Towards a European Capital Markets Union

Barriers to the further development of the European capital markets

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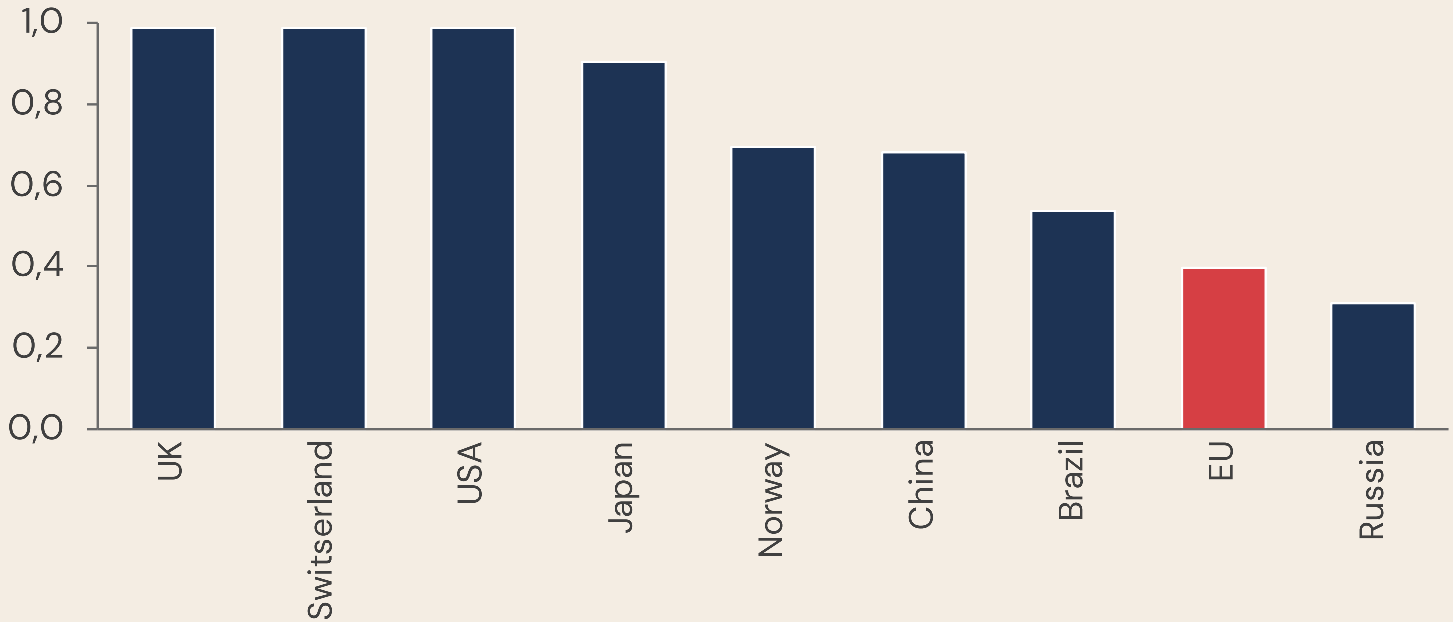
The report at a glance

Capital markets in Europe do not function optimally

They are relatively small and fragmented. This has implications for the economic growth and stability of the European Union and the Netherlands.

EU capital market depth lags



Source: IMF Financial Markets Depth index (2021)

Further development of the Capital Markets Union in interest of the Netherlands

Higher returns on savings and pension assets

Lower financing costs for businesses

Opportunities for financial sector

Three barriers to further development of the Capital Markets Union:

1. European Commission **depends on member states** to improve capital markets
2. European Commission gives **too little direction**
3. The **sense of urgency** among member states is lacking

Our advice

The cabinet should take a **leading role** in Europe

The parliament should work together with the cabinet to **formulate Dutch goals** and include them in its own program of action

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Reason for the study and justification

This research constitutes the implementation of the Slootweg and Grinwis motion of March 8, 2023.[1] This calls for "analysis and advice [...] on what juridical, practical and political barriers exist to an integrated European capital markets union and what are possible solutions to them, and to identify the advantages and disadvantages of different solutions." Following the motion's directives, we submitted a research proposal which the Finance Committee of the House of Representatives approved on September 14, 2023. Our proposal outlines an approach encompassing three key objectives: (1) an analysis of existing barriers to the Capital Markets Union, (2) identification of underlying reasons for the persistence of these barriers and (3) formulation of strategic recommendations to advance the Capital Markets Union agenda. Proposals (1) and (2) are addressed simultaneously in the analysis in Section 3.

Additionally, we provide illustrative examples of potential policy measures that could be effective in fostering further integration and development of European capital markets. However, it is not within the scope of this study to analyze and appreciate all feasible policy options. Consequently, while the policy examples offer valuable insights, their effectiveness in driving forward European capital market integration cannot be conclusively asserted.

We conducted literature research for this study and interviewed several experts on the capital markets union. Stakeholders consulted include representatives of the Ministry of Finance, The Dutch Central Bank (DNB), the Dutch Financial Markets Authority (AFM), the Department of Analysis and Research of the House of Representatives (DAO) and the Bruegel think tank. It is noteworthy that all sourced materials are publicly available and that direct quotations from interviews are not used. .

The Institute for Public Economics (IPE) is a Dutch think tank specializing in economics. IPE publishes research and analysis on economic policy. We collaborate with academics, journalists, civil servants, and political institutions. IPE was founded in 2022 and is located in The Hague, the Netherlands.

The conclusions and recommendations presented in this study are the result of independent research. Responsibility for the content lies solely with the authors.

[1] https://www.tweedekamer.nl/kamerstukken/moties/detail?id=2023Z04144&did=2023D09690

Summary

Capital markets in Europe do not function optimally. They are fragmented and underdeveloped in some member states. Consequently, savers receive lower returns on their savings and companies face higher costs on their loans. A larger and better functioning capital market benefits economic growth and increases the stability of European economies.

The Netherlands has much to gain from further development and integration of European capital markets. Dutch households can get more returns on their pensions and savings as a result of further development and integration, Dutch companies get lower financing costs, and it offers opportunities for Dutch companies to expand their activities to other member states.

