



Q&A

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How to make capital markets work for people and firms

From a macro-economic and financial-stability perspective, does the Savings and Investments Union (SIU) remain a key priority?

I am convinced that the Savings and Investments Union is the way forward to make progress in channelling European savings into productive investment, to boost growth and competitiveness. European households sit on abundant savings, around 40 trillion euros. However, they are allocated very conservatively, with too much being in bank deposits. The European Commission estimates that around 10 trillion euros of these could be shifted into capital markets, making room for productivity-enhancing investments. Removing barriers to cross-border investment will allow capital to flow to opportunities with the highest potential for productivity growth, improving resource allocation and supporting innovative companies. And we know that innovation is a key driver of sustained economic growth. Easier access to capital enables firms - especially start-ups and innovators - to grow, invest in new technologies, and create jobs. Higher growth will, in turn, improve the sustainability of sovereign debt.

Market integration doesn't just boost growth, it can also strengthen financial stability. Well-integrated capital markets enhance private risk-sharing, allowing investment and credit to flow more freely across countries. This helps to absorb economic shocks, distribute losses and profits, and smooth out economic cycles, making the system more resilient. As such, greater market integration supports financial stability without overburdening public finances.

Will the SIU be sufficient to close Europe's innovation gap?

Evidently, Europe has to ramp up its innovation efforts. When compared to the U.S., Europe invests significantly less

in Research and Development (R&D). Consistent with this pattern, we also have a lower rate of innovation, as evidenced by the number of annual patents granted per capita. These factors are key drivers of our lag in productivity growth relative to the U.S. There is reason to believe that Europe's bank-centric model of financial intermediation is partly accountable for this. Banks prefer lending against collateral and are less suited to provide financing for R&D investments. The rationale for the SIU measures is to unleash a higher supply of equity capital from retail investors and pension funds, as well as market integration measures to pool capital more effectively across borders, hoping that this will help to bridge the investment gap. However, the question is sometimes raised whether this will be sufficient. Put differently, is the problem only due to insufficient supply of capital, or do we lack innovation capacity on a more fundamental level?

European experience shows that lack of financing indeed constrains innovation. In an ESM Discussion Paper, we look at successful examples of well-functioning capital markets in the Netherlands and the Nordic countries, as a benchmark for other member states to aspire to.[1] There is evidence that these countries also invest more in R&D and have higher rates of innovation. Because of this, their productivity is also higher than the EU average and compares favourably to the U.S. These examples suggest that Europe has the capacity to innovate, when there is a financial ecosystem in place to support R&D investments. If we succeed in implementing the SIU measures, I believe that Europe can reap a growth dividend driven by productivity-enhancing innovation and R&D investments.

At the same time, we need to stimulate more demand for risk capital to finance innovation. The SIU is no panacea. In parallel with pursuing the SIU agenda, we should strengthen the capacity to innovate. We urgently need to renew efforts to complete the single market, so that European firms can provide their products and services at scale across borders and strive to simplify regulation to lower the burden on them. In addition, structural reforms to reduce labour market rigidities are needed to ensure that firms have access to the right employee skill set. Here, the reformed Stability and

Growth Pact can act as a powerful ally, unlocking higher public investment, while incentivising member states to pursue structural reforms that translate into Europe-wide growth. And those reforms deliver results. If we take the example of the five countries that came through ESM and EFSF programmes, they are now among the euro area's fastest-growing economies. These success stories show the power of reform momentum, and that momentum must endure beyond programme support.

Should the EU aim to converge towards a US-style financing model or rather develop its own model reflecting the diversity of European economies and financial systems?

Europe has to develop its financing structures in a global context, in a way that is suited to its own economic and social priorities. As I already mentioned, we have examples of European countries with well-functioning capital markets. The Netherlands and Nordic countries have among the highest levels of stock market capitalisation to GDP in Europe and compare favourably to the U.S. But unlike the U.S, they also have low levels of income inequality and low wealth inequality. In fact, welfare policies have facilitated broader retail participation in capital markets, which in turn has played a key role in lowering their wealth inequality.

The same group of countries also provide an example of how banks can support the development of capital markets. For instance, Nordic banks were early movers when it comes to digitalisation and in providing user-friendly investment apps for retail customers. This is another factor that has facilitated broader participation in capital markets, by improving accessibility and lowering transaction costs. Apart from the benefits to society, banks stand to profit themselves from broadening their business model to provide retail investment services, as the revenue base becomes more diversified.

As such, I believe that we have outstanding European examples that provide an alternative to the US-style financing model. They show us a vision of how well-functioning capital markets can be combined with policies that protect

vulnerable citizens, with lower income and wealth inequality, in a way that builds on the strong role of banks.

Going forward, I believe that the strength of the European banking sector can be leveraged further to support the objectives of the SIU. For instance, a pan-European securitisation platform for SME loans could broaden the investor base for lending to firms. This would improve risk diversification, enhance banks' lending capacity and the supply of credit to firms, while relying on their underwriting competence.

Is the importance of digital innovation sufficiently emphasised in the SIU?

Digital and financial innovation has already played a key role in facilitating broader retail participation in capital markets. These innovations facilitate market entry by reducing transaction fees, enabling smaller ticket sizes and making investments accessible through a few clicks on one's smartphone.

Looking to the future, tokenisation of assets could further lower transaction costs for both domestic and cross-border investments. Crucially, DLT settlement would eliminate the reliance on national CSDs for cross-border settlement, increasing transaction speeds and lowering costs. Here, the ECB has been at the forefront of pioneering solutions that allow for settlement of tokenised transactions in central bank money, currently being explored in the Pontes and Appia projects, while the retail digital euro will strengthen Europe's strategic autonomy in the payments area. The European Commission has also been proactive in supporting digitalisation, with the Markets in Crypto Assets Regulation and DLT pilot regime.

I believe there is considerable attention devoted to initiatives that support the digitalisation of European capital markets. However, it is important that we regularly take a step back and reassess whether we have the right balance of priorities in the area, also because of the rapid pace of technological progress in the field.