

# Capital Markets Union

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# CMU: Policy Intent

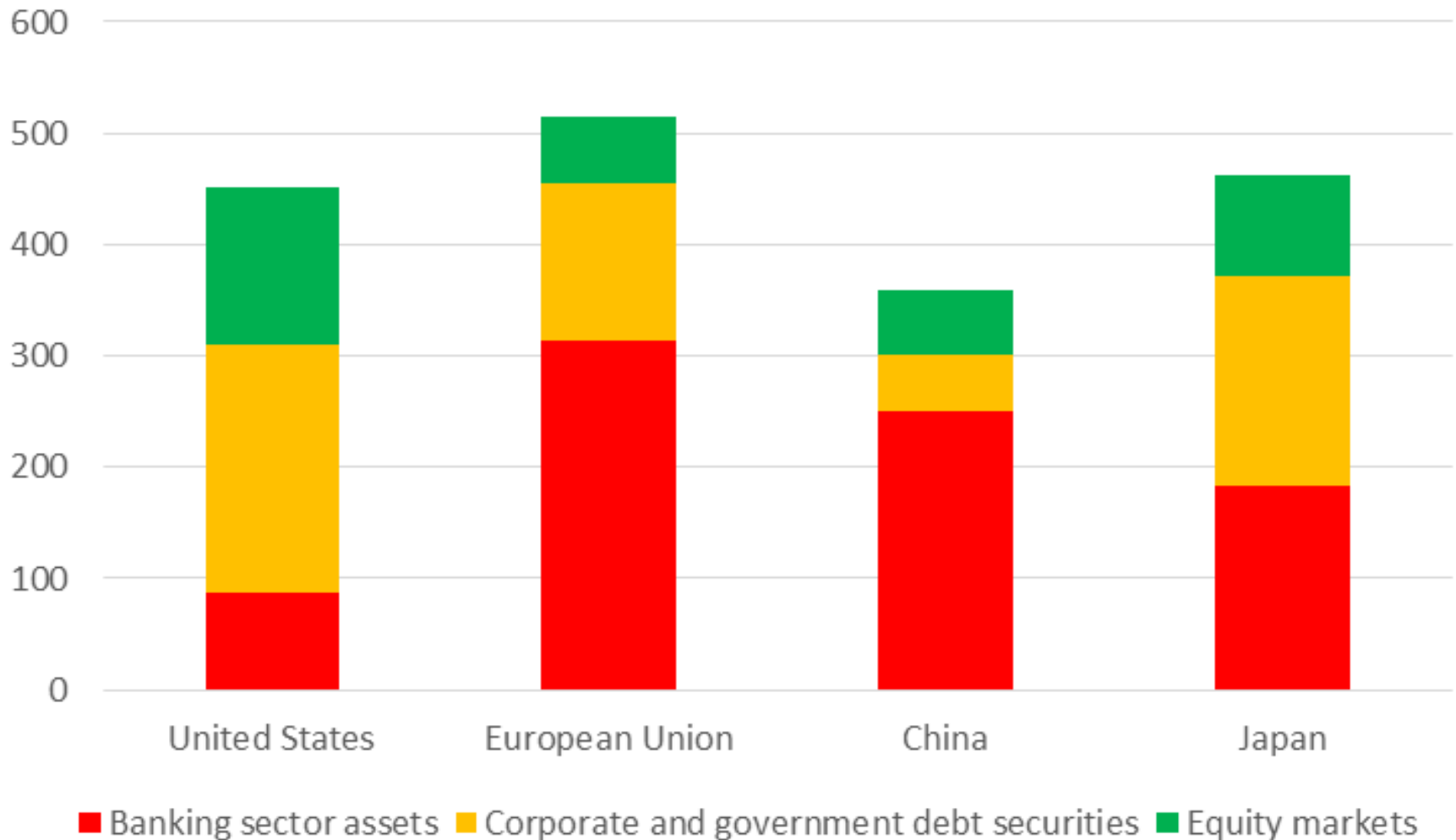
“Over time, I believe we should complement the new European rules for banks with a **Capital Markets Union**. To **improve the financing of our economy**, we should further develop and integrate capital markets. This would cut the cost of raising capital, notably for SMEs, and **help reduce our very high dependence on bank funding**. This would also increase the attractiveness of Europe as a place to invest.”

