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Economic and Monetary Union – Deepening and Convergence

Keynote lectures: Financing the economy – SMEs, banks and capital markets

Thank you very much for the invitation. I think inviting me in my function [as Chair of the Division Bank and Insurance of the Austrian Federal Economic Chamber] is just a cover; in reality, you invited me because you know how much I love the European Economic and Monetary Union and how much I love European regulators. Let me reveal the reason why I love them so much: It is simply because they are just another perfect example of how Europe actually works and how the EU works. We always start off with a great idea and then we have great politicians who actually make it happen. Then, everybody is happy about what happens in Europe and then we find out that a couple of things do not really work out simply because we forgot to implement them when we started off. And slowly, everything starts to deteriorate even though it is still a great idea but suddenly nobody is happy with it anymore. This is true for the EU, this is true for the European Economic and Monetary Union, this is true for European regulation and, lately and very sadly, this is also true for Schengen.

Maybe, the new era of the European Economic and Monetary Union did not accidentally start or coincide with the beginning of the financial crisis. In this context it's important to state that financial regulation did a really great job in Europe – and I do not mean that cynically, I mean that very seriously. So did regulation in the United States and in most of the Asian countries. Thanks to regulation, the banking system or the financial system of Europe has been substantially better and safer in 2018 compared to 2008. Banks are better capitalized, they are less crisis-prone than they were ten years ago, supervisory systems and tools are substantially better, as well as resolution mechanisms. Could we therefore actually say: mission accomplished? Well, maybe there are some aspects of that "mission accomplished" to be found in the United States where the threshold for "regulation light" has just been raised to a balance sheet of 250 billion dollars. Maybe there are some aspects of that "mission accomplished" to be found in Asia, but there is definitely no mission accomplished in Europe. Here, "regulation light" – if it exists at all – ends with a balance sheet of 5 billion euros. And in order to put a "cool European touch" on it, we will actually lower the threshold for "regulation super-tough" – for the biggest banks – to 100 billion euros. That is a typically European solution and, in my view, it is simply a compromise between Germany and France. The Germans, representing their banking sector, got proportionality, and the smaller banks loved it. But not all banks in Europe are smaller banks.

So, have we really thought that through? We see what is going on in the United States, and we should not do what is good for Germany, or what is wanted by France but what is good for Europe. The U.S. approach is very different and very typical of the United States: The U.S. regulators said, "We punish the banks, then we repair them, then we make a lot of money repairing them, and then we regulate them such that they can help us to make America great again." The European approach is: Taxpayers should never ever have to pay again; therefore, we need to control everything banks do 24/7, irrespective of what it costs. Now, I agree with the taxpayers but I definitely do not agree with 24/7 regulation, and I do not agree with all the costs. What are the reasons for the different approach of Europe? Reason number one is that the European political system is very complex and therefore it is very difficult to change direction. From 2018 to 2028, the problems of the financial system will be completely different from the problems experienced from 2008 to 2018. The second reason is that Europe is the most democratic continent in the world – which I love – but it is also the most bureaucratic continent in the world – which I do not love. Regulators are bureaucrats, and if nobody tells them otherwise they will simply continue to regulate. Reason number three is that the term "bankster" is still somewhere in every regulator's mind. That might be good for a regulator, but it is not good for regulation; maybe regulation should actually help to identify, locate, punish and eliminate banksters, instead of trying to establish a system that is so good that even banksters cannot do any harm. This is not going to work, and every year that Europe continues on this path will destroy some of the values it has created.

