MARCO ZANNI

The Collapse of the European Financial System

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Good afternoon everyone, and many thanks to the Schiller Institute for the opportunity to speak on the situation of the European Union and of the European financial system.

Briefly, before assessing the status of the European economy and financial system, let me say a couple of words about what happened on Friday, the surprising result of the UK referendum on its membership in the European Union. As I say, the result was "surprising" and a very strong message of democracy to the European Union and to the European institutions. The European Union ignored the will of peoples and citizens, in forcing a political integration that is not the right way for Europe to cooperate. I remember referenda in 2005 that rejected the European Constitution, in France and the Netherlands, and I remember in 2008, the referendum in Ireland on the Lisbon Treaty. The European institutions decided to ignore the voice of the citizens and Brexit is the result of this lack of a political view for a united Europe with cooperation among European countries.

I think that this is a huge opportunity for European countries to sit together around the table, to assess and declare the failure of this project of the European Union, and try to set up together a new project, an alternative project for Europe; because Europe is different from the European Union, and I am a strong supporter of Europe and of European citizens. [applause] And as I was saying, to try to create an alternative project for Europe that will restore economic growth in Europe, that will respect the differences that European countries have, and in a framework of real cooperation. So, a Europe focussed on the real needs of the real economy, of small and medium enterprises, and not a Europe based on the needs of speculation, of finance and of big banks, as this European Union is doing.

I received very good news just an hour ago: The European Commissioner responsible for financial regulation, former lobbyist in Brussels for the financial system, Mr. Jonathan Hill [Commissioner for Financial Stability, Financial Services, and Capital Markets Union] has resigned as a result of the Brexit. So this is good news; let's resolve that we can all work better on economic and monetary affairs inside the European Parliament.

Upside-Down World of the ECB

I will try to assess and present the status of the European financial system. As the title of this panel points out very well: "The European financial system is collapsing." It is collapsing because of wrong policies brought about by European governments and by the European Union. After the financial crisis in 2008, the European Union decided to focus on the wrong problems. So they tried to set up financial regulations focussed on trying to overcome the *consequences* of a crisis.

In my view, this is not the right way to restore, and to guarantee the stability of the financial system. If we want a banking system, a financial system that is safe, if we want financial stability, we should focus regulations on *preventing* financial crises. Working and regulating the liability and equity side of banks is not the right way; we have to focus on the asset side, on the exposure of the financial system to certain types of financial assets. In this way and in this task the European Union failed, and the project of the banking union failed.

Let me talk about the first pillar of the banking union, that is, the single supervisory mechanism for all of the participating member states of the banking union, for the banking systems of the member states. The approach to single supervision delivered by the European Central Bank (ECB), or by a branch of the ECB, is completely wrong, and the evidence of this is in the stress tests presented by the ECB after November 2014.

The mistake in the analysis and approach of the ECB is that it assesses only major risks contained in the balance sheets of the European banking system. It completely failed in assessing the exposure to problematic, speculative financial assets that are contained in the balance sheets of the system. I am talking about what the regulation calls "Level 3 assets." Level 3 assets are financial assets that are illiquid, so that the price and the figure that is posted on the balance sheet on the assets side of a bank is decided by an internal model prepared by the same banks, whose interest is to set a certain figure for the value of these assets. The single supervisory mechanism decided not to assess and not to consider the risk related to Level 3 derivatives exposure of the European banking system, and this is a *huge* mistake that is threatening the stability of the system.

According to the stress tests and analysis of the ECB, a bank like Intesa San Paolo, one of the most important Italian banks, has problems. I know that Intesa San Paolo has problems on the nonperforming loans (NPL) side, on the credit risk side. But 80% of Intesa San Paolo's assets related to credit, are related to the real economy, and just 20% of its exposure is related to speculative financial instruments, to trading and so on. According to the ECB, this bank is riskier than Deutsche Bank or the BNP Paribas bank, for example. But looking at the balance sheets of Deutsche Bank and BNP Paribas, the proportion on the asset side is completely the opposite: They have exposure of 80% of their assets to Level 3 assets, to derivatives, to speculative instruments, to trading assets, and just 20% of the assets are dedicated to the real economy.

