What finance for what growth?

Participants

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Transcript

Welcome by Benoît Lallemand

Hello, everyone. If I do funny faces don't worry, I broke my wrist two weeks ago and am still being reminded of it. A warm welcome to all, it is a great pleasure for us and a privilege to see so many people attending a Finance Watch event. We're very happy when we have to close registration a bit in advance of an event. I want to thank Friedrich Ebert Stiftung for their financial support for this event, which simply makes it possible, so thank you. I also want to thank the new head of ECON, Member of the European Parliament Roberto Gualtieri, who gives us the honour of being here tonight. Also the Member of the European Parliament Sirpa Pietikäinen, Thorsten Beck, Wim Mijs and Jean-Louis Bancel will be participating in the discussion – thank you to all the speakers for being here.

At this time of the year, as you know, usually we do the Finance Watch annual event, which is usually a full-day conference. We sent the save the date in July based on the date of the 6th of November and two weeks after that, the Commission together with the Council, also picked the 6th to do a big event on the same topic. Obviously we are ambitious, but not crazy.

So we will be announcing very shortly the annual full day event in February and you will receive the save the date very soon.

We wanted to maintain the event because there was large demand following the save the date, and also to bring some sort of perspective to the event of the Commission which will happen tomorrow, which we will attend of course. This brings us to the part of the discussion we hope to have tonight. The Commission event is a joint event with the Commission and the Council, it's called "Finance for Growth – Towards a Capital Markets Union". We think this kind of title seems to be loaded with quite a few assumptions, so that's why the title of our event is a bit more humble, and brings the debate forward, which is what type of growth do we want and then what type of finance is fit for purpose for the sort of growth we had in mind.

As we all know there has been a first phase of financial regulation which is prudential, you could call it negative. It has been about making sure the financial system does not hurt society. Following the crisis in 2007-2008 we had a prudential phase and then we moved to a more positive phase with the communication on long term financing and of course we know things are speeding up – the Commission just downgraded yesterday their projections for growth for Europe by more than half a per cent. So there's an understandable obsession for growth, if you like, we are all aware of that. That is obviously fine for us – it should be that way – but the thing is that how we are going to finance growth is extremely critical. Certainly, our view is that you cannot just embark on such an important journey – this is not exactly a holiday or a honeymoon, a large proportion of the EU population depend on the success of this journey. I think that when that's the case you should make sure before you embark on the journey that you know where you want to go, precisely. That is what type of growth. There is a political or economic vision. It had better be there otherwise you just won't know where you are going. You need a proper navigation tool, the right compass. That is indicators and metrics to make sure you are going the right way, you can navigate properly. That's the policy options. Finally you want to make sure you find the right type of boat. Did you want a very large boat, or one that is more agile? Something that is more like Titanic or something that maybe is a bit more flexible, and that is the type of finance. It's what type of finance do you want for what type of growth.

The thing is, we see in Brussels, that there has not been a proper debate on the link between finance and growth, or even on the link between financial regulation and the ability of the financial sector to support growth. What we want to avoid is going back to a situation which is based on basic assumptions, which is that any sort of finance, and more finance in general is inevitably and automatically going to be good for growth and European citizens. As you know, this has been a quasi-religion. It has also been called market fundamentalism. It has been a drive for a good part of 20 years that indeed finance would actually drive growth in the real economy, versus the situation where finance is an indispensable support for growth in the productive sector. It was thought at one point that creating financial assets would itself drive economic growth, rather than the opposite.

You could call this debate some sort of moratorium, where you take a step back and look at what has been done for 20 years. Not only in the industry, but many people in Brussels have asked for a moratorium on financial regulation. They are basically saying "Oh that is it", there has been such a tsunami of reform over the past five years, let's stop it all and let's look at it. If you talk to regular citizens, they will tell you "No, but wait." There's been a major crisis. Obviously we have been told a story for 20 years. Most people believed it, and it would have been good if it succeeded. It didn't quite turn out that way, and politicians had these heavy words after the crisis saying never again, and so on. And so it gives the impression that, on the contrary, the focus should be on what have we done for 20 years, very precisely what are the results of that, and then questioning some of the assumptions, following that maybe different policy options. I think there has been a rush following the crisis and we are afraid that this sort of reflection has not properly taken place. It's alluded to but it's not been properly reflected on. And that's what we are asking at this stage, together, tonight, is to have this discussion.

We will be publishing later this year a big piece on the long term financing agenda, and some of the options in there. So a much more detailed report by the end of the year and again some further research on banking structure and the too big to fail problem. At this stage we are much more asking questions, and that's also the sense of the hand-out that we sent to you a couple of hours ago, which is about really bringing some pieces of research and findings to feed the debate. There is no easy conclusion to the debate but it is really important to have it.

One element of this debate is the subsidy that is mentioned by the Commission in terms of supporting large banks. You can discuss the figure but the Commission is putting out the fact that there is an implicit subsidy to large banks in Europe to the amount of 0.8 per cent of EU GDP. That's an order of magnitude. Again for the order of magnitude the projection of European growth is slightly above one per cent. We are in times when we cannot afford inefficiencies in terms of setting the right policies and finding the right kind of finance for the right kind of growth. We can't afford to have subsidy for activities that we're not absolutely certain will contribute to a change in the economic situation.

I'll just point out something you have in the booklet, which is research inspired by Thomas Philippon, who was granted an award for his career in Germany a few days ago. Thomas Philippon tried to measure the efficiency of the financial system over a long period. He looked at the unit cost which was really the cost of lending, if you like, one euro to the economy over time and how it interacts with the level of regulation or regulation in different countries. What you have in your booklet is a study we are proud to have supported which replicates the methodology that was used for the US and looks at the EU financial sector. We would be happy to discuss this piece of research with you as well.

Before I finish I would like to put some emphasis on the fact that, before we embark on this ship, and nobody knows exactly what the Capital Markets Union is going to be – that's the hundred thousand dollar question. We'll hear what is going to be said tomorrow, of course, but it seems some options have already been taken and it seems that it is full speed ahead with these options. If they are right, that's perfect. We have doubts, which we will explain in further research to be published later this year, as I mentioned. We think they can take a step back, with the metaphor of a boat, as I mentioned.