Jean-Claude Juncker, speech at the European Parliament, July 15, 2014 (emphasis added)

# CMU: Definition

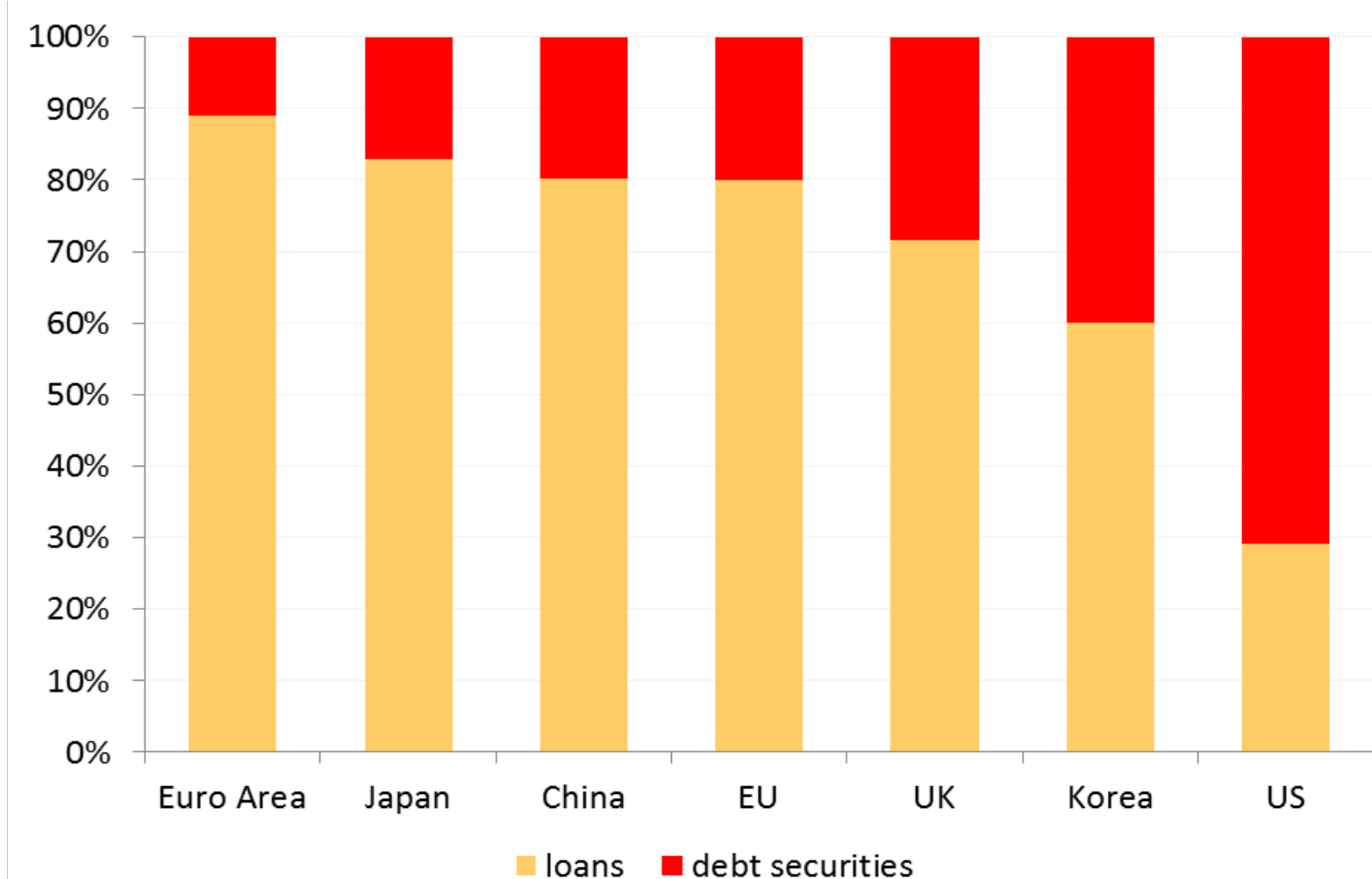
- EU internal market policy in financial services
  - Follows Segré Report (1966), Single European Act (1985), Financial Services Action Plan (1999)...
- Capital markets development
  - Critical mass of market segments / investor access
- Not Banking Union
  - Banking Union (BU) was radical response to acute crisis
  - BU focused on changes in institutional framework
  - BU is euro area (possibly euro+), UK not included

