



# **THE TRADE OFF (?) BETWEEN FINANCIAL STABILITY AND (ECONOMIC) DYNAMISM: WHICH CAN BE THE STRATEGY TO PROMOTE TRANSFORMATION AND MINIMIZE FINANCIAL SHOCKS SO THAT GROWTH IS SUTAINABLE? (STABILITY GROWTH PACT, BANKING UNION, EMS, ECB, COMMON FISCAL CAPACITY)**

## ***The Problem Setting***

The economic and financial management of the European Union is frozen.

We have been living in years of permanent reforms, and yet the entire architecture of the EURO area is a working in progress.

The revision of the stability and growth pact is still to be finalized (and the pact is still suspended); the Banking Union still waits to be completed (with a “deposit insurance” and few more crucial details missing); the reform of the backstop facility to react to crises of national debts is in a limbo; the idea of providing the EU with a permanent common fiscal capacity to buy European Public Goods<sup>1</sup> is still far from being operationalized and the jury is still out on the evaluation of the NEXT GENERATION EU; a revision of the EU budget will certainly need a reform of cohesion policies, common agricultural policies, HORIZON and it is far from clear how should we make these instruments more effective; even the discussion on the mandate of the update of the European Central Bank is still almost exclusively within academic circles.

One of the fundamental questions for the EU is still: how can we both guarantee the financial stability (without which any medium/ long term plan is untenable) and the economic dynamism (which is fundamental to make Europe to compete within fast transforming markets)? Why are we being so slow in achieving a stable frame (which will need to be flexible enough to adjust to further changes)?

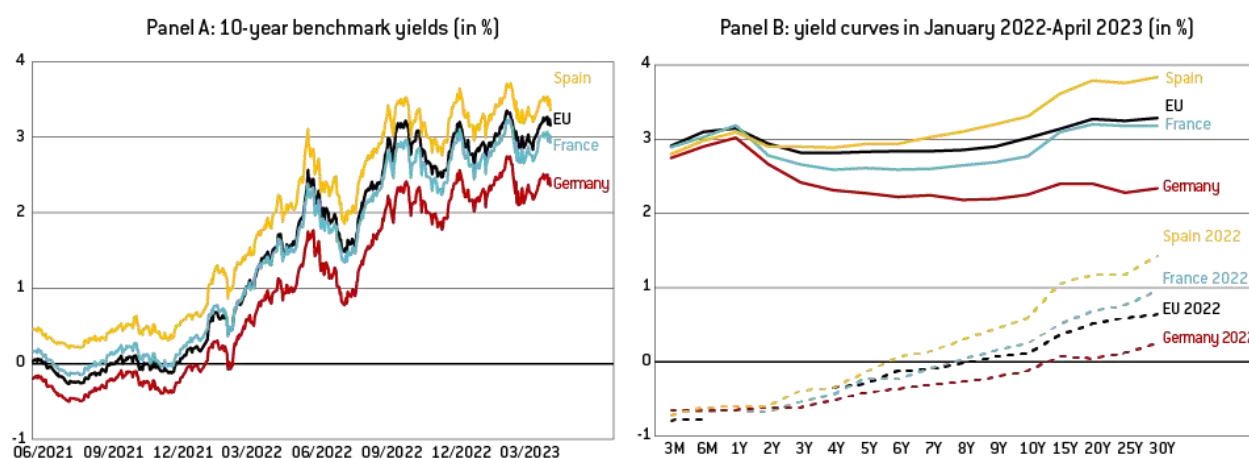
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<sup>1</sup> By “European Public Goods” are meant those required to address common challenges like the one implied by the ecological and digital transitions. Buti, M and M Messori (2022), “A Central Fiscal Capacity in the EU Policy Mix”, CEPR Discussion Paper. For a categorization of European public goods see also Allemand, F., Creel J., et al. (2023), “[Making Next Generation EU a permanent tool](#)”, Recovery Watch Policy Study, pag. 19.