To be fair, I think none of us in this room is on the front line of the effects of the recession, but a few figures that you know: 24 million unemployed in Europe, 5 million are youths, people below 25 years of age. There was a report by UNICEF that in rich countries as a direct result of the recession there is an additional 2.6 million children now in poverty. It's always difficult in Brussels to relate to these figures. I think there is an obligation for the people in this room, obviously policy makers and everyone involved in financial regulation that we make the right choice, and at the minimum, that we have this debate thoroughly and properly. The people I have just mentioned deserve that we have this debate as a minimum. Someone said that every time history repeats itself the price goes up. I think none of us in this room wants to see what happens if at the end of this Parliament the recession has deepened, possibly another financial crisis has hit. I don't think we want to know what the result of that would be, including in terms of the political consequences and then the ever increasing democratic deficit of the European Union. This debate goes much beyond the technical debate about specific capital requirements and stuff like that; it has much broader consequences.

I want to thank you for your attention. I want to welcome Mr Gualtieri who has just joined us. I will leave you the floor for the keynote speech and then we will move on to the debate. I invite you all to join us for the buffet dinner right after.

Roberto Gualtieri

I discovered it is a busy job to be ECON chair. Thank you very much for this invitation, I was delighted to accept it and I would like to thank you for the opportunity to join you in this meeting. I consider it very important what happened in the recent hearing when the new Commissioner for financial affairs publicly and strongly recognised the importance of the role of Finance Watch, in order to have a finance that serves society. It was good for us to hear from him, who clearly has a different background to recognise this and, because as you know for the European Parliament it was a very important achievement to have you as a counterbalance, in the representation of broader society. This is especially with the new incredible increase in competences, powers of the institutions, of the European Parliament. If we want to make it work, to build an efficient new democracy, now we are at the core of the legislative process. This makes the Parliament, our committee, the institution at the very centre of crucial decisions for the world, for Europe, for the citizens. We need to address the gap in terms of access to information, the gap in terms of capacity to be part of a debate on the dossiers. We have a huge gap because, of course, vested interests are able to know exactly when and where decisions are taken, where the existing mechanisms of public opinion, the media is not yet able to focus on the very, very moment of the deliberating process. We have this asymmetry.

In my country the media focus on the political debate in the national arena, mostly on issues which are really not relevant. So citizens, if they read the newspaper or watch TV do not know, they did not know, which very relevant decisions were discussed and taken at the EU level on very crucial pieces of legislation. Why? Of course, the representatives of the industry know exactly where, when and who decided. So we have this huge gap, this huge asymmetry. And that's why your role is so relevant. Try to help us to rebalance, to at least partially address this gap to create a public awareness, a public discourse, a public watching on this crucial arena of regulation in the area of finance which in itself in our modern age at the very centre of the functioning of the whole of society. Really, you have a central role for the very functioning of the process of building up European democracy. My conviction is that the only way to have fully functioning democracy is to build it at European level.

I am very happy to be here and I am also very satisfied that the importance of your role is recognised also by the new Commissioner. Your conference addresses, of course a crucial item, what finance and what growth. It is difficult for me to reply to this question in a few minutes but I would like to make some consideration on it. I think as a new ECON Committee we should engage in addressing those issues in this new legislature. What finance can be addressed from many perspectives. Maybe we could start from an issue that I know for you is very relevant, and also we started to discuss yesterday, which is the structure of the banking system and the role of the banking system in the union in financing the economy. This is an issue which is also closely linked to the other new label which is the Capital Market Union, which will be a very interesting item to discuss with the new commissioner and we are expecting of course there will be a vision, a plan on this by the new commissioner. But the two things are strongly interconnected.

I think the first thing we should do is start from the reality. Politicians should always start from where the reality is. As we all know banks have a predominant role in financing the real economy in Europe. Europe has a different model than other societies and banks have such an important role. This is a fact. We should try to support more diversification, that's why CMU is important, but of course we cannot change the reality. So we have to address the reality. That's why of course the very heart of the crisis was this link between the banking crisis and sovereign debt crisis. The figures that explain why the crisis hit Europe so hard are those figures which show the increase in the assets of banks in the years before the crisis. So that is why banks are at the heart of the problems, and at the same time an essential tool going back to growth. We first have to recognise that we did a lot on this. Probably, as a profession I am an historian, and I always try to imagine how a future historian will describe the moment we are living in. How a book written in 200 years will describe these years. I am sure, I might be wrong, that two things will make 2014 an historical year.

One, for the first time we started the process of having elected government for Europe. I think the process of the spitzenkandidaten will be considered even more important than we are aware of now, and the fact that for the first time the Parliament elected the president of the Commission on the basis of candidates presented by the parties.

The second element is the birth of Banking Union. This really is a huge achievement and I think my predecessors – I was a simple member in the previous committee – the relevant players on these files did an amazing job. It is good to remember how it was the Parliament who was first to have a vision, and when we first had this vision to have a Banking Union it was considered a dream, then it happened because it was necessary. It was logical.

First of all I think we should recognise the importance of what has been done, and these structures with the single rule book, the BRRD, the SSM, which exactly yesterday entered into force, the Single Recovery Resolution Framework with the Single Resolution Fund. I have come from meetings about the establishment of the Single Resolution Fund. Even with limits, at least we will have a single resolution fund. These are really major achievements that we should never underestimate. Also, the exercise of the comprehensive assessment, I think has to be considered as a success. It has limits, and I am happy Madame Nouy recognised the limits in the hearing of the ECON committee a few days ago, but still we have to recognise that this was a big step forward, that this exercise surely contributed to improving the quality of the information on banks, to repair some problems of under capitalisation. And also to recognise that in a global picture, the capital shortfalls of banks was below the market expectation, but nonetheless this exercise also shows that a lot still has to be done to improve the situation of our banking sector, and also to improve the way in which we assess this situation. I think it clearly emerged that the actual mechanism of calculating the risk of banks relies more on the lending to the real economy than on the financial assets in the balance sheet of the bank. Of course, some of us think that this diversification is an element which gives resilience to the banking sector (we had this debate yesterday in ECON) but on the other hand we cannot avoid seeing the problems if we still see the huge amount of assets in the balance sheets. The difficulty is to assess the level of risk of those assets in the comprehensive assessments, Madame Nouy recognised that she had not been able to assess the risk of those financial assets because there are internal models, there are the level 3 categories which are really very difficult to quantify, but the fact that it was difficult to quantify or measure this risk does not mean that this risk does not exist. So the picture that we have is, on the one hand, reassuring that we have a good banking system in Europe, but we cannot deny there are problems. The problem is our approach in how we assess. That's why I welcome the comprehensive assessment but at the same time I say that we can and we should improve, and also going into a unified assessment of the risk of assets.

