

# THE PLACE OF THE EMERGING ECONOMY OF ROMANIA INSIDE THE EUROPEAN UNION ECONOMIES IN TERMS OF FTSE CRITERIA

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*The importance of this research lies from the need to know the economies developed, emerging and frontier of the European Union and the mode of their manifestation according to the market indicators. Consequently, we had in mind a presentation of the economies in the categories mentioned above framed in terms of market criteria used by FTSE Group, a provider of stock market indices and associated data services. Using data from a series of reports published by FTSE we made an analysis of how each of the considered economies and in particular Romania, acts according of these. Was taken into consideration criteria as: market and regulatory environment (formal stock market regulatory authorities actively monitor market; fair and non-prejudicial treatment of minority shareholders; non or selective incidence of foreign ownership restrictions; free and well-developed equity market; no objections or significant restrictions or penalties applied on the repatriation of capital; free and well-developed foreign exchange market; non or simple registration process for foreign investors); custody and settlement (settlement-rare incidence of failed trades; custody-sufficient competition to ensure high quality custodian services; clearing & settlement; stock lending permitted; settlement-free delivery available; custody-omnibus account facilities available to international investors); dealing landscape (brokerage-sufficient competition to ensure high quality broker services; liquidity-sufficient broad market liquidity to support sizeable global investment; transaction costs-implicit&explicit costs to be reasonable and competitive; short sales permitted; off-exchange transactions permitted; efficient trading mechanism; transparency); derivatives (developed derivatives market). The final part of the paper is reserved to the understanding of the mode in which each of the considered economies of the European Union, including Romania and regardless of what category they belong (developed, emerging or frontier economies) behave in relation to the above criteria used by the FTSE in relation with the market quality. In terms of research methodology, this took into account the data collection through the observation method. This method use, as research tool, the observation guide. We have also had regard to the proper definition of the concepts and their operationalization in order to bring to the fore a number of relevant indicators for the economies of the European Union.*

*Keywords FTSE group, emerging market, frontier market, market criteria*

*Jel classification G10, O 52*

This paper has, as main goal, to present certain matters related to Romania's position as frontier economy, inside the European Union economies according with the FTSE classification in terms of Global Equity criteria. These was structurated into five groups in the following manner: first reveals aspects looking Market and Regulatory Environment, the second is about the Custody and Settlement, Dealing Landscape make the object of the third group, and the elements considered by the fourth and fifth group are making reference to the Derivatives and, also, to the market size. Are also fallowed, through the present paper, the extent to which the developed, emerging and frontier countries of the EU meets or not the presented criteria.

