CREATING CAPITAL MARKETS UNION - OPPORTUNITIES AND LIMITATIONS

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Abstract: *Union of European Capital Markets is a recent initiative of the European Commission, issued the credit crunch from EU. This paper aims to discuss the advantages and disadvantages of this Union, estimated to be achieved by 2019. At the same time, we intend to analyze the opportunities and limits of achieving this union, its impact on European integration and the Member States, on the expansion possibilities of funding SMEs, on sustainable economic development. In our opinion, the project to union capital markets from the European Union is commendable, following completion of more and more domestic companies could obtain financing from international capital markets.*

Keywords: *capital markets union, European Union, medium – sized enterprises, securitization, finance access*
JEL classification: *F36, G15, G20*

I. Introduction:

The Capital Markets European Union is the latest policy initiative of the European Commission in the financial domain, launched in September 2015. Unlike the monetary union plan, the capital markets union has benefited from broad support, including from Great Britain. The idea of creating the Capital Markets European Union is not new, it arose from a report entitled “The Development of a European Capital Market”, drawn up in 1966 by the experts of the Commission of European Economic Community. In this report, the authors has shown the conditions of effective use of economic policy instruments on an integrated European financial market, the benefits of developing a European capital market, how to achieve an integrated capital market and how to remove the existing obstacles.

In the fifty years since then, capital markets in Europe have developed in all respects, although the pace of this development was neither constant nor uniform. There were periods of significant changes in the regulation of financial markets, especially in the Financial Services Action Plan, periods of inactivity.

The global financial crisis followed by the sovereign debt crisis in the euro area had significant negative effects on the financial system in the European Union, the most important being the fragmentation of the banking system and the decreasing of the cross-border loaning in the European Union. (Delcea, Bradea, Scarlat, 2013)

The Capital Markets European Union and the Banking Union complete the financial reforms in recent years, aimed at strengthening and supervision of the financial sector. (Delcea, Bradea, et.al., 2013)

Capital Markets European Union has, according to the European Commission, seven main objectives:

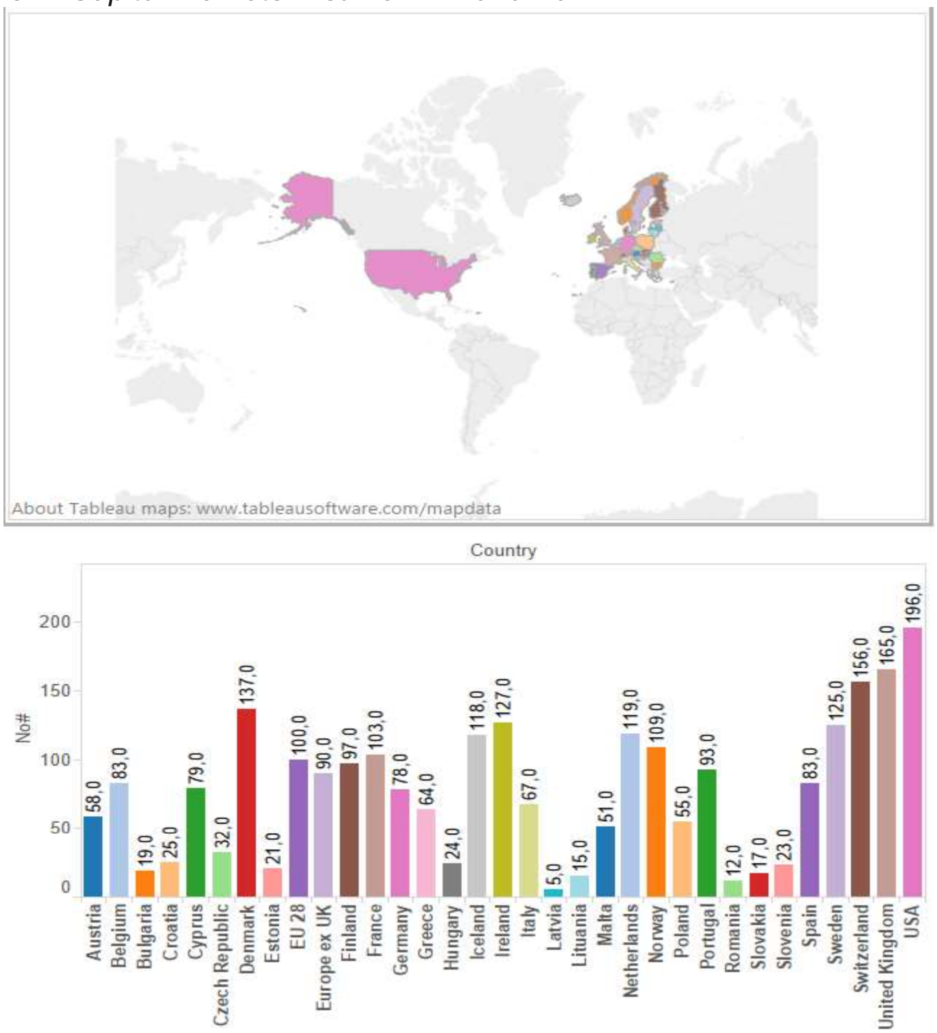
1. The financing of innovation, start-ups and non-listed companies;
2. An easier access to finance through the stock market;
3. To facilitate the companies' access to finance on the capital markets, especially for SMEs;
4. Promoting the long-term investments, especially those in infrastructure;
5. Stimulating the individual and institutional investments in order to strengthen the European capital markets and expand the supply of funds;
6. Mobilizing the banks' ability to support the European economy by issuing bonds;
7. Facilitating the cross-border investments and promoting the financial stability by eliminating remaining barriers of a European capital markets union.