But on the other hand this problem leads to another one, that is very difficult to avoid, to address, the fact that we cannot only have the safety of our banking sector put only on the basis of an assessment of the risk and not on an element of the structural design of the banking system and reform of the banking system. So that's why I think we have to be really open to the concerns of the market, of the industry that we should assess the real weight on the financial industry of this mass of new regulation that has been approved. This is an issue and we decided at ECON to have an impact assessment on the regulation, because really nobody knows that the combined impact is of those pieces of financial regulation which have been approved in the last year.

On the other hand, if we have to be open to the concerns of the industry, we cannot simply say that structural reform is a legacy of the past, because now we have to address growth. That's why I think it is important that ECON started working on the structural reform of banks. The debate reflected the various points of view in the Committee, which are obvious. But we saw that at least a large part of the Committee still recognise that this issue cannot be forgotten about on the contrary we need to address the issue of the structure of European banks, and find some common elements of structural reforms, which is an essential part of comprehensive regulatory framework in order to reduce the risk and make our finance system more linked to the real economy, and that's the financial exercises which will continue to be very risky.

Another issue that we also have to learn from the comprehensive assessment is that diversification of the banking system is not a bad word. Of course we are looking at a model that puts capital at the centre, and that is right. Even as we address this issue of the role of capital, I am thinking about the discussion at Basel level now on the new TLAC, we also should be aware of the fact that we have to know that there are some differences, for example between the American environment and the European one. We don't have Fannie Mae and Freddie Mac, we don't have a public guarantee on mortgages. We should also seek to avoid importing a model which is based on a different economic and financial environment and in this regard also another priority of the ECON committee is to put more democracy in the way that this international exercise works.

We will make a report on the accountability of the Commission in international fora, because for us it is very relevant which is the democratic mandate of the Commission when the Commission goes to Basel. Then they go to us and tell us to make this legislation, introducing the standard that we decided, so if we have to only implement and we are not free to decide. As the representatives of the citizens we should be free to be involved, and as the people who elect the Commission we should be more involved also in discussing which is the position and the mandate of the commission when they go to international fora to discuss new elements, maybe CRD V or something to make the big banks more resilient, which is a good goal but something which should be achieved by the appropriate means.

Another lesson was also the lesson that the diversified model is a good element for the new banking system. I was happy to see many cooperative banks, for instance, having good performance in the comprehensive assessment. I think that this variety in the European banking system must be defended, protected, and considered an element of strength of the European society. Again, of course we need to give SMEs broader access to capital markets, and so the territorial element cannot be the only one. On the contrary, we must help the big SMEs to issue bonds, to get capital from other countries, to create a single new market for capital. But this does not mean we should forget the fact that those on the ground close to enterprises which have a cooperative form and do not make profit and redistribute income by lending are also a good asset for our SMEs to get finance. So we have to have a balanced approach. And not follow the line that one model fits all. We have to acknowledge this difference. Having said that, Capital Market Union is a complementary tool. I don't see any antagonies. We have to support diversification. I see a positive link between the two elements, for instance the ABS is very important to support the finance for SMEs to create the new asset class and at the same time to make less heavy the burden of non-performing loans. This is a great example of how the two elements capital market union and a strong banking system can go hand in hand and are not contradictory.

So we have a lot to do. We have to assess where maybe we did too much and too confusing elements of regulation but we have to also fill the gaps in regulation. There is also the very big issue of shadow banking; we have to avoid regulating one sector and not enough another one. Here I see very big agenda to be addressed in order to properly regulate shadow banking, we are starting with MMFs but we have to go beyond. This is just some reflections and maybe what I have to do is to listen instead of speaking but these are my first impressions after some months in this position.

Then there is the other element: growth. I consider very useful your concept of a smarter use of scarce resources as a way to make more concrete the classical formula of more sustainable and inclusive growth that risks being very generic and not translating into anything substantial. I consider it very positive that now under the Lisbon strategy we have this emphasis on inclusive because we have to know that the huge distribution of wealth among citizens is one factor of the economic difficulties. So to address the social problems of Europe, it is crucial to have growth. I think we have to stress the inclusive more.

I am happy that the new Juncker Commission seems to have a stronger commitment to a social market economy and make it more social. Some consider that a market economy is social in itself because the market alone can make optimal distribution of resources. I think that a social market economy is a market economy corrected by social policies. This is something that is not only for the sake of equality or solidarity but also to have stronger growth. This is an element that I add when discussing scarce resources.

Then, what kind of growth is another pillar of reflection in ECON. We are working, on the new concept of the policy mix of Jackson Hole, that recognises we need to work with different tools. Structural reforms are important but they are not enough; liquidity is important; monetary policy is important; there are brave moves by the ECB in this regard but still it is not enough because the horse does not drink if there is not also something done on the level of aggregate demand and that's an issue of fiscal policy on the one hand and the issue of investment on the other, the investment plan by Juncker and this issue of addressing this huge investment gap in the European Union. We will have two initiative reports – one on the revision of the stability and growth pact and the other one on investment because we want to be an active player. We want to engage with the Commission and the Council and the European Council in addressing this issue: how to make the best use of flexibility and make more binding the country specific recommendations. So have a fiscal policy, because a common currency requires a common economic policy, and you cannot have a common economic policy if you have only one per cent of GDP of your budget and you don't have a common fiscal policy at Member State level. So you have to address this issue and we will come up with our proposal on that and on the other hand you need new tools to address the investment gap.

And then really I close my considerations and sorry for speaking for so long. But when I speak with the market people I see no contradiction between the need to attract private capital for investment and on the other hand to provide public support for investment. When I speak to the market people they say "No, for us it is important that you come up with the programme, with public guarantee, with project bonds because you then also contribute to make attractive an asset class linked to long term investment infrastructure" so I think the two elements are very connected and I think we have not worked on both sides, on the side of attractive capital markets and on the side of new innovative instruments. I think also a new fund which can borrow on the market , and now how can that be financed, I think this is something that can be addressed now. We received yesterday the autumn forecast, it is very gloomy. We are close to deflation, we are close to recession. We have an investment gap if we compare with the US of 1:10. So we need bold moves, it cannot be done only by private capital but also by public initiative. We expect Juncker to have this ambition. This is our vision and thank you very much for your attention.

