IMPROVING EU'S GLOBAL ECONOMIC COMPETITIVENESS

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Enhancing competitiveness in Europe: old and new challenges

Improving Europe's competitiveness has been a long-standing challenge. Since 2010, the euro area's economic growth underperformed its global competitors, particularly the US.[1] One third of this difference in growth can be explained by less favourable demographics in Europe, but two-thirds is due to weaker productivity of labour and capital. The productivity gap between Europe and the US has been widening because of differences in technological progress, market efficiency and institutional framework. Europe's underinvestment in innovation constraints technological progress, while market failures and excessive administrative burden keep the economy away from its full potential.

Prior to the pandemic, a favourable global environment masked Europe's relative underperformance, but this will not be longer the case. Dynamic external demand and low import costs helped the euro area to keep its positions in global trade markets. However, after the pandemic and the energy crisis, the global situation has changed dramatically: increasing geopolitical fragmentation and uncertainty expose Europe's dependence on external energy supplies and vulnerabilities to swings on global energy markets, which raise production costs and amplify the risk of resource misallocation. Additionally, the ageing of the population is another challenge. It can aggravate labour shortages, lead to higher wages, and divert financial resources from investment, further hindering competitiveness.

In the face of increased geopolitical uncertainty and mounting global challenges, Europe needs determined action to strengthen its resilience to external shocks and maintain its international standing. Remaining competitive in this context requires not only addressing long-lasting productivity challenges, but also building up resilience to external shocks. To achieve these goals, policy priorities should focus on:

- First, accelerate structural reforms to ensure that resources move to sectors with more sustainable and higher growth potential. Reforms prioritising flexible labour markets foster a dynamic workforce. Educational reforms must align curricula with evolving industry needs, digitalisation and the greening of our economies. Innovation policies, including incentives for research and development, are crucial in cultivating a culture driving technological advancement. Businesses should be encouraged to embrace digital technologies.

- Second, deeper economic and financial integration is imperative for a more robust and resilient Europe. Facilitating workers' movement across borders within Europe is crucial for labour market integration. This involves addressing barriers to labour mobility, recognising qualifications across countries, and fostering a more flexible labour market that allows skilled workers to contribute to the economies of different member states. Completing banking union and further progress towards a Capital Markets Union are also vital to avoid financial fragmentation, unlock funding and boost investment.

- Third, green investment and trade policies play a pivotal role in boosting productivity and limiting Europe's dependence on energy imports. Investments in renewable energy and energy efficiency strengthen Europe's technological infrastructure while reducing its exposure to external shocks to energy supply. By reducing trade barriers, harmonising regulations, and creating an investor-friendly environment, Europe can attract greener, more productive investments to foster innovation.

> **Addressing Europe's competitiveness challenges require not only enhancing its growth potential but also strengthening resilience to a more volatile global environment.**

- Finally, advancing in Europe's "open strategic autonomy" can also foster competitiveness to ensure a more resilient business environment. As a large open economy, Europe is more dependent on imports of energy and several strategic raw materials than the US and China, making it more vulnerable to geopolitically induced supply shocks. Progress towards an "open strategic autonomy" (reducing dependencies while remaining an open economy), can achieve more predictable input costs. This can help firms' long-term planning, foster investments, and facilitate more efficient resource allocation.

In conclusion, addressing Europe's competitiveness challenges is now more urgent than ever and requires a comprehensive approach. A comparison with the US underscores the importance of addressing technological factors and inefficiencies across various economic dimensions. Action is essential to rising geoeconomic challenges, higher energy costs, and demographic shifts. Structural reforms and deeper economic integration are vital in ensuring resilience and prosperity in the future.

1. *In the last fifteen years, potential growth in the euro area has been on average 1pps lower than in the US.*

ALFRED KAMMER

Director - European Department - International Monetary Fund (IMF)

Europe has fallen behind - but more integration promises higher growth

Europe's income levels are behind the global frontier. Per capita income levels in the European Union (EU) are on average around one-third lower than in the U.S after correcting for price and exchange rate changes that do not reflect changes in living standards. This is an eye-catching difference, and it is not just driven by less-rich European countries, such as Bulgaria and Greece which have per capita incomes of less than half of the U.S. With the exception of Luxembourg and Ireland, per capita incomes in all advanced EU economies are lower than in the U.S. This gap is driven by shortfalls in capital stocks, choices in working fewer hours and retiring earlier, and productivity.

