NEW FINANCIAL
Rethinking capital markets

THE POLITICS OF EU CAPITAL MARKETS

ANALYSIS OF THE SIZE, DEPTH & GROWTH POTENTIAL OF CAPITAL MARKETS IN EUROPE THROUGH THE LENS OF POLITICAL CHALLENGES

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By Christopher Breen, Maximilian Bierbaum, and William Wright

> *Building bigger and better capital markets in Europe is a long, complex, and technical project - but above all it is a political project. This report identifies more than 20 specific types of political resistance to developing capital markets in Europe, and outlines some of the tough political decisions that European and national authorities will need to take to unlock the potential benefits of capital markets for the EU economy and its citizens.*

The politics of capital markets

Building bigger and better capital markets in Europe is a long, complex, and technical project - but above all it is a political project. This is our eighth annual report on the state of EU capital markets, and this year it focuses on the politics of capital markets. It identifies more than 20 different but interconnected types of political resistance to the capital markets union (CMU) project and outlines how to address them.

European capital markets are heading slowly in the right direction, but they are still not as developed as they could or need to be. CMU needs a combination of EU-wide 'top down' measures to encourage harmonisation and national-level 'bottom up' measures to increase capacity. While the main achievement of CMU so far is to have put capital markets on the political agenda across Europe, it is not a political priority in most member states and faces many political hurdles ahead. Member states often resist 'top down' efforts to drive progress, while simultaneously shying away from or delaying the introduction of their own 'bottom up' initiatives.

In light of Brexit, Covid, Russia's invasion of Ukraine, and the subsequent energy crisis, it is understandable that EU governments do not always have enough bandwidth or political capital to focus on CMU. However, we think strong capital markets would strengthen Europe's economic resilience, help fuel an economic recovery, and help address systemic challenges such as demographic change and the transition to net zero.

With this report and our unique analysis of the size, depth, and growth potential of capital markets across Europe, we hope to underline to European policymakers the urgency and benefits of developing bigger, better, and more integrated capital markets. The good news is that European capital markets are bigger and deeper than they have ever been. The not-so-good news is that companies in the EU are still heavily reliant on bank lending for their funding, and there is a stubbornly wide range in the depth of capital markets across the EU.

The report's first section identifies more than 20 specific types of political obstacles to developing capital markets in Europe. The second section shows the size and depth of EU capital markets in 2021. We then take a look at what has (and has not) changed since CMU was launched; analyse the huge but realistically achievable growth opportunity in selected capital markets sectors; and discuss how to encourage European and national authorities to take some of the tough political decisions to drive forward more growth and integration across EU capital markets.

We hope this research provides relevant insights and we are always interested in feedback. I would like to thank Christopher Breen for collecting and analysing the wealth of data that underpins this report, William Wright for his support and feedback, Dealogic and Invest Europe for providing access to their data, and our members for supporting our work on bigger and better capital markets. Any errors are entirely my own.

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New Financial is a think tank that believes Europe needs bigger and better capital markets to help drive growth and prosperity.

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Here is a short summary of the report:

1. **A long-term game:** building bigger, deeper, and more integrated capital markets in Europe requires a combination of EU-wide 'top down' measures to encourage harmonisation and national-level 'bottom up' measures to increase capacity. CMU will not be built in Brussels but in each and every member state. It is a long-term game and will take decades to become a reality.

2. **The politics of capital markets:** there is noticeable political resistance to CMU in member states across Europe. Driving CMU forward requires understanding and addressing five different but interconnected types of political obstacles: deeply rooted philosophical, cultural, and political scepticism; a desire to protect domestic markets; a fear of loss of sovereignty and control; tension between Brussels and member states; and the limited political bandwidth available for longer-term and unpopular projects.

3. **Bigger and deeper:** EU capital markets have grown consistently since the launch for CMU in 2015 and, relative to GDP, are now deeper than ever before (overtaking their previous peak in 2007 before the financial crisis). In the EU, capital markets are moving in the right direction, but they are still not as developed as they could be.

4. **A wide range in depth:** every year this report measures the depth of EU capital markets in different sectors of capital markets activity in all EU member states, and every year we see a huge range in depth that shows little sign of narrowing. The range in depth of capital markets across the EU is far greater than the difference in depth between the EU and the US, or the EU and the UK.

5. **A Franco-German duopoly:** after Brexit, France and Germany have become the largest and second largest (or vice versa) EU markets in 14 out of 20 capital markets sectors. In terms of size, France and Germany combined account for more than 50% of EU activity in five sectors, and for more than 45% of activity in another four.

6. **A rising star:** after a bumper few years in equity markets activity, capital markets in Sweden are now almost as deep as in the UK. Over the past few years the depth of capital markets has grown much faster in Sweden than in the rest of the EU and it has overtaken the Netherlands as the poster child for EU capital markets. It remains to be seen whether Sweden can maintain this depth, but it shows what is possible.

7. **The reliance on banks:** companies in the EU are still heavily reliant on bank lending for their funding despite some progress over the past decade. In the face of economic headwinds, structural challenges, and regulatory reform, banks will be unable to provide the necessary funding for European companies on their own.

8. **Deeper pools of capital:** deep pools of long-term capital such as pensions and insurance assets - as well as direct retail investment - are the starting point for deep and effective capital markets. But pensions assets in the EU remain less than a third as big relative to GDP as in the UK. Shifting more savings from bank deposits to investments would deploy more capital to help drive a more sustainable recovery in the longer term.

9. **Game-changing growth:** there is huge potential for growth in capital markets across the EU: an additional 4,800 companies could raise an extra €500bn per year in capital markets and an additional €12tn in long-term capital could be put to work in the economy. Progress towards this growth would significantly reduce the reliance of the EU economy on banks, boost growth, innovation, and jobs, and provide a more sustainable future for EU citizens.

10. **Tough decisions ahead:** there is no silver bullet or magic wand to address the many types of political resistance to CMU. To drive more growth and integration in European capital markets, CMU needs a political reset to inject new urgency into the project, a new narrative, and a consistent and enduring framework based on core principles.

The size and depth of capital markets in Europe

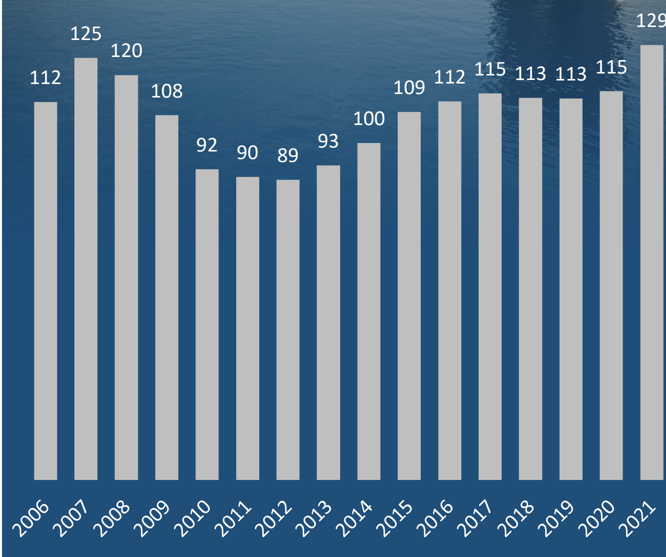
There is a lot of data in this report, and it would be pretty exhausting to read it all in one go. This section provides ten key takeaways on the size, depth, and growth potential of European capital markets.

1. BIGGER AND DEEPER

+29% The growth in capital markets depth in the EU between 2014 and 2021

EU capital markets are bigger and deeper than they were before CMU was launched in 2015. In terms of size, the value of activity in nearly all sectors of capital markets has increased between 2014 and 2021. In terms of depth, EU capital markets are deeper than they have ever been. With 2021 having been a bumper year, it remains to be seen whether the EU can maintain this depth.

The depth of EU capital markets across 24 different sectors of activity since 2006 (rebased to EU average =100 in 2014):



2. A RANGE IN DEPTH

28x The multiple between the EU's most and least developed capital markets

The range in depth of capital markets across the EU is far greater than the range in depth between the EU and the UK: Luxembourg's capital markets are 28x deeper than Slovakia's, while Dutch markets are twice as deep as in Italy or Germany.

3. A LONG WAY TO GO

65% The Netherlands, Denmark, and Sweden's combined share of EU pension assets

The Netherlands, Denmark, and Sweden combined account for nearly two thirds of the EU's pension assets - €3tn in 2021 alone - but only 11% of EU GDP.

4. STUBBORNLY UNCHANGED

⅓ Nearly a third of EU household financial assets are in bank deposits

Households in the EU divide their financial assets (excluding property) roughly equally in three parts: a third in bank deposits, a third in pensions and insurance, and a third in stocks, bonds, and funds - a ratio stubbornly unchanged since 2014.

5. KICKING THE HABIT

75% The proportion of bank lending of total corporate debt in the EU

On average, bank lending represents 75% of corporate borrowing for EU companies. This is the inverse of the US, where bank lending accounts for just 26% of corporate borrowing.

6. SIGNIFICANT GROWTH POTENTIAL

+€12tn The potential growth in pools of long-term capital in the EU

We estimate that pension and insurance assets in the EU could nearly double to €127,000 per household. The additional €11.8tn in long-term capital would significantly lower the future pensions burden on taxpayers and government budgets and could be put to work in the wider EU economy.

+4,800 The potential increase in the number of EU companies raising money in the capital markets each year

We estimate that the number of companies raising money in capital markets could almost double to around 11,000 - an additional 4,800 or so companies a year - and the amount of money being raised would jump from €689bn a year today to nearly €1.2tn.

7. RECORD-BREAKING SECTORS

110% ESG corporate and government bond issuance growth in the EU

We are seeing record-breaking growth in a number of sectors: in 2021, ESG corporate and government bond issuance in the EU reached €207bn (+110% year-on-year), private equity (PE) fundraising reached €72bn (+57%), and venture capital (VC) deals reached a value of €15bn (+88%).

8. A FRANCO-GERMAN DUOPOLY

€3.2tn Insurance assets in France account for 38% of the EU's total

France and Germany combined account for more than 50% of EU activity in five sectors (insurance assets, value of corporate bond market, assets under management, corporate bond issues, value of equity trading) and for more than 45% of activity in another four. France is the largest market in 11 sectors, Germany in five.

9. A FOCUS ON SWEDEN

108 The number of companies that went public in Sweden in 2021

329 companies went public in the EU in 2021. Sweden made up a third of all EU initial public offerings (IPOs), and a quarter of EU IPO value, despite accounting for only 4% of the EU's GDP. Sweden's capital markets are now almost as deep as the UK's and give an idea of what EU capital markets could look like.

10. THE GLOBAL PERSPECTIVE

44% The depth of EU capital markets relative to the UK's

EU capital markets are still not as developed as they could or need to be: capital markets in the US are nearly twice the size relative to GDP than in the UK, which in turn is more than twice as deep as the EU. Despite making progress, the EU still has a lot of catching up to do.

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A complementary role

Bigger and deeper capital markets can bring many benefits to the European economy and citizens in terms of investment, jobs, and growth. In the face of current economic challenges, this has become even more urgent. Here is a selection of some of the potential benefits of bigger capital markets in Europe:

1. **A wider range of funding:** capital markets provide a valuable additional source of financing for EU companies that complements traditional bank lending and provides companies with a wider range of sources of potential funding. This reduces the economy's reliance on bank lending and enables companies to diversify both the sources of the capital they use and the term over which they borrow.