Benoît Lallemand

Thank you very much. I will take a few questions. I think you have been a bit humble, and the audience will agree, saying you have just come in and you have just given a few thoughts. I think your speech was comprehensive with some concrete elements. I will take three questions from the audience to Mr Gualtieri on anything that was discussed.

Question from the floor

I was wondering whether you agree with the criticism of the stress test for banks because clearly one of the reasons why deflation is threatening is because the banking system especially in southern Europe still has a lot of bad debt. In Italy, Italian banks are far from healthy. Do you think that these stress tests actually go far enough to restructure the banking sector, to allow growth in the future? Thank you.

Roberto Gualtieri

You made a reference to a country I know best. As I said, I consider the stress test a good exercise, very positive. But I consider it not enough and with some critical elements in the way it has been conducted of course if you look at the results it is true that the critical issues are in some peripheral countries – not all of them – but if you for instance see the broader picture, if you sum up the excess of capital aggregated at the national level, you will have a better result even than some other Member States. So I think on the one hand Madame Nouy was right to say this was not an exercise on countries but an exercise on banks, and some generalisation has been made from grouping banks by country. In Italy, for instance, they did not consider the fact that Italy did not give any public money to banks. Just 4bn euro. In Germany 250 million. So, of course, you didn't have hundreds of billions of public capital so you have less capital, but that does not mean that the system is less healthy if you go by individual banks.

And then there is the other issue I already addressed, which is that this exercise focused on the ratio between the capital and the risk weighted assets. While the trading part, the finance part, were counted less than the lending to the real economy. Of course the consequence of this if you have a situation of stagnation, in the stress test, because banks passed the comprehensive assessment but not the stress test, and you imagine point five per cent of recession in an already critical situation and you have a balance sheet which is more oriented to lending to the real economy, and you have less derivatives, then you have a problem. But this does not mean that having a huge portfolio of derivatives, whose risk you cannot calculate as you don't have the formula, so you rely on the banks for their own formula, this does not mean that they are safer. Simply, as even Madame Nouy admitted they could not calculate that. So they are looking forward to having a new formula instead of the internal model. I consider it a good exercise, but not complete, not fully satisfactory, a step forward but we require a better way of assessing the risk on the one hand and on the other hand also to go to push through the structural element of safety of the banking system. Not only the risk weighted prudential supervision.

Question from the floor

Thank you for your very clear explanation, Mr Gaultieri. You have referred to two processes. You have referred to the need to take stock of all the things that have been done, this makes a lot of sense. At the same time you have talked about the need to fill in the holes. My question is do you see a sequence in these two processes? Should we go first for the review or can these two processes be run in parallel? Thank you.

Roberto Gualtieri

That is a very good question. I wish I had a clear answer because of course you don't know the result of the assessment until you have done the assessment, but this does not mean that you don't do anything before the assessment is complete. So we have to find a pragmatic solution but in this sense we will be helped by the fact that I don't feel, for instance on structural reform by the Council, the rush, so we will make our exercise, but I don't expect this reform to be finalised in the next few months. So we have time for making our assessment which we will start in January. And in the basis of what we will assess we try to propose to the Commission to better recalibrate some elements, to address some problems maybe at the level of delegated acts, for instance insolvency, this is a very big monster. I am sure that a lot can be done to improve the solvency framework to support investment in the real economy. We did something that is correct in terms of ABS. We should start working parallel but that does not mean that we should conclude anything before we have a clearer picture.

Question from the floor

There has been lot of talk about the banking side of things. Insurers are the largest investors in Europe, with 8.5 trillion of assets. Obviously we have played a role in investment for many years and are keen to continue that role, however one area where we are very frustrated is there is a series of changing in solvency, in accounting rules, in tax rules, which make it harder and harder for us to play a role in long term investment. How are aware are you of those things and how much of that will play a role in the work you are doing?

Roberto Gualtieri

We are aware of this, everybody tells us about this. I admit it is so complicated that I don't know where all the technical shortcomings are, but I am aware of the problem, and I am aware of the fact that we cannot give artificial advantages to certain asset classes, but at the same time we have to avoid giving disadvantages, especially if our strategy says we should support long term investment. There are some public goods, we also have a role in terms of new projects which address short comings of the EU in terms of EU in terms of infrastructure, the economy, these are public goods and I think we should come up with some suggestions for new delegated acts on solvency in order to better address the regulatory framework of insurers in order to encourage safe investment that makes use of this huge amount of resources in terms of addressing our long term investment needs.

Benoît Lallemand

We will move to the panel; I invite the speakers to join the panel.

Greg Ford

We now move to the panel. My name is Greg Ford, I'm Head of Communications at Finance Watch and I shall be moderating this discussion. Just a quick word about why we're here. As Mr Gaultieri mentioned there was a growth forecast yesterday and the European Commisison's new Vice-President for Growth, Jobs, Investment and Competitiveness introduced the gloomy news with the words "the economic and employment situation is not improving fast enough." So that's why we're here. There is a policy maker agenda being made at the moment which is looking at how to encourage financing for activities that will bring economic growth, with a particular focus on SMEs and infrastructure projects. First on the list are promoting capital markets and securitisation, also on the list are institutional investors, public banks, retail savings and the safety of banks. While this is going on, researchers are making new discoveries about what kinds of finance create what kinds of growth. I am very happy that we have one of those researchers with us this evening. Which leads us to some questions from the panel. How does this emerging agenda fit with these new research findings? Are we working on the right assumptions? How could the finance growth agenda be improved from the public interest point of view. I hope that by the end of this panel, the distinguished panel of experts will have answered the question for you: What finance for what growth? And I encourage you to chip in with your thoughts in the Q&A session. First of all though, I would like to ask the audience if they think the EU has had enough discussion about what kind of finance is needed to support smart sustainable and inclusive growth? [Few hands were raised] OK, that tells us that we are here for the right reason.

So let me introduce our distinguished panellists. We have Sirpa Pietikäinen, member of the ECON Committee for the EPP. Also a substitute on the Environment, Public Health and Food Safety Committee. Sirpa was EPP shadow on the special committee for the Financial, Economic and Social Crisis. She has been a member of the Finnish Parliament for 20 years and was Minister for Environment between 1991 and 1995. Your Wiki page tells us that you still teach courses in

Negotiating Theory so I am sure that will be of great use in advocating your desire that Europe should be built in an ecologically sustainable way.