The agenda setting for the next five years is, however, a great opportunity to move forward and the 2024 PONTIGNANO Conference can be a unique opportunity for a problem solving in a multi-partisan context.

In fact, one year after the last year edition of the Conference on the future of EUROPE (June 2022) we have both good and bad news for stability and dynamism. There is good news and bad news:

1. as far as the stability: the cost of borrowing has increased of about 100 BP for all main EU issuers and the EU itself continues to pay more than the strongest issuers (especially Germany) and yet the curve is flattening. More importantly the banking crisis of the first half of 2023 (with First Republic Bank, Silicon Valley Bank and Signature Bank, three of the largest five bankruptcies in US history<sup>2</sup>, and Credit Suisse – one of the thirty lenders that the Financial Stability Board considers "globally systemic" -- rescued by UBS) left the EU banking system broadly immune. And yet, the overall public EU debt continues to be very high (89,9%) and yet slightly less than one year ago (92,2%);



2. for economic growth: the forecast for the 2024 is slightly below 1% (with Germany still technically in recession) way below the average of 2,2% in the five years before the Covid19 Pandemic (and this even casts a shadow on the impact of the Next Generation EU that should have added approximately 1% per year to the baseline). On the positive side, inflation, however, has almost got to normality (2,4% for 2024);
3. as far as dynamism: the EU tech landscape gives surprising signs of vitality. Germany and France are at position number five and number six in the ranking of countries for unicorns; and amongst the top twenty we also have Netherlands, Ireland, Spain, and Sweden. Even in the ranking of the largest companies for capitalization, there are some improvements. Two years ago, there were only three

<sup>2</sup> Considering inflation adjusted assets under management. All five largest corporate collapses in US history are of financial institutions: four of them have been commercial banks (the above mentioned three plus Washington Mutual in 2008) and one was Lehman Brothers, an investment bank again in 2008.

EU companies amongst the top 100, now Novo Nordisk from Denmark, ASML from Netherland, LVMH from France are amongst the top 20. And yet, other parts of the EU are lagging behind: Italy largest company for capitalization sits at position 234 (Ferrari) and it has got less tech unicorns than Greece.

## **The Problem Setting**

There are some improvements and yet the medium-term scenario is risky.

1. some countries have learnt how to attract and nurture innovative companies, as well as how to select champions and make them grow; France and Germany are even developing consistent industrial policies and yet this is not happening at EU level (actually EU seems to specialize in regulation); this may be a sign that even some of the founding members are skeptical about the idea to draft solutions for EU's competitiveness at EU-level;
2. yet only the EU is an enough large market so to compete with China, USA/ UK, India; in the medium-term financial stability without enough growth is untenable; and economic growth cannot happen if we do not allow for the "creative destruction" that allocated scarce resources (and investments) to most productive uses (and entrepreneurs).

Against this background, we can then frame the questions to be tackled:

Are our regulations sufficiently extended and efficient to guarantee enough stability to banks (and how can the "European banking union" be completed)? What was the impact on the capability of banks to innovate their products (and serve the transformations that the EU's "real economy" needs to undertake)? How can the "stability and growth pact" be reformed so that sovereign debt is sustainable and moral hazard minimized? What should be the role of central banks in pursuing all the above policy objectives? How would a common fiscal capacity be operationalized? And more importantly why is the reform of the overall financial architecture of the EU is being changed so slowly and what should we change to achieve a consistent frame?

## **SOME REFERENCES:**

1) PONTIGNANO PAPER 2023

2) Three correctives to complete Europe's Hamiltonian moment .

<https://www.thinktank.vision/en/media-en/articles/nexEuro> news: Young, Portuguese, Green voters most in favor of stronger EU: exclusive poll

3) European Union countries' recovery and resilience plans, Dataset, Bruegel

4) The Revised Stability and Growth Pact: A first assessment, Marcello Messori, IEP – Bocconi, 14 Feb 2024