2. **Economic resilience:** capital markets help increase the 'shock absorption' capacity of the wider economy. The impact of an economic downturn is transmitted less quickly and directly to individuals in economies with more developed capital markets than those that rely more heavily on bank lending, and they tend to recover quicker.

3. **Access to capital:** capital markets offer the right companies the ability to raise a larger amount of capital at a lower cost and for a longer period than borrowing from their bank. Through equity financing they provide high potential companies - the sort of companies that Europe needs to drive growth, innovation and jobs - with risk capital that banks are not designed to provide.

4. **Increase bank lending capacity to SMEs:** capital markets are not a realistic option for most SMEs, but wider use of capital markets by companies that are large enough to access them can help free up bank balance sheets and enable banks to focus on lending to smaller companies that need it the most. Freeing up banks to support SMEs is more vital than ever.

5. **Capital allocation and standards:** capital markets improve what economists call the 'allocative efficiency' of capital by effectively crowdsourcing funding to a wide range of investors and channelling investment to those companies that can make the best use of it. The need to compete for capital and be accountable to investors helps improve discipline, operational standards, corporate governance, performance, and transparency.

6. **More flexible:** while capital raising can come to an abrupt halt in the wake of market disruption, capital markets rebound faster than bank lending. The flow of gross new bank lending in the eurozone fell by a nearly third from 2008 to 2021, but issuance in European bond markets has doubled relative to GDP since 2007.

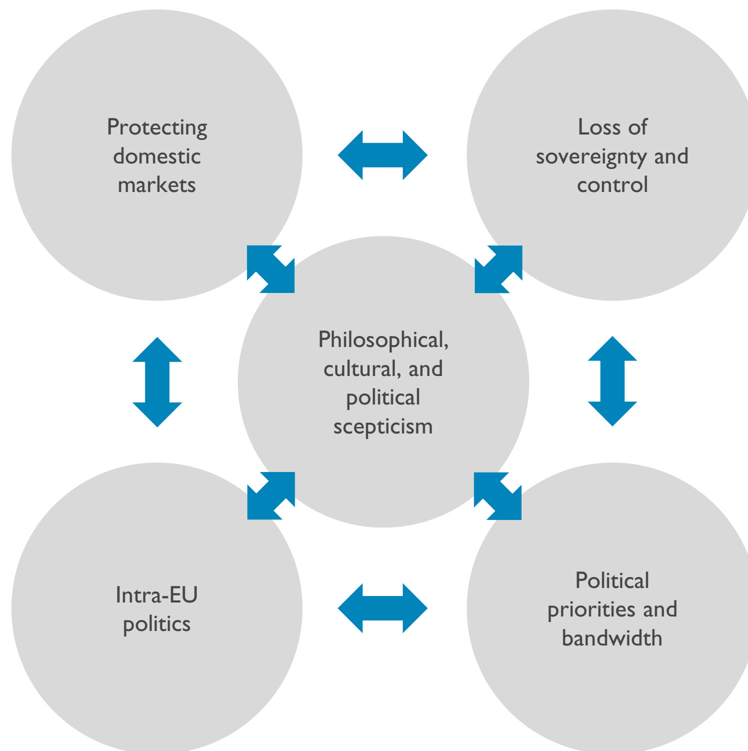
7. **Long-term returns:** markets can be volatile in the short term but investing in capital markets across a range of assets over the long term generates higher returns than keeping savings in the bank, providing a better future income in retirement. Long-term pension savings also reduce the future economic burden on EU taxpayers and government budgets and help address the demographic time-bomb faced by many countries in the EU.

8. **Longer-term investing:** capital markets provide long-term investors such as pension funds and insurance companies with a wider range of assets to invest in that better match their liabilities. Annual pension contributions by employers and employees add up to billions a year that can be put to work supporting the economy in much needed areas such as investment in infrastructure and innovation.

9. **Wealth creation:** capital markets democratise wealth creation by enabling a wider range of people to invest in high growth and successful companies through their investments and pensions, particularly in equity markets. Over time, money that it is invested in capital markets grows faster than money that is deposited in the bank.

10. **Sustainable growth:** Europe needs to invest between €600bn and €1 trillion a year over the next few decades to address climate change and finance a transition to a more sustainable economy. Bank lending and taxation are not enough: capital markets can close this gap by providing capital at scale through a wide range of instruments.

Fig.1 What are the underlying reasons for political resistance to CMU?



Political hurdles at every turn

Building bigger, deeper, and more integrated capital markets in Europe is fundamentally a political project as well as a technical and regulatory one. Progress on the combination of EU-wide 'top down' measures to encourage harmonisation and national-level 'bottom up' measures to increase capacity requires political momentum from the top down and political buy-in from individual member states. It can be tempting to bundle up political resistance to CMU as 'politics'. However, we think it is more useful to identify the different types of political resistance to better understand the underlying reasons behind them and to identify how to address them. We have identified more than 20 specific types of political opposition and grouped them into five broad but interconnected and related themes (Fig.1).

1) **Philosophical, cultural, and political scepticism:** the dominant European social model and a widespread mistrust of finance, money, and markets means that many Europeans are not natural supporters of capital markets.

2) **Protecting domestic markets:** while the EU as a whole would benefit from more integrated capital markets, domestic players with political connections benefit from existing national barriers and complexity - and have a lot to lose in the short-term from more competition and integration.

3) **Loss of sovereignty and control:** more integration at an EU level inevitably involves a trade-off with sovereignty and control at a national level. Without a sense of urgency, many member states are reluctant to embrace these trade-offs.

4) **Intra-EU politics:** many countries - particularly smaller economies with less developed markets - view CMU as something being imposed on them from Brussels, while other member states are jostling for position with each other.

5) **Political priorities and bandwidth:** national governments have to deal with domestic political priorities and have limited bandwidth and political capital to spend on projects that are unpopular or of limited relevance to their voters, or that are too long-term for them to receive the political benefits.

1) Philosophical, cultural, and political scepticism:

Political opposition based on cultural fabric and a dominant social model: the dominant European economic model has been shaped by decades of social democratic policies with a particular focus on a strong welfare state. Many people argue that this model does not need bigger and better capital markets, and - worse - that more capital markets would undermine the cultural and social fabric. For example, the pension system in France (as in many countries) is deeply embedded in the national psyche and previous attempts at significant reform have failed.

While Europe's political landscape is constantly shifting, it has a long tradition of governments and political factions that are not natural supporters of capital markets, such as socialist governments, strong green parties, and more populist movements. When CMU was launched, many unions and environmental groups criticised the plans, with the biggest pan-European trade union saying at the time it would 'incentivise financial actors to re-enter a casino economy', and some of CMU's fiercest critics in the European Parliament have been the greens, socialists, and hard right. However, this does not mean things are set in stone. In Germany, the SPD and Greens have formed a coalition government with the pro-business FDP who want to encourage Germans to invest more.

A lack of trust: across Europe there is a long-standing historical lack of trust in banking and finance, which is often viewed suspiciously as Anglo-Saxon capitalism, speculation, 'casino banking', and a driver of instability and inequality with little or no social value. Bigger capital markets are broadly associated with more foreign banks, more bonuses, more hedge funds, and more crises. This antipathy is not new: one academic study of sentiment towards banking and finance based on analysis of eight million books in different languages from 1870 to 2009 found that sentiment in the US and UK is twice as positive as in France, Italy, and Spain, while average sentiment in Germany is negative (and has been for the past 150 years).

A recurring nightmare: many European countries had a terrible 2008 financial crisis and memories of their experience with financial markets - and particularly with international firms - are still understandably raw. Much of the programme of regulatory reform in Europe since 2010 has been driven by the desire to ensure that such a crisis cannot happen again. Many Europeans associate the crisis with (US) investment banks, (US) hedge funds, and capital markets more generally. Even within Europe, international banks amplified the effects of the crisis: in the decade before the crisis, many countries in Central and Eastern became reliant on Western European banks, who retreated to their home markets during the crisis.

Getting their fingers burned: this suspicion echoes the direct experience of millions of individuals across Europe whose previous encounters with capital markets did not end well. For example, when Deutsche Telekom was privatised in the 1990s during the dot-com bubble, risk-averse Germans suddenly started buying stocks, only for many to lose a lot of money. For many potential German retail investors, Deutsche Telekom (and the collapse of the Neuer Markt) is the reason they are so suspicious of the stock market. The harrowing experience of hyperinflation in the 1920s and to a lesser extent the 1970s also left deep cultural scars.

Lack of comfort engaging with risk and money: a lack of trust in banking and finance, combined with low levels of financial literacy and a reliance on welfare state policies, means that many Europeans are uncomfortable engaging with or talking about money. Many Europeans prefer safe but lower returns over the risk of higher returns, as demonstrated by stubbornly high levels of bank deposits and low levels of retail participation in the stock market. When the ECB first lowered interest rates and then introduced negative rates, it was widely accused of harming European savers, who have been earning a guaranteed negative real return for more than a decade.

This highlights the risk of taking no risk. Perhaps the best example in relation to CMU is the pan-European pension product that was launched in March 2022 after seven years of consultation and argument. One of the main hold-ups - and one of the main reasons that this product is not yet commercially available - has been that some member states insisted that the product must include an element of guaranteed return.

2) Protecting domestic markets:

Cui bono? The fundamental political challenge for CMU is while the EU as a whole would benefit from bigger and more integrated capital markets, domestic players benefit from the existing national barriers and complexity. A lot of people in a lot of countries would feel the impact of removing those barriers very acutely in the immediate term, whereas the benefits would only be felt at a more diffuse level in the longer term. Larger firms with a strong position in their domestic market (and many smaller local firms) are protected from the full force of cross-border competition that would come with a genuine single market and have lobbied their governments and the EU. Most recently, for example, many incumbent national stock exchanges fought hard against EU proposals for a consolidated tape that would open up more competition in trading on different venues across Europe.

A local imperative and double standards: calls to protect domestic markets are not just based on economics but also on local market customs and traditions, particularly the role of the banking system. The Czech National Bank has argued CMU would provide no 'greater added value' as bank lending to the economy works, while the Bundesbank in Germany has argued that a local bias was particularly relevant for SMEs when raising finance. Sometimes, this local imperative can create a sense of double standards, with countries demanding free access to markets across the EU for market participants supervised in their jurisdictions while getting touchy about companies from the rest of the EU accessing their markets.

Getting the balance right: any European project faces the challenge of accommodating the different economic models, financial systems, and levels of development of 27 member states. With CMU, this is an extreme problem: the advanced level of capital markets in countries like Sweden, the Netherlands, and Denmark is completely alien to big economies such as Germany, Italy, and Spain - let alone smaller markets in Central and Eastern Europe. While more integrated capital markets would benefit all EU countries, some less developed markets might be more supportive of plans if they could take things at a slower pace. Equally, countries with already deep capital markets might ask why they should introduce reforms at all if capital markets are functioning well there. For CMU to be successful, it may be necessary to strike a balance between establishing a centralised 'core' or minimum level of CMU, while simultaneously accommodating the needs of local markets.