Catching up to the frontier requires higher growth—and that just hasn't been happening. While over the period from 2010 through 2022, on a per capita basis the EU has grown at the same average annual pace of around 1.4 percent as the U.S., if one adjusts for Europe's shorter work hours the EU has grown by 1 percent on average—faster than the U.S.' 0.7 percent. Still, with this narrow edge it would take the EU 80 years to catch up with U.S. income levels. Also, Europe is aging faster than the U.S., and the resulting fiscal costs are increasing with the size of the older population—here growth per capita matters more than growth per hour worked.

Convergence as an engine of growth has also been stuttering within Europe. Larger income differences within the EU than in the US, should make the EU grow faster given the growth opportunities lower-income countries offer. The poorest U.S. state has a per capita income level of around 80 percent of the U.S. average. In the EU alone, there are no fewer than eight countries with income levels below 80 percent of the EU average. Yet, growth in the EU's lower-income countries has been insufficient to make progress on income convergence. For example, the growth slowdown between the early and late 2010s in Central and Eastern European economies implies that its convergence to average euro area living standards would be achieved half a century later, beyond the year 2100.

Looking ahead, Europe risks falling further behind due to scars from the crises and looming structural changes. In many countries, hours worked per worker are on a declining trend, private investment is weaker than pre-crises, and the fiscal space for growth-enhancing public investment has shrunk. In addition, geoeconomic fragmentation, and how the EU responds to it, can have a large bearing on productivity via supply chains, energy security, and access to technology.

The good news is that Europe has the tools to respond to these challenges—and the single market is the place to start. Working together, EU countries could substantially lift per capita incomes by addressing remaining internal barriers. As a rough guide of the still-untapped potential from the single market, we have estimated that a reform package that combined were to reduce within-EU barriers by 10 percent could permanently lift real incomes by more than 7 percent. Such reforms include completing the banking and capital markets unions, for example, through greater harmonization of national rules on taxes and subsidies, improving insolvency regimes, and reducing administrative burdens. Efforts at the EU-level should be complemented with domestic policies to address old and new challenges, including governance and business environment. Such reforms would spur investment rates, improve business dynamism, and incentivize labor force participation. For instance, our research shows that closing the gap between involuntary and desired working hours alone would increase EU labor supply by about 1.3 percent.

Deepening the single market is also the right response to geoeconomic fragmentation. There are often legitimate economic security concerns around the overreliance of supply from other countries or economic specialization. Here Europe has an advantage. In contrast to China and the U.S., China specialized in manufacturing and the U.S. in innovation, Europe spans both manufacturing and innovation centers. This makes Europe's single market a formidable answer to these concerns allowing factors of production, goods and services to flow freely across borders. European countries should avoid responding to fragmentation with blanket industry support unless they address well-targeted market failures.

Europe has the tools to respond to growth challenges - and the single market is the place to start.

As an illustration, we have estimated that the continent's per capita incomes would shrink permanently by around half a percentage point in a scenario where the EU mimics a U.S. subsidy for inward multinational production that reduces relocation costs by 20 percent. This is because the less efficient allocation of resources leads to losses in some European countries and sectors that more than offset the benefits to subsidized firms.

Strengthening the single market—the EU's unique growth engine—policymakers can foster resilience to global shocks and deliver faster convergence and higher living standards.

TIBOR TÓTH
State Secretary - Ministry of Finance, Hungary

Europe at crossroads: how to strengthen the foundations of the European economy

As Europe faces a decline in her global economic standing and encounters increasing challenges, the EU needs to strengthen its economic foundations and its productivity; from regional disparities and geopolitical vulnerability to strategic investments in technology, energy and human capital for sustainable competitiveness and strategic autonomy.

Following the US, the EU is the second largest economy in the world, but such an economy should also secure its own autonomy in many aspects. Wealth without the ability to safeguard the economy and society is a dangerous combination.

