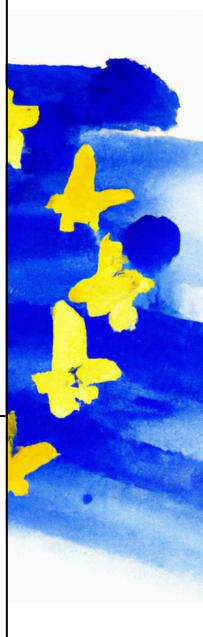
Draghi's Blind Spot: Making EU Prosperity Inclusive and Secure

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Index

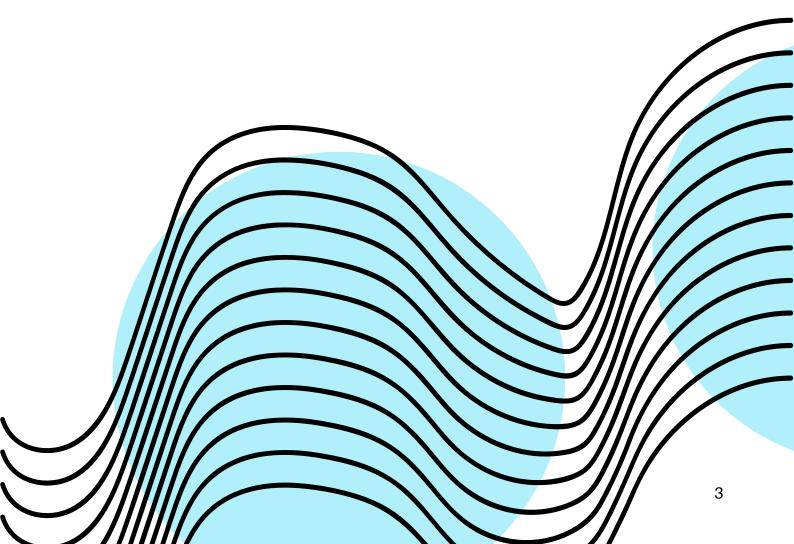
1. Introduction	3
2. Vision on Growth	4
3. Decarbonisation as a goal	5
4. Financial regulation	7
5. Conclusion	o

Introduction

Last September, former ECB President Mario Draghi published his infamous report 'The future of European competitiveness', on how to revamp the EU's economy and compete with the US and China. He identifies three strategic areas to focus on during the coming political mandate: innovation, competitiveness and decarbonisation, and security. According his calculations, the EU will need €800 billion of investments in innovation and modern industries to get out of its economic rut, which should be financed through public and private investments, in turn stimulated by a Savings and Investments Union. However, Draghi's proposals prioritise a crude upscaling of the EU's economy above the equitable

inclusive growth that is necessary to create a sustainable economy. His failure to address this inherent tension between industrial growth and the EU's sustainability targets begs the question: how compatible are the plans for a short-term increase in EU economic productivity with the EU's socioeconomic sustainability and challenges?

Following an analysis of Draghi's report through the ethical finance perspective, we develop our criticism in three main points of improvement to make his plans future-proof: his view on growth, decarbonisation and financial regulation.



Vision on growth

In his report, Mario Draghi aims for one thing: growth. However, the report's vision on growth is limited to an average increase in GDP, excluding societally relevant factors such as wealth distribution and sustainability. With his proposals, Draghi aims to ramp up EU GDP to levels comparable to those of the US and China - the benchmarks for the EU's economy Draghi consistently uses throughout the report revamping European industrial competitiveness through innovation. However, in both the US and China, the tunnel vision on GDP growth is the main driver of their high levels of wealth inequality and resource depletion. For one, China achieved global competitiveness by consistently violating its workers' human rights, and the US through minimal government intervention, which among other things led to the breakout of the Global Financial Crisis (GFC) in 2008. Similarly, Draghi states that "EU households have considerably lower wealth than their US counterparts," leaving out that the US scores lower than any EU Member State on the distribution of this wealth.[1] While he does acknowledge the US' subpar social situation and pushes for the preservation of the EU's social model, his proposals lack any substantive measures to prevent the desired growth from resulting in a comparable disparity.