Since 2015, the European Union has been focusing on deeper integration and development of capital markets with the Capital Markets Union action program. While the implementation of the action program is progressing well, significant fundamental adjustments crucial to advancing and integrating European capital markets are missing.

Essential modifications are needed to move the capital markets union forward, particularly in the areas of supervision, bankruptcy and tax legislation, and pensions. These measures require policy commitment at the national level and sometimes go against interests of certain business sectors.

There are three barriers to these fundamental adjustments for the development and integration of capital markets:

1. **Dependency of the European Commission on member states for capital market enhancements**. As crucial policy areas fall within national jurisdictions, the Commission's has few tools to address opposing member states.
2. **The European Commission gives too little direction**. The amount and variety of goals for the Capital Markets Union raise expectations that cannot be met. Without a goal and without clarity about the benefits, Member States will not be willing to set aside national interests.
3. **The sense of urgency among member states is lacking**. Unlike the banking union, the Capital Markets Union lacks momentum.

We advise the Dutch parliament to encourage the Dutch cabinet to assume a proactive role. Given the Netherlands' vested interest in a more efficient Capital Markets Union, pioneering initiatives could catalyze further development and integration of capital markets. By aligning Dutch objectives with strategic action plans, parliament and the cabinet can collaborate effectively, increasing the likelihood of substantial progress and attainment of Dutch goals. Therefore, we recommend parliament's collaboration with the cabinet to articulate and integrate Dutch objectives into the broader action program.

Box 1: What is a capital market?

A capital market facilitates the flow of funds from savers to borrowers, comprising a primary market for the initial issuance of financial products and a secondary market for subsequent trading among investors.

On the supply side, entities such as banks, fund managers, and private investors offer capital in exchange for returns, including dividends or interest. Conversely, on the demand side, entities seek capital for investment purposes and may issue bonds or shares to that end. Intermediaries, such as trading platforms, investment banks, and financial institutions, play a crucial role in connecting supply and demand within the market. Assets traded within capital markets typically possess a maturity period of two years or more.

1. Integration and development of European capital markets is important for growth and stability

The Capital Markets Union is a policy agenda aimed at developing and integrating European capital markets. Before turning to this policy agenda, we show what problems it seeks to solve. In this chapter, therefore, we examine the current status of European capital markets, show what improvements can be made, and show the benefits that Europe and the Netherlands stand to gain from a better functioning of these capital markets.

1.1 Capital markets are not functioning optimally in the European Union

In an optimally functioning capital market, there is good coordination between capital supply and demand. In an optimal capital market, all market participants have the same rules and the same access to financial products and services.[2] In theory, this means that products with a similar risk-profile have similar prices, irrespective of the trading jurisdiction. Moreover, the smooth transfer of financial flows ensures consistent expected returns for similar risk-tiered products, regardless of geographical location.[3]

Capital markets in the European Union do not function optimally. European capital markets suffer from fragmentation and are relatively small. For example, investable assets in the EU amount to approximately €6 trillion, constituting roughly 50 percent of the GDP, whereas in the United States, this figure stands at 90 percent of GDP.[4] Fragmentation demonstrates itself in differences in development of capital markets between member states (Figure 1) and in capital that remains primarily within national borders, a phenomenon known as "home bias".

This results in higher costs for both demanders and suppliers of capital. Firms in member states with shallow and inaccessible capital markets often resort to borrowing from local banks, resulting in higher costs. For companies that do raise capital through equity and bond markets, the low supply of capital makes the cost of capital relatively high. Firms in some member states pay up to 2.5 percentage points more in debt than their sector peers in other member states.[5] Not only do firms face higher costs, some providers of capital also suffer from malfunctioning capital markets. For example, private investors face higher costs than institutional investors.[6]

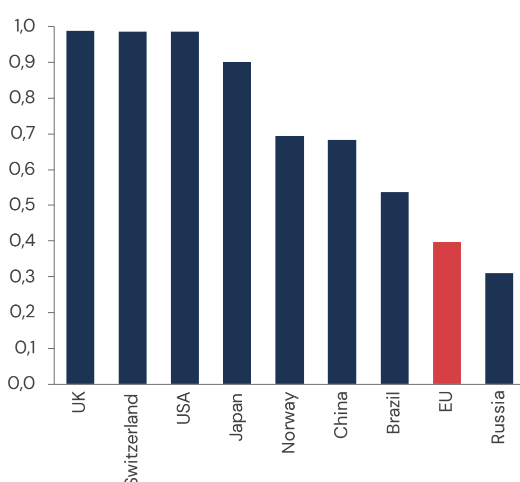
The United States have better-functioning capital markets. The United States is often mentioned as an example of having well-functioning capital markets. Companies in the United States are more often financed through the capital markets and are less dependent on the banking sector. Nonetheless, the American capital markets are also subject to fragmentation; for example, there are several competing trading platforms.[7] The main difference with Europe is that actors on the American capital markets do not have to deal with different types of legal systems and legal systems and tax laws.[8]

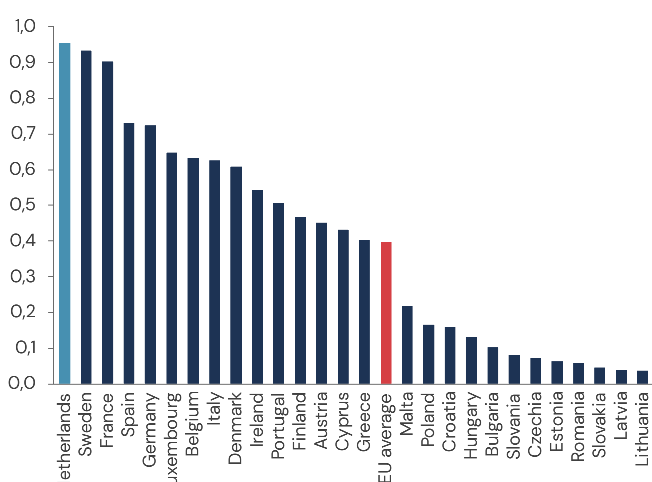
[2] ECB (2004)
[3] Thomadakis & Lannoo (2019)
[4] IMF (2019)
[5] IMF (2019)
[6] Thomadakis & Lannoo (2019)
[7] Better finance (2023); Mackintosh (2023)