# The EU Is Bank-Heavy...



Amounts outstanding, Percentage of GDP. Source: Véron & Wolff (2015), Figure 1

# ...Especially Corporate Debt...

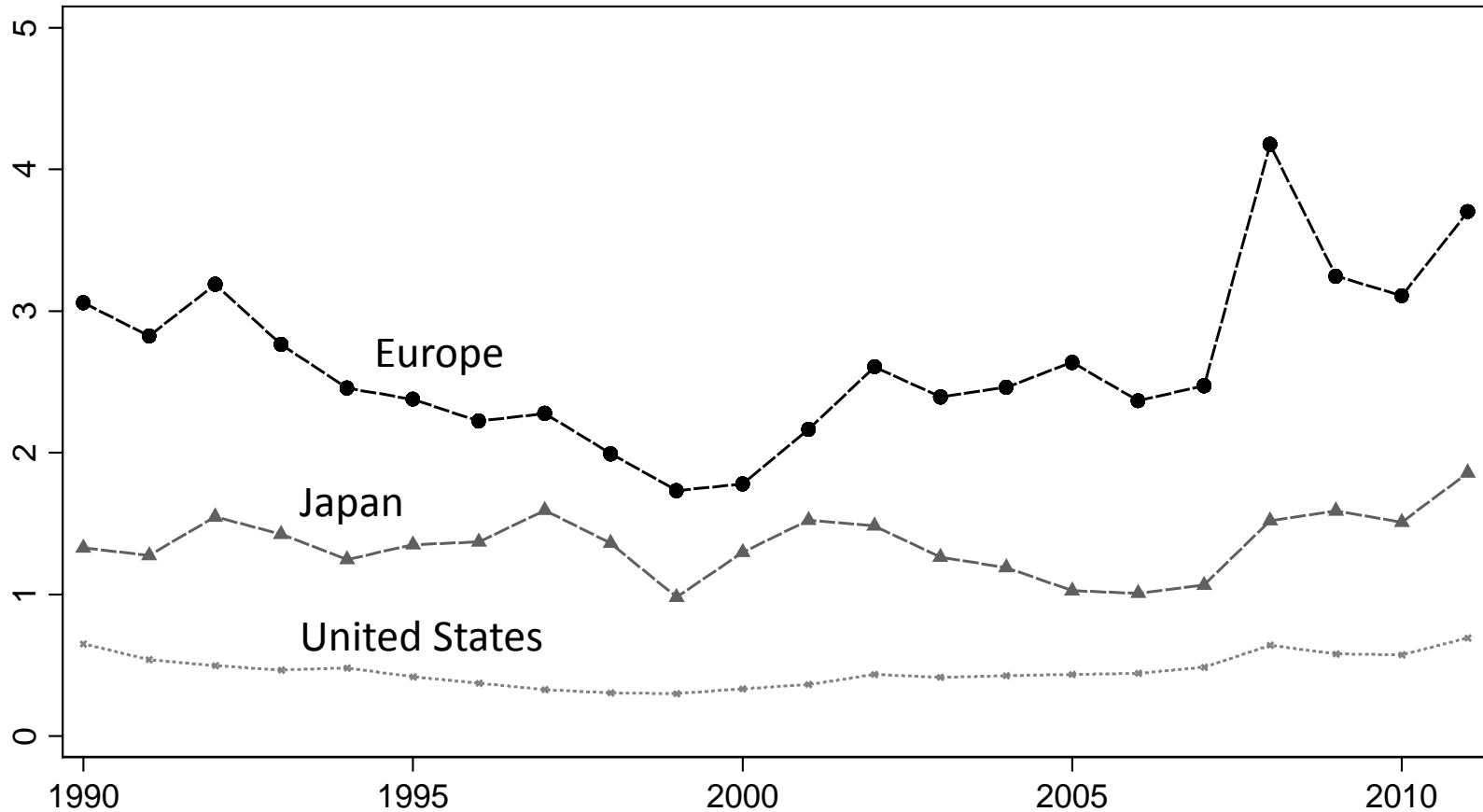


Percentage of total debt of non-financial companies, latest available year.