This is a missed opportunity, as it has been proven that social investments

stimulate rather than counter innovation and economic prosperity, and that the latter is a function of productivity and an inclusive welfare state.[2] Increasing therefore social investments is achieving the essential towards economic goals Draghi sets for the EU, while simultaneously improving social equality and inclusion. Yet he does not mention it. This reveals a large untapped potential of an expansion of welfare states, overlooked by Draghi.

In light of the above, we suggest that any policies to upscale the EU economy should aim for more inclusive, controlled and sustainable growth, rather than merely a boost in industry size through innovation. This ensures that no EU citizen is left behind in the path towards prosperity and that Member States get on track towards achievement of the Paris climate targets. This requires stimulating smart social investments (such as retraining workers in declining industries to build skills for modern industries) as well as a shift in priorities to focus the limited EU public investment capacity on social and green objectives (rather than on e.g. defence and industry spending). A good example of the latter is InvestEU, which has shown to be very effective in leveraging investments in the social sphere through An upscaling of such guarantees. financial instruments, which have proven effective and do not require enormous amounts of investments on the EU side, should be a vital part of the new political

priorities, including an expansion to support the green transition. Finally, Draghi dedicates an extensive part of his report to security, pleading for an increase of investments in the defence industry. Aside from protecting the EU from territorial threats, his defence plans feed into his narrative of industrial growth and innovation. Contrarily, ethical finance argues that the defence industry should not be a central EU priority. There are several sectors within the European economy that could benefit from additional funding, also contributing to the bloc's strategic independence, namely social well-being and sustainable growth. In contrast, expanding the EU's defence capacity and industry risks to indirectly finance the ongoing human rights violations taking place in third countries due to ongoing conflicts. In FEBEA's view, this outweighs any strategic (side-)effects of common EU defence investments, such as the boost in innovation mentioned by Draghi.

Decarbonisation as a goal

'The future of European competitiveness' pleads for the EU to become a global champion of decarbonisation, identifying it as an opportunity to become an export-hub of clean energy technologies. But this argument for directing capital towards research and innovation instrumentalises decarbonisation to drive economic growth, rather than viewing it as a solution that ensures sustainable prosperity, and a key ingredient of a stable economy. Aside from this, the EU has committed to the targets of the 2015 Paris Agreement and therefore cannot afford to wait for decarbonisation to become profitable in the short-term. Plans to stimulate EU prosperity should thus treat innovation as a means to decarbonise the economy and secure a future for the bloc's population, where the human rights of current and future generations are guaranteed. Treating decarbonisation as a goal in itself is an essential part of this.

To do so, there is a wide range of possible measures that would simultaneously fit Draghi's proposals. A proven effective measure is to leverage green investments through **European Green Guarantees (EGGs)**, also proposed by Enrico Letta in his recent high-profile report 'Much more than a Market'. Similarly, **InvestEU** has shown to be successful in mobilising resources towards target sectors, dedicating €9.9 billion in guarantees to sustainable infrastructure projects and €6.6 to research and innovation. This is a combined 63% of InvestEU guarantees, which leveraged a total of €218 billion in investments,[3] and an overall 53% of guarantees contributed directly to the EU's green transition.[4] Additionally, there are many other proposed policy instruments with which the EU could stimulate decarbonisation investments (see box).[5]

[3]https://ec.europa.eu/commission/presscorner/detail/en/ip_24_4888#:~:text=InvestEU%20is%20having %20a%20meaningful,anticipated%20multiplier%20effect%20of%2014.76

[4]https://commission.europa.eu/document/download/3055e243-41a8-414b-b55e-ae885950c62d_en? filename=InvestEU_Final_TechnicalAnnex_Clean.pdf

[5]See also our recommendations to stimulate sustainable investments in our recent paper on the Letta-report: https://febea.org/publication/much-more-than-a-transition-the-sustainability-shortcomings-of-the-capital-markets-union/