EU's global economic importance and its competitiveness have been gradually decreasing since 2000's. There is a significant gap with the US in terms of GDP per capita, and emerging Asian countries are also increasingly challenging the EU in regard of competitiveness. Recent years have particularly highlighted the importance of the urgency to strengthen EU's productivity to maintain our competitive edge and achievements in sustainability, social inclusion, and high living standards.

While making considerable efforts towards convergence, the EU remains highly fragmented. The war in Ukraine and the energy crisis caused by the imposed sanctions against Russia affected EU countries very negatively, while other global regions, like North America, did not have to face energy price explosion, leaving the European industry at a significant competitive disadvantage.

NGEU is a good, but a very bureaucratic instrument in many areas for potentially supporting economic recovery. However, it puts some member countries at a significant competitive disadvantage when the resources are withhold, they are entitled to, by this undermining common competitiveness ambitions. Approaching rigid deadlines also suggest serious problems in delivering ambitious goals.

Regarding SGP, EU budgetary rules may prove to be too strict in the current geopolitical situation, which hinder economic recovery, worsening EU's competitiveness by potentially forcing a cut-back of public and climate friendly investments.

Rising cost of capital highlights Europe's lower returns and investment gaps. Europe has consistently lagged behind the United States in net investment. Europe needs more risk-seeking capital to bolster sustainability and competitiveness.

EU must invest in tech, energy, human capital for sustainable competitiveness amid global decline.

Competitiveness needs strategic autonomous economic foundations, such as accessible and affordable energy, critical raw materials, human capital and state-of-the-arts technology. Europe has to diversify and develop its own energy sources to secure sufficient supply at much lower cost. We need to heal the wounds in a way that is consistent with climate objectives but tailored to Member States. For instance, where geographical conditions limit the efficiency of certain renewables, additional carbon neutral capacity is needed, like nuclear plants. Once nuclear is not supported appropriately in policy terms, private investments, research and technology development will not take place to further improve the nuclear energy's operational safety, efficiency and the recycling of nuclear waste.

With the rise of electromobility, Europe's dependency is increasing on critical raw materials. The establishment of EU owned battery factories and chip producing facilities should be encouraged, as much as research in new technologies, sustainable energy storage systems based on abundant and non-critical raw materials, such as Na-ion batteries.

R&D expenditures play a key role in overcoming current challenges, especially in improving productivity. There is a significant, widening gap in R&D&I expenditures between the US and EU. It would be essential to at least double Europe's corporate R&D budget to lay the foundations for future growth.

The competitive edge now increasingly originates from the application of frontier technologies, but Europe is lagging behind in areas such as microchips, AI or quantum computing. The US invests much more capital and private equity into AI than Europe, which will further deepen competitiveness gaps, unless the human capital and the financial capacity are able to turn things around. Asia is also very active and dynamic in this area.

Although Europe has skilled human capital, there are already serious shortages in many of the professions that should ensure future growth. The decline in educational standards, coupled with an aging population and diminishing educational achievements, may place Europe at a considerable competitive disadvantage. Addressing this challenge requires a strategic focus on acquiring new skills that are currently lacking in the European landscape and preventing the absorption of such skills by the US. Moreover, the urgency of the demographic turnaround is critical for the labour market. To this end, more support is needed for families, which contributes to increasing the number of births and the fertility rate all over Europe.

DECLAN COSTELLO
Deputy Director General, DG for Economic and Financial Affairs - European Commission

Sustainable competitiveness in the EU: challenges and opportunities

In recent years, the EU successfully responded to the COVID-19 pandemic and tackled the fallout from Russia's aggression against Ukraine, including an unprecedented surge in energy prices. The strong and coordinated response was a sign of remarkable resilience and solidarity across the EU. Now is the time to look beyond the short-term crisis management and confront long-standing challenges of competitiveness, to build and secure prosperity for EU citizens over the long run.

While the EU's overall performance as measured by trade indicators and price and cost competitiveness has been relatively stable over the past years, indicators on productivity and innovation point to weaknesses. Compared to the US, the EU's starting position is less favourable. The slowdown in labour productivity since the 2000s has been more pronounced in the EU, with substantial heterogeneity across Member States. Sluggish investment dynamics, lower R&D spending, and a lack of diffusion of new technologies are driving these differences. There are also challenges related to access to finance, including venture capital, the regulatory framework, public administration, and investments in infrastructure and education and skills.