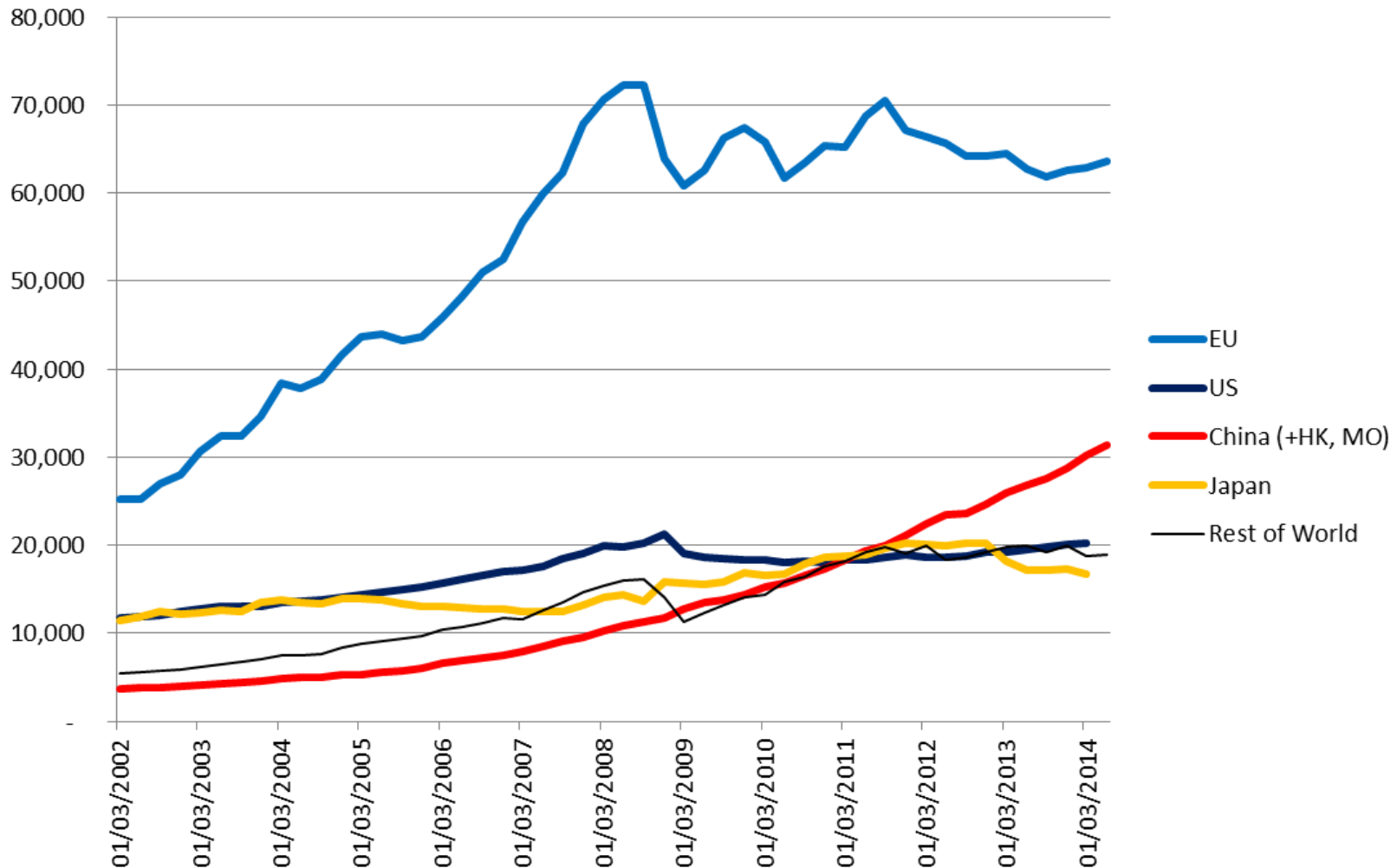
Source: Merler & Véron (2015), Figure 1

# ...Increasingly since 2000...

Bank-market ratio  
(bank assets divided by stock and bond market cap)