Traditionally, the SMEs in the European Union have opted for bank financing. But, it was confirmed statistically that SMEs are vulnerable to the economic downturns and credit supply restrictions. The index calculated by the European Commission to reflect the level of access to bank loans and the problems encountered by SMEs when seeking for bank loans, recorded a lower level than the European Union average in the case of ten EU countries, like Denmark, Spain, Romania, Hungary and Greece.

The capital market financing has recorded low values in the European Union (69% for listed shares and 171% for debt securities, averaged over 2010-2014), compared to bank loaning, that has a weight of over 200% of GDP in same period. In contrast, in USA, the option of financing is clearly heading towards capital markets, with 126% for listed shares and less than 200% for debt securities. (W. Wright and L. Bax, 2015).

As can be observed in Figure no. 1, after size, the European equity markets are just over half of the USA. Britain's capital market is almost twice as developed as the rest of Europe; the same thing can be said also about Denmark, Sweden and the Netherlands, as they have mature capital markets. Germany, Italy, Spain, Belgium and Greece have underdeveloped capital markets. Many countries in Central and Eastern Europe have emerging capital markets.

Figure no. 1 *Capital Markets Disunion in 2010-2014*



Source: Processed data from http://newfinancial.eu/wp-content/uploads/2016/04/The-potential-impact-of-Brexit-on-European-capital-markets-New-Financial-Apr-2016.pdf

A capital markets union would bring substantial benefits to the entire European Union, as financial markets will become deeper and more competitive integrated with a more efficient allocation of capital within the European Union and will contribute significantly to economic growth. But these benefits will be realized only if the entry barriers are eliminated in the European financial markets.

II. Literature review:

This capital markets union in EU is a highly debated issue in the literature. Some criticize this plan; others praise the initiative of the European Commission, arguing that this will accelerate the sustainable development of the European Union.

In his research, Pierre Schammo (2015) presents the concept of the common capital market and its incidence on the accessibility to finance the SMEs. The author proposes a pan-European financing platform and a mandatory informational referral system in the European Union to connect EU SMEs with capital providers, including commercial banks.

Christopher P. Buttigieg (2015) analyzed in a critical manner the past and present mechanisms for regulation and supervision of capital markets and, most importantly, proposed a theoretical framework for future supervision of European capital markets, based on the economic aspects of federalism that shares the surveillance between national and European authorities.

Wolf-Georg Ringe (2015) shows in his work both the merits and the drawbacks of this plan for European capital markets union. The author believes that this ambitious political project is an attempt to repair the relationship between the European Union and Great Britain, believing explicit that this project will help strengthen the companies' access to capital at the expense of traditional bank financing in Europe. But most important is the political message, because, according to the author, this union of capital markets is a commitment to the European Union's single market, especially with Britain in it.

William Wright and Laurence Bax (2015) measured in their study, the degree of development of European capital markets, showing that it, on average in the European Union is less than half the level of development of capital markets in the US. In their study, the authors identify countries with emerging capital markets (most countries that joined the EU after 2004) and underdeveloped capital markets, indicating the potential benefits of the capital markets union for their individual economies.