Next on the panel is Jean-Louis Bancel, President, Group Crédit Cooperatif. He is now a banker and has ten years as an executive at the Crédit Cooperatif. He has been president since May 2009. Before that he worked for the French government in the Ministry of Finance and in insurance before that. He is a leading light in the cooperative bank movement and shares two important associations in that area.

We are pleased to welcome Wim Mijs, Chief Executive of the European Banking Federation. Wim has a long career in representing the interests of the banking industry. He was chief executive of the Dutch Banking Association, and before that worked for ABN Amro in Brussels as their EU liaison officer and in the Hague as the Head of Government Affairs. Wim has a background in arbitration and law and has probably seen quite a few commissions and Parliaments coming and going, and I see from your profile that you know how to make the right noises as you play the electric guitar.

This brings us to Thorsten Beck, Professor of Banking and Finance at Cass Business School in London and also a research fellow for the London-based think tank Centre for Economic Policy Research. Thorsten was a professor of economics at Tilburg University where he set up the European Banking Centre and has previously been a senior economist for the World Bank. And he consults for the IMF, the European Commission and the German Development Corporation. Let's dive straight into the discussion. Perhaps if each speaker could mention their personal interest in this topic.

I would like to start with asking Sirpa, what kind of growth should we be encouraging?

Sirpa Pietikäinen

We are looking too much in silos: finance regulations, then growth, then monetary challenges, social challenges and so on. This kind of silo approach will never fix the problem. Then when you combine it with a forecasting approach you see you are taking the next steps a bit fast and a bit better than you had been doing. But if the direction is wrong it doesn't actually help you. So what would we need to do? From forecasting to back casting. We would need to see where we would need to be and what the challenges are, and go from a silo to a holistic view. We are using 1.5 planets at the moment, you don't need to be a genius to understand that to go to 4 planets by 2050 is not going to happen. Its going to cause financial stress too. The point is how to change the direction and how to analyse what incentive in the economy in general and the financial markets point in the wrong direction.

What kind of problem? It needs to be green, resource efficient, getting the same outcomes for the people from a tenth of the resources. Everybody needs to benefit, and everybody needs to be using sustainable resources. Renewable energy – not non-renewable in 30 years' time. And no harming of biodiversity or any ecosystems. It is resource efficiency and legislative challenge but you would need to link it into finance. You would need to take into account the environment in credit ratings. You would need to take into account in the next Basel or whatever, that those banks would be required to have higher own resources if they are lending to environmentally risky or fossil based activities. You would need to integrate it in IFRS. You would need to start monetising the environmental and resource impacts. You would need to link financial stability on budgets, on many things. What kind of growth? We would need that kind of think tank and Commission and Parliament activity with industry to see what needs to change in finance or regulation that is keeping it in silos, so that it would incentivise those companies and investments in those things. And then it would go through all pieces of financial legislation. Thank you.

Greg Ford

Thank you, Sirpa. Perhaps we can start by looking at what kind of growth we should not be encouraging? I would like to start by asking Thorsten for a view on where we should be trying to discourage economic activities.

Thorsten Beck

Perhaps I can begin by explaining where my interest comes from. My interest in finance and growth came from originally from the developing country side, as I spent some time involved in it in Washington DC. Of course we are talking about very different financial systems. We're talking about hundreds of trillions in the EU compared with a few billion, so very different challenges, obviously. I think this is actually lessons for wealth for low income countries, middle income countries and high income countries. I think one of the lessons that we can learn from it is that finance and growth is really long term growth. It's not necessarily about encouraging short term growth bursts. For example, associated with asset booms. It's really about long term growth not necessarily about getting out of the next recession. Finance is an important condition for the proper functioning of policies, as you see, for example, the monetary policy transmission channel is partly blocked because of the problems in the banking system. But ultimately a big effect of finance comes through long term growth and second it's not only the pure accumulation effect, yes more investment is needed, but it's more important in terms of the allocation function. There are one or two important examples where we could see the importance of finance in terms of allocation, is in the countries of central and eastern Europe. The market-based financial system played an important role in terms of improving government structure, helping firms grow, helping new firms enter, cutting entrenched relationships and creating new ones. It's something that's not always easy to measure in terms of percentages. Yes, I can give you regression results, but it won't necessarily capture the reality as we see it right now.

I want to make three additional points: when we talk about finance and growth, it's about financial services *for* the real economy. It's not about the financial sector in itself. Yes, we know there are countries which rely on having the financial sector as an export centre, one of them being the country where I live right now, which can also have some benefits. It brings more volatility with it, as we have seen, but the real function, the real growth effect of finance comes from the intermediation function, supporting the rest of the economy. Within that, what we've also found is that it is more through the enterprise side lending to firms rather than households and mortgages. There is nothing bad bout mortgages but it will not necessarily lead to a long term growth effect from lending to households and through mortgages. It's really through lending to enterprises, which are often cut off, especially in a recession. They are sandwiched between the corporate on the one side and the households on the other side.

The third point I want to make is that I think there is an imbalance in Europe, and there is some research showing that we have a heavily overbanked economy and an underdeveloped non-bank sector: capital markets, institutional investors and so on. It might seem ironic but I actually think that going back to a single market in banking, where a Banking Union will actually help us, can actually make the sector more competitive, innovative and ultimately make the whole financial system more diversified, to reduce the reliance on banks and put more emphasis on the other components of the financial system.

Greg Ford

Two points that really go to the heart of the banking industry, and luckily we have two representatives of the banking industry from slightly different perspectives perhaps, but both extremely well-qualified to address this. So I'd like to ask first Wim and then Jean-Louis to comment on the points that Thorsten raised. Firstly, is targeting growth in financial services itself an adequate substitute for targeted growth? Are they somehow in contradiction to each other?