1.2 The European Union can increase growth potential and improve stability through capital markets

Better functioning capital markets can increase Europe's growth potential. If capital markets in Europe operate more efficiently, the matching of capital supply and demand will improve, leading to an increase in investments, which is an important precondition for productivity growth and thus economic growth.[8] Competition between parties, such as investment banks, trading platforms and investment institutions, will increase the efficiency of capital markets. This will result in lower costs of capital for borrowers and higher returns for savers. In addition, the supply of capital is expected to increase as the European market becomes more attractive to investors from outside the EU.[9]

Figure 1: Depth of capital markets





Source: IMF Financial Markets Depth index (2021)

Note1 : The term "depth" reflects the size and liquidity of a capital market. Depth is calculated using data on stock market capitalization, traded shares, international government debt securities and total debt securities of financial and non-financial corporations, all relative to GDP. Source: IMF Financial Development Index database (2021).

Note2: Based on these data, the Netherlands has the deepest capital markets in the European Union. This is partly explained by its large pension assets and relatively highly developed stock and bond markets.

Growth potential is also increased by better financing for young innovative companies. It is difficult for innovative start-ups to secure bank financing, primarily due to heightened risk and the scarcity of tangible collateral, given the reliance on intangible assets within their business models. Capital providers such as private equity and venture capital parties are more willing to invest in these ventures, partly because of their ability to identify promising projects (winner picking).[10] However, the European markets for

[8] Rajan & Zingales (1996)
[9] European Commission (2020)

venture capital and private equity remain relatively undeveloped (see Figure2). [11] This limits the possibilities for financing start-ups and has negative consequences for economic growth.

In addition, a well-functioning capital market in the European Union can ensure financial stability. Enhanced capital market functionality diminishes dependence on bank financing, mitigating the vulnerability of financial systems to crises.[12] Predominantly bank-oriented economies need more time for recovery from a financial crisis, because there is less room for new lending due to a large amount of non-performing loans on bank balance sheets.[13]

Better developed and integrated capital markets improve macroeconomic stability at the national level, but increase systemic risk at the European level in the event of a major shock. Integrated capital markets create room for risk development as investments are more dispersed across countries. Investment is then less correlated with a country's national income, reducing the sensitivity of households and investors to national shocks. Research indicates that between 2007 and 2014, capital markets in the U.S. absorbed 22% of shocks, versus 2% in the euro area.[14] However, the downside of private risk sharing is that it increases systemic risk for the Euro area as a whole. The impact of a large local economic shock can spread more easily because of the connectedness of national capital markets.[15]

Recent developments, according to the European Commission, make integration and development of capital markets more urgent.[16] The climate transition and digital transition require large private investments that can be fostered by better integrated and developed capital markets with a better supply of (market) financing. In addition, integration and development of capital markets offer potential solutions to the challenges posed by demographic aging. Market-oriented pension systems use capital markets to increase the returns on pension assets. Also, the integration of capital markets provides opportunities for the international role of the euro by making the European market more attractive to international investors.

The Brexit made the Capital Markets Union more urgent. With the Brexit, the European Union lost its most important capital market, both in size and connections. London was the financial heart of the European Union and acted as an important gateway to the U.S. capital market. Due to the departure of the United Kingdom, European capital markets are no longer connected through London and are thus more fragmented.[17] At the same time, the Brexit presents opportunities, particularly for the Netherlands, through the relocation of activities to continental Europe.[18]

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[10] Demertzis et al. (2021)
[11] Thomadakis & Lannoo (2019), European Commission (2023a)
[12] Demertzis et al. (2021); Bats & Houben (2017)
[13] IMF (2019)
[14] Milano (2017)
[15] Thomadakis & Lannoo (2019); Anderson et al. (2016); IMF (2019)
[16] European Commission (2020); additionally the de speech by Dutch Central Bank president Klaas Knot at 9/11/2023
[17] IMF (2019); High Level Forum on Capital Markets Union (2020); Commission European Economy (2021)
[18] Part of the daily trading volume has shifted to Amsterdam after Brexit, see for example Stafford (2021).

1.3 *The Netherlands' interest in enhancing European capital markets*

The Netherlands stands to gain substantially from the improvement of European capital markets. Better functioning European capital markets increase stability in the Euro area and stimulate economic growth. This is important for the Netherlands, recognized by the Dutch government.[19] In addition to this general interest, there are also specific Dutch challenges in which better functioning capital markets can be of significance.

It helps Dutch households. The Netherlands has a savings surplus, which means that there are lot of savings that can be used for profitable investments.[20] The current return on savings deposits is relatively low.[21] Better developed capital markets are opening up more investment opportunities, which benefits Dutch savers. This also applies to Dutch pension funds, where a large part of Dutch assets are located. Dutch pension funds invest the largest part of their assets abroad, 40% of which are in other European countries and 24% in the United States.[22] Better functioning European capital markets lead to higher returns on Dutch pension assets due to increased investment opportunities and lower transaction costs.

It reduces costs for Dutch companies. Small and medium-sized enterprises (SMEs) in the Netherlands, heavily reliant on bank loans, encounter challenges in securing financing, resulting in higher costs.[23] Furthermore, the banking sector in the Netherlands is highly concentrated; interest rate levels point to market power of banks.[24] More integration of European capital markets increases the supply of capital and thus the financing possibilities for Dutch companies.[25]The Dutch government also emphasized this in the initial phase of the Capital Markets Union.[26]

It offers opportunities for Dutch companies to expand into other member states. The share of the financial sector in the Dutch economy is relatively large.[27] More developed and integrated European capital markets offer opportunities for companies in this sector. It will become easier for them to expand business activities to other Member states. There is therefore a number of Dutch companies that welcomes further integration and development of European capital markets.[28] More developed and integrated European capital markets can also further strengthen components of the Dutch capital market, for example through more trading on Dutch trading platforms.[29]

1.4 *This requires European capital markets to integrate and develop*

European capital markets can be further integrated. For example, regulation can be harmonized and improved. Currently, disparities in insolvency and tax legislation among member states hinder cross-border investments,