Against the background of these long-standing challenges, a number of new challenges have emerged, notably the need to accelerate the green and digital transitions and to adapt to a more uncertain geopolitical environment. As energy prices in the EU are likely to remain structurally higher than in the recent past, there is a risk of competitiveness losses and slower productivity growth as firms must shift to less energy intensive production processes.

Considering these challenges, Europe cannot afford to stand still. Fostering the EU's sustainable competitiveness will require continued policy action, and policymakers will face several key trade-offs going forward.

First, the EU will need to find the right balance between managing an effective industrial policy and preserving market incentives. While temporary changes to the framework for state aid allowed for a targeted response during the crisis, one must be mindful that a massive surge in subsidies would risk fragmentation of the single market, given very different starting positions and fiscal space across Member States. Moving away from providing firm-specific support to supporting structural reforms and improvements to framework conditions would help foster investment and productivity while preserving competition.

The EU faces key trade-offs when deciding on the right policies to preserve its competitiveness.

Secondly, addressing the challenges requires an upfront increase in public and private investment. At the same time, one needs to recognise that fiscal sustainability risks have risen due to the impact of the pandemic and the surge in energy prices. Whilst the recent high inflation has lowered debt-to GDP-ratios, fiscal challenges will become more apparent, as pressure on public sector spending appears with a lag, the impact of ageing populations takes hold, security and defence needs are mounting and the period of ultra-low interest rates has ended. Policymakers therefore need to effectively prioritise public investment projects in the context of medium-term fiscal adjustment efforts. A reform of the EU fiscal rules with the right incentives to protect investment will be key be put public finances on a credible path towards sustainable budgetary positions. In addition, support from the NextGenerationEU instrument will help keep up public investment levels without overburdening national budgets. Moreover, the private sector will have to play its role in closing the investment gap to foster the green and digital transition, which requires further progress in developing the Capital Markets Union.

Thirdly, recent disruptive geopolitical events have highlighted the risks to supply chains and a lack of diversification. Going forward, the EU will need to find the right balance between reaping the benefits from trade and de-risking supply in strategically important sectors. With the objective of open strategic autonomy, the EU is committed to open trade while also asserting itself against unfair practices. In addition, further unleashing the potential of the single market and leveraging the size of the European economy can help mitigate vulnerabilities of international supply chains.

Finally, the EU is determined to foster the digital transition and allow European firms to benefit from efficiency gains through digitalisation. However, many key players are located outside Europe, which raises questions of strategic dependence. In addition, digital leaders benefit from significant increasing market power, which could hamper innovation and knowledge diffusion. The widespread use of artificial intelligence could amplify these challenges.

Hence, the EU needs to enable companies and citizens to fully embrace the digital transition and to compete at a global level, while setting the right framework to preserve competition and address important risks related the use of AI.

MARIO NAVA
Director General, DG for Structural Reform Support - European Commission

The ComPAct: enhancing quality public administration to ensure competitiveness

The competitiveness of Member States is significantly influenced by the quality of their public administrations. Disparities in institutional quality contribute to variations in income per capita, while countries with robust institutions can specialize in high-value sectors, relying on innovation to generate more fiscal revenues and effectively implement reforms and investment projects. Such countries are better equipped to provide social safety nets and implement tailored strategies for regional development, playing a key role also in carrying out the Capital Markets Union action plan.

Improving the implementation of EU policies and enhancing administrative performance holds the potential to generate substantial annual savings. Member States could save billions annually by optimizing their administrative performance. For example, business establishment procedures could be simplified and made more efficient in many countries.

Identifying underperforming areas can inform the design of structural reforms, leading to cost savings and improved services for citizens and businesses. The complexities of starting a company within the EU vary but on average, the labour costs for new companies to fulfil formal requirements amount to about EUR 3,000. Furthermore, businesses can potentially save billions annually by reducing the time required for tax preparation, filing, and payment.