Wim Mijs

Targeting growth in the financial sector itself has been proven wrong before the crisis. It has led not only to huge social costs and the leveraging of banks; it has also led to the leveraging of economies. I would argue that this might be one of the problems that we now have with private investment as well. I would like very much a holistic approach looking at what you want in growth. I am not the one as a banking representative who should steer what growth we should have. It should come from society, the economy. It is important that banks serve the economy and that is the looking glass through which we look at their activities. Sometimes, SME lending, mortgages, also more sophisticated things, I feel very much to promote universal, European domestic banks, together with diversity – savings banks, public banks, but they all have one single reason they should support economic activity wherever it goes. It might be very interesting to see if we can get more entrepreneurship. I see a traditional role banks have played. We have gone through a stress test, we have a new supervisory mechanism, and now of course the next step is the implementation of that mechanism, and we should look carefully if we are going in the right way. That is the comparison to the ship. But next to that what I find a fascinating question is that the Commission's economic outlook doesn't really understand where the lack of investment is. Why in other parts of the world this is picking up, but not here, and that needs an ambitious plan from this Commission, an ambitious plan from politicians and an open mind from banks not only to their traditional business. It is the demand side, it is equity and I think banks should also help find alternatives. Looking at the question why such a large amount of investment in Europe comes from banks, which is different in the United States. If you ask researchers to look at it some of their findings are pretty dark. With a lot of banks on offer it has been very easy to get credit and it has been cheap. Whereas if you are a mid-sized company trying to finance yourself on the capital market, it has been difficult and cumbersome. The choice for an entrepreneur is easily made; he will go for the easiest way. So we should look at this. Another element that I've heard from researchers is that because in Europe we have fantastic institutional investors and collective pension systems whereas in the US there are more individual schemes for retirement provision that means more individuals are looking for places for private investment in the hope of getting a return. That creates a different dynamic. What growth for society, banks should serve in a traditional way but also try to help to see if they can help get access to finance. The CMU is one thing I think the banking industry should try to support.

Jean-Louis Bancel

As you said, I am a banker, I work for a cooperative bank and I am the chair of the International Association of Cooperative Banks (ICBA). What I would start with is a story of people. I would start from the European motto "united in diversity", with a knowledge that we are diverse, we are a tremendous continent. There is diversity inside the countries, between the people. Each of us should be able to finance ways for our own development, settlement, in social lives, and there should be an answer from the financial system. That's my first point.

There are big and small players, public players. We need, of course, public investment because for everyone to go forward, our system is different in retirement, and social security for health, and so on. I believe that we still have to keep with the classical basic ideas of the European democratic system. Everyone knows better than anyone what is good for himself and maybe nobody else.

The second point is how we acknowledge the question of discrepancies and difference in the single person and in of course a banker on the other side. What we believe as coops is that we are better when we are united. We believe that when in a bunch of people try to do things together it works better than if everyone tries to do it by himself. What I believe is important is that regulation the whole idea would be to enhance everyone to build a better world a better future. My ideas would be to first focus on youth. This is a major question. The question of education, it's not only through banking or classical banking that we need to work on. Education is very important. You help people define in their own mind what they want to learn. Diversity should be represented on the banking system, in the financial systems. We need big players, cooperative capital, banks and so on, public structure. What I believe is that it is not one size fits all. We need a single view but that doesn't mean everything should be the same. I brought *Le Rapport Moral sur l'Argent dans le Monde* and this year's topic is about regulation and complexity in finance. I love one of the titles of one of the chapters. It has been written by a Professor who is a specialist of regulation and she said that everything in finance should be people based, even regulation should be people based. It's not a question of gods, we are not trying to build the perfect city or perfect paradise only for gods. We are just ordinary people so we need regulation that fits humans.

Greg Ford

We have had some interesting answers talking about the important role of bank lending to businesses and enterprises, the important role of traditional banking in the economy, and also what finance means for individuals to work collaboratively and have the financial support to do that. There is this idea that finance is the means to productivity as opposed to a source of productivity itself, is this the right business model? I think Erkki Liikanen in his report said 28 per cent of European bank balance sheets are being devoted to lending. Only 28 per cent. And the rest involved in other activities. And within that 28 per cent a large part is perhaps tied up in real estate. So the actual proportion of bank lending involved in the kind of activities we're talking about is really small. I don't have the exact figures at my fingertips.

I think I'd like to move on to the finance part of the discussion, perhaps without the Q&A at this mid-point to save a bit of time. I'd like to ask Thorsten, is the small amount of bank balance sheets devoted to enterprise lending a problem for growth?

Thorsten Beck

Yes it certainly is. As I mentioned earlier if you focus on the SMEs, they are being squeezed between corporates with relatively easy access to bank lending and capital markets, and on the other hand mortgage holders who can be screened in a more effective way. Then in the eurozone by governments as well, because there are large bank loans to governments. I think that the issue is to go away from the close linkage between government bonds, here I am addressing the regulatory bias that still exists, in the holding of government bonds because they hold zero capital risk weight. That's definitely one issue. The other is to also encourage mundane financing forms. In London, in England, you can see these popping up – lending circles, peer to peer, crowd funding and that kind of thing. I think that's something that has to be very much encouraged. For us it's not about the financial intermediation, but it's about the services that are being provided. And if the services aren't being provided, let somebody else come in and provide it. That's the important point.

Greg Ford

Sirpa, do you think there is a justification for policy makers to step in and look at the financial sector and which services are being provided, and say this is not of the good stuff, this is not enough of what is associated with growth, and it is our job to change that mix. Do policy makers have that right?

Sirpa Pietikäinen

Finances are part of the economy. How it circulates, this is regulatory affairs work and in that we have political interests. One question is how much risk do we want to take? Risk itself is not bad. How much do we want to pay for stability? I wouldn't sacrifice our public economies for the risk. That makes banking a bit dull, because it's not a fancy place where you can take big risks and do big things. I think it should be rather safe. What is the banking structure? The second one I would like to comment on is bonds. Yes I think that we need some stability, and that is a political decision. Think of bonds if everything would be flexible, what that would create in the financial markets. I think that it is for the benefit that the public debt has the three elements. It is stable, you can rely on this, and politicians' responsibility is to make debt structures in our semesters, in our funding structures.

Greg Ford

Do you think there is a link between where the risk is taken and where the risk falls? Given what we have just been through with the financial crisis, we've seen too big to fail banks, we've heard very much about asymmetric risk taking. Is there a link between that and where investment is made? For entities that are in that position.