## **1. The types of promoters of the EU economies and the assessment criteria promoted by FTSE Group**

Generally speaking, Emerging Markets (EMs) was previously defined in the economic literature as nations with social or business activity in the process of rapid growth and industrialization which increase their number from 28 in 2006 to over 40 in 2010. Due to their faster development and to their openness towards the realisation and adaptation at the new demands of the free market, to the foreign direct investment attraction and to the technology transfer, these economies are becoming major players on the global economy arena which tend to change the global economy's orientation. As a result, a number of bodies and international publications (FTSE group, MSCI Barra, S & P, The Economist, etc..) manifests a continuing concern for how these economies evolve and classifies them according to a number of criteria, each considered of maximum relevance for each mentioned group or publication. Thus, the FTSE group, created in 2002 as a British provider of stock market indices and associated data services identified in 2010 a number of 48 emerging markets, MSCI Barra established for May 2010 the existence of 21 emerging markets, S & P established in December of that year 19 countries with the title of emerging markets and Dow Jones increased this number to 35 in May 2010. Besides the emerging markets encountered on the European plan also exist the notion of Frontier/Secondary Emerging Markets (F/SEMs) which is an economic term commonly used to describe a subset of emerging markets (Ems). Frontier markets (Fms) are investable but have lower market capitalization and liquidity than the more developed emerging markets. The frontier equity markets are typically pursued by investors seeking high, long term returns and low correlations with other markets. The implication of a country being labeled as frontier is that, over time, the market will become more liquid and exhibit similar risk and return characteristics as the larger, more liquid markets represented by the developed emerging markets. The ensemble of the market economies met in the European Union area is complemented by the developed markets (DMs) which are those countries that are thought to be the most developed and therefore less risky in terms of investing. To be more specifically, we can say that through investment we understand the commitment of money or capital to the purchase of financial instruments or other assets so as to gain profitable returns in the form of interests, dividends, or appreciation of the value of the instrument (capital gains) (Sullivan and Sheffrin 2003: 271). After the identification of the categories of markets which manifest their action in the economic zone of the European Union the present paper expose the mode in which the promoters of this area economies are positioned in relation to a set of indices calculated by FTSE Group and which are integrative part of the FTSE Global Equity Index Series (GEIS). These indices are based on certain *criteria* created on the beginning by the FTSE group from a number of 25 new frontier markets, which has been screened using its established country classification methodology that assesses markets against the size requirements, basic governance and market infrastructure elements required by international institutional investors. Presently, the indices are calculated in real-time and are designed to be used as the basis of financial products such as *ETFs* (an investment fund traded on stock exchanges and which holds assets such as stocks, commodities, or bonds, and trades close to its net asset value over the course of the trading day), *mutual funds* (a professionally-managed type of collective investment scheme that puts money from many investors to buy stocks, bonds, short-term money market instruments, and/or other securities), and *derivative products* (as form of alternative investment it represent a financial instrument whose value depends on other, more basic, underlying variables (Hull 2006: 1) such as: the price of another financial instrument (the underlying asset) (McDonald 2006: 54), interest rates, volatilities, indices, etc., the most common derivatives being swaps, futures, and options). The identification of the origin of the criteria is followed by the presentation of the ones used by the FTSE group for a market. These are: there must be a formal and independent stock market authority that actively monitors the market; there should be no objection to or significant restrictions or penalties applied on the repatriation of capital and income; transparency; there should be market depth information, visibility and a timely trade reporting process and a requirement of international price dissemination; settlement (there should be a rare incidence of failed trades); clearing and settlement period shorter than T+7 (and greater than T+1). For a better understanding we present the mentioned criteria (detailed in Table 1) with the specification that to

describe the country's status are necessary to be verified: all the criteria (for the developed markets), 15 criteria (for the advanced emerging markets), 9 criteria for the secondary emerging ones and 5 criteria for the markets of frontier.

**Table 1. The quality market criteria used by the FTSE classification**

Criteria used by the FTSE classification	D	AE	SE	F
<b>1. Market and Regulatory Environment</b>				
1.1. Formal stock market regulatory authorities actively monitor market	X	X	X	X
1.2. Fair and non-prejudicial treatment of minority shareholders	X	X		
1.3. Non or selective incidence of foreign ownership restrictions	X	X		
1.4. Free and well-developed equity market	X	X		
1.5. No objections or significant restrictions or penalties applied on the repatriation of capital	X	X	X	X
1.6. Free and well-developed foreign exchange market	X	X		
1.7. Non or simple registration process for foreign investors	X	X		
<b>2. Custody and Settlement</b>				
2.1. Settlement - Rare incidence of failed trades	X	X	X	X
2.2. Custody-Sufficient competition to ensure high quality custodian services	X	X	X	
2.3. Clearing & settlement - T +3 or shorter, T+7 or shorter for Frontier	X	X	X	X
2.4. Stock Lending is permitted	X			
2.5. Settlement - Free delivery available	X			
2.6. Custody - Omnibus account facilities available to international investors	X	X		
<b>3. Dealing Landscape</b>				
3.1. Brokerage - Sufficient competition to ensure high quality broker services	X	X	X	
3.2. Liquidity - Sufficient broad market liquidity to support sizeable global investment	X	X	X	
3.3. Transaction costs-implicit&explicit costs to be reasonable and competitive	X	X	X	
3.4. Short sales permitted	X			
3.5. Off-exchange transactions permitted	X			
3.6. Efficient trading mechanism	X			
3.7. Transparency - market depth information / visibility and timely trade reporting process	X	X	X	X
<b>4. Derivatives</b>				
4.1. Developed derivatives market	X			

- Source: FTSE Global Equity Index Series. Quality of markets criteria (September 2010)