DG REFORM offers support to Member States in improving regulation, reducing administrative burdens, and simplifying the business environment. Through the Technical Support Instrument (TSI) DG REFORM has facilitated initiatives such as ensuring data-driven decision-making approach in PAs, establishing institutions for early consultations on regulatory issues, enhancing public sector capacity for assessing impacts on businesses – with particular attention to SMEs - reducing tax compliance costs, improving justice systems, and promoting digitalization. In 2024, the specific actions will include development of data analytics to optimise workloads, efficiency and competitiveness.

Actions that from now on can rely on a strong commitment: in late 2023, the European Commission presented its Communication on public administration, entitled "Enhancing the European Administrative Space (ComPAct) with a set of actions aiming to support administrative modernisation in the Member States and ensure their efficiency and competitiveness.

> **Member States could save billions annually by optimizing their administrative performance.**

The ComPAct responds to the imperative of enhancing administrative performance and ensuring public administrations that are collaborative, effective, strategically oriented and providing high-quality public services. The Communication outlines 25 actions to modernize PAs, focusing on three core areas: improving the skills of civil servants, digitizing PA, and transitioning to a more environmentally sustainable model.

Among the actions there is the new Public Administration Cooperation and Exchange (PACE) flagship, aimed at encouraging peer learning and the exchange of best practices among civil servants across the EU. In 2024, there will be 31 exchanges for 12 Member States.

The European Year of Skills in 2023 has heightened awareness on the need for a paradigm-shift in the job market and ComPAct is actively addressing this matter for the public administration through a targeted set of initiatives, falling into the so-called "Agenda for Public Administration Skills". The agenda comprises actions such as

(a) the establishment of a passport of core competences,

(b) the creation of a European network of centers of excellence for training,

(c) a new joint leadership training program for senior management, called the "EU Public Administration Leadership Program."

Another pillar of ComPAct focuses on ensuring the administrative capabilities to attain the Digital Decade goals, aiming for 100% online accessibility of key public services. This entails updating regulations, embracing AI, and enhancing cross-border interoperability. The third ComPAct pillar centres on the green transition, in line with the EU's climate neutrality goal by 2050, recognizing PAs' role in environmental efficiency, efforts involve implementing eco-friendly measures and limiting ecological footprints.

This marks the starting point to shape the future of PA in response to technological progress, demographic shifts, and the demands of green transformation.

FERNANDO VICARIO

Chief Executive Officer and Country Head for Ireland - Bank of America Europe DAC

Improving the EU's global economic competitiveness may require bold choices

The economic growth model of the European Union (EU) is centred on fair competition, economic security, strong regulatory requirements, while promoting a sustainable and digital transition of economies. This has provided prosperity in the past and remains the approach for the future, as it was evidenced by the adoption of the Next Generation EU package back in 2020. In an unprecedented effort, the EU Member States decided to invest €806.9 billion with the intention to transform the EU economy and make it more resilient, green and digital.

However, since the 2010s, Europe's consumption and investment levels have struggled to keep pace with those on the other side of the Atlantic. The EU's policy choices play a part in improving aggregate consumer demand. Over the past decade, European fiscal policy, in response to large shocks, has been markedly different from that seen in the United States. The same applies to the level of resources mobilised to address long term challenges in the region. If we add to that a more growth and productivity friendly business environment, a different demographic profile, and as of late, the different energy mix and dependence from abroad, we can explain the underperformance relative to the US in recent years.

Thinking ahead, various evolutions to the European structure present an opportunity to nurture Europe's economic performance and further increase its global footprint. Enabling at the EU level a common fiscal capacity for common public goods, such as defence, energy transition and independence, and health would strengthen the European voice, both within the region and globally. This is no easy matter from a political perspective, and would have to be supported by strong governance principles.

The recent reforms to the Stability and Growth Pact (SGP) support this view. It is not yet clear whether the agreement reached in late 2023 will allow fiscal policy to act through the cycle, while leaving enough room at the country level to invest in the key priorities for the near future. A common fiscal policy in coordination with strict fiscal rules offers a potential solution. It would allow for investments to take place, with governments still able to deliver a credible medium term consolidation path. Perhaps the question we should ask is not whether the new SGP is strict enough, but rather, how the SGP can be leveraged to foster the convergence of objectives at both the EU and country level.

The greatest challenge arguably remains the creation of a European safe asset.

