

Improving economic policy



**The interaction between finance and the real economy:
how can Capital Markets Union contribute to productivity growth?**

November 27th 2024

How to bridge the productivity gap?

European League for Economic Cooperation, Group of Wise Persons (ELEC-GWP)

Comment to the presentation of Jordi Gaul

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Jordi's contribution

Jordi has delivered a very interesting perspective on the relationship between CMU and increased productivity.

I find it useful to set his contribution in a simplified setting

CMU is a very complex project

Body

For example, 16 legislative and non-legislative measures were proposed by the EU Commission in the September 2020 Action Plan.

Last year we addressed this complexity by choosing 5 actions:

- Insolvency harmonisation,
- Securitisation,
- Stimulate retail investment,
- ESMA reform,
- Eurobill fund

A simplified interpretation of CMU



Body

- I think it is useful to simplify this complex project down to its two essential macro characteristics:
 - Reducing the intermediation margin and
 - Improving resource allocation,
- In other words, reducing the cost and improving the allocating efficiency of the financial system

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A magical result



- Reducing the intermediation margin achieves the “magical” result of increasing the return to savers while reducing the cost for borrowers.
- This will increase investment and, if the elasticities are right, will also lower the current account. The idea of Letta and Draghi that the large current account surplus can be mobilized to increase domestic investment would thus get a plausible macroeconomic interpretation. A current account surplus of around 400 bn could fund of up to a half of the famous Draghi’s 800 billion.

Better resource allocation



Body

- The idea that CMU will improve resource allocation often takes the specific form of funding for new firms, long term investment, green investment, ICT...
- But the issue is more general: a richer, more diversified financial system, with a capital market at par with the EU real economy can find the best investment opportunities and thus increase the return on investment.

Et voilà, you get closer to the 800 bn. Draghi objective!



- The increased return will positively interact with the reduction of the intermediation margin to increase investment, thus further contributing to reach the Draghi target.
- The message is both obvious and powerful: you reduce funding cost, you increase the return and investment grows!
- Larger and more profitable investment leads to productivity growth as both the capital/labour ratio and TFP increase.
- The Draghi report assesses that a reduced intermediation margin would not fill the investment gap. How much would enhanced return help?

En passant, a tension in Draghi's report



Body

- While, including in some discussions held at Bruegel, there is a view that the report gives too much importance to public intervention, I have no firm view on this issue.
- I think, however, that the role of the private sector could have received more prominence, even if CMU gets quite some attention.
- Maybe all the public interventions called for are needed, but the role of the market could be emphasized.

If you force me to choose...



- CMU kills two birds with one stone: more investment and better resource allocation, and we definitely need both.
- If I was forced to choose one, however, I would probably go for better allocation.
- Indeed, the diagnostic part of the Draghi report documents “a static industrial structure which produces a vicious circle of low investment and low innovation.”
- The attention has instead concentrated on the huge, additional investment need.

In conclusion



Body

I have two messages, a positive one and a negative one:

- The good message is that if the pressure to substantially progress on CMU, which is coming from so many sources, succeeds, there is a reasonable hope that productivity will significantly increase because of more investment and better resource allocation.
- The negative message is that experience so far in implementing CMU has been disappointing and we still see resistance to its progress.