3) Loss of sovereignty and control:

Sovereignty, national interests, and red lines: pooling a degree of national sovereignty for the greater good is an essential element of the European project, but is one of the key obstacles when it comes to CMU. Banking and finance are so central to the economies of individual member states that the desire to retain sovereignty and control is perhaps understandable, but the scale and ferocity of resistance in areas such as supervision are still surprising. At the same time, when you overlap the red lines of 27 member states across dozens of initiatives within CMU, you have a recipe for stalemate.

For example, when the 2015 Five Presidents Report argued that CMU should ultimately lead to a single European markets supervisor, it was met with strong opposition from the UK and other countries. This is despite the fact that members of the eurozone have already given up their currencies and monetary sovereignty, as well as a degree of sovereignty over banking supervision as part of banking union. So far only a fraction of EU capital markets is centrally supervised, such as credit rating agencies under the direct supervision of ESMA.

Not quite enough of a crisis: it is a cliché that the EU is forged in crisis, but one of the problems with CMU is that there has not been a big enough crisis for which CMU is the obvious answer. The rapid if incomplete progress of banking union was a direct response to the euro crisis, and the decision to allow central supervision of credit ratings was in part a response to the sovereign debt crisis. While Covid, invasion of Ukraine, and the energy crisis make the case for CMU more urgent, the challenge is that CMU is not an 'oven ready' solution to address it. Without a sense of urgency, many member states are unwilling to cede more sovereignty or give up more control.

A circular argument: the debate around sovereignty and local markets can sometime descend into a circular argument. The line that 'this proposal will not work for us because we do things differently here' can be very close to saying 'we do things differently here to ensure that this proposal will not work'. For example, everyone agrees that addressing insolvency legislation will make cross-border investments easier and drive capital markets integration. At the same time, insolvency legislation is so deeply engrained in legal traditions and national norms that member states do not know how - or do not want - to start reforming it.

Turkeys voting for Christmas: unsurprisingly, the strongest opposition often comes from those who have a lot to lose. More integrated capital markets mean more consolidation among market participants, financial institutions, and regulators. This in turn means that many senior executives at the top of their national game face losing their power or their jobs. Why would the CEO of a national stock exchange agree to become head of the local office of a larger international exchange group? Why would a national supervisor vote to become the local branch manager of a European-wide authority, or agree to something that gives them less control over what they do for a living? Why would financial institutions, asset managers, or market infrastructure providers be keen to give up the close relationships they have built with their national supervisors?

Symbolism: in any country national institutions and symbols are important, and they play a role in driving political resistance to CMU. Just as any country should have its own army, national anthem, and flag carrying airline, many argue that a country should have its own stock exchange, supervisor, and national champions. This is compounded by the fact that many exchanges and financial institutions carry the name of their country or capital city, and many countries persist in protecting these 'national' institutions despite the overwhelming evidence that they create inefficiencies that act as a drag on the national economy. Local market participants sometimes prey upon this this symbolism and effectively lobby national governments to protect outdated national infrastructure.

4) Intra-EU politics:

Not invented here: a strong view in many countries is that CMU is something being imposed on them from Brussels, not something in which they are actively involved. European member states are generally suspicious of rules and processes they have not designed themselves. This can apply as much to larger economies with more developed capital markets as it does to smaller economies for whom not much of CMU is particularly relevant. The NextCMU project led by France, Germany, and the Netherlands in 2019 can be seen in part as an attempt by key member states to wrestle back a degree of control of CMU from the EU. These concerns include: 'let us not try to fix something that is not broken'; 'we have done things this way for decades'; or 'just because it works in one country does not mean it will work here because we are different'.

A 'big boys' club: many smaller economies with less developed capital markets feel that CMU is a plan for bigger economies with more developed markets. This is perhaps not surprising when France and Germany between them account for around 45% of all capital markets activity in the EU, according to our research, and the five largest economies represent over 70% of all activity. Many smaller markets are concerned that CMU is irrelevant to them, that EU-wide rules do not take into account the nascent state of their markets, that local firms will be swallowed by larger players, and that their concerns are not listened to in Brussels.

Competition between markets: within the EU there is competition between financial centres for business. This creates fear that more integrated capital markets will mean business leaving local markets and moving to more competitive centres: after all, as part of the single market London increased its dominance of European capital markets as many firms moved whatever was not nailed to the floor from their local offices to the UK. The Italian government and the French regulator warned of this risk in their responses to the original CMU consultation. Brexit might change this conversation: member states know that a strong, integrated European capital market would be in a better position to compete with London than individual financial centres dispersed across the continent.

An intra-EU powerplay: sometimes, however, member states can be quite selective with their feelings and CMU can be a vehicle for political jockeying between member states. For example, the countries forming the New Hanseatic League in the north west of the EU were more excited about CMU than some others as they hoped bigger European capital markets would reduce the need for the French-German vision of deeper economic and monetary integration. This suggests the Hansa countries' support of more integrated capital markets is at least partly driven by the hope to avoid more European integration in other areas.

5) Political priorities and bandwidth:

A lack of relevance and a lack of understanding: policymakers across Europe do not want to spend political capital on something they do not think is relevant to their country, or something so long-term they will not receive the political benefits, or something they do not really understand. Of the 400 written responses to the initial CMU consultation, nearly three quarters came from just six countries, with just a quarter from the remaining 22 countries (22% were from the UK, which has a strong financial services sector, and 16% from Belgium, home of the Commission and many engaged lobbying organisations).

Even after the Brexit referendum, many EU countries showed limited interest in CMU 2.0. It is hard to get national governments excited about listings reform or a consolidated tape when they only have a tiny stock market. This lack of interest, and perhaps a lack of understanding, might make policymakers susceptible to local lobbying: if you do not understand you do not need to have a national stock exchange to have access to capital, you are more susceptible to lobbying from people who insist you do need to have your own national stock exchange.

Competing political priorities: national governments do not have enough bandwidth to focus on CMU even if they wanted to. Heads of government or finance ministers agree to something in Brussels and then often seem to have forgotten about it by the time they return home. National political priorities, the immediate demands of national media, and relentless electoral cycles, inevitably get in the way of working on a diffuse project like CMU. In the past five years, governments have had to deal with Brexit, Covid, the invasion of Ukraine, the subsequent energy crisis, as well as rising geopolitical tension, economic nationalism, and populism. This leaves little room for unpopular, long-term, or (seemingly) irrelevant policies on the minutiae of cross-border fund marketing rules.

Short-term vs long-term: the problem with bandwidth is made more acute by the fact that CMU has always been a long-term project and will take many decades to take shape. The first few terms of CMU are all about laying the foundations for the future, with little tangible short-term reward. In the face of urgent crises and the inevitable twists and turns of national politics, how much time are governments realistically going to spend on pushing through unpopular or abstract reforms which are unlikely to generate any political reward until long after they have left office? As Jean-Claude Juncker once joked about the challenges of politics: 'We all know what we need to do, but we don't know how to get re-elected after we have done it'.

Top down: while CMU has to be built in each and every member state, it needs strong support and momentum from the top down. As President of the European Commission from 2014 to 2019, advancing CMU was one of Jean-Claude Juncker's top priorities. He oversaw the launch of the project and mentioned it in all four State of the Union addresses he delivered. This is unsurprising given his background as economic specialist and former finance minister and Prime Minister of Luxembourg - a country with deep capital markets. His successor Ursula von der Leyen has had plenty of other issues to deal with - most obviously Brexit, Covid, and Ukraine - but it is notable that she had been less public in her support for CMU. She has a stronger background in security and defence, which is ideal for the current crises, but she has only mentioned CMU in three out of the 243 speeches she has given that are available on the Commission's website and she has not mentioned it at all in nearly two years. Out of more than 3500 tweets from her account since she took office in July 2019, just one tweet from September 2019 mentions CMU. This sends an oblique message that CMU is not a top priority at the very top of the EU.

EU capital markets: size & depth

In this section we look at the size and depth of EU capital markets in each EU country across 27 sectors of activity, discuss how companies in the EU are funded, and analyse the available pools of long-term capital in the EU.

Range in depth of EU capital markets 14

Depth of EU capital markets by country 15

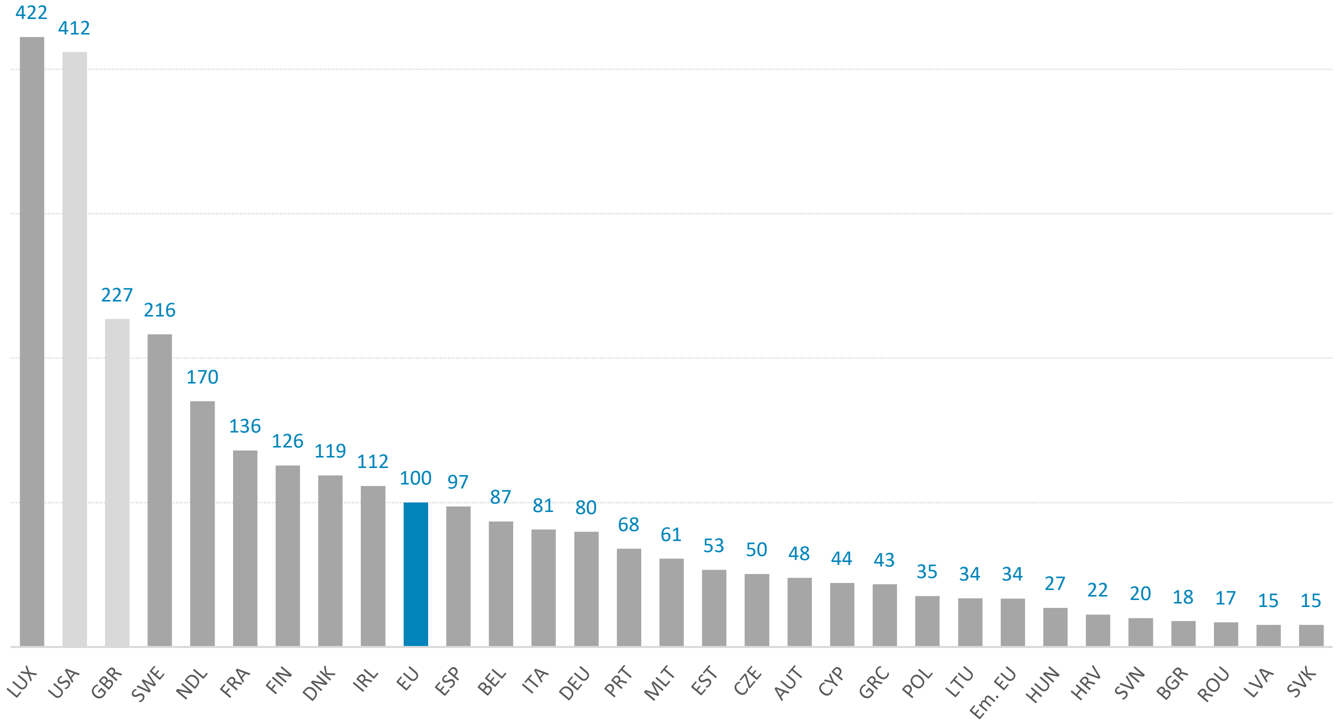
Size of EU capital markets by sector 16

How companies in the EU are funded 17

Pools of long-term capital in the EU 18

Fig.2 What is the range in depth of capital markets in the EU?