# ...EU Has Most Bank Assets



Total banking assets, source IMF/IFS. 16 out of 30 “Global Systemically Important Banks” listed by the Financial Stability Board (Nov. 2014) are from Europe, of which 14 from the EU

# EU Financial Policy Basics

- **Legislation / rulemaking: mostly EU level**
  - European Parliament + Council (qualified majority)
  - Secondary rulemaking by European Agencies since 2011
    - EBA (banking), EIOPA (insurance), ESMA (markets)
  - All 28 member states including UK (not Switzerland)
  - Exceptions: e.g. Vickers (UK), consumer protection
- **Supervision / enforcement: mostly national**
  - 51 national agencies, members of EBA/EIOPA/ESMA
  - UK: mostly Bank of England (PRA) and FCA
  - Exception: euro-area banks / Banking Union (ECB, SRB)
  - Smaller exception: CRAs and TRs (ESMA)



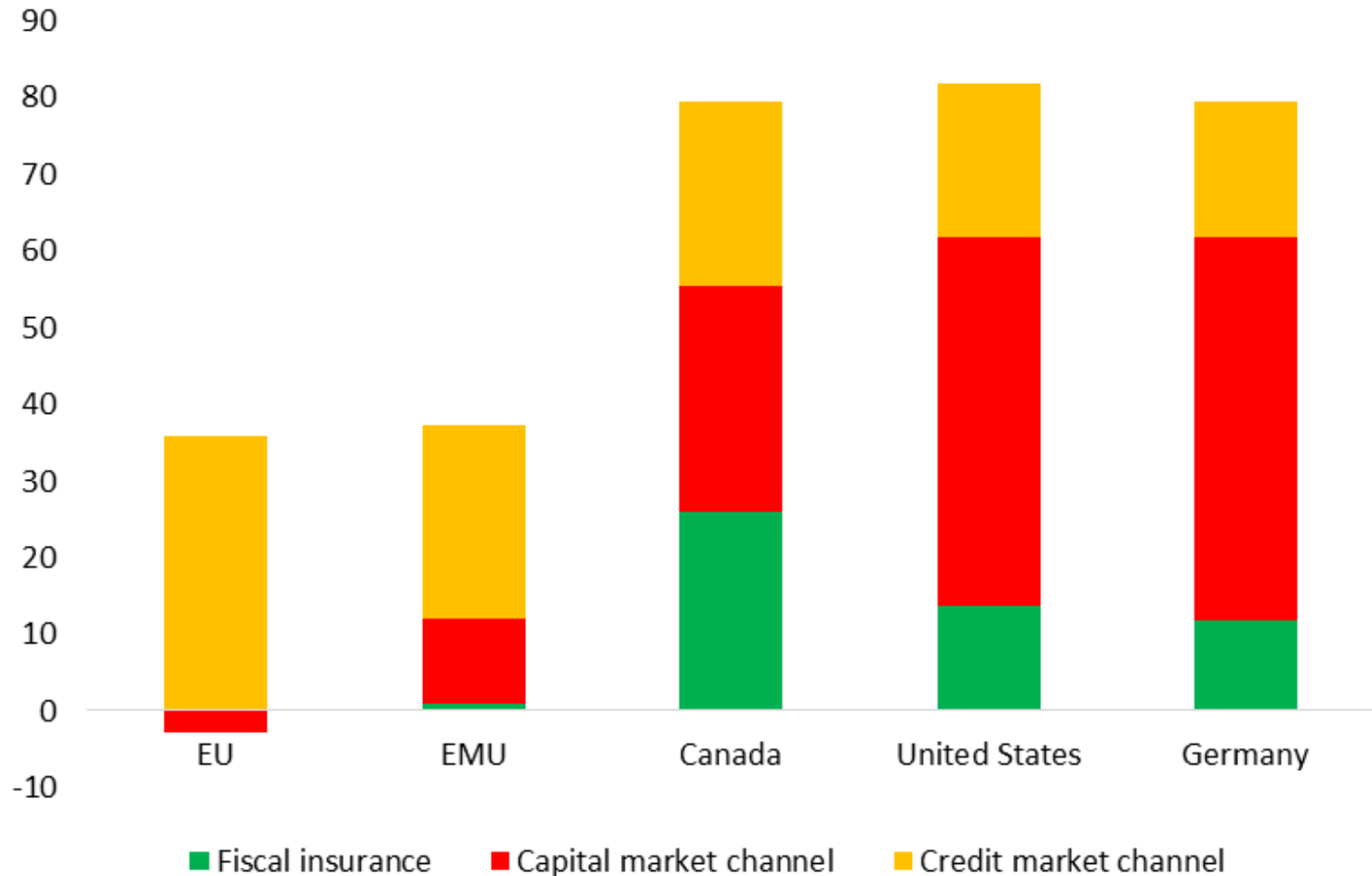
# The Case for CMU

- Stability
- Growth
- Politics

# CMU Rationale #1: Stability

- Moral Hazard (Too-Big-To-Fail & beyond)
- “Spare tire” argument / diversity
  - Greenspan (1999) on Asian crisis
- Risk-sharing through markets channel
  - Asdrubali, Sorensen & Yosha (1996) on US
- Comparison US/EU after 2007-08 shock

# Channels of Risk Sharing



*Percent of shock smoothed by the different channels. Source: IMF (2013)*

# CMU Rationale #2: Growth

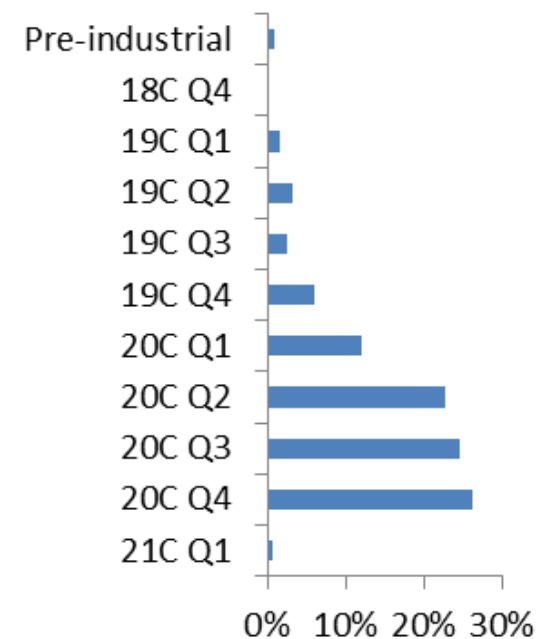
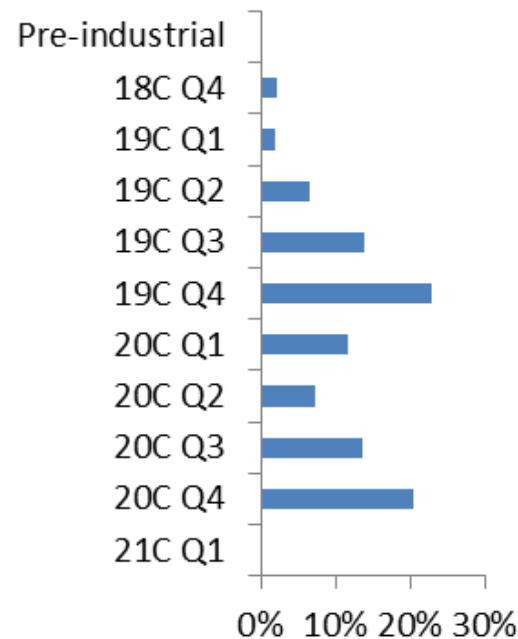
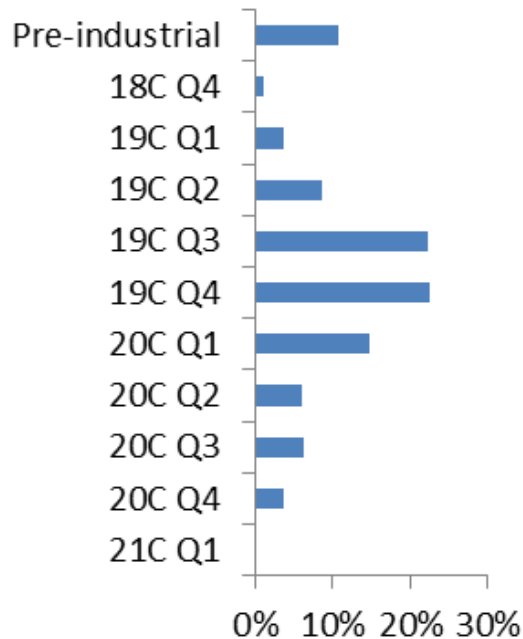
- Non-bank finance better suited for high-growth firms
- Better opportunities for investors
- Positive impact on non-financial sectors
  - More ambiguous impact on financial sector
  - Not uniform across EU member states