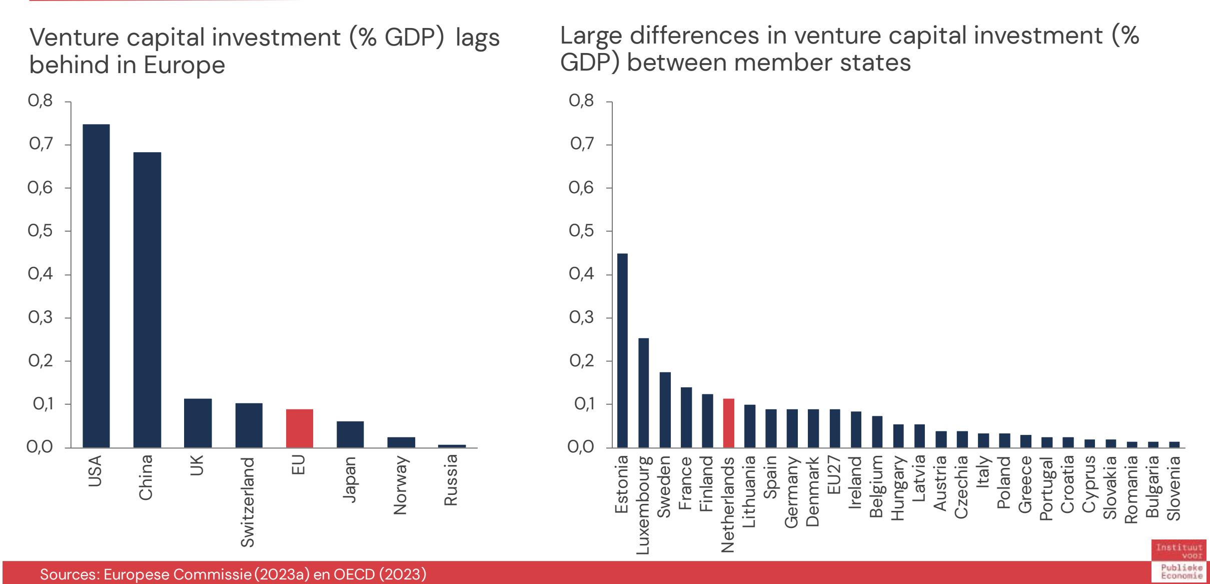
[19] Ministry of Foreign Affairs (2020)
[20] CPB (2015); DNB (2019)
[21] The ACM is currently investigating the functioning of the Dutch savings market due to the low savings interest rates.
[22] DNB (2023)
[23] For instance, the market interest rate on corporate loans with a maturity of 1 to 5 years was 2.3% in the Netherlands in 2018, followed by 1.6% in Germany and 1.4% in Italy (CPB, 2019).
[24] CPB Policy brief SME Financing (2019); Brouwer et al. (2023)
[25] Ministry of Foreign Affairs (2020)
[26] Ministry of Finance (2015)
[27] WRR (2019); Ministry of Finance (2023a)
[28] Examples include Optiver, BNP Paribas, and ING actively participating in the debate by publishing position papers.
[29] For instance, the gas futures market (TTF), based in Amsterdam, is already attractive to exchange traders from within and outside the EU, as indicated in the trend overview of 2023 by AFM.

decreasing investor confidence and imposing administrative burdens on companies seeking foreign capital. [30] Moreover, decentralized supervision creates arbitrage opportunities, higher administrative burdens, and differences in protection for capital providers.[31] Detailed explanations of these policy areas are provided in Chapter 3.

In addition, access can be improved by removing informational barriers. Due to differences in financial literacy, entrepreneurs are not always familiar with the financing options offered by capital markets. Investors also sometimes lack sufficient and/or correct information about companies in other countries in order to make cross-border investments.[32]

Capital markets can also be further developed in some member states. Integration of capital markets between member states can only take place if there are functioning capital markets to begin with. Broadly speaking, three groups of countries can be distinguished in Europe. Countries with deep and highly developed capital markets (generally the North-Western member states), countries with relatively developed capital markets, but whose market depth is disproportionate to the size of their economies (e.g. Germany, Italy and Spain) and smaller member states with shallow, low-developed capital markets (generally Central and Eastern European member states).[33]

Figure 2: Venture capital investment



Note: Venture capital investment in the year 2022 as a percentage of GDP. Data from 2022 were missing for Japan and Russia. For these countries the years 2021 and 2019 were used, respectively. Sources: OECD (2023) and European Commission (2023a)

[30] High Level Forum on the Capital Markets Union (2020); IMF (2019); Demertzis et al. (2021)

[31] High Level Forum on the Capital Markets Union (2020)

[32] High Level Forum on the Capital Markets Union (2020)

[33] New Financial (2020)

2. European policy agenda the 'capital market union' falls short

The "Capital Markets Union" is part of a long history of integrating and developing European capital markets. In this chapter, we look at the most recent developments: the Capital Markets Union programs of 2015 and 2020. We show the progress of these programs and demonstrate that many important policies for the integration and development of European capital markets are not part of the action programs, or are part of them to a limited extent.

2.1 The Capital Markets Union is the latest development in integration and development of European capital markets

Developing and integrating capital markets is a long-term undertaking. Capital markets are complex and consist of many levels of government institutions, self-regulating institutions and other actors interacting with each other. This takes years to come to maturity.[34] Such complexity necessitates a long-term perspective, given the multifaceted nature of capital markets and the enduring influence of factors such as social norms, cultural practices, pension systems, and the broader business, legal, and regulatory landscapes within each member state.[35] Capital market integration began with the Treaty of Rome in 1958. Since then, there have been about four waves of harmonization. Since 2015, it has been referred to as the Capital Market Union (Box 2).[36]

The Capital Markets Union is a policy agenda under which many goals and policies are being collected. Although the basis for integrated capital markets was already established in the last century with the Maastricht Treaty, the term "Capital Markets Union" has only been in use since 2015. The Commission deliberately chose the term "union" to emphasize its complementarity with the Economic and Monetary Union and Banking Union.[37] The concept of the Capital Markets Union should be understood as a policy agenda aimed at optimizing the single market for capital. It does not imply that perfectly integrated and fully developed capital markets will emerge once actions under the Capital Markets Union are completed. Just as disparities persist between the capital markets of Silicon Valley and New York in the United States, variations among European member states are inevitable.[38]

The Capital Markets Union policy agenda comprises two action programs. The first action program was introduced in 2015; a follow-up in 2020. In these action programs, the European Commission formulates the main objectives and corresponding proposals, encompassing both legislative and non-legislative measures. Legislative proposals are made for new or a revision of existing directives and regulations. Non-legislative proposals include expert studies, consultations, and best practices.[39] These proposals, or parts of them, are submitted to the Council of the European Union and the European Parliament, which can then introduce amendments.