This chart shows the overall average depth of capital markets across 27 different sectors of activity over the three years to 2021.
Note: rebased to EU average = 100



Source: New Financial

A wide range

A good starting point to understand how developed capital markets in the EU are is to have a look at the depth of capital markets across member states and at the EU level. The range in depth of capital markets across the EU is far greater than the difference in depth between the EU and the US, or the EU and the UK. Fig.2 shows the wide range in the depth of capital markets across 27 sectors of activity in each country.

Capital markets in the US (on 412) are nearly twice the size relative to GDP than in the UK (on 227), which in turn is more than twice as deep as the EU (100). In the last year, the depth of US capital markets has increased relative to the EU, whereas the UK and Luxembourg have remained virtually unchanged in relative terms. Luxembourg still has the deepest capital markets in the EU (422), mainly because of its role as a regional hub for investment funds and international bond issuance, but in terms of size Luxembourg's capital markets are very small (around 2% of EU activity and just 0.5% of EU GDP). After a bumper year in equity markets activity, Sweden's capital markets are now almost as deep as in the UK.

There are three clear groups of countries in terms of the depth of their capital markets. The first group is made up of wealthier countries in the north west of the EU such as Sweden, the Netherlands, and France. These countries' capital markets are significantly more developed than the EU average and give an idea of the potential of CMU.

The countries in the second group have relatively developed capital markets but are less developed than the EU average (between 80% and 97% of the average). In many cases, there is a big disparity between the depth of capital markets and the size of their economy. Three out of the four biggest economies in the EU - Germany, Italy, and Spain - have capital markets that are less developed than the average. And finally, there is a long tail of smaller economies where a fully developed CMU could make a big difference.

Fig.3 What is the depth of capital markets across EU countries?

This table is a ranking of the overall depth of capital markets in each EU country and the UK across 27 sectors of activity. It is divided into four groups, from most developed (top quartile) to least developed (bottom quartile).

Note: the numbers in brackets show last year's position of each country in the ranking based on revised 2020 data

● Top quartile ● Second quartile ● Third quartile ○ Bottom quartile

Group	Rank	Country	Overall depth	Pools of capital	Equity markets	Bond markets	Asset management	PE, VC & crowdfunding
Top quartile	1 (=)	Luxembourg	Top	Top	Top	Top	Top	Top
	2 (=)	UK	Top	Top	Top	Top	Top	Top
	3 (=)	Sweden	Top	Top	Top	Top	Top	Top
	4 (=)	Netherlands	Top	Top	Top	Top	Top	Top
	5 (=)	France	Top	Top	Top	Top	Top	Top
	6 (7) ↑	Finland	Top	Top	Top	Top	Second	Top
	7 (6) ↓	Denmark	Top	Top	Top	Second	Top	Second
Second quartile	8 (=)	Ireland	Second	Third	Second	Top	Top	Second
	9 (=)	Spain	Second	Second	Second	Second	Third	Second
	10 (=)	Belgium	Second	Second	Second	Second	Second	Second
	11 (=)	Italy	Second	Second	Second	Second	Second	Second
	12 (=)	Germany	Second	Second	Second	Second	Second	Second
	13 (=)	Portugal	Second	Second	Third	Second	Third	Third
	14 (=)	Malta	Second	Second	Third	Third	Second	Third
Third quartile	15 (18) ↑	Estonia	Third	Third	Third	Third	Third	Top
	16 (15) ↓	Czech Rep.	Third	Bottom	Third	Second	Bottom	Third
	17 (16) ↓	Austria	Third	Second	Second	Third	Second	Third
	18 (17) ↓	Cyprus	Third	Third	Second	Bottom	Second	Third
	19 (20) ↑	Greece	Third	Bottom	Third	Third	Bottom	Bottom
	20 (19) ↓	Poland	Third	Bottom	Third	Third	Third	Bottom
	21 (22) ↑	Lithuania	Third	Third	Third	Third	Third	Second
Bottom quartile	22 (21) ↓	Hungary	Bottom	Third	Bottom	Third	Bottom	Third
	23 (24) ↑	Croatia	Bottom	Third	Bottom	Bottom	Bottom	Bottom
	24 (23) ↓	Slovenia	Bottom	Third	Bottom	Bottom	Bottom	Third
	25 (26) ↑	Bulgaria	Bottom	Bottom	Bottom	Bottom	Bottom	Bottom
	26 (25) ↓	Romania	Bottom	Bottom	Bottom	Bottom	Bottom	Bottom
	27 (28) ↑	Latvia	Bottom	Bottom	Bottom	Bottom	Third	Bottom
	28 (27) ↓	Slovakia	Bottom	Bottom	Bottom	Bottom	Third	Bottom

A Franco-German duopoly

Large and deep capital markets provide a more diverse, flexible, and resilient source of funding for the wider economy than bank lending alone. One of the most striking, but perhaps unsurprising, aspects of EU capital markets is that depth does not always translate into size.

Fig.4 shows the three largest EU markets in each sector measured by total value of activity over the three years to the end of 2021. In 14 out of the 20 sectors we are looking at, France and Germany are the largest and second largest (or vice versa) markets. In terms of size, France and Germany combined account for more than 50% of EU activity in five sectors, and for more than 45% of activity in another four. This effectively creates a Franco-German duopoly across most activity.

France is the largest market in 11 sectors. The country accounts for 40% of EU private equity fundraising, 38% of the EU's corporate bond markets, and 35% of the EU's insurance assets. Germany is the largest market in another five sectors. For reference, France's share of EU GDP is 17%; Germany's share is 25%.

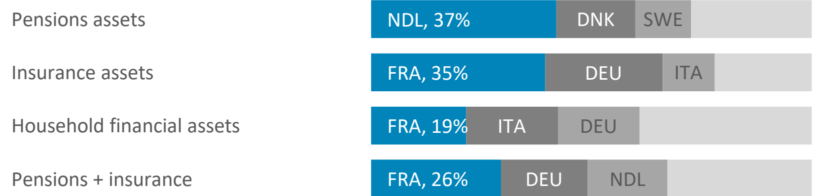
Luxembourg, the EU member state with the deepest capital markets by some distance, accounts for 32% of the value of the EU's investment funds, but this is the only area of activity where Luxembourg can compete with other markets in terms of size.

Pension assets are the only area of activity where neither France nor Germany are one of the three largest EU markets. The Netherlands, Denmark, and Sweden combined account for nearly two thirds of the EU's pension assets - €3tn in 2021 alone - but only 11% of EU GDP. Deep pools of long-term capital are the starting point for deep and effective capital markets, and all three countries have capital markets that are more developed than the EU average.

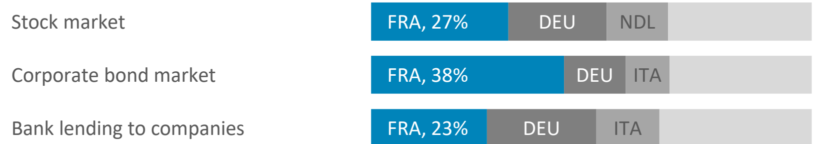
Fig.4 What is the size of EU capital markets by sector?

The three largest markets in the EU in each sector measured by total value of activity in the three years to 2021

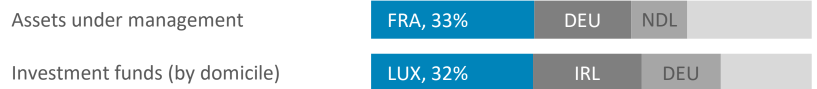
Pools of capital



Market / asset values

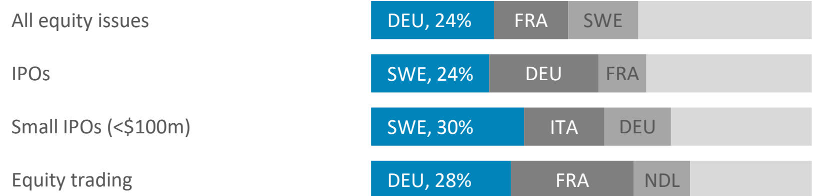


Asset management



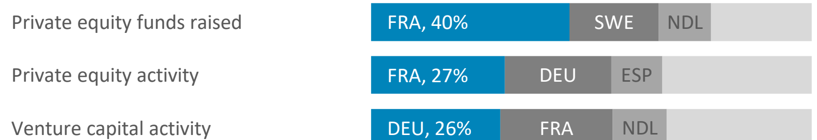
Debt markets

Equity markets



Mergers & acquisitions

Private equity & venture capital



Source: Dealogic, OECD, Insurance Europe, Eurostat, FESE, local exchanges, ECB, BIS, National Central Banks, EFAMA, Invest Europe

Kicking the habit

While there are some encouraging signs showing companies in the EU have begun to reduce their reliance on bank lending over the past few years, the EU economy is still heavily exposed to a struggling banking sector. Fig.5 shows the extent to which companies in the US, the UK, and the EU rely on bank lending as a source of funding. The good news is that corporate bonds' share of company financing in the EU has increased by six percentage points, a welcome - albeit small - increase.

On average, bank lending represents 75% of corporate borrowing for EU companies and bond markets account for 25%. This is the inverse of the US, where bank lending accounts for just 26% of corporate borrowing. In the UK, corporate bonds represent nearly half of all corporate borrowing.

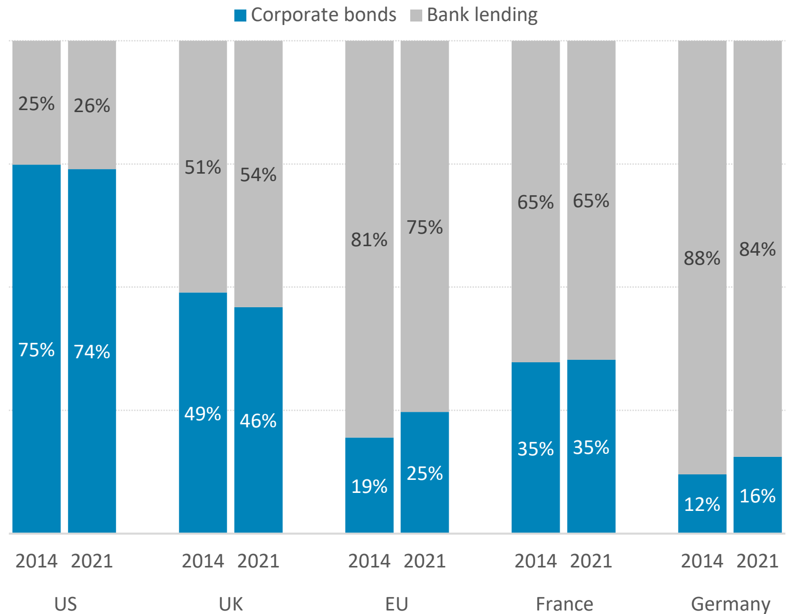
There is a wide range in the level of adoption of corporate bond markets in the big four economies in the EU. In France, corporate bonds represent a significant part of corporate borrowing (35%). Corporate bond markets in Germany, Italy, and Spain are far less developed. Here, companies rely on bank lending for more than 80% of their borrowing.

The reliance on bank lending and the slow progress towards more capital markets financing is more evident in the way EU companies are funded. Fig.6 shows the structure of liabilities of non-financial companies in the UK, EU, and three of the biggest EU economies.