I think a system that considers Intesa San Paolo riskier than Deutsche Bank or BNP Paribas is completely wrong and is threatening the stability of the European Union, of European countries, and of the European financial system. The single supervisory mechanism is unfair, because it fails to assess the market risk, and also the level risk on the balance sheets of banks. All of those too-big-to-fail banks, all those speculative banks, are facing billionaire legal actions due to their behavior in the financial markets: They manipulated the exchange rate markets, they manipulated the interest rate markets, and they are facing billions in fines that could threaten the stability of bank balance sheets. And the ECB is not assessing this risk, deliberately. This is a political decision.

Further Financialization Is No Answer

By looking at what is happening in the Italian banking system, we see the evidence of the inequity of this approach. Italian banks have problems related to the exposure to NPLs, but it is, I say usually, an "error-induced crisis," because if your economy shrinks, if your small and medium-sized enterprises go into bankruptcy, if your homeowners cannot pay their mortgages, borrowers cannot pay mortgages, clearly the banking system will suffer a huge exposure to NPLs. If your economy is not performing well, you will experience problems in the credit market and problems related to the NPLs.

Now, as I say, this crisis, these problems, are related to the euro in my view, because the single currency is creating huge macroeconomic imbalances between European countries. The Eurozone is an optimized currency area, and I think that due to political constraints and due to huge differences between eurozone countries, we cannot fix this currency union. So this is the problem related to the euro.

What about the policies that the European Union is trying to set up to make the financial system safer, more stable? It's all related to more financialization of the system. Just one example: On a policy proposed by the former commissioner for financial regulation, they think that if we need to restore growth in the European Union, we have to revive securitization. So the proposal that now is on the table in the European Union, in the European Parliament, is a framework for a simple, transparent, and standardized securitization. That is meaningless. Because, looking at the proposal, there is nothing simple, nothing transparent, and nothing standardized about securitization. If you use synthetic securitization, if you use derivatives, collateralized debt obligations (CDOs), there is no simple securitization. And securitization is not the means to restore funding for the real economy.

Europe's Role in the New World Economy

We have proposals in the European Parliament to restore growth and the stability of the financial system—clearly a first step. We have proposed one bill in the Italian Parliament and one in the European Parliament, in the framework of the banking structural reform, for restoring banking separation. We think that we have to set up a sort of modern, European Glass-Steagall that will simplify the regulation of the banking system, and will make separation between the core part of a bank and a speculative bank, in order to create a banking system that is no more focussed on speculation in the financial system, but on the needs of the real economy, on the needs of people. And this is the first step. [applause]

The second step is a proposal related to one of the most troubled banks in the European Union, that is, Monte dei Paschi di Siena. I think you all know the situation of the third Italian bank, the oldest bank in Europe. Monte dei Paschi di Siena was founded in the 15th century and operated throughout the centuries to support the real economy.

Now we have the opportunity—the Italian government has the opportunity—to take over this bank that is really in trouble, and make it an example of what could be a banking system focussed on the real economy. So we are proposing to nationalize Monte dei Paschi di Siena. The Italian Treasury is already the main shareholder, with a 4% stake. We are proposing to set up a clear mission for Monte dei Paschi di Siena, in order to have the bank focus clearly on the needs of the real economy. We will not allow it to operate in trading business, to operate in the derivatives business. Its mission will be just to operate as a public service for credit, in order to support the real economy.

I think that this proposal could be a benchmark for Europe, for the European banking system. We have to do more in the European Parliament, and I hope that after Mr. Hill, we will be able to talk again about the banking structural reform and the European Glass-Steagall that this lobbyist blocked, after being elected commissioner, and then go on with a project for Europe, a project that will overcome this failure of the European Union and will bring Europe again to the center of the global scenario as a connection between the United States and Asia. I think that this is a good way for Europe to restore growth, to restore democracy, and to take the role that European citizens and European people should have in the global scenario.