[34] There is a high degree of path dependence in the structure of the capital market, as evidenced by the differences between European and American capital markets (Gordon & Judge, 2018).

[35] New Financial (2020)

[36] Thomadakis & Lannoo (2019); European Commission (2023b)

[37] Qualia et al. (2016)

[38] Mackintosh (2023)

[39] European Court of Auditors (2020)

Once the Council, Parliament and Commission agree, the proposal can be adopted.[40]

The 2020 Action Plan is more ambitious than the 2015 Action Plan. For example, more attention is given to the access and protection of private investors and the opportunities for capital market financing for SME companies.[41] Whilst in the 2015 Action Plan many action points were preparatory and exploratory (e.g., "Investigate ways to develop or support pan- European information systems"), in the 2020 Action Plan more concrete proposals are made (e.g., "Establish a single European access point for business data").

Currently, the Eurogroup spearheads the Capital Markets Union initiative. The March 2023 Euro Summit called for moving the Capital Markets Union forward. Currently, the Eurogroup is working on a strategic initiative to agree on the main medium- and longer- term priorities for the development of European capital markets.[42] The Eurogroup plans to present a proposal in March 2024.[43] The first and second phases of the initiative have been completed, which entailed comprehensive assessments of European capital markets' current status, inclusive of insights from the IMF, ECB, and the European Commission, along with consultative dialogues with market stakeholder.[44] Starting in January 2024, political negotiations will take place. The goal is to reach a joint agreement with priorities for the mandate of the next Commission.

2.2. Capital Markets Union plans are not ambitious enough

The implementation of the proposals from the action plans is progressing well. The actions from the 2015 action plan and from the 2017 midterm review have been largely implemented.[45] The proposals from the 2020 action plan are also being energetically addressed. Agreement has been reached on a large part of the action points or a legislative proposal has been published by the European Commission. Examples are the establishment of a European Business Information Access Point (ESAP), which is expected to come into force in 2027, publication of a European framework for financial literacy and an agreement on the introduction of a so-called Consolidated Tape, a European information system with consolidated information on trading in financial products such as shares and bonds.[46]

But there is criticism that the action plans lack ambition. Many important measures that could boost capital market integration remain absent from the action plans, for example in the areas of insolvency and tax legislation (see Box 3 in Chapter 3), pensions (see Box 4 in Chapter 3) and supervision (see Box 5 in Chapter 3). Additionally, concerns are raised regarding the dilution of European Commission plans during negotiations with the European Parliament and the Council, resulting in compromised outcomes (see Box 6 in Chapter 3).[47]

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[40] Some policy proposals from the action plan require unanimity by the Council, such as tax reform; other legislation can be passed by the Council with a qualified majority. (European Union, 2023)
[41] New financial (2020)
[42] Donohoe (2023)
[43] In addition, in 2024, a report by Mario Draghi on European competitiveness is expected, mapping out challenges for the single market (Reuters, 2023).
[44] Donohoe (2023)
[45] European Commission (2020)
[46] European Commission (2023b)
[47] This tension can also be seen in the so-called Consolidated Tape, as described by Brenton (2023).

Determining whether the action plans have led to improved functioning of capital markets poses a considerable challenge. Although the proposals in the action plans have largely been implemented, improvements in the functioning of capital markets are not immediately visible. This is in the first place due to the inadequate monitoring of the progress made.[48] In 2021, only six years after the first action plan, the European Commission began to monitor progress.[49] Secondly, improvements are not immediately visible: it takes time for changes to be fully implemented and reflected in the functioning of capital markets. There are studies on the status of European capital markets. These assessments often indicate limited improvements.[50] In addition, there are signs that significant improvements in the depth of capital markets are lacking. For example, European companies are still heavily dependent on bank financing.[51]

Most progress is made among the member states that already have well-developed capital markets. If there is improvement in the functioning of capital markets at the European level, it is mainly because the capital markets of member states with already well-functioning capital markets have become even better.[52] An example of this is the registration of venture capital funds under EU VECA and EUsef regulations. The increase in registrations was caused entirely by countries with already relatively well-developed venture capital markets.[53]

2.3. Fundamental adjustments in capital markets are needed

Steps must be taken in the area of integration of European capital markets. However, a substantial part of capital still remains confined within member states. To foster cross-border investments, laws and regulations must be harmonized. Major improvements can be made in harmonizing insolvency and tax legislation (see Box 3 in Chapter 3) centralizing supervision (see Box 5 in Chapter 3), and encouraging private pension schemes (see Box 4 in Chapter 3).[54]

Additionally, proactive measures should be taken to facilitate the development of capital markets. In several member states, the absence of a functional capital market persists, with consumers predominantly storing their savings in bank accounts and companies heavily reliant on bank funding. In countries such as Germany, Italy and Spain, 80% of corporate loans come from banks.[55] While harmonizing legislation can help improve capital markets in these member states, it may not suffice to achieve the transition to well-functioning national capital markets. Such a transition necessitates policy adjustments within each member state, particularly addressing national issues like pension and tax systems, investment climate, and financial literacy. Examples of such measures include strengthening the government bond market in Bulgaria, tightening national supervision in Greece and relaxing regulations regarding venture capital in Germany.[56]