Bank loans represent more than a quarter (26%) of the total liabilities of non-financial companies in the EU, whereas listed shares and debt securities account for a fifth of all corporate financing. EU companies have a preference for unlisted shares and other non-public equity instruments which account for more than 40% of all non-financial corporates' liabilities. Along with unlisted shares, the EU's share of listed shares has increased, with countries such as Germany seeing a three percentage points growth.

Fig.5 How do companies borrow money?

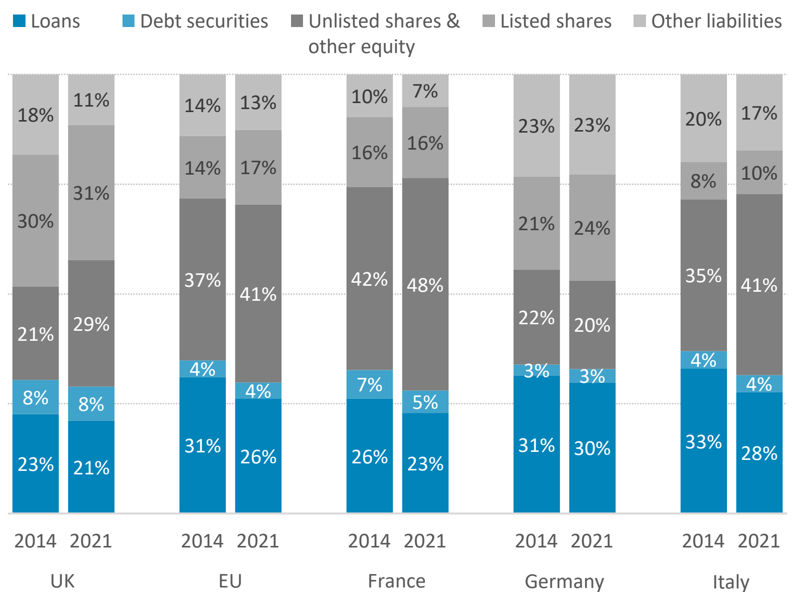
Bank lending and corporate bonds as a % of corporate borrowing in the three years to 2014 and 2021 in the US, UK, EU, France, and Germany



Source: ECB, BIS, Dealogic, US Treasury, New Financial

Fig.6 How are companies funded?

The distribution of total liabilities of non-financial corporations in the three years to 2014 and 2021 in the UK, EU, France, Germany, and Italy



Source: Eurostat, ONS, BoE

A long way to go

The starting point for deep and effective capital markets is deep pools of long-term capital - but households in the EU are almost as dependent on bank deposits as companies are on bank lending. Fig.7 shows how households in the EU invest their financial assets.

Households in the EU divide their financial assets (excluding property) roughly equally in three parts. Nearly a third (32%)of their financial assets are in bank deposits - about three times the level in the US. Another third(32%) are held in pensions and insurance products, and the rest (36%) is invested directly in stocks, bonds, funds, and 'other'. This ratio has remained stubbornly unchanged since 2014.

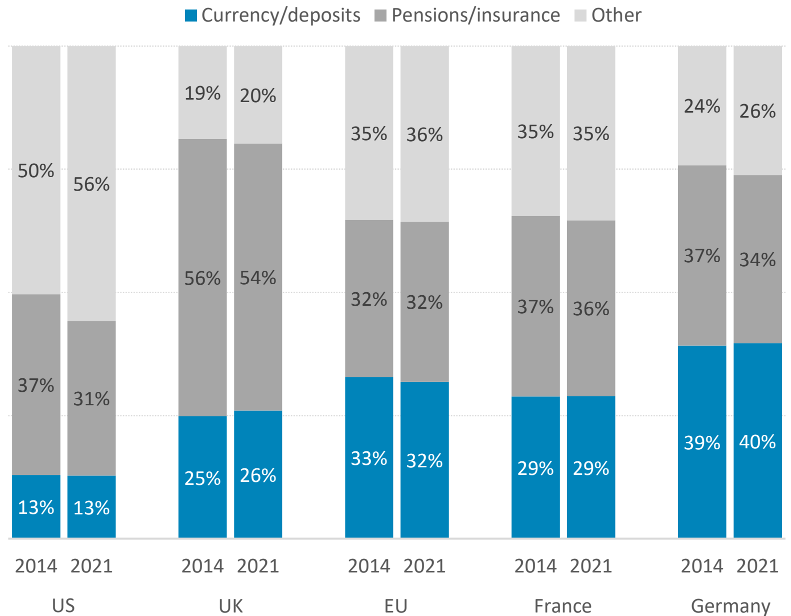
There is a wide range across the EU. In the Netherlands, Denmark, and Sweden the share of bank deposits is relatively small and well below the EU average, with an outsize share held in pensions assets. In more than three quarters of EU member states, the share of bank deposits is above the EU average, ranging from a third to more than 60% of total household financial assets.

While the size of long-term pools of capital in the EU has grown since 2014, pension assets in France and Germany remain relatively low compared to smaller economies with more developed capital markets such as Sweden. If France were to lessen its proportion of bank deposits to that of Sweden, it would free up more than €1tn for pensions and other assets.

Fig.8 shows the total size of financial assets in the US, UK, EU, France, and Germany. Relative to GDP, total financial assets in the US are more than twice as large as in the EU. Between 2014 and 2021, the US saw 26% growth in the size of its long-term capital, while the EU saw growth of only 15%. This is largely explained by the fact that US pensions assets are around five times the size as in the EU, and direct investments in funds, stocks, and bonds are around three times the size.

Fig.7 How do households invest their assets?

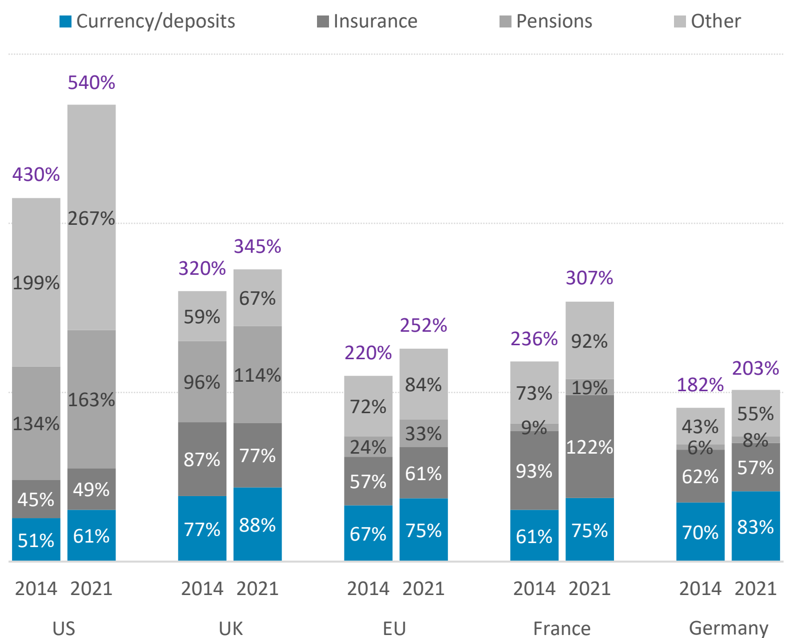
The allocation of household financial assets (excluding property) in the three years to 2014 and 2021 in the US, UK, EU, France, and Germany



Source: Eurostat, ONS, Federal Reserve, New Financial

Fig.8 What is the size of pools of capital?

The size of long-term capital in % of GDP in the three years to 2014 and 2021 in the US, UK, EU, France, and Germany, with the number in purple showing total size



Source: ECB, ONS, OECD, Insurance Europe, New Financial

What has changed?

In this section we discuss how the size and depth of EU capital markets have changed since 2014 - one year before CMU was launched - and take a look at the long-term trend.

What has (and has not) changed 20

At a glance: EU capital markets since 2014 21

The long-term trend 22

A long-term game

CMU is a long-term game and will take decades to become a reality. In this report we do not attribute any growth in EU capital markets over the past seven years to CMU itself - it is far too early for that - nor do we blame CMU for a lack of progress. Instead, this report provides context to where we are now, why CMU is important, and how capital markets in the EU are developing. Here is an overview of how things have (and have not) changed since the launch of CMU in 2015:

1. **Bigger:** EU capital markets are growing steadily and are bigger than they were before CMU was launched in 2015. The value of activity in nearly all sectors of capital markets increased between 2014 and 2021, with average growth in nominal terms of nearly 70% across 20 sectors. The growth in pools of long-term capital is particularly welcome, although they have a long way to go.
2. **Deeper:** EU capital markets are nearly a third deeper relative to GDP than they were before CMU was launched in 2015, and they are now deeper than they have ever been (having overtaken their previous peak in 2007 before the financial crisis). Capital markets in Sweden are now almost as deep as in the UK after a bumper year for activity in 2021.
3. **Not as deep as they could be:** EU capital markets are moving in the right direction, but they are not as deep as they could be or need to be. In sectors such as assets under management, equity issuance and trading, venture capital, or M&A activity, the EU market has grown more slowly than the UK. The EU has only narrowed the gap in depth with the UK in half of the sectors we looked at.
4. **A range in depth:** every year this report measures the depth of EU capital markets in different sectors of capital markets activity in all EU member states, and every year we see a huge and stubborn range in depth. The range in depth of capital markets across the EU is far greater than the difference in depth between the EU and the US, or the EU and the UK, and this has remained essentially unchanged since 2014.
5. **Not pulling their weight:** of the four largest economies in the EU, only France has capital markets that are deeper than the EU average. This was not always the case: until 2017, Spain too had deeper capital markets than the EU average. Germany and Italy's capital markets have become less deep relative to the EU average.
6. **Struggling to catch-up:** in the seven years since CMU was launched we have identified a long tail of smaller economies mainly in Central and Eastern Europe with the least developed capital markets. Their economies have significant growth potential and have much to gain from deeper capital markets.
7. **More integration needed:** building more capacity in domestic capital markets across the EU remains the top priority, but having more integrated capital markets across the EU would be an added bonus so that pensioners in Finland can benefit from economic growth in Austria - and vice versa.
8. **What if…:** while the EU's pools of long-term capital have grown by €3.6 trillion between 2014 and 2021 - an extra €18,000 per household - we estimate they could grow by a further €12tn to around €25tn. The number of companies raising money in capital markets could nearly double to around 11,000 - an additional 4,800 or so companies a year. These are achievable benchmarks, but it will take time and dedication to get there.
9. **Change is afoot:** things may not move as fast as some had hoped, but CMU has propelled capital markets up the political agenda across Europe. The first pan-European pension product was launched in March 2022, Germany is about to introduce a public fund investing in global equities to support its pension system, and many countries across the EU established growth markets to support SMEs in accessing capital.
10. **More to be done:** building bigger, deeper, and more integrated capital markets in Europe will require more national-level 'bottom up' measures. In this report's last chapter we discuss how European and national authorities can drive growth and integration.

Bigger and deeper

EU capital markets are bigger and deeper than they were before CMU was launched in 2015. Fig.9 looks at 20 sectors of capital markets activity and shows whether the value of activity and depth relative to GDP have increased since 2014, and if the EU has narrowed the gap in depth compared with the UK.

The value of activity has increased in almost all 20 sectors. This is unsurprising given the seven-year time frame. In half of the sectors, value has increased by more than 50%. For example, the value of all EU stock markets in 2021 was €3.6tn bigger on average than in 2014, an increase of 57%.