Let's take a look at the three components of the financial crisis when it hit Europe. The first one was an imported component and came from the United States where, basically, inexperienced institutional investors bought billions of U.S. real estate junk. Had Europe had a well-established capital market culture back then, maybe some of the big shots in European Banking would have actually known what they were about to buy and would not have bought it. Now, that is being taken care of by the European Capital Markets Union. So if we are not doing a good job on this one, I see a big problem coming up for us. Let's not fool ourselves: We do not have a capital market culture in the European Union. The two biggest capital market countries in Europe are either not in the European Union; Switzerland, or will leave the European Union very soon. Establishing capital markets is not done by changing the legislation for venture capital funds, and it is not done by building a stock exchange for SMEs – that is the last step. The first thing that we need in Europe is a true and honest capital market culture, and this is not only true for Austria, this is also true for Germany. If a German Minister of Finance actually believes that saving is good and that investing is bad; because investing is for capitalists. Everybody who produces dividends is valuable for the economy, but he is not somebody we want to deal with. We like the good *deutsche Kaufmann* who saves. The problem is that saving has been the biggest form of speculation on this planet over the last ten years because we all lost money by saving money. So, if we are to establish a Capital Markets Union that can actually call itself a capital market, we will not see any results before 2050 – that is my bet. What do we do until then? How do we help Europe not to continue to fall behind Asia and the U.S.? And what does it all have to do with regulation?

If you take a look at the chart, the first thing you see is that, compared to the total financing of the economy, bank assets are substantially higher in the EU, and particularly in Austria, than they are in the U.S. The second thing you see is that stock market capitalization in the EU is substantially lower than it is in the U.S. and Switzerland. In Austria and in CEE, it is practically non-existent. Yes, we do have a stock exchange in Vienna, and we do have a stock exchange in Poland, but we do not have anything in some of the countries, and that is a huge issue for our region. In total, the capital market in the region that many of us have to deal with is completely underrepresented. What this actually tells us is another story: It is not only the story of us having a much lower capital market than the United States or the U.K., which of course has enormous effects on pension funds and on the ability of our citizens to invest in our economies. It is also the story of another effect that is, in my view, highly important for European financial regulation: The banking system in Europe is substantially more important for Europe than the banking system is for the U.S. economy. So, whatever we do with regard to regulation in Europe has a substantially higher effect on the ability of our economy to grow than it would be the case in the United States.

What are the other components of the crisis? The first one was the imported component from the U.S. The second component included the homemade crises. Each of the EU countries – Ireland, Spain, Greece, Austria, Romania, Italy, Germany, and so on – had its own form of a crisis: It was real estate lending in different forms, it was foreign currency loans, liquidity problems, undercapitalization, and so on and so forth. In some countries, the EU had to step in in order to help the respective country and the banks to get out of the crisis. In other countries, the EU did not have to step in; rather, the crisis was dealt with locally. And in yet other countries, we did not even have a crisis, like in Poland or the Czech Republic.

The third component of the crisis is the cross-border crisis in the EU and what we generally call the death loop between banks and governments.

What was the role of regulation in these three areas? In area number one: zero. I think regulation had nothing to do with the imported part of the crisis other than the fact that it created parts of the crisis but that is something we will deal with in the Capital Markets Union. In the second area – the local crises – the EU and regulation played a hugely important role. The rules that were established back then will substantially reduce the risk of a lending crisis and bank failures in Europe in the future. And for that, regulators deserve the praise for the next 100 years because the system itself would not have made it without regulation. However, the third area – the death loop – cannot be dealt with by regulators. It can only be dealt with seriously by the third pillar of the European Monetary Union, the so-called European Deposit Insurance Scheme, which is – as you all know – a long shot. That is also not in the hands of regulators, it is in the hands of politicians. And presently, I am sorry to say, they deal with it pretty much in the same way as they deal with migration. It´s a pitty, because if we want to make sure that the European banking system becomes a real competitor to the U.S. and Asian banking system at some point in time – which we all hope and wish for – we have got to get work done, and we have got to get work done very soon.