[48] The European Court of Auditors (2020) criticized the monitoring of progress made. It was inconsistent and irregular.
[49] European Commission (2023)
[50] For example, see the annual reports of AFME, New Financial, and Better Finance.
[51] New Financial (2020); AFME (2023)
[52] New Financial (2020)
[53] European Court of Auditors (2020)
[54] See for example the background notes from IMF (2019)
[55] New Financial (2023)
[56] European Bank for Reconstruction and Development (2022); Aristeidou (2023); IMF (2023)

Box 2: Capital markets integration in Europe

Year	Event
1958	Treaty of Rome
1980-1990	European listing regulations (harmonization wave 1)
1990-1995	Maastricht Treaty (harmonization wave 2)
1995-2010	Financial Service Action plan (FSAP) (harmonization wave 3)
2010-2014	Regulation in aftermath of financial crisis (harmonization wave 4)
2014	Creation of Banking Union
2015	First CMU action plan
2017	Midterm review and expansion of first action plan
2019	Progress report
2020	Second CMU action plan
2021-2022	Legislative proposals
2024	Proposal from Eurogroup

Note: box shows rough indication of development of European capital market integration over time, concerns a non-complete list.

Sources: Thomadakis & Lannoo (2019); Europese Commissie (2023b)

3. Various barriers to further integration and development of capital markets

Previous chapters show that European capital markets can be further developed and integrated. We identify in this chapter three barriers that hinder further steps. We observe that (1) the European Commission depends on the member states to improve capital markets, but that (2) the European Commission provides too little direction in doing so and (3) a sense of urgency among member states is lacking. Additionally, accompanying boxes provide insights into the decision-making processes concerning key measures for capital market integration and development.

3.1 European Commission depends on member states to address capital markets

The pursuit of further integration and development of capital markets may encounter resistance from member states for various reasons. For example, some member states do not want to lose control over certain institutions, such as their national supervisory authorities, or want to prevent certain market players, such as stock exchanges, from moving to other European countries.[57] In addition, different interest groups may present opposition. For example, with further integration and development of capital markets, banks might witness a diminished role in funding provision, which may lead to counter-lobbying. Smaller European banks in member states, for instance, were critical on the first action plan advocating their ability to better serve the small- and medium-sized enterprises.[58] Furthermore, even apparent proponents of the Capital Markets Union may oppose specific proposals due to the potential impact on existing business models.[59] Finally, the policy adjustments necessary for capital market development and integration could also encounter resistance within member states. Implementing crucial national legislation, such as insolvency law reform (Box 3) or pension system restructuring (Box 4), demands considerable time and consensus among stakeholders, potentially impeding capital market union interests. Table 1 in the appendix shows potential winners and losers of select policy proposals.

The European Commission has few instruments to do anything about opposing member states. Thus far, the European Commission has been trying to use the action programs to shape the capital market union. However, this is not a strong tool to get member states to move. In addition, the European Commission could use country- specific recommendations (CSRs) to urge member states to implement reforms to develop their capital markets.[60] Currently, there are few measures on the Capital Markets Union in the CRSs; if they are included, the Commission has few means of exerting pressure on

[57] Quaglia et al. (2016)

[58] Quaglia et al. (2016)

[59] An example is the position of trading platforms regarding the Consolidated Tape legislation. Trading platforms stand to gain a lot from more integrated European capital markets and are therefore considered supporters of the CMU. However, they have criticized the Consolidated Tape legislation, as evidenced by reports from the Financial Times (Cats & Rotteveel, 2021).

[60] During the period 2016-2019, the Commission did not make recommendations for reforms to the ten member states with less developed capital markets.

member states to implement reforms.[61]

3.2 European Commission gives too little direction to member states

Recurring critique highlights the lack of clarity and definitive objectives within the action plans, echoing concerns regarding vagueness and delayed prioritization. The European Court of Auditors (2020) examined whether the objectives set in the first action plan and the mid-term review had been achieved and found that the objectives of the capital market union were vague and priorities were set too late. The complexity of the legislation has also been criticized.[62] For example, prospectus regulations remain complex and costly for SMEs.[63]

Member states additionally have their own perspectives of the Capital Markets Union. Member states do not always agree on the Union's trajectory. For instance, there is no agreement on the extent to which the Capital Markets Union should lead to centralization. For member states with highly developed capital markets, centralization offers opportunities because market players gravitate toward them due to economies of scale.[64] Member states with less developed capital markets are more reluctant to centralize because of the fear of being swallowed up.[65]

The multitude of objectives surrounding the Capital Markets Union breeds unrealistic expectations that often remain unfulfilled. The content of the first Capital Markets Union Action Plan and its communication raised high expectations. The action plan was supposed to lay the foundation for a well-functioning European Capital Markets Union.[66] Nevertheless, the ambitions for Capital Markets Union have been broadened in the latest action plan, encompassing objectives ranging from Covid-19 recovery to digitalization and strategic autonomy.[67]

Without a goal and without clarity on the benefits, member states cannot succeed in setting aside their national interests. The long-term benefits outweigh the sacrifices member states must make in the short term.[68] In the absence of a clear goal, and the sacrifices that go with it, member states can claim to support the overall goals of Capital Markets Union but at the same time they can continue to put their national interests first in specific areas (see Box 7). According to Commissioner McGuinness (financial services and capital market union), the components of the Capital Markets Union should therefore be addressed more collectively.[69]

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[61] The Commission gained more influence for its CSRs in the recovery and resilience plan. In addition, CSRs are likely to play a larger role in the new European budgetary rules.

[62] Thomadakis & Lannoo (2019)

[63] Qualia (2018) describes how the amendment of prospectus legislation and legislation harmonizing securities markets was particularly beneficial for the largest, most competitive financial centers in Europe.

[64] Luxembourg and Poland's ministers emphasize the importance of diversity and advocate for a polycentric Capital Markets Union. (Backes & Rzeczkowsza, 2023)

[65] The European Court of Auditors (European Court of Auditors) (2020) gauged the attitude of Finance Ministries towards the first Capital Markets Union action plan. The image emerges that Southern and Central and Eastern European countries felt disadvantaged compared to Western and Northern European countries. The first group demanded more measures to strengthen local markets.

[66] European Court of Auditors (2020)

[67] European Commission (2020) These policy objectives can influence each other. For example, economic recovery can lead to more economic growth, which in turn affects household investments.