With EU inflation since the end of 2014 at just over 8%, it is concerning to see that the value of all equity issues has increased by only 1% - a fall in real terms. The value of small IPOs has decreased by 11%. The decline in small IPOs is a problem across Europe, and both the EU and the UK are working on implementing measures to make listing more attractive again.

The depth of EU activity relative to GDP has increased over the same period. Most sectors are deeper than they were in 2014 - apart from equity issues and small IPOs. The depth of bank lending to companies has decreased - an encouraging sign that companies in the EU are reducing their reliance on bank lending.

Private equity and venture capital are the stand-out growth markets. Across the EU, the value of PE fundraising has increased by 175%, PE activity by 130%, and VC activity by a whopping 305%. This growth is driven by activity in France, Sweden, and Germany. However, it is not enough to narrow the gap between the EU and the UK.

The growth in pools of capital is welcome. Overall, EU pension, insurance, and household financial assets have increased in both size and depth, and they have narrowed the gap with the UK. But growth is uneven. While some EU member states recorded triple-digit growth figures, the value of Poland's pension assets declined by 29% between 2014 and 2021.

Fig.9 How have size and depth of EU capital markets changed?

The change in absolute size and depth relative to GDP in different capital markets sectors in the EU, comparing the three years to 2021 with the three years to 2014
*Note: sectors marked with * are more developed relative to GDP than in the UK. Here, traffic lights denote whether the EU has extended or reduced its lead*

Sector	Increase in value since 2014?	Increase in depth since 2014?	Narrowed gap vs UK since 2014?
Pools of capital			
Pensions assets	Green 64%	Green	Green
Insurance assets	Green 27%	Green	Green
Household financial assets	Green 40%	Green	Green *
Pensions + insurance	Green 38%	Green	Green
Market / asset values			
Stock market	Green 57%	Green	Green
Corporate bond market	Green 46%	Green	Green
Bank lending to companies	Green 7%	Red	Red *
Asset management			
Assets under management	Green 62%	Green	Red
Investment funds (by domicile)	Green 93%	Green	Green *
Debt markets			
Corporate bond issues	Green 39%	Green	Green
High-yield bond issues	Green 27%	Green	Red
Equity markets			
All equity issues	Green 1%	Red	Red
IPOs	Green 66%	Green	Green
Small IPOs (<$100m)	Red -11%	Red	Green
Equity trading	Green 32%	Green	Red
Mergers & acquisitions			
All M&A activity	Green 51%	Green	Red
Domestic M&A	Green 76%	Green	Red
Private equity & venture capital			
Private equity funds raised	Green 175%	Green	Green
Private equity activity	Green 130%	Green	Red
Venture capital activity	Green 305%	Green	Red

The good and the not-so-good

EU capital markets are not just deeper than they were before CMU was launched in 2015: they are now deeper than they ever have been. This is good news and shows member states overall are moving in the right direction. But there is still not enough finance available to support the growth of the European economy and significant growth potential remains.

Fig.10 shows the depth of EU capital markets since 2006 rebased to the EU average of 100 in 2014, one year before CMU was formally launched. With an average depth of 129 in 2021, capital markets are nearly a third deeper relative to GDP than in 2014 and have trumped the previous peak year of 2007 and ended the stagnation in growth between 2017 and 2020.

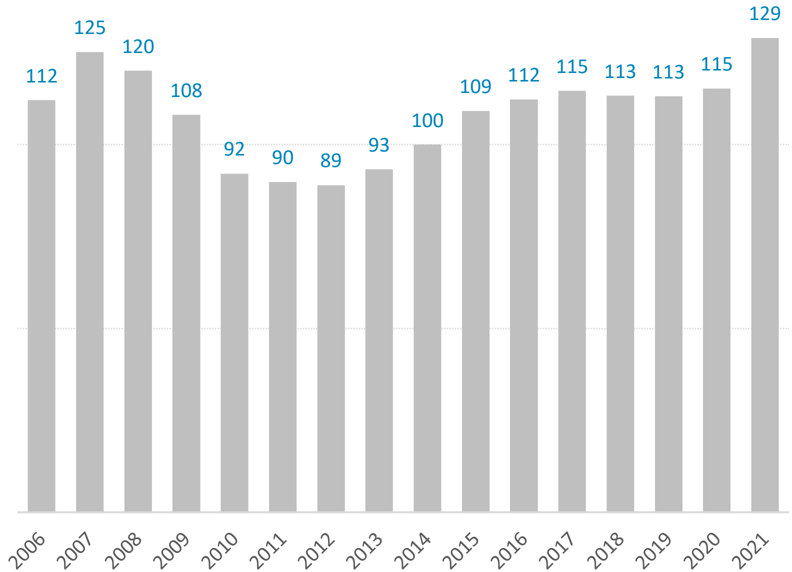
In terms of capital markets development, 2021 was a good year for many individual member states, too. For EU countries such as Sweden, the Netherlands, and France, but also Estonia and Lithuania, we measured deeper capital markets than ever before. With 2021 having been a bumper year, it remains to be seen whether the EU and member states can maintain this depth.

On the downside, bank lending to non-financial corporations in the EU remains far below its 2008 peak. Fig.11 shows the flow of bank lending since 2005 in total volumes and as a percentage of GDP.

In 2021, non-financial corporations in the EU accessed €2.9bn via loans from banks - nearly 30% less than the €4.1bn in 2008 (a fall of more than 40% in real terms). While the volume of bank lending in 2021 was higher than it was in 2014, as a percentage of GDP it was slightly lower. This means companies have begun to reduce their reliance on bank lending over the past years, but at the same time, capital markets financing is not offsetting the decrease in bank lending yet. To give European companies better access to finance and support economic growth across the EU, the success of CMU is crucial.

Fig.10 How has the EU-wide depth of capital markets changed?

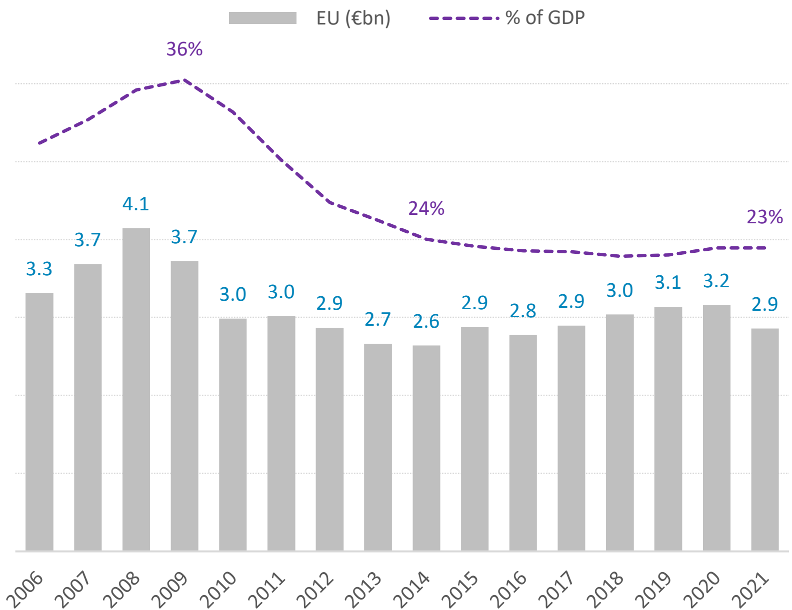
The depth of EU capital markets across 24 different sectors of activity since 2006
Rebased to EU average = 100 in 2014



Source: New Financial; for comparability this analysis excludes growth markets, ESG corporate bond issuance, and digital capital raising

Fig.11 How has EU bank lending changed?

The flow of gross new bank lending to non-financial corporations in the EU in €bn and as a % of GDP



Source: ECB, National Central Banks, New Financial

Driving growth & integration

In this section we outline the huge but realistically achievable growth opportunity in selected capital markets sectors, discuss how to encourage European and particularly national authorities to take some of the tough political decisions to drive forward more growth and integration across EU capital markets, and list ten questions to encourage debate about what measures individual member states could take to help drive bigger and better capital markets from the bottom up.

Growth opportunity: pools of capital 24

Growth opportunity: capital markets 25

How to drive growth and integration 26-28

Some questions for individual EU member states 29

Significant growth potential

While the relatively small pools of long-term capital in many countries across the EU present a number of challenges for policymakers, they also represent a huge opportunity for growth.

We analyse the potential growth in pools of long-term capital - funded pensions assets and insurance assets - in each country based on ranking countries by depth relative to GDP and dividing them into four quartiles. We then estimate the growth potential if pensions and insurance assets in each country increased in depth to the average level of countries in the quartile above and express it in terms of assets per household to make it more tangible. This is our 'what if?' scenario.

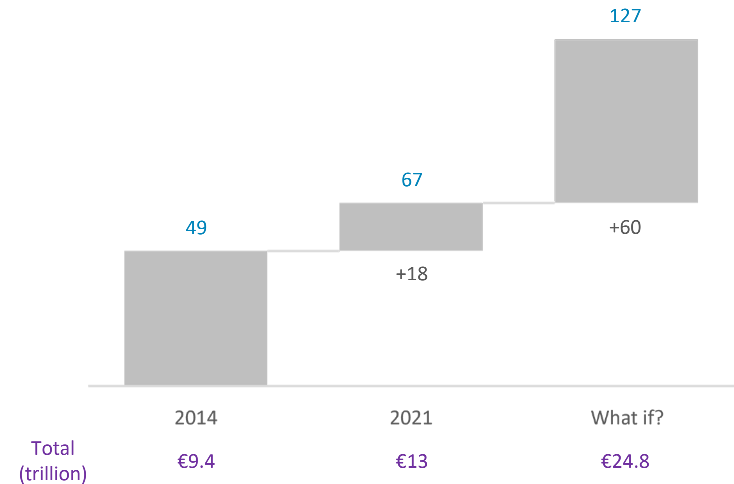
Fig.12 shows the growth potential in pensions and insurance assets in the EU. In the three years to 2014, the average value of long-term assets per household in the EU was €49,000. This had increased to around €67,000 in 2021.

If each country had pools of capital as large relative to GDP as in the countries in the quartile above, pensions and insurance assets would nearly double to €127,000 per household - an increase of €60,000 per household. This translates into an additional €11.8tn in long-term capital in the EU that would significantly lower the future pensions burden on EU taxpayers and government budgets and could be put to work in the wider EU economy. The potential larger pools of capital in France and Germany alone would add €5.3tn.

