risk-aversion. What is bad, however, is not risk as such, but excessive risk and poor risk

management. The upshot has been a further slowdown in investment, both public and private. The investment and infrastructural deficit is a worldwide phenomenon. It is estimated that between 2007 and 2012 the richest countries "spent" around 2.5 per cent of their GDP, when they should have been investing 3.5 per cent. In any case, in our continent, the problem is more serious. In 2013 public investment in the euro area was 15 per cent below the pre-crisis level of €3 trillion; it was down 25 per cent in Italy, 39 per cent in Ireland, 64 per cent in Greece. And we have renounced growth.

For this reason, even though the numbers are not fabulous, we need to put the Commission's new policy orientation into practice and activate the Juncker Plan's €315 billion worth of investment. Thanks to the leverage of collateral and the multiplier of infrastructural investment, the robust resurgence of European economic growth could result.

Let us go a bit into the details.

3. Finance at the service of the real economy

a) Bank credit

In Europe, and especially in Italy, bank credit is central, the crucial source of finance for the economy. But there is no gainsaying the problems. There is a need to foster the financing of those parts of the economy – in particular small businesses, which typify so much of the European economic fabric – that have less access to credit and consequently risk being driven out of the market despite potential for growth and development that they need to capitalize on.

In any case, the introduction of new instruments of enterprise finance cannot but be welcomed. These instruments are not alternative but complementary to traditional bank credit.

Liquidity is now ample, as is repeatedly recalled. An important role in this has been played by the policy measures of the ECB under Mario Draghi, most recently the quantitative easing programme initiated on 9 March.

Banks operate in the market; the logic of their activities is not basically dissimilar to that of "productive" enterprises. The banker is a businessman whose business consists in collecting savings and investing it to earn a return. He invests where he thinks his loan will be paid back, and earn interest.

If we set this fact in context – the stiffening of capital requirements on banks under Basel 3 (and the forthcoming Basel 4 as well) – it is easy to see that the normal measures of "business management" are all the more cogent today.

The difficulties of our enterprises are not rooted in the crisis, long and difficult though it has been. The difficulties are structural, in that only in the last few years have many European and Italian firms begun laboriously to develop the competence and size needed

to measure themselves in globalized markets. Our small businesses need to embark on a path of growth and management. This crisis has been an epiphenomenon, making it clear just how far behind we lagged on this path and how greatly we need to pick up the pace if we are to stay in contention.

In this context – an already poor situation not created but only made worse by the economic and financial crisis and then recession – we must sustain and accelerate the transition towards adequate size by enterprises that are now in mid-stream and that require support.

Paradoxically, the exit from recession risks further aggravating the position of these firms, because the recovery, de facto, will heighten "quantitative and qualitative competition" among firms that are seeking finance.

It must not be thought that in Europe – and in Italy in particular – bank credit can serve as the sole instrument of support to industry in this fight for survival.

To sustain new flows of finance, new support systems must be brought in to flank the traditional banking channel, and the sources of finance must be multiplied.

This means developing a comprehensive, diversified and consistent "system of guarantees" exploiting all the opportunities already in being and seizing new ones, capitalizing on public-private partnership and responding to the various needs of economic operators.

The Banking, Insurance and Finance Federation – as a forum for economic and financial policy discussion and proposal – is heavily engaged on this theme in Italy. We are working actively on the issue, trying to bring all the relevant forces together at the negotiating table: the government, public institutions, financial and industrial associations need to work together to make the most of what is already available to firms and what can be put at their disposal by channeling resources both to activate the private sector and to effectively exploit supranational resources.

b) **"New finance" for enterprise, new instruments and new initiatives**

b.1) **Europe, the Juncker Plan, CMU and support to enterprises**

The Plan and the proposals for a Regulation of the European Fund for Strategic Investment, the first pillar of the Plan, provides for intervention with instruments to finance or guarantee new or existing portfolios of bank loans. This could possibly be effected by means of a national development bank (for Italy, this would be Cassa Depositi e Prestiti) assigned to maintain relations with commercial banks at local level.

We at the Banking, Insurance and Finance Federation have already voiced our positive judgment of the Juncker Plan, but this judgment is conditional upon rapid, efficient and transparent implementation.

What is more, much remains to be done to overcome the fragmentation of European markets, with its serious implications for competitiveness. With the Banking Union now at an advanced stage of completion, other essential elements in the integration of financial services need to be put in place.

The Commission has moved in this direction with its Capital Markets Union plan, publishing a Green Paper on 18 February. The project is conceived of as a way to help firms to tap diverse sources of capital, in any EU member country, and offer savers and investors additional opportunities for profit. CMU is designed to create a single capital market for all 28 member states, sweeping away the obstacles to cross-border investment and thus lowering the cost of finance within the Union.

The integration of European capital markets is a broad project, for the medium term, scheduled for completion in 2019. But there are some areas in which, consistent with the overall objectives of the CMU, action is possible already in the almost immediate future. Let me just mention a few.

EUROPEAN LONG-TERM INVESTMENT FUNDS

These are specialized funds instituted by a Community Regulation scheduled for implementation in December or January intended to sustain a recovery in long-term investment.