Sirpa Pietikäinen

Yes. For a start I always hate the debate about whether investors or actors in financial markets are moral or not because if the incentives are in a certain direction, I would take due consideration regardless of my personal preference of how the world should look. So politicians have to take responsibility on the incentives. Firstly, the risk taking. Risk and benefits are linked. We have a lot of incentives to take risk in the short term, so money is going in that direction. If you don't have enough incentives in long term investment, why on earth would someone invest pensioners' pension funds in renewable energy, and so on, if I'm not sure it will be rewarded. That's why I think we will need to react on that and this is the debate of the FTT and some other elements – we can have a bit of a break in one place and a bit more incentive on the long term end. It is the balance who pays the bill. It is always the poorest. A big risk is the risk for those people who are rewarded taking the risk; they lose their jobs and money. But the biggest consequences are on the poorest who benefitted the least, and didn't have any impact on the situation. This is the moral dilemma.

Thorsen Beck

When you talk about the fragility of the banking system, this mechanism is the same that helps have a positive effect on growth. The fact that short term deposits are transformed into long term loans makes banks better to run. Of course, that banks lend to borrowers has repercussions if the bank fails. You have to have both at the same time. There is no free lunch. We have to keep that in mind. That's why we have regulation in place. I think that we shouldn't avoid failure at any price but we just have to manage it better. I think that is why BRRD is a good step forward.

I think the second part of the SRM is a little bit of a disappointment. It is still not really a European resolution mechanism but it is still a compromise. But we are going in the right direction not in avoiding failures but in avoiding failure being picked up by the tax payer, which will hit the poorest the most.

Greg Ford

In the interest of fairness we should turn the floor to Wim. We've heard that where risk falls and rewards are reaped, if not the same place, affects asset allocation, it affects what kind of financing, and ultimately what kind of growth and whether we get good growth. Bankers are in a unique position to see that. Is it seen within the industry as a problem?

Wim Mijs

I heard a very good description of the banking industry; it is about the pricing of risk. Before the crisis there was excessive risk taking, and then finally when the bill came it went to the lender of last resort, the tax payer. Since then I think what has been done is recalibrating risk, I think risk was completely wrongly priced. That's why you saw some of the excesses. If you look at bankers as well, not only commercial bankers, but also central bankers, there is a completely different view of risk in society. On SME loans, I think it is correct policy makers, regulators look at what banks do. As I said in my introduction, finance for financial gain only doesn't work. It should serve the economy. To set that out is correct. Having set that out, the ultimate trade of being a banker is assessing risk. You have the money from institutional investors and deposit holders, if you then are being guided to subsidise certain parts of the economy then this will have the an effect on the people who put them money with you in the first place. Yes on the regulation. I think the framework works very well. I think the resolution fund puts a dam between society and banks, this is all correct. But I think the actual role of a banker is to assess risk, so where the loan is put is ultimately hit straight.

Greg Ford

Jean-Louis, do you think there is a fundamental question about banking business models that needs to be addressed?

Jean-Louis Bancel

I do agree that we need all types of banks. I do believe it is a good way of doing things. What I believe is we need SMEs, my bank works with the social economy sector. But we also need big players in the finance industry for the big players in industry. What I believe is important is that most European people are educated, they can understand if there is transparency. If you look after crowd funding, social impact clients and so on, you find people that can decide by themselves that they want to invest on a long term perspective with a positive impact on the environment, neighbourhood and so on. I think this could be done by the banking industry itself, not only regulators, but with transparency. Just explaining what it is all about. Something we have done in my own bank is published every year what money is coming in and what it is used for. When you look at what it is it is just a balance sheet. But don't tell people it is a balance sheet, they will say they don't understand, say it is transparency. Stop the banks being black boxes. I believe this is the most important thing we can do. The other thing that I believe is important, and this goes back to the checks and balances democratic process, is that regulators should not only tighten things. If it's too tight the only place where everything is well set is graveyards. I believe diversity means complexity, and that the institutions need to work on proportionality. Small players cannot be asked to work on the same rules as the big international players. I believe this is very important.

Greg Ford

We will now turn to the audience for a few minutes of Q&A and also our keynote speaker Mr. Gualtieri, if you would like to ask any questions to our panellists.

Question from the floor

I would like to talk about stress testing again, sorry to go back there. There is an interesting paper by Acharya and Steffen that analysed risk in the banking sector based on methodology by Robert Engle. They come up with a much higher capital shortfall in the European banking sector, in the hundreds of billions. It we take that number and link it with the 0.8 per cent implicit subsidy described by the European Commission, and we link that number with the amount of lending that Greg Ford mentioned of 28 per cent of the balance sheet going to lending, which is actually too high because there is a lot going to real estate. If I take these three elements together I have the impression is that the big risk in the large systemic banks has not been addressed and is blocking the growth that we are looking for.

Question from the floor

Good evening, thank you for the exciting panel. On the one hand we wonder if finance can contribute to the real economy and growth, but we know that it is about financial regulation policy and not policy in general. For instance within Basel III we don't have consideration of the sustainability of the environment. Also just two hours ago I was on a debate on energy efficiency. Member states have just provided their long term financing plans but there is no consideration of if private finance is present. Another inconsistency, there is no link between the European long term investment fund and sustainability and long term. How do we connect the dots?

Question from the floor

This is a question to Sirpa about the option to put climate risk on the political agenda, because of the trend towards taking excessive risk. And on the economy part, the contribution to risk mitigation in energy efficiency in the context of building. Could that be part of economic growth?

Greg Ford

Perhaps Sirpa could answer that question first.

Sirpa Pietikäinen

This is exactly the point. We have a very short termism in financing. We are building and repairing constructions we are building after 30 years. We should take that into account, and all the infrastructure. Our systems do not reflect it. We are very much in a hurry to get it in the right place. Ok, there are department subsidies and so on on the one hand, but on the other it is making the environmental costs fall on businesses, and making them affordable in the value of the stocks and on the loans if you are investing in the right things. It is about investing in energy efficiency; we could cut up to 60 per cent of our buildings' energy use in 30 years, so we should put a lending mechanism there. Whether buildings are energy efficient should be reflected in the price of the regulation and on the lending. It should be reflected in capital requirements regulations by insurers and on pension funds and so on, to make it more profitable to put the investments there.

Jean-Louis Bancel

I want to give my impression first on long term, and what we mean by it. First, I would say that we need resilience. This is in my view the major question. It means there is diversity. I do understand the question in the capital level that banks should have. The Basel Committee is working on that question. Let's suppose the next figure is 20 per cent. Do you believe anyone, cooperative banks or private banks would be a shareholder? No-one could cope with that. The other thing is if we want to get right to the bottom, and we have wonderful tools at the European level, the European Investment Bank, it should play a more important role, but they have to find inside the national banking system, people who will lend to the last small SME. We need to find ways to get the money to trickle down to where it should be.