## 2. Developed economies, emerging and frontier of the EU in terms of FTSE criteria

As we can observed, the FTSE group use the criteria grouped in Table 1 for the European Union's economies which was divided, for greater granularity into developed, emerging (advanced or secondary) and frontier economies. Regarding these type of economies in the *developed ones* we can talk about Belgium, France, Germany, Italy, Netherlands, Denmark, Ireland, UK, Greece (possible demotion from Developed to Advanced Emerging according to the FTSE list for March 2011), Portugal, Spain, Austria, Finland and Sweden; the *emerging group* includes Czech Republic (promoted in September 2010 from Secondary Emerging Economy to Advanced Emerging Economy), Poland and Hungary, as Advanced Emerging Economies); the *frontier group* is formed from Cyprus, Estonia, Lithuania, Malta, Slovakia, Slovenia, Bulgaria and **Romania**. Making appeal to each criterion specified in Table 2 we made, further on, a synthesis of the mode in which, each countries from the EU which belongs to one or another of the previous mentioned category of economies are situated according to the quality market criteria promoted by the FTSE group (Table 1-3). We made in this purpose a presentation of the criteria which must be taken into consideration followed by the precision of the accomplishment or of the existence of certain restriction related to the respective criterion.

**Table 1. The position of the UE developed economies in relation with the FTSE criteria**

Developed economies
<b>Belgium, France, Germany, Italy, Netherlands, Denmark, Ireland, UK, Greece, Portugal, Spain, Austria, Finland and Sweden</b>
1.1. Formal stock market regulatory authorities actively monitor market
1.2. Fair and non-prejudicial treatment of minority shareholders
1.3. Non or selective incidence of foreign ownership restrictions
1.4. Free and well-developed equity market
1.5. No objections or significant restrictions or penalties applied on the repatriation of capital
1.6. Free and well-developed foreign exchange market
1.7. Non or simple registration process for foreign investors
<i>All countries pass the 1.1.-1.7. criteria excepting France, Germany, Italy and Sweden which are restricted to the 1.2. criterion</i>
2.1. Settlement - Rare incidence of failed trades
2.2. Custody-Sufficient competition to ensure high quality custodian services
<i>All countries pass the 2.1. and 2.2. criteria</i>
2.3. Clearing & settlement - T +3 or shorter, T+7 or shorter for Frontier
<i>All countries has T+3 at that criterion only Germany has T+2</i>
2.4. Stock Lending is permitted
<i>Only Greece is restricted at this criterion</i>
2.5. Settlement - Free delivery available
<i>Only Spain is restricted at this criterion</i>
2.6. Custody - Omnibus account facilities available to international investors
<i>Only Greece is restricted at this criterion</i>
3.1. Brokerage - Sufficient competition to ensure high quality broker services
<i>All countries pass the criterion</i>
3.2. Liquidity - Sufficient broad market liquidity to support sizeable global investment

<b>Developed economies</b>
<i>Only Belgium, Denmark, Portugal and Austria are restricted to this criterion</i>
3.3. Transaction costs - implicit and explicit costs to be reasonable and competitive
<i>Only Ireland and UK are restricted at this criterion</i>
3.4. Short sales permitted
<i>Only Greece, Portugal and Spain are restricted at this criterion</i>
3.5. Off-exchange transactions permitted
<i>Only Greece is restricted at this criterion</i>
3.6. Efficient trading mechanism
<i>All countries pass the criterion</i>
3.7. Transparency-market depth information/visibility and timely trade reporting process
<i>All countries pass the criterion</i>
4.1. Developed derivatives market
<i>All countries pass the criterion</i>
5.1. Market capitalisation \$mn (as at 31 <sup>st</sup> dec. 2009)
<i>Belgium 364,742; France 1.960,403; Germany 1.292,355; Italy 655,848; Netherlands 558,281; Denmark 140,391; Ireland 61,291; UK 2.796,444; Greece 112,632; Portugal 98,067; Spain 1.297,227; Austria 114,076; Finland 178,838; Sweden 363,085</i>
5.2. Total number of Listed Companies
<i>Belgium 187; France 941; Germany 704; Italy 291; Netherlands 121; Denmark 196; Ireland 55; UK 2.179; Greece 285; Portugal 48; Spain 3.435; Austria 97; Finland 128; Sweden 260</i>