Long standing commitments to complete the Capital Markets Union (CMU) and the Banking Union should also be a priority. The European Commission's plans for the CMU would ideally be complemented by a genuine harmonisation of national legal, insolvency and tax frameworks. The potential consolidation of stock exchanges under a single regulator, as recently called for by European Central Bank President, Christine Lagarde, would contribute to a more unified European capital market, too. Finally, improving the regulatory framework to develop and deepen a European securitisation market would deliver benefits and support a broader disintermediation trend.

Nevertheless, the greatest challenge arguably remains the creation of a European safe asset, which could serve as the ultimate risk free benchmark in the single market. A European safe asset may also address the sovereign bank nexus, and in turn, help provide the political basis to complete the Banking Union.

A completed Banking Union would bring scale and efficiency benefits which are now lacking. Currently, national competent authorities require significant banks in their countries, to maintain the structure of independent banks – boards, capital, risk management. Hence, Euro area banks that made cross-border moves have not been able to unlock their full potential to scale.

Why does this matter? Wholesale and investment banking are scale businesses. While banks with large retail and commercial banking operations can balance the risks needed to deliver good returns in wholesale and investment banking with other earnings, banks with structurally smaller retail and commercial banking franchises cannot.

Finally, changes to the EU state aid regime should be considered to respond to subsidies put in place in other regions and to finance the bloc's climate transition. The EU should consider an approach that supports all EU national economies, not just the largest, and ensure the cohesion of the single market.

While Europe's "to do list" is by no means easy, we must continue to push ahead, both in the public and private sector, to further improve and secure Europe's competitiveness, especially in the current volatile geopolitical environment.

JOSÉ ANTONIO ÁLVAREZ

Vice Chair of the Board of Directors - Santander

EU Comp: actions speak louder than words do

A new year begins, but the feeling is the beginning of a new geopolitical era – the world continues to evolve at dazzling speed. In this regard, Europe faces an urgent challenge to change its trajectory: we need to fix the state of the EU's competitiveness. I am delighted EU leaders recognize the importance of the task at hand and that this cannot be business as usual.

If we look at where we are now, plenty of examples appear. Take the list of the global top 20 companies by market cap, we hardly find any European champions. In terms of market size, the US equity markets are the largest in the world and continue to be among the deepest, most liquid and most efficient, representing 42.9% of the $106tn global equity market cap in 2023. This is 4.1x the next largest market, China, followed by Europe.

So, how do we push the power button?

First, looking at the distribution of power between European institutions and Member States. We need to be more ambitious about the EU's political and economic integration if we really want to advance towards a Single Market. Member States should cede competences to the EU institutions in areas such as defense, migration, energy or mobility infrastructure. All that is needed to ensure the free movement of goods and persons. We have reached a point where not advancing in integration is leaving the EU behind other more integrated areas that can take full advantage of their economies of scale. If we renounce to scale EU solutions, we are renouncing to be on the race.

Second, changing our fiscal policy. As long as we do not have some kind of fiscal union, we will continue having a fragmented euro in our pockets with asymmetric fiscal policies. The response to the European shared challenges ahead (climate, digitization or security) will be suboptimal in the absence of some common fiscal policy, in a period where great strategic view and investment are needed.

Europe faces an urgent challenge, we need to fix the state of the EU's competitiveness.

Third, changes needed in the regulatory framework towards the completion of the Single Market:

- To complete the Capital Markets Union. Starting by boosting the EU securitization market and explore ways to enable banks to free up capital and liquidity for the express purpose of providing additional funding to EU businesses. This should include an immediate review of the EU securitization framework.
- Need to finalise the Banking Union by establishing a common risk sharing mechanism: the European Deposit Insurance Scheme (EDIS). Without it, there is not a level playing field for cross-border offering of retail financial services. If we want to build a real Single Market, depositors should feel that they are equally protected in all countries across Europe.
- We need to work on harmonizing the regulatory framework. Although the single rulebook is a fundamental piece, the most common regulatory tool still are Directives and still national rules play a key role – there are many examples: insolvency frameworks, consumer protection rules, etc. The existence of different regulatory frameworks is the main barrier to European consolidation, due to the number of resources needed to understand and implement the different national regulatory frameworks.
- This takes us to the lack of potential synergies that could be achieved in a merger. If regulatory frameworks are different, merged banks would still need different teams to deal with the different national frameworks, different products, different procedures to attend customers, different IT systems which are designed to give response to the specific regulatory framework in each country. Mortgages are different, payment commissions are different. There are limited cost synergies and economies of scale.
- We need to improve the resolution framework. It is key to facilitate an acquisition regime for failed entities. Making the acquirer responsible for the conduct of management of the acquired entity before resolution is normally unjustified. This cannot be easily prevented through due diligence, bearing in mind the rapid reaction needed in this process. So, the responsibility regime should be reviewed. Lessons can also be taken from the US. Banks do not acquire the legal entity, but specific assets and liabilities.
- Finally, competitiveness is not only about the Single Market, but about supporting EU business operating in third countries. International companies are crucial to the competitiveness of the European industry and the EU's strategic autonomy. A top priority for the next Commission should be to ensure that the EU regulatory framework does not penalize highly diversified businesses operating in third countries and that duly recognizes banks that operate in those countries.

The current Regulatory framework is excessively biased towards the protection of financial stability. If we want to realize Europe's potential, and increase European growth, we will need to rebalance our attitudes to risk as well as to recalibrate the size and complexity of our regulatory framework to favor growth. This, I think, would be a major shift.

ANNA DUNN
Chief Financial Officer,
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EU Competitiveness in banking

Looking at the global economy versus Europe over the past decade, I'd characterize global growth as driven by technological change involving a large scale shift in labour market deployment. To reference the European economist Schumpeter, capitalism is a process of creative destruction. European markets over the past decade have inclined more to preservation than destruction.

The challenge for Europe: how does it want to compete in the financial sector? Given their focus on deriving value, activist investors provide a blueprint for what this involves including increasing efficiency with reduced employment, competing for global talent with competitive pay packages, investing in the best technology to automate manual efforts, and creating scale that allows for standardization away from local specificities. The European approach to regulation treats the financial sector as more a part of the broader social policy agenda, such as looking at double materiality assessments under CSRD or bonus caps. Is the ideal European bank a social utility providing community service and financing for political objectives? Or is it a streamlined interface providing access to competitive international financial market pricing for consumers and companies, with personalized financial advice earning market competitive rates? They are two very different banking models with very different investor returns. One accelerates public policy whilst the other accelerates the economy.

Regardless of the financial sector model that Europe chooses to pursue, I'd flag two consequences of the current regulatory approach which may merit revisiting.

First, the ECB actively discourages – to the point of prohibition – dual hatting of executives in international firms' subsidiaries in Europe. The objective of this policy is to ensure that European subsidiary management has local focus. The result of this policy is an ongoing European brain drain within international firms. Top European talent that are ambitious for global roles move to international financial centres such as London or New York that welcome having global executives based in their jurisdictions. The EU is an international outlier in not wanting global executives involved in running its entities, and it undermines its competitiveness by suggesting that European bankers in international firms cannot gain valuable international experience if they remain based in the EU. Having global executives involved in the running of European subsidiaries would attract the expertise and investment that follows senior talent.

> **The EU is an international outlier in not wanting global executives involved in running its entities.**

The second point is that reducing investors' returns in unexpected ways not linked with risk reduces the European financial sector investor universe and demand, which then weighs on European bank stock prices. Examples of this include the restricting of dividends during Covid, and more recently the ad hoc taxes assessed due to banks' earnings on net interest income as the European rate environment normalized. If profits from deposit beta as a core element of banking are viewed as windfall gains, European banks will struggle to have a price to earnings ratio comparable with jurisdictions in which banks return profits to investors via dividends.

A political risk premia is assessed by the market over time when political decisions disrupt the flow of profits to investors. Although some policymakers may view this as acceptable collateral damage, I would note that depressed share prices in the financial sector can restrict capital market access and ultimately harm financial market stability.

These two items do not speak to the parliamentary agenda, and indeed in many areas I would suggest that less rather than more regulation may aid competitiveness. In situation where permitting and contracting in the EU takes significantly longer than in the US, the return on investment projections over the lifespan of the project completely changes. Looking at the European financial sector in particular, I would encourage legislative focus on the securitization market. One reason why the US banking sector has been such a powerful engine for the US economy is that it is able to recycle risk and financial resources, rather than relying on warehousing traditional credit products on balance sheet.