[68] This is sometimes referred to as short-termism in political and economic literature, see for example Pesendorfer (2015)

[69] McGuinness (2023). The importance of coherence is also emphasized by the Dutch government in the assessment of the second CMU action plan (Ministry of Foreign Affairs, 2020)

3.3 The sense of urgency among member states is lacking

Capital market union lacks momentum. The need for the Banking Union was recognized by most member states in the aftermath of the financial crisis, resulting in swift action and the willingness of member states to accept supranational elements to promote the stability of the Euro area.[70] However, a similar momentum is lacking for the Capital Markets Union. Despite the various challenges, which the European Commission believes can be effectively addressed with integrated and developed capital markets, such as the recent recovery from the Covid-19 pandemic and the Green Deal, groundbreaking initiatives remain absent. This may partly be due to the difficulty of expressing the benefits of more integrated capital markets in quantitative terms.[71]

[70] Demertzis et al. (2022)

[71] Bekaert & Harvey (2003), Rajan & Zingalas (1996)

Box 3: Insolvency legislation: major national policy adjustments needed

Insolvency legislation in certain member states remains underdeveloped, posing challenges for capital providers contemplating investments in companies. A robust insolvency framework provides clarity to investors regarding their rights in the event of a company's insolvency, thus fostering confidence in investment prospects. Furthermore, it facilitates the timely exit of unproductive enterprises from the market, thereby incentivizing innovative investment initiatives. Disparities in insolvency laws across member states exacerbate these challenges, impeding cross-border investments and burdening companies with heightened administrative complexities when seeking foreign capital.

Member states need to make substantial adjustments to harmonize and improve their insolvency laws. Member States have their own system of insolvency law, rooted in policy preferences, traditions in legislation and existing case law. It would require completely new organizational structures and procedures for most member states. Harmonization also requires full agreement among member states, which would imply an intensive negotiation process.

There has been limited progress in improving and harmonizing insolvency legislation. Partly for this reason, the European Commission proposed a directive harmonizing certain parts of insolvency law in 2022, which was adopted by the European Parliament. The biggest obstacle is the Council negotiations that are now taking place, as national interests will be defended in this phase. It is therefore not inconceivable that the final agreement will be a lot less far-reaching than the Commission's original proposal.

Sources: CPB (2017), European Commission (2022a) AFME (2023), Alegren-Benndorf (2023)

Box 4 : Pan-European Pensions: challenges in progress

Long-term capital, such as pensions and insurance assets, play a crucial role in deepening European capital markets by increasing the supply of capital. However, many European countries currently have some form of public pension provision resulting in relatively limited private pension accumulation. If European households were to increase their investments in stocks, bonds, or pension funds by 5 percentage points, it could unlock approximately 1.8 trillion euros in investment capital.

Pensions are a national matter. Consequently, there are great differences across Europe in the design of pensions. The Netherlands, Denmark and Sweden accounted for 62% of European pension assets in 2022. These nations operate pension funds that invest customer contributions (funded system), diverging from many EU countries with a pay-as-you-go system, wherein pension contributions are immediately allocated to elderly provision (a system also prevalent in the Netherlands for the AOW).

In 2019, the European Commission introduced the Pan-European Personal Pension Product (PEPP) with the aim of boosting the retirement accumulation of European citizens and increasing the supply of long-term capital. Embedded within the 2017 review of the Capital Markets Union Action Plan, PEPP constitutes a voluntary pension offering alongside existing national pension provisions. Financial institutions can apply to offer these pension products, subject to approval by their respective national authorities.

The success of PEPP remains a topic of debate. Its relatively high cost stems from extensive information and disclosure requirements. Additionally, despite its pan-European scope, PEPP's fiscal attractiveness varies among member states due to disparities in tax treatment. As of August 2023, only six PEPP products, all from a single provider, had emerged.

While PEPP holds theoretical promise, challenges related to cost and tax treatment disparities among member states impede its widespread adoption. Although potential exists for PEPP to gain traction among European citizens over time, overcoming these obstacles necessitates concerted efforts by member states to integrate more private pension accrual into their national pension frameworks.

Sources: New Financial (2023), IMF (2019), AFM (2023c), AFME (2023), European Commission (2022b), Bär (2022)

Box 5: European Securities and Markets Authority (ESMA): limited influence

A pivotal entity in the realm of capital markets is the regulatory body. Regulators safeguard consumers and investors by upholding regulatory standards, thereby fostering trust in the capital market and enhancing accessibility for depositors. Robust supervision is thus considered a fundamental prerequisite for the effective functioning of capital markets.

Supervision of capital markets in the European Union is predominantly organized nationally: each country has one, or sometimes several, supervisory bodies. Disparities in supervision among countries impede cross-border investments, as investors face ambiguity regarding their rights and obligations. Such discrepancies also amplify administrative burdens, necessitating thorough examination of laws and regulations by both investors and companies. Furthermore, divergent supervisory practices may present arbitrage opportunities. Consequently, experts advocate centralized supervision as essential for the integration of European capital markets.

To foster convergence between national regulators in the EU, the European Securities and Markets Authority (ESMA) was established in 2011. ESMA employs various tools, including the formulation of directives, technical standards, interpretations of existing laws and regulations, and provision of advice to national supervisors and other stakeholders.

The question is to what extent these tools are adequate. For instance, the interpretations of European laws and regulations published by ESMA to create a level playing field in Europe are not binding, neither are the opinions issued. The formulation of directives and technical standards is fundamentally promising for supervisory convergence, but it is a cumbersome process because these decisions must be taken on the basis of a qualified majority of national supervisors.

To achieve greater integration of European capital markets and a more equal level playing field, ESMA's mandate and tools could be expanded, with corresponding resources. For example, components such as trading venues and central securities depositories (CSDs) could be placed under direct ESMA supervision to achieve harmonization in these domains as well.

In addition, ESMA's strength can be improved by establishing an independent board with full-time members. In line with this, the voting procedure can be changed to the model of the European System of Banking Supervision (SSM). In this model, a proposal is agreed upon, unless an objection is raised. These measures would strengthen and accelerate decision-making.