In the paper „Principles for the European Capital Markets Union - Strengthening capital markets to foster growth" (2015), the authors proposed the following principles in order to meet the European capital markets union: regaining the investor's confidence, improving the non-banking financing, promoting financial stability, increasing transparency for the stock market, removing the legislative, territorial, regulation and supervision barriers.

Stefanova and Stoev (2015) summarize the actual European Union's financial regulations and the ones that may be introduced for a full integration of European capital markets. At the same time, their work evaluates the measures proposed by the European Commission to finalize the pan-European capital market.

Brühl, Volker et al. (2015) analyzes the project of unification of European capital markets, showing that it is likely to strengthen the institutional architecture of economic and monetary union and to integrate European financial markets. The authors propose several ways to achieve the unification, through instruments that take into account the asymmetry of information and capital market imperfections, such as: harmonization of legislation debt restructuring in the European Union, the use of risk capital for financing innovation or start-ups, harmonization of financial accounting and financial reporting standards for SMEs, strengthening the private pension funds to deal equally the shares, bonds or government securities investments.

III. Opportunities brought by the Capital Markets Union

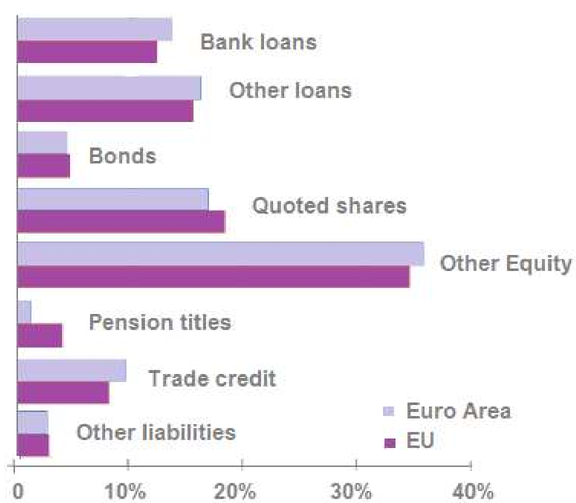
According to the Treaty of Rome, the capital must flow freely within the EU and thus the capital markets must be fully integrated to be able to generate growth. The integration of capital markets is essential for sustainable development of the European economy. This is because, due to competition, the financing cost will decrease for soliciting companies and the received interest for bank deposits will increase. All the Member States of the European Union benefit from EU capital markets, by achieving higher returns by local companies, a wider range of financial instruments and investors.

By removing territorial and legislative barriers, the European capital markets union could have a positive impact by reducing the development disparities existing within the EU capital markets. However, European capital markets union could help unlock billions of Euros to provide long-term funds required for investment companies (Wright and Bax, 2015).

Thus, through this capital markets union in the European Union would facilitate the access for companies, especially SMEs, to finance, to the detriment of the traditional bank funding. The companies can be financed through the capital market by issuing equity or debt instruments. (Bradea, 2014)

If a company chooses to finance by issuing a series of new shares, then there is an increase of its equity, number of shareholders, which will have to pay annual dividends, or to capitalize the profit, as it will decide the general meeting of shareholders. If a company chooses issuing corporate bonds for financing at the expense of bank credit, it will determine unilaterally the conditions of the loan or the interest rate value, that will be payed quarterly or every six months, with no guarantee or warranty. In general, the larger indebted companies can successfully issue corporate bonds on the capital market, while the small companies, the start-ups have more chance of success in bank loans financing.

Figure no. 2 *Sources of financing used by non-financial companies*



Source: Processed data from European Financial Stability and Integration Review, 2016.

In the Euro Area the non-financial companies are financed primarily through the unlisted shares issue. The financing through issuing bonds, bank loans and other loans represent approximately 17% each of total funding sources. In contrast, non-financial companies use different funding sources in the European Union. Within the old Member States prevail the financing through the issuance of quoted shares. In the new member states, the financing by listed shares represent less than 5% of total funding sources. The non-financial companies funding represents, usually no more than 50% of their liabilities. Financing by issuing corporate bonds is seldom used in the EU, with a few exceptions, among which Austria and the UK, where corporate bond financing has a share of about 10% in financial liabilities (European Commission, 2016).

An European capital markets union could encourage the cross-border financial activity of financial intermediaries, especially for countries that have been affected by the sovereign debt crisis. By removing territorial and legislative barriers the European capital markets union could have a positive impact on reducing disparities in development of capital markets existing in the European Union. If in emerging markets, in Central and Eastern Europe, where it is felt an acute need for infrastructure investment, is expected after capital markets union large flows of capital and foreign direct investment which will generate growth in GDP /capita. In conclusion, all EU countries will benefit from EU capital markets; it offers new opportunities for all stakeholders. But the generated benefits depend heavily on the thoroughness of the implementation of this action plan at national level.