- realized by the author on the FTSE's data

**Table 2. The position of the UE emerging economies in relation with the FTSE criteria**

<b>Emerging economies</b>
<b>Czech Republic, Poland and Hungary</b>
1.1. Formal stock market regulatory authorities actively monitor market
1.2. Fair and non-prejudicial treatment of minority shareholders
1.3. Non or selective incidence of foreign ownership restrictions
1.4. Free and well-developed equity market
1.5. No objections or significant restrictions or penalties applied on the repatriation of capital
1.6. Free and well-developed foreign exchange market
1.7. Non or simple registration process for foreign investors
<i>All the emerging countries pass the 1.1.-1.7. criteria</i>
2.1. Settlement - Rare incidence of failed trades
2.2. Custody-Sufficient competition to ensure high quality custodian services
<i>All countries pass the 2.1. and 2.2. criteria</i>
2.3. Clearing & settlement - T +3 or shorter, T+7 or shorter for Frontier
<i>All countries are T+3 to this criterion</i>
2.6. Custody - Omnibus account facilities available to international investors

Emerging economies
<i>All countries pass the criterion</i>
3.1. Brokerage - Sufficient competition to ensure high quality broker services
3.2. Liquidity - Sufficient broad market liquidity to support sizeable global investment
3.3. Transaction costs - implicit and explicit costs to be reasonable and competitive
3.7. Transparency - market depth information / visibility and timely trade reporting process
<i>All the countries pass the criteria 3.1.-3.7.</i>
5.1. Market capitalisation \$mn (as at 31 <sup>st</sup> dec. 2009)
<i>Czech Republic 44,775; Hungary 30,037; Poland 150,962</i>
5.2. Total number of Listed Companies
<i>Czech Republic 16; Hungary 44; Poland 470</i>

- realized by the author on the FTSE's data

**Table 3. The position of the UE frontier economies in relation with the FTSE criteria**

Frontier economies
<b>Cyprus, Estonia, Lithuania, Malta, Slovakia, Slovenia, Bulgaria and Romania</b>
1.1. Formal stock market regulatory authorities actively monitor market
1.5. No objections or significant restrictions or penalties applied on the repatriation of capital
<i>All countries, including <b>Romania</b>, pass the criteria 1.1. and 1.5.</i>
2.1. Settlement - Rare incidence of failed trades
2.3. Clearing & settlement - T +3 or shorter, T+7 or shorter for Frontier
<i>All countries, including <b>Romania</b>, are T+3 excepting Bulgaria and Slovenia which is T+2 at this criterion</i>
3.7. Transparency - market depth information / visibility and timely trade reporting process
<i>All countries, including <b>Romania</b> pass the criterion</i>
5.1. Market capitalisation \$mn (as at 31 <sup>st</sup> dec. 2009)
<i>Cyprus 10.269; Estonia 2.654; Lithuania 4.619; Malta 4.080; Slovakia 5.176; Slovenia 12.119; Bulgaria 8.647; <b>Romania</b> 27.456</i>
5.2. Total number of Listed Companies
<i>Cyprus 115; Estonia 16; Lithuania 41; Malta 20; Slovakia 172; Slovenia 76; Bulgaria 399; <b>Romania</b> 175</i>

- realized by the author on the FTSE's data

## Conclusions

Regarding the EU economies as expected, these accomplish, generally speaking, all the criteria promoted by FTSE. Exception to this rule makes *France, Germany, Italy* and *Sweden* which are restricted to the „fair and non-prejudicial treatment of minority shareholders criterion”; *Greece* which is restricted to the „stock lending is permitted”, „short sales permitted”, „off-exchange transactions permitted” and „omnibus account facilities available to international investors” criteria; *Spain* restricted to the „free delivery available” and „short sales permitted” criteria;



*Belgium, Denmark and Austria* restricted to the „liquidity - sufficient broad market liquidity to support sizeable global investment” criterion; *Ireland and UK* restricted to the „Transaction costs - implicit and explicit costs to be reasonable and competitive”; *Portugal* restricted at „liquidity - sufficient broad market liquidity to support sizeable global investment” and „short sales permitted” criteria. For the emerging countries, all of them pass the criteria specified by the FTSE. As component of the economies classified like frontier markets, *Romania* pass with succes both the criteria taken into discussion for these categories of economies (formal stock market regulatory authorities actively monitor market, no objections or significant restrictions or penalties applied on the repatriation of capital, settlement - rare incidence of failed trades, clearing & settlement - T +3 and transparency - market depth information/visibility and timely trade reporting process) but also and other criteria which belongs to the advanced emerging economies or even to the developed economies such as (non or selective incidence of foreign ownership restrictions, free and well-developed equity market, Custody-Sufficient competition to ensure high quality custodian services, Brokerage - Sufficient competition to ensure high quality broker services, Efficient trading mechanism).

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