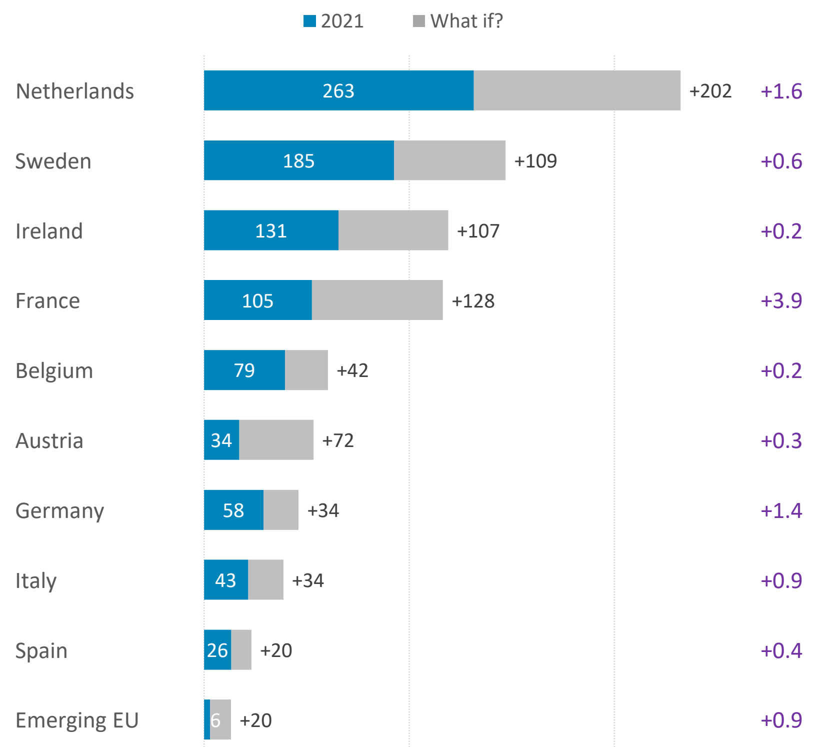
At country level, there is a wide range in the growth potential. Long-term assets per household would increase in today's money by between €20,000 and €202,000 in large economies such as France, Germany, Italy, Spain, and the Netherlands. In smaller EU economies such as Austria, Greece, Portugal, and the most recent member states, long-term assets per household would increase by between €7,000 and €98,000.

Fig.12 What is the growth opportunity in pools of capital?

i) The growth opportunity in pools of long-term capital per household in the EU (pensions and insurance assets) expressed in terms of additional assets per household in thousands of euros



ii) The growth opportunity in pools of long-term capital per household in a selection of countries: potential additional assets per household in thousands of euros, with the number in purple showing the additional capital in €tn



Source: New Financial

Making a difference across the EU

With CMU, the EU aims to develop sufficient domestic and regional capacity in capital markets to provide the range and depth of financing that can support a vibrant economy. Our analysis of the growth potential in capital markets financing (which includes investment grade bonds, high-yield bonds, IPOs, follow-on issuance, convertibles, leveraged loans, and venture capital) shows there is huge but realistic potential for growth.

Fig.13 shows the growth potential in capital markets financing in terms of the additional billions of euros in funding and additional number of companies using capital markets per year in each country.

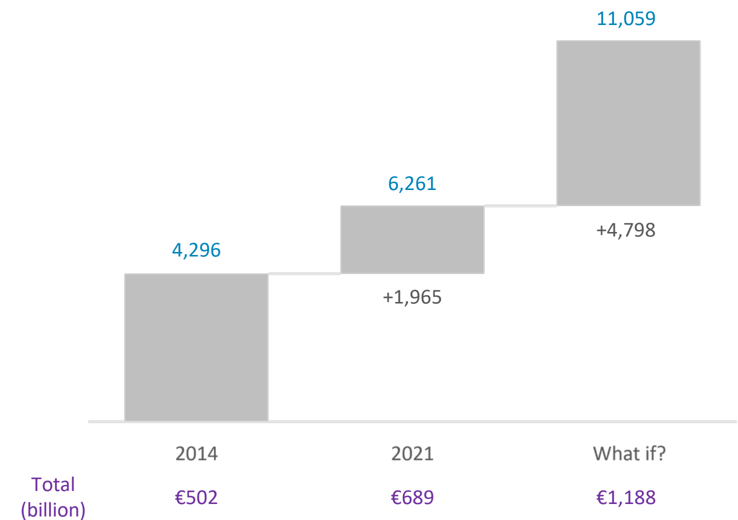
In the three years to 2014, around 4,300 companies in the EU raised a little more than €500bn a year in capital markets. By 2021, an average of around 6,250 companies used capital markets to raise €689bn a year. In other words, the number of companies accessing capital markets in the EU has grown by nearly 46%, and the amount of money raised has increased by more than a third.

While the growth in activity is welcome, it is not really going to move the dial. Under our 'what if?' scenario, the number of companies raising money in capital markets would almost double to around 11,000 - an additional 4,800 or so companies a year - and the amount of money being raised would jump from €689bn a year today to nearly €1.2tn.

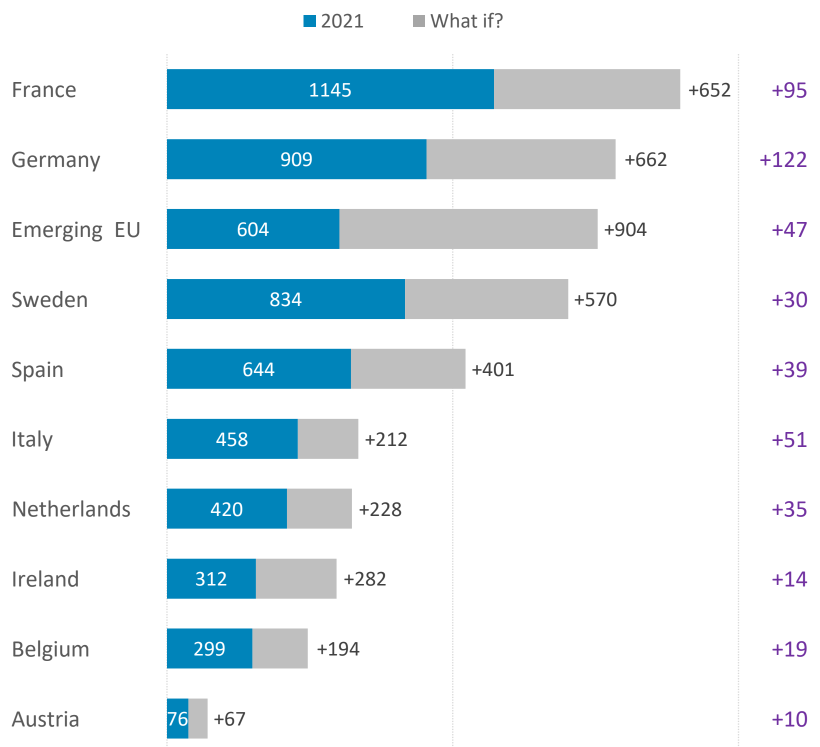
The potential for economies in the EU is huge. In France, an additional 652 companies a year would raise an additional €95bn a year. In Germany, Sweden, and Spain, the number of companies using capital markets would increase by between 400 and 660 a year. Emerging EU economies would also see significant growth: the number of companies using capital markets per year would more than double from an average of 600 today raising €33bn to 1,500 raising an additional €47bn per year.

Fig.13 What is the growth opportunity in capital markets financing?

i) The growth opportunity in capital markets financing (corporate bonds, equities, leveraged loans, and venture capital) in the EU expressed in terms of additional firms accessing capital markets



ii) The growth opportunity in the number of firms that can access capital markets in a selection of countries, with the number in purple showing the additional capital in €bn



Source: New Financial

'Knowing is not enough; we must apply. Willing is not enough; we must do.'
Johann Wolfgang von Goethe

Capital markets union will not be built in Brussels but in each and every member state, and it will take a lot of political courage to sub-ordinate established national interests to the bigger but more diffuse economic and social benefits of more integrated markets across Europe. There is - of course - no silver bullet or magic wand to address the many types of political resistance to CMU, but here is a selection of political rather than regulatory proposals to get started.

1) A political reset

After seven years of solid if unspectacular progress, CMU needs a political reset with a more focused plan to re-engage member states and inject more urgency into the project.

A top-down push: there is little more than 18 months left until the end of this Commission's term and the next European elections. In order to unblock the stalemate, inject more political momentum into CMU, and demonstrate concrete progress, one option is for a renewed political push from the top down. This could take the form of a tripartite political agreement between the European Commission, European Parliament, and European Council to agree a short list of perhaps five to eight initiatives that will be delivered by 2024 - and focus on delivering them. This approach would echo the approach in the run up to the Lisbon treaty in 1992 that paved the way for monetary union, and would lay the foundations for more concrete progress under the next Commission.

Engaging member states: repairing relations and improving engagement with member states should be a priority for the Commission and other European institutions. Many countries - particularly smaller and less developed capital markets - feel that CMU is a project for big economies that is being imposed upon them rather than one which involves them. Reaching out to these countries and providing a formal forum for their views, while simultaneously supporting and encouraging regional cooperation initiatives such as the common capital markets project in the Baltic states, would drive more engagement and help address this disconnect.

A rebalancing act: over the past seven years CMU has perhaps got the balance wrong with too much emphasis on 'top down' / EU-wide measures to improve integration and harmonisation, and not enough on 'bottom up' / national measures to build capacity. Shifting that balance more towards 'bottom up' initiatives while retaining a sharp focus on a core group of cross-border measures would create more engagement and likely accelerate progress. This could be extended into a 'concentric circles' approach, with a 'core CMU' of pan-European projects and a wider circle of parallel EU-wide and national projects.

A more focused approach: CMU has tried to solve too many problems at once. A shorter and simpler action plan based on a smaller number of clearly prioritised projects with the biggest economic impact and combining top-down and bottom-up initiatives would provide a more practical programme for the next decade. It is important to avoid expending too much political capital on the wrong problems and focus instead on a smaller number of 'first principle' problems such as: building deeper pools of capital, making it more attractive for companies to use capital markets, making EU markets more attractive to European and global investors, and simplifying the fragmentation of market infrastructure.

An honest debate: too many countries in the EU have avoided an honest debate about the sustainability of their financial systems, from the viability of pay-as-you-go pensions or the efficacy of an economy dominated by bank-lending provided by a banking industry struggling with overcapacity. As a quid pro quo for a more focused CMU and a shift in the balance between top down to national initiatives, the Commission should encourage member states to reassess their approach to CMU and perhaps conduct a social and economic impact assessment of existing capital markets systems with all member states. It may be helpful to start with our 10-point questionnaire for member states: which part of bigger, deeper, more diverse, and more efficient capital markets that better support their economy and improve the lives of their citizens do they not like?

Reinventing the wheel: the ingredients for healthy and effective capital markets are not some form of alchemy and policymakers at an EU and national level should be wary of trying to reinvent the wheel. There are many examples of what works and what does not in different sectors across the EU and further afield. The Commission could use its convening authority to act more as a forum to identify and showcase best practice, what works and why, and encourage the sharing of relevant examples and initiatives. It could help conduct feasibility studies for introducing different initiatives in different countries.

This could involve closer cooperation between DG FISMA and other parts of the Commission like DG ECFIN and DG REFORM, which has worked directly with countries such as Italy, Poland, and Romania to help them develop their own capital markets. A key aspect of this work would involve identifying the essential building blocks for deeper capital markets and highlighting the steps being taken by member states to make progress, such as the capital markets strategy in Poland, pensions reform in Spain and potentially Germany, and tax reform in Italy.

2) A new narrative

CMU needs a new narrative with a bolder, clearer, and more focused vision: rooted in addressing some of the huge economic challenges faced by the European economy, and framed in concrete and tangible terms.