Various possible policy instruments to stimulate investments in decarbonisation

- Formulation of a clear definition of transition and transition finance products to facilitate transition plans envisioned by multiple EU financial regulation;[6]
- Harmonising the different green classifications of the EU Sustainable
 Finance Framework e.g. the definitions in the EU Taxonomy and in the
 SFDR and reporting standards, based on scientific evidence;
- Implementation of a European Safe Asset, as proposed by Draghi, to finance and derisk decarbonisation investments;
- Application of a European Financial Transaction Tax (FTT), to both repurpose money for long-term projects supporting clean energy technologies, as well as countering short-termism in the financial sector;[7]
- Deposit EU budget in fossil-fuel free banks to set a good example, as proposed by the Sustainable Banking Coalition in their #EUSwitchBanks campaign launch

Financial regulation

Basel and securitisation

Draghi furthermore proposes to boost EU competitiveness through several interventions in the financial sector. The first of these is cutting red tape to enhance the efficiency of the financial sector (which was even incorporated in von der Leyen's second Commission by introducing a 'Commissioner for Simplification'). While FEBEA supports harmonising standards and regulations, the EU should be wary of regulatory rollbacks for the sake of financial stability, the first signs of which are already noticeable in the EU's postponement of finalising Basel III implementation,[8] and the European Parliament's postponement of the Fundamental Review of the Trading Book (FRTB) to 2026.[9] Recent measures such as Basel III and IV (transposed into EU law through the CRR and the CRD) have restricted the range of action of financial institutions, and as they are meant to prevent these institutions from taking on risks they cannot afford, such regulations should not be diluted.[10] This should remain a constant point of vigilance through next term, in line with the 'harmonisation over deregulation' stance of the new Commissioner for Financial Services and the Savings and Investments Union, Maria Luis Albuquerque.

For the same reason, Draghi's proposal to stimulate the EU's securitisation market is a dangerous idea. While securitisation frees up lending potential in the short term by transferring loans from banks' balance sheets to the hands of investors, it disperses risk it took an obligation upon into the productive economy in the long term. This is especially true for Non-Performing Loans (NPLs), for which a bank is legally required to retain more capital reserves due to their higher risk. Securitising these loans is problematic in two ways: firstly, it increases systemic risk in financial markets, as the risk of default on these loans is transferred onto the real economy. Secondly, borrowers are stripped of the possibility to negotiate better terms on their loans with the bank, feeding into default risk on the loans themselves. Thus, this practice empowers less regulated and more risktaking segments of the market, simultaneously eroding the protective, communityoriented role banks have traditionally played. While the aim of securitisation is to free up liquidity to increase credit potential, there are more responsible ways to do so by improving the status of NPLs on a bank's balance sheet. For one, FEBEA-member Banca Etica has a policy of actively negotiating terms of repayment with clients struggling to service their debts, aiming to change NPLs back to performing loans.

[8]https://www.reuters.com/business/finance/eu-says-delay-core-element-basel-bank-capital-rules-2024-06-18/

[9]https://www.finance-watch.org/press/finance-watch-responds-to-european-parliaments-inaction-on-crucial-financial-stability-regulation/

[10]The relaxation on banking regulation was also <u>recently noted</u> by head of the Basel Committee Erik Thedéen, specifically in response to the US and EU postponement of Basel III implementation, fearing a fragmented regulatory system may "trigger a race to the bottom across jurisdictions, resulting in a frail regulatory framework that would threaten global financial stability and banks' own viability." Aside from financial regulation, broader sustainability policies such as the <u>CSRD</u> and <u>the Green Taxonomy are also under pressure</u>.

A second way in which securitisation transfers risks from bank to economy was showcased during the 2008 GFC: securitisation can create opaque, complex products that become untraceable to their originators, let alone to market supervisors. This lack of not onlv transparency jeopardises financial stability but also increases systemic risk, destabilising the productive economy itself, especially if combined with a regulatory rollback. This is another reason why taking the US market as a best practice is dangerous, as its elevated levels of household wealth are directly related to high levels of pensions and insurance securitisation, which creates more systemic risks that directly affects citizens.