Ten years into the European Banking Union, two out of its three pillars have been established: the SSM and the SRM; the third one, however, has not been established. What is the outlook for the European Economic and Monetary Union? We could ask, "What will it look like ten years from now?" But allow me to formulate it differently, so instead of asking, "What will the European Banking Union look like in ten years?," allow me to ask, "What should the European financial system look like in 2028 in order to fulfill its only purpose, which is to help create prosperity for all citizens of the European Union?" Or we find yet another way of formulating: "How and what do we need to do in order to make sure that the European financial system provides European businesses and citizens with an advantage vis-à-vis the rest of the world in 2028?" This is not a Trump copy of "Europe first," this is much more modest. This is just saying, "Please, let Europe not be second." We all see what is going on in the world. Europe is still the best place to live but we all know that we are falling behind in many areas. What was the contribution of Europe to the digitization of the world? What is the contribution of Europe online overall in the world? What is the contribution of Europe to artificial intelligence? What will the contribution of Europe be to car battery manufacturing? What is the contribution of Europe to block chain technology? We are very happy to hear that a new payment company headed for the stock exchange in the Netherlands, being valued at 14 billion euros. We should have companies, high-tech companies that are valued many many hundred billions of euros because big companies also create small companies.

These days, we are also wondering why there are so many European brains in Silicon Valley. Because it is so nice to be in California? European brains are in Silicon Valley because that is where they receive financial support. This is the only reason why they went to Silicon Valley. We should not be happy about small springs in Berlin, Vienna or Munich; we should have much grander aspirations as Europeans. We should say, "what Silicon Valley can do, Kitzbühel can do too!" Not only skiing, but we could create the same thing. What we need for that, however, are clever forms of financing. Establishing capital markets will take a while, and it is not going to happen overnight. The first thing we now need to do is stop European politicians calling investors speculators. We need to make politicians aware of the fact that their citizens have lost millions, and billions during the last ten years because they helped to create a climate in which everybody who buys a share has to feel bad. If we do not stop that, it will be over. However, establishing capital markets will take a while, so what do we do in the meantime?

Could we not think about how to shape the financial system of Europe and, in an intermediary step, get the banks involved in creating products that could help establish capital markets? Could we not try to speed up the development of capital markets and a capital market culture dramatically? Could we not just say bankers and regulators together, whereby the bankers actually say, "Dear European regulators, please do everything possible to make us less important. We are presently financing 75% of the economy and in Austria as well as Central and Eastern Europe we are financing 90% of the economy. This is unhealthy." I do not want a system like in America where American banks are down to 25%; but why not try to get to 50:50? Do you know how long that would take and what that would mean for us if we tried to get to 50:50?

You also mentioned start-ups today. We are saying that the European banking system has improved a lot, and that the NPL ratio has come down dramatically even though there are still some countries in which the NPL ratio remains relatively high. But in total, it dropped dramatically in Europe. So why could we not say – now after ten years and after having seen how the banking system has developed: Why do we not let banks with an NPL ratio of less than 5% lend 1% of their risk-weighted assets without guaranties, without collateral, to start-ups and social enterprises? And trust the bank managers that they are smart enough and that they have the expertise necessary to decide whom they want to finance? 1% of our risk-weighted assets, or maybe – if a bank has an NPL ratio of less than 3% – we could let them lend 2% of their risk-weighted assets in unsecured uncollateralized loans to SME start-ups and social enterprises.

By the way, some of the European funds are doing an absolutely great job in helping us to develop exactly that. We are very fortunate to have been working with a European fund that helped us to develop a social banking system in Central and Eastern Europa and the Western Balkans, which we needed desperately. And raising 50 million euros for something like that is a huge effort. Just imagine: If regulators together with politicians could agree on taking the risk and letting us lend 1% of our balance sheet, this would not create 50 million euros, this would create 50 billion euros. 50 billion euros to finance start-ups, to build an atmosphere somewhere in Europe, where we could create our own Silicon Valley. At the same time, we could help the more than 13 million people in the European Union who have no access to banking back on track and back to life. All we need are the guts to make a mistake. And that is one of the problems that we have in Europe, and that the Americans do not have. We hate to make mistakes but sometimes the biggest mistake is not to try. Thank you very much.