# Corporate Demographics

## Europe

## United States

## Emerging



*Share of aggregate market cap of FT Global 500 companies (as of September 2012), by demographic cohort and region of headquarters. Unpublished results based on Véron (2008)*

# CMU Rationale #3: Politics

- Juncker's growth policy package
  - Cyclical: €315bn investment initiative (“Juncker Plan”)
  - Structural: CMU, Energy Union, Digital Single Market
- Positive agenda with UK
  - Context: euro area “remorseless logic”, referendum
  - British Commissioner: Jonathan Hill
  - UK-centric communication by European Commission

# CMU & the UK: Soundbites

“This [CMU] is good news for the City. This is a classic case of what is good for the UK also being good for Europe”

*David Cameron, 10/02/15*

“Lord Hill’s proposals for a CMU [are] arguably the most significant EU proposal of the last 10 years”

*Chris Cummings (CEO TheCityUK), The Telegraph, 02/18/15*

“Politically, CMU shows how the UK can influence policy in Brussels in an area of national economic interest”

*William Wright (New Financial), The Telegraph, 10/04/15*

“the CMU, however symbolic, is a commitment to the Single Market, and to keeping the UK on board.”

*Wolf-Georg Ringe, SSRN, 03/09/15*

# Political Obstacles

- Sovereignty on supervision / enforcement
  - All member states; most acute in UK
- Vested interests
  - local market infrastructures, parts of banking industry
- Anti-market bias

“The crisis of European banking after the collapse of Lehman was a crisis of market-based banking... In this context, it is remarkable to see the growing consensus that growth in Europe requires more market-based finance.”

*D. Gabor & J. Vestergaard, FEPS, October 2015*



# Current Status

- CMU announcement: July 2014
- Green paper: February 2015
- Action Plan: September 2015
  - Infrastructure investment incentive for insurers (done)
  - Revival of securitization (draft EU Regulations)
  - Simplified IPO disclosures for small firms (end-2015)
  - EU legislation to harmonize insolvency law (end-2016)
  - Numerous consultations & strategic reviews, e.g. on retail financial services, covered bonds, venture capital

# Many Challenges Still Open

- “Banking Structural Reform” legislation
- Taxation of financial investment & trading
  - Financial Transaction Tax; OECD BEPS project
- Accounting & auditing
- Financial market infrastructure
- Credit information frameworks
- Pension and housing finance frameworks
- Systemic Risk Oversight

# The Institutional Question

- CMU plan would not change institutional architecture
- But fragmented regulatory enforcement prevents market integration
  - National authorities mistrust each other
  - Defense & promotion of “national champions”
  - Passporting / mutual recognition has disappointed
- Not unique to finance
  - all regulated services, including energy & digital

# Current Outlook

- Change of tone
  - Financial policy is also about growth (structural reform)
  - Markets can be a good thing
- Policy development: incremental, slow
  - Structural reform is difficult, also at EU level
  - No institutional change possible until UK referendum
- Most structural change in European finance to be driven by post-crisis bank deleveraging
  - Banking Union more impactful than CMU