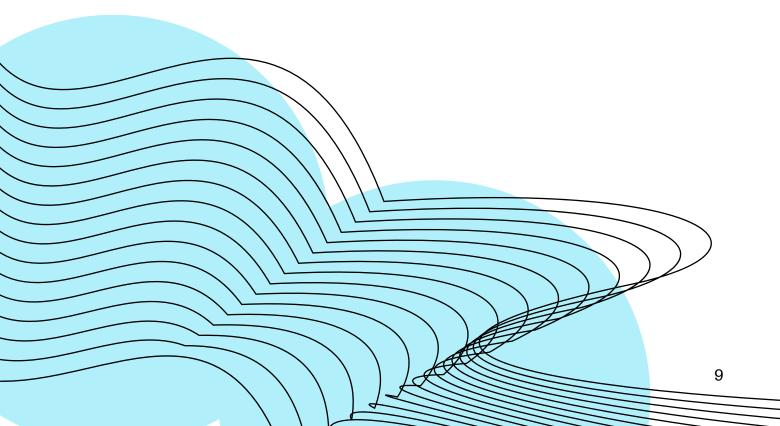
For these reasons, FEBEA strongly warns against watering down prudential regulation and discourages securitisation of banks' assets. There are safer avenues to increase credit allocation in the economy and the EU already has instruments in place to facilitate this. finance Leveraging through policy dedicated guarantees, for example through the InvestEU programme, has, again, proven effective in stimulating finance. **FEBEA** private strongly supports an expansion of the programme's Social Investment and Skills window and the addition of a decarbonisation window, to be in line with the EU's policy priorities and commitment towards the **Paris** Agreement.

Banking Union and supervision

Among Draghi's proposals are the completion of the Banking Union to facilitate cross-border investments and competition. and centralising and increasing the power of the European Securities and Markets Authority (ESMA). While these are effective measures to improve competitiveness and market regulation, they mostly aim at fostering growth of EU financial institutions and stock markets that can compete with their counterparts overseas. As has happened in the past decades, the EU might therefore overlook the interests of smaller banks with ethical agendas. who are at the frontline in facilitating inclusive access finance to and stimulating the real economy. These banks would benefit from proportional and diverse regulation, with stringent requirements than for their larger peers. For one, as many of them are social finance providers, they could benefit from a decrease in capital retention obligations for loans to the social economy. This would also help the EU in reaching its policy objectives in social areas, such as those mentioned in the 2021 Social Economy Action Plan (SEAP).[11]

Conclusion

Mario Draghi's vision for enhancing European competitiveness through innovation, decarbonisation, and security presents both opportunities and challenges. While his proposals emphasise a need for substantial investment and financial market scale, they would benefit from a more balanced approach that prioritises sustainability and inclusivity. This is not only important in achieving a healthy climate and ensuring all EU citizens enjoy the EU's prosperity, but it is also conditional for a stable economy. By adopting policies that view decarbonisation as a core goal, embracing equitable economic expansion, and maintaining robust financial regulation, the EU can foster a resilient economy aligned with social and environmental values. Future EU initiatives should therefore balance Draghi's growth-oriented objectives with broader priorities that address long-term stability, equality, and environmental commitments.





FEBEA - the European Federation of Ethical and Alternative Banks and Financiers - is a non-profit association based in Brussels. It gathers 34 financial institutions whose aim is to finance social and solidarity economy (SSE) and projects with social, environmental and cultural value in 17 European countries, serving more than 700,000 people.

Its objective is to support the exchange of experiences and promote cooperation between social economy and social finance practitioners.

Each FEBEA member is integrated in the SSE Sector in its country, focusing on mobilising savings and equity from responsible citizens and using these funds to finance sustainable development and local communities. FEBEA is member of GSEF, the European Commission's expert Group on Social Economy and Social Entrepreneurship and of Social Economy Europe, the main European network of social economy practitioners.

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- Sustainable development: renewable sources of energy, organic farming, biodiversity, etc.;
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