IV. Limitation of the Capital Markets Union

A classification of the barriers to the creation of the European capital markets union is the following:

- Barriers to entry the capital markets of the European Union or in third markets - refers to the costs of listing and trading of the financial instruments.
- Barriers to integration. This includes existing major obstacles to the establishment and operation of cross-border companies and regulatory barriers, the cost of setting up investment funds and on achieving quality administrator who also varies between Member States.

The first barrier to entry is given by the high cost of issuing financial instruments in the capital market. From a study conducted by Oliver Wyman consulting firm (2013) was observed that only 5% of SMEs have issued equity instruments and only 2% of SMEs have issued debt instruments. SMEs in the European Union can be financed through the capital market in two ways: using traditional platforms, which are small but widely available to SMEs, such as Euronext or platforms, specifically designed for SMEs. New platforms of stocks and bonds represent the obvious alternative to bank financing, although the cost of issuing and trading of shares and bonds are high and involve complex legal and compliance framework. The total cost of printing (including the costs of underwriting, financial and legal advice) is estimated at approx. 90,000 euro and the annual fee for maintaining the platform is estimated at approx.100, 000 euro (PWC, 2015).

Another obstacle is the cultural barrier, because European investors are less attracted to invest, directly in financial markets. The Risk aversion of individual investors and a high level of saving block the development of European capital markets. Another barriers arising from the operation of capital markets are the measures and securitization of costs. The capital regulations have two contradictory effects on the development of securitized products: promote the issuance of securities and diminish the attractiveness of this securitization (PWC, 2015).

The barriers to unification and full integration of European capital markets are the followings. The first barrier of this kind refers to asymmetric information circulating among actors, the heterogeneity and insufficient financial information provided by SMEs, and the asymmetric information between EU countries on national accounting standards. However, transparency of information must be in compliance with national legislation and European directives, ie to be disclosed only information and public data (Cristian Popa Miheş & Carmen Ardeleanu, 2008).

A major obstacle in terms of European investors is that investments taxation is not harmonized in the EU countries. Differences between the tax treatment of European countries create conditions of unfair tax competition and prevents market integration: different regimes of taxation between residents and nonresidents (UK), significant differences in the taxation of investments of individuals and legal persons (Slovenia, France) and many exemptions on the taxation of dividends (UK, Slovenia, Czech Republic). These should be gradually harmonized, the fiscal responsibility being very important if we want to have a sustainable development of the European Union (Ardeleanu Carmen Popa, Diana Cârmaciu, 2010).

Another major obstacle is the lack of coordination and surveillance of specific regulations of capital markets in the European Union. Following the financial crisis from 2008 was created the oversight body of the European Securities and Markets Authority that coordinates the actions of national financial supervisors across Europe. However, the daily financial supervisory actions is left to national supervisors and the convergence of regulatory practices of national supervisory authorities is low.

In the EU, the capital market supervision is fragmented along national lines, with a minimum convergence. Until this oversight remains fragmented, it will be difficult to achieve the European capital markets union, to achieve capital markets more integrated and a viable alternative for bank financing (C.P. Buttigieg, 2015).

It is quite obvious that the plan to unify the European capital markets brings with it the need for new regulations, new reforms for their level of centralization, one of the most important future danger being the error of systemic regulatory (Jennifer Payne & Elizabeth Howell 2015). What we do not know is how it will work and will stand the unique set of rules to European capital markets at a future financial crisis.

V. Conclusions:

Under the Treaty of Rome, capital must flow freely within the EU and thus capital markets must be fully integrated to be able to generate economic growth and sustainable development. All EU countries will benefit from EU capital markets; it offers new opportunities for all stakeholders. But for a country to benefit fully from the Union depends heavily on the thoroughness of the implementation of this action plan at national level.

Through this union of capital markets in the European Union would facilitate companies' access to finance, particularly for SMEs, to the detriment of traditional bank financing in Europe. But there are several barriers to achieving union of European capital markets: barriers to entry on the capital markets of the EU or in third markets and barriers to unification and full integration of European capital markets.

So, it seems pretty obvious that this plan for unification of European capital markets brings with it the need for new regulations reformed them. But what we do not know is how it will work and will stand set of rules unique to European capital markets at a future financial crisis.

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