Wim Mijs

Actually to support the European Investment Bank. I completely agree with that. They play a very important role getting the money to where it needs to be with industry. But we need to look if it has the tools if they can move because I do believe it should trickle down to SMEs. Someone at the EIB told me they have a 5 page definition of SMEs. This is too difficult for the smallest SMEs. That is correct. We need to help the EIB to see if they have the right framework to do that.

On the stress tests and the implicit subsidy, was it long enough? This is a question that needs to be asked and should be asked constantly. Yes, the stress test was the most severe we have seen. Yes the AQR was the most comprehensive and I think for banks to really go deep to some of the portfolios of banks. Was it enough? It needs to be constant. It is a new style of supervision. It was a moment of time. I think what the ECB did was well done. I think the question needs to be constantly asked. On the implicit subsidy, before the crisis there was this implicit subsidy but one of the results of the regulatory framework is that we try to bring down this implicit subsidy. But by having the resolution fund and the Banking Union we are trying to bring down the subsidy, and that is the right way to go.

Thorsten Beck

I agree it is a very first important step. One issue, is if you look at the very end of the ECB report, on the leverage ratio, most of the 25 banks that are in question actually failed the test, they are below the 3 per cent. The question is should it be 3 per cent or much higher. In the UK it is now supposed to be 4 per cent. So I think there will be more rounds coming. I think if it is a first step it is great. But we shouldn't expect any wonders from someone having a better capitalised banking system. One quick remark on environmental issues, I am all in favour of environmental policy, I would not overburden a prudential toolbox like Basel III with an additional policy area. I think there are other much better tools that can approach environmental externalities that we have to address.

Greg Ford

Before I ask the panellists for their closing statements I would just like to ask for two more questions from the floor.

Question from the floor

I think it was Keynes who said that in the long term we are all dead. The problem is only that our children will still be around. I think that we should really focus on these long term ESG criteria. I completely disagree with the last point that we should not take them into account. I rather agree with Sirpa Pietikäinen that this is absolutely crucial. In the short term, though, politicians are not reflected. Very quickly, ESG criteria are essential to take into account not only in the prudential area, the accounting area but also in the pricing of risk. Academics show now it is a factor of risk in the long term. But at the end of the day why do we continue to calculate growth in GDP?

Thorsten Beck

Churchill said that democracy is the worst form of government except for anything else. I think this is the same for GDP. In the absence of having a better measure, GDP is still a pretty good proxy. It is correlated with lots of other issues that we do care about. I didn’t say we shouldn’t take into account ESG issue I just meant that we should have different policies for different tools. I care very much about the environment.

Question from the floor

We are a think tank trying to integrate the long term environmental considerations in financial processes. We are currently writing a study for the prime minister of France about saving our child through the banking and investment system. In the conclusions from this study is that the investment chain reduces the investment horizon. It was incredibly hard to find the data on liabilities and assets. Why is it so difficult to find data bout sectorial allocation of lending, and how can it be improved?

Wim Mijs

I will speak first. I am from the Netherlands. I have been here for too short a time. I started on 1st September but before that I was active, as many were, in the right approach in longer term investment in the financial sector. In the Netherlands there was an energy agreement that was concluded between government, employers, unions and banks. I co-signed it on behalf of the banking sector and the importance was it was long term commitment to do investment on one side, it also showed long term commitment of the government. In the past one of the problems was short term policies of government, which would derail investment vehicles. It was concrete in a sense that it had targeted action to bring together institutional investors, banks, employers and entrepreneurs to see how this could be explored. In my view this is the way to go. All institutions in society need to get together and see if they can make a long term plan, and commit to it.

Greg Ford

Thank you. Jean-Louis, why is this data so difficult to find?

Jean-Louis Bancel

Crédit Cooperatif, my bank, joined two years ago, a global alliance for banking on values. It is a worldwide system with Dutch bank Triodos, our bank, banks from other continents. We believe working on values is something that adds things to people making deposits in our banks. So we decided to publish indicators to help people choose banks. I am the head of the steering committee working on that. Where is the only place where we count figures to compare systemic banks and our banks? The United States. Why does it work so? Because in the United States they have the insurance for deposits. So each bank each quarter publishes figures which are public. Everyone can get them. Why isn’t it the same in Europe? That’s something I wonder about.

Greg Ford

Thank you very much that seems to be bringing us to the end of the session with a question for the MEPs in the room. That's brining us to the end of the Q&A session. Perhaps we could now work along the line of speakers with closing statements and any additional comments that you would like to make.

Thorsten Beck

What I would like to see for Europe going forward is a competitive, innovative, diversified financial system that does not serve itself but rather the real economy for future generations of Europe, with forward-looking investment. Finance is too important for society to leave it just to the bankers. We need financial innovation; we need more players in the arena.

Wim Mijs

The most important thing is that what growth is a choice for society, and the banking system should be ready to share that. I think banking has become more fascinating after the crisis, not only because now we have more interest from society. And now I must say everybody is interested and that is good. It repositions banker as someone who can bring expertise to society on assessing risk and who will help alternative investment. With that is a fantastic opportunity for bankers to reinvent themselves.

Jean-Louis Bancel

It goes back to what I started with, growth and finance should be from people to people, that is my view. The word I would like to finish with is trust people. I believe that it much more important than only relying on experts.

Sirpa Pietikäinen

I was educated in the Helsinki School of Economics and Business Administration. Quite a big number of my close friends are working in the financial industry and on economics. So I can hear very well how much we don't understand the same things when we discuss societal challenges, resource efficiency, monetary challenges and banking. This is what we need to learn to do in the future. I strongly agree that you can mix these two things. The financial sector is not physics. The incentives are there already but we do not recognise that they are guiding us in the wrong direction. So that with the right foot we are trying to walk in the right direction and with the left foot we are trying to walk in the left direction, and then we wonder why we do not get results. How to get results? This is the big thing, we should get together in these and other events to pressurise the Commission for a working group that is intra-DGs to start thinking about how to do it. I am not going to start telling you what to do with Basel IV, IFRS or any other legislation, but we should start thinking about this seriously. Otherwise time is running out, we do not get investment in the long term and in the next 20 or 30 years we will be thinking how we got to where we are when we wanted to be somewhere else.

Greg Ford

Thank you, Sirpa. Please join me in giving a round of applause to our speakers.