HIGH-QUALITY SECURITIZATION

If well structured, securitization can be a significant channel to diversify the sources of finance, permitting broader distribution of risk. This risk-sharing enables the banks to free up resources to funnel back into the economy. Securitization can also offer additional investment opportunities, allowing banks to transfer assets to institutional investors by serving their need for diversification, yield and duration.

PRIVATE PLACEMENT

By private placement we mean the underwriting of capital or debt securities (likened in this case to mini-bonds). Where in the United States the private placement market has grown to an annual issue volume of $60 billion, Europe has no equivalent market. The consequences are not negligible: investors interested in these instruments channel significant resources into markets outside Europe; firms are denied access to a significant source of capital. Overcoming fragmentation and constituting an efficient trans-European market is crucial. According to the International Capital Market Association, the European enterprises potentially interested number no fewer than 200,000. We are following this issue closely as well, in close cooperation with the British financial industry, as part of the “Anglo-Italian Financial Services Dialogue” with our British counterpart, TheCityUK.

b.2) **Italy**

Historically, in Italy the bond market has always been a less important source of corporate finance than bank credit (accounting for just 10 per cent of total Italian corporate debt). There are a number of reasons. Let me mention a few: the large number of small and micro-enterprises, the considerable resilience and soundness of Italy's bank-centred model of finance and, until a few years back, regulatory restrictions that discouraged bond issues, especially by SMEs.

In recent years the legislative and regulatory framework has been transformed, thanks in particular to a series of decrees enacted between 2012 and 2014 that have permitted the expansion of several important channels of finance complementary to bank credit:

MINIBONDS

These are bonds issued by SMEs and reserved to institutional and other qualified professional investors. To date there have been a hundred placements or so, 66 of them in 2014 alone. The issues, with face value of about €6.2 billion, are mostly (in two thirds of the cases) for the purpose of increasing company size, while 22 per cent serve to modify the mix of outside finance, sometimes preliminary to equity operations or stock exchange listing.

PRIVATE DEBT FUNDS

These are closed-end investment funds specializing in mini-bonds, investment vehicles that bring together a series of commitments from potential investors (banking groups, funds of funds, insurance companies, foundations) to invest in financial instruments with certain characteristics. In Italy mini-bond fund initiatives number 29. Since last year AIFI, the private equity and venture capital association, which belongs to our Federation, has also been organizing private debt funds.

CROWDFUNDING

This method of grassroots microfinancing mobilizes people and resources "spontaneously". Crowdfunding is growing rapidly all around the world. Italy is the first country in Europe, and perhaps in the world, to have enacted – three years ago – a comprehensive regulation of this matter.

4. Conclusion

I would like to end by offering an overall judgment on what is being accomplished. The direction taken by the European Union and by the Italian government – which is enacting significant structural reforms – is the right one. In fact, we are putting in place good economic, industrial and monetary policy measures whose combined action will produce beneficial effects, including for small businesses.

There are no simple recipes for complex problems like those we are experiencing in this phase of our history, but I believe that this set of policies will enable us to hasten the

transition to economic recovery and more sustainable productive and financial structures in the Old (but not too old) Continent.

In the last twenty years Italy has suffered a marked, widespread weakening of our ability to grow and to compete. The decline in the economic growth rate, which was clear as far back as the early 1990s, worsened after 2000, since when Italy has been growing at an average annual rate of 0.8 per cent. Per capita GDP and labour productivity have followed the same pattern. From 2000 to 2005 per capita GDP gained just 0.6 per cent per year (one of the lowest rates in the European Union); and the growth of hourly output diminished from 2.3 per cent in 1995 to 0.9 per cent at the end of the century and actually turned negative thereafter. Of the other European countries, only Spain displays a similar pattern. The rapid, growing integration of world markets, the spectacular emergence of new powers in the global economy caught us unawares, unprepared to deal with this heightened competition. Italy's specialization in traditional products meant that we felt the competitive pressure from what we used to call "emerging countries" sooner and more intensely than our main European partners.

For some months now, Italy has been marked by an appreciably new, more constructive atmosphere. The government is engaged in a set of structural reforms designed to recoup competitiveness, and the effects are beginning to be felt.

The latest forecasts put Italian economic growth at 0.9 per cent this year and more than 1.4 per cent next. At last Italy too has converted the "minus" sign into "plus." After fourteen consecutive quarters of rising unemployment, joblessness diminished in the first quarter of 2015, and in the second quarter the rate came in at 12.1 per cent (down by 0.1 percentage point from the year-earlier quarter). In the first seven months of the year the number of persons employed gained more than 100,000.

Growth needs to be consolidated by the reforms the government is enacting. The flexibility that the executive is counting on in the upcoming budget bill is absolutely right; it should give the lie to what Mario Baldassarri has provocatively termed the "stupidity" of the Maastricht Treaty. Broader scope for interpretation of the Stability Pact (which is also, may we recall, a "Growth" pact) could open the way to "intelligent" flexibility thanks to an exemption of investment from the deficit ceiling, the realization of structural reforms and allowance for cyclical conditions.

There is no alternative. "What is needed is talent, sacrifice, hard work." These words were written a propos of the startling triumph of Italian women's tennis at the US Open. But they apply everywhere, to everything.