Some inconvenient truths: CMU inevitably involves compromise and trade-offs that the EU and member states need to address head on. If the EU really wants the sort of capital markets it needs, individual EU member states will have to accept that they cannot have the sort of capital markets they want. The EU cannot have the capital markets it needs with 27 different versions of the single rulebook or 27 different markets supervisors. And it cannot build a world class equity market with 27 different national equity markets in the EU. Something has got to give. This is also an opportunity to put to rest some of the tired political arguments frequently deployed by member states to push back against CMU. There is nothing intrinsic to being in the EU, or having a social democratic model with high levels of and a well-developed welfare state, that means you cannot have well-developed capital markets. Ask Sweden, the Netherlands or Denmark.

Making a better case: the benefits of CMU have too often been framed in abstract and technical language, such as 'increasing the shock absorption capacity of the EU economy' or 'improving the allocative efficiency of finance'. While these are important, it would be better to frame the case to member states in concrete and accessible terms: highlighting the tangible benefits of bigger and deeper capital markets to their businesses and their citizens in practical terms such as 'this is what it means for jobs, investment, and growth in your country'. We think there are three specific areas that could help connect more people with CMU.

i) A post-Covid recovery: in the wake of Brexit, Covid, and the invasion of Ukraine, the EU economy needs all the help it can get. Capital markets can play an important role in helping to fuel a recovery, make the EU more resilient against future shocks, and reduce its dependency on other markets. The EU should be shouting from the rooftops about the role capital markets play in supporting government intervention in the energy crisis and in helping to finance the NextGenerationEU €800bn recovery programme, which has already seen the Commission raise nearly €130bn in its own right in the bond markets since June 2021 (with another €40bn to come this year). This money is being disbursed across the EU and is a textbook example of the potential benefit of capital markets and CMU.

ii) Financing growth: the EU desperately needs to finance more innovation and growth at scale, and support the sort of high potential companies that will help drive an economic recovery, change people lives, and create jobs. While the EU is not short of innovation and ideas, too many of these companies struggle to secure the sort of funding they need to scale-up. They are often forced to turn to US and other investors for funding, which often involves them moving their business overseas. There is nothing wrong with companies choosing where to raise money - but it should be a choice, not the only available option. If the EU is serious about creating high growth companies to rivals global firms based in the US or Asia, its members will need to get serious about financing them.

iii) The path to net zero: the EU will need a vast amount of investment to address climate change and achieve net zero in the next few decades, with estimates ranging from €600bn to €1 trillion a year. Sustainable finance is one of the few areas in banking and finance where the EU has a clear global lead: more than 40% of all global sustainable finance activity is EU-based, and the EU's green finance taxonomy is more advanced than comparable initiatives elsewhere. But current levels of activity are still only around a third of what is needed. Without deeper capital markets, where do member states think the money to address climate change is going to come from?

3) Core principles

Here is a selection of core themes that we think can help define CMU across different initiatives and provide a consistent and enduring framework:

Rebuilding trust: ultimately CMU will depend on trust. If we want more retail participation, EU citizens will need to trust that the banking and finance industry has their interests at heart and that capital markets are not a casino where the house always wins. The industry will need to trust that EU authorities are applying a proportionate regime - and that national authorities are operating a level playing field and not protecting their own national markets and national champions. And individual member states will have to trust that the EU is not bulldozing their concerns or imposing inappropriate regulations on them. This trust has to be earned, not simply stated, by all parties.

Education, education, education: an essential part of rebuilding trust and encouraging EU citizens to engage more with their money is financial education. Low levels of financial literacy, financial participation, and trust in the financial industry in Europe (along with a cultural reluctance to talk about money) translate into low levels of financial well-being and resilience, and a low level of engagement by European citizens with their money and financial matters. The EU and many member states have done some great work in developing a framework around financial literacy, but many of these initiatives lack the scale or consistency to have a big impact. Our recent concept paper on financial health checks maps out an ambitious but achievable programme that could help drive EU citizens towards relevant and timely financial education at key points in their lives.

A focus on customer outcomes: perhaps too much of the debate around CMU so far has been focused on its impact on market participants and not enough on its potential impact on the industry's customers and end users. The inconvenient but undeniable truth is that the fragmentation of European capital markets increases inefficiencies and raises costs for users of the capital markets, acts as a drag on EU growth, and encourages rent seeking by market participants. At every opportunity the debate should focus on improving access to capital for companies, and widening access to investments, reducing costs, and improving outcomes for individuals.

Incentivising change: CMU can sometimes seem to member states and the industry as too much stick and not enough carrot. The relentless programme of reforms since the financial crisis and the drumbeat message of what member states will have to give up as part of CMU could be softened with more of a focus on what they stand to gain. For example, member states could be incentivised to develop their pensions systems with more flexible budget deficit targets, while market participants could be incentivised with less onerous capital requirements or reduced costs in one area of their business in exchange for developing other parts of it. The EU should focus the argument on expanding the overall size of the pie and seek to shift the debate away from member states and local market participants protecting the current size of their slice.

Nudge, nudge: many of the barriers in EU capital markets are cultural and behavioural and cannot be addressed by regulation or legislation. The EU should marry legislative measures with non-legislative measures aimed at nudging individuals and firms, particularly in areas such as pensions and retail participation. Individuals can be nudged towards better pensions provision through the development of simpler pensions dashboards, pensions apps on their phones, or by including simple and accessible information on people's future pension income in their payslips.

Driving growth from the bottom up

One of the key messages in this report is that bigger and better capital markets in Europe will only happen if the EU successfully combines 'top down' measures at an EU level to improve harmonisation *and* individual member states complement this with 'bottom up' initiatives to increase capacity. Here is a selection of questions for national governments, finance ministries, and regulators, to encourage debate about what measures individual member states could take:

1. **Access to funding:** do companies in your country who want and need capital to invest in their business have sufficient access to a diverse range of short- and long-term funding? How reliant are companies on bank lending? Are banks in your country healthy enough to provide that funding over the course of an economic cycle? And what other sources of funding could step in to fill that potential gap?

2. **Savings vs investments:** how much of your citizens' financial assets are held in bank savings and how much is invested? Are you confident that bank savings are the best way to help drive long-term wealth creation particularly in a new world of higher inflation? What would be the potential impact (including the benefits and trade-offs) if a significant part of those savings were moved into other forms of investment?

3. **Pensions:** how sustainable is your pension system across all three pillars (state, workplace, and private pensions)? What is the balance between pay-as-you-go and funded pensions and how does that compare with other EU member states? What measures could you take over 25 years to shift that balance? What impact would it have on your economy and public finances if more people were making annual contributions to their pensions and building a bigger pool of long-term capital that could be invested in your economy?

4. **Market infrastructure:** is your market infrastructure (stock exchanges, settlement, clearing etc) appropriate for an economy and market of your size? What barriers - if any - does your market infrastructure present to the future development of your financial markets and to cross-border investment in your economy?

5. **Venture capital & risk capital:** do high potential companies in your country that could drive job creation have enough access to early-stage risk capital? Do they have sufficient access to other sources of risk capital, and if so, which sources? Is the level of equity funding through the stock market and IPOs in your economy sufficient to meet demand? And are there measures that you could take to boost supply and demand?

6. **Cross-border investment:** how important is cross-border investment to your economy? Can domestic sources of capital provide all the funding your economy needs? What barriers - if any - do your tax, regulatory, and legal systems present in terms of your economy's attractiveness to foreign investors?

7. **Regulation:** how well regulated is your economy and your financial system? On what metrics? How does this compare to other countries in the EU and the rest of the world? What barriers - if any - does your regulatory system and implementation of EU law present to growth and investment?

8. **Tax:** what is the balance in your economy between the taxation of labour and capital, and between debt and equity? Do you have any tax measures that implicitly or explicitly disincentivise investment? Without fundamentally changing your tax system, are there changes you could make to incentivise more investment? If so, which countries could provide examples of what does and does not work?

9. **Legal system:** How comfortable are you with where your country ranks in international rankings of the rule of law, complexity, and timeliness of legal process, and issues such as corruption and transparency? What barriers - if any - does your legal system present in terms of investment and growth and cross-border flows of capital?

10. **Regional cooperation:** how could regional cooperation with other EU member states help boost your economy? What form might this co-operation take in the banking and finance sector? Do you have the right systems and structures in place to encourage and facilitate this sort of cooperation?

NEWFINANCIAL
Rethinking capital markets

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Driving growth: the New Financial Global Financial Centres Index

Brexit & the City: the impact so far

Our sample:

We analyse the size and depth of capital markets in the following 27 different sectors of activity in all 27 EU member states. This year, we have added SME growth markets, ESG corporate bond issuance, and digital capital raising to our analysis.

- **Pools of capital:** pensions assets, insurance assets, household retail investments (excluding pensions, insurance, cash deposits & unlisted equity)
- **Equity markets:** stock market, initial public offerings, secondary equity issues, convertible bonds, SME growth markets, equity trading volumes
- **Bond markets:** corporate bond market value, bond market value, investment grade bond issuance, high-yield bond issuance, ESG corporate bond issuance, bank lending relative to corporate bonds
- **Loans & securitisation:** value of outstanding securitisation, securitisation issuance, leveraged loan issuance
- **Assets under management:** assets under management, investment funds by domicile
- **Corporate activity:** M&A by target nationality, M&A by acquiror nationality, domestic M&A
- **Private equity, venture capital & crowdfunding:** private equity activity, venture capital activity, private equity fundraising, digital capital raising (estimated figures for 2021)

Measuring depth:

In each sector and country we measure the value of activity as a percentage of GDP on a three year rolling basis from 2004 to 2021 to iron out the annual volatility in capital markets. To enable a comparison in depth between different sectors, we rebase these percentages in each sector to the EU28 average. We then again rebase the average of all sectors to the EU27 average. We call this the 'EU' average and do this to allow for comparisons with previous reports where we used the EU28 average. For example, the value of stock markets in the EU in the three years to 2021 is 73% of EU GDP. We rebase this to 100, meaning that a country with a score of 50 has a stock market that is half as deep relative to GDP as the EU average, and one with a score of 200 is twice as deep.

While this methodology has the advantage of simplicity, in a handful of countries with a particularly large sector relative to GDP - for example, investment funds by domicile in Luxembourg - it can distort the overall ranking. To reduce these distortions, we cap each metric at two standard deviations from the mean for every country. This reduces the distortion of a few outsize sectors more fairly than not including the outlying metrics at all.

Measuring growth potential:

In each sector and country we estimate the growth potential in terms of the number of additional companies that could get funding, how much they could raise, and as a percentage increase on the current level of activity. In each sector we rank each member state by the value of activity as a percentage of GDP and divide them into quartiles. We then estimate the potential growth opportunity for capital markets in each economy by assuming that in each sector activity increases in depth to the average level of the quartile above. For countries already in the top quartile in a particular sector, we assume that activity has the realistic potential to grow at half the weighted average rate of less developed markets.

This is our 'what if?' scenario. For example, if a country was in the third quartile for IPOs, what would its IPO market look like if it were as a deep as the average of countries in the second quartile? We then translate this growth into the potential number of additional IPOs a year based on the average value of IPOs across the EU in the past.

There is no perfect way to estimate growth potential in capital markets and our approach has obvious limitations. However, we think our approach creates a simple, realistic, and achievable benchmark for potential growth. There is, after all, no reason why a country should not be able to move up into the quartile above in a particular sector. We think this methodology may underestimate the growth potential for countries that are towards the top of their quartile and overstate the growth potential for countries towards the bottom of each quartile. In any case, we would stress that these numbers are not a growth forecast but a directional and realistic indicator of what could be achieved.