Sources: European Central Bank (2023), High Level Forum on Capital Markets Union (2020); European Securities and Markets Authority (2023), AFM (2023b), IMF (2019), Thomadakis & Lannoo (2019).

Box 6: European Single Access Point (ESAP): long road

Information asymmetry poses a significant barrier to the accessibility of capital markets for both investors and companies seeking funding. Insufficient information hampers investors' ability to assess the creditworthiness of potential investments, leading to reluctance in providing capital.

The European Single Access Point (ESAP) for companies' financial and non-financial information emerged as a potential solution to this challenge as early as 2013. The ESAP platform aims to provide investors with convenient access to comprehensive information about companies, thereby enhancing transparency and facilitating foreign investment opportunities.

However, the realization of ESAP has encountered various hurdles along the way. Despite its alignment with the objective of improving access to capital markets, ESAP was notably absent from the 2015 action plan. Subsequently, the responsibility for the ESAP project was delegated to the European Securities and Markets Authority (ESMA). However, due to limitations in resources, mandate, and data comparability, ESAP was deprioritized by ESMA in 2017.

Nevertheless, ESAP resurfaced in the 2020 action plan, signaling renewed efforts to advance the project. In 2021, the European Commission proposed a legislative framework for ESAP, followed by agreement by the Council in 2022. Subsequently, a trilogue agreement was reached in spring 2023, paving the way for the phased implementation of ESAP, expected to commence in summer 2027.

Sources: European Court of Auditors (2020); European Commission (2023e)

Box 7: European inducement ban obstructed by some member states

The European inducement ban exemplifies the challenges encountered when translating overarching goals into concrete policy measures at the member state level. A key component of the European Commission's agenda is to enhance the protection afforded to retail investors. The absence of such a ban creates an incentive for investment firms to prioritize products with higher commissions over those that may be more suitable for clients, leading to inflated costs for financial products and eroding retail investors' confidence in capital markets.

While several European countries, including the Netherlands, have already implemented inducement bans domestically, achieving consensus on a pan-European ban has proven to be a difficult task. The proposed ban directly impacts the business models of investment firms, financial advisers, banks, and insurers, prompting resistance from industry stakeholders. Notably, the German finance minister expressed his concerns about a possible inducement ban, as did his Austrian colleague. Eventually, the Retail Investment Strategy does not include a complete inducement ban, but only a ban on provisions for the sale of investment products where no advice is provided .

Sources:, AFM (2023a), Allenbach-Ammann (2023), European Commission (2023c), European Commission (2023d)

4. The Netherlands must define its position

Following the identification of barriers hindering the integration and development of European capital markets in the preceding chapter, this section presents recommendations aimed at overcoming these obstacles. We focus here on the role of the European Commission and the Council (4.1.), show what the Netherlands can do at the national level (4.2.) and provide some considerations for the Dutch position in the European Union (4.3.).

4.1 Establish a clear European plan with defined objectives

To further integrate and develop capital markets, fundamental market structures need to be changed. The low-hanging fruit has been picked. However, fundamental adjustments will face resistance in member states: some member states will see certain financial institutions disappear, and significant adjustments to national legislation may be required (see Boxes 3 and 4 in Chapter 3).

The benefits of developing and integrating capital markets must become clearer. Member states will only relinquish their positions if they perceive long-term benefits. However, the current discourse often lacks clarity regarding these advantages, leading to a perceived lack of urgency. Insufficient attention is given to the ramifications of a less integrated capital market in the Dutch dialogue, where the correlation between market integration and prosperity, sustainable growth, employment rates, and the overall resilience of the European Union could be underscored.[72]

It is important to draw up a plan that member states can support. For member states to actively engage with the Capital Markets Union, they must be assured of the plan's long-term benefits and be in agreement regarding the strategies to achieve these goals.

Further steps require commitment from Member states, for example, through the Council. *W*hile the European Commission can spearhead *Capital Markets Union* initiative by formulating an ambitious and transparent action plan, the Council's involvement is paramount, given that the execution of these measures hinges on member state endorsement. *Encouragingly, progress is underway, as the* Euro group created a work plan on the Capital Markets Union in March 2023.[73]

4.2 Defining Dutch policy priorities for capital market integration and development

The Netherlands must determine what goals and priorities it sees for the Capital Markets Union. Box 8 shows that the Netherlands is taking a favorable stance toward the Capital Markets Union. But as we showed, the integration and development of capital markets involves many different types of policies. Given the diverse array of policies involved, simultaneous implementation is impractical, and not all policies carry equal feasibility.[74] The Netherlands must therefore determine what its objectives and priorities are. In terms of goals, the Netherlands can focus on, for example, a better position of venture capital for startups, more capital for the green transition or better investment opportunities for Dutch

[72] For an overview of the approach of a possible story, see the report by New Financial from 2023.

[73] Donohoe (2023)

[74] Moreover, multiple goals can be pursued simultaneously; one goal does not necessarily exclude the other. On the contrary, progress on one priority can contribute to achieving another. For example, if there is more capital available due to larger pension funds in Europe, this can also contribute to the availability of financing for start-ups and scale-ups.

pension funds. Regarding management priorities, the Netherlands could emphasize harmonizing insolvency legislation, centralizing supervision, or consolidating European stock exchanges. The Dutch parliament can ask the cabinet to draw up a plan outlining these goals and priorities.

Furthermore, the Netherlands can explore areas of domestic policy synergy with the Capital Markets Union. Challenges for which the Netherlands seeks national solutions could be addressed through the union, either as a supplement or replacement to national policy. For instance, addressing the high financing costs for small and medium-sized enterprises—a pressing issue in the Netherlands—can be significantly influenced by the Capital Markets Union.[75] Moreover, aligning national and union policies in areas such as innovation and sustainability can foster greater coherence and effectiveness.[76]

In parallel, the Netherlands can draw up a plan on how to improve its own capital markets. Despite having relatively well-developed capital markets within the European context, there remains room for improvement. This is relatively easy because no agreement needs to be found with other Member states. One problem, for example, is that SMEs in the Netherlands have difficulty obtaining financing.[77] *This