Financial market participation increases with securitization, banks are able to use their financial resources more efficiently with securitization, and there is greater availability of credit into the real economy.

In closing I would say that despite the challenges there are many reasons to be optimistic about the European economy going forward. The renewed European focus on enhancing competitiveness should further improve economic outcomes, whilst European banks are already forecast by financial analysts to outperform American banks in 2024.

I'd encourage Europe to take this opportunity to further develop securitization markets, and carefully weigh their regulatory and political interventions in the financial sector.

PIERRE PALMIERI

Deputy Chief Executive Officer - Société Générale

Sustainability is at the heart of long-term competitiveness

The recent energy crisis in Europe underscores the pivotal role of the ecological transition linked to economic and energy security frameworks, directly influencing the competitiveness of European companies. Being competitive involves positioning firms strategically in an ecosystem increasingly focused on long-term sustainability and where climate, environmental and social risks become more tangible. Companies that build up credible and realistic sustainability pathways into their business models are not only contributing to a greener future but are also gaining a competitive edge.

We are entering a new industrial revolution – a major economic upheaval to transition away from an economy traditionally leading to heavy GHG emissions. Further enabled by digital innovation, this is now subject to rapid change. Transformations in all sectors are already under way and innovative companies, developing breakthrough technologies or new business models, are looking for new financial services. This transformation is on a global scale, and the EU's share alone is estimated to require EUR 620 bn per year (estimation of the European Commission to meet the objectives of the Green Deal and RePowerEU). Achieving the sustainability transition will inevitably depend on securing sufficient and swift funding through the combination of public and private financing, the latter essentially provided by banks in the EU.

Today, the EU is probably the region where the financial industry's commitment to ecological responsibility most directly supports regulators' vision of a resilient and future-proof economy.

In recent years, the EU's leadership has been amply demonstrated – from its first climate stress testing to its comprehensive consideration of ESG risks as part of banks' prudential package. EU companies, Societe Generale among them, increasingly deploy vast resources to support the low-carbon reindustrialization. But we need the support of legislators and regulators to go beyond, because EU companies face increasingly intense international competition, progressing thanks to State-sponsored incentives on green investment and growth.

How can legislation support these investment flows?

First, the EU Net-Zero Industry and the Critical Raw Materials acts should be applauded. It is essential that the EU strengthens its manufacturing capacity in net-zero technologies and guarantees access to basic industrial resources.

Competitiveness is now about our adaptability to embrace a new industrial revolution.

But we need to move one step further: the immaturity of some disruptive technologies, the uncertainty around the commercial viability of new business models and a regulatory framework that is still in flux do not encourage the transition of industrial players. In fact, it is only once the projects have been identified and deemed financially viable (i.e., with an acceptable risk-reward) that private financing resources can be fully mobilized. Regulation should bring visibility and be ready-to-implement to allow for prompt decision making in order to stay at the forefront of innovation and remain competitive.

Another avenue is to bring more and clearer fiscal or tax incentives for our clients, and risk-sharing mechanisms between public and private funds. Although the US and EU sustainable funds are of similar aggregate size, fragmentation between funds and administrative bottlenecks hamper EU companies compared to their US peers.

Furthermore, to enable EU financial actors and companies to further extend their reach internationally, EU authorities should ensure that norms and standards are interoperable, do not overlap and remain comparable. With national and international initiatives growing fast, the question of how the EU's legislation will interact with measures introduced outside its borders is more relevant than ever. For example, ESG indicators influence a firm's ability to secure capital and maintain its level of financing. Hence, an excessively restrictive approach may impact the attractiveness of EU companies and in turn their ability to finance their transition. Similarly, in a context where reliable and comparable ESG data is still lacking, ESG rating agencies and ESG data providers should also be subject to a best-in-class global regulatory framework.

Finally, EU authorities should ensure that EU regulation allows banks to support hard-to-abate sectors in their transformation towards decarbonization. Contingent upon these companies demonstrating genuine commitment, it is with these companies that the impacts will be the highest. It is for them that the acceleration of private and public investment is also most urgently needed, both in capital and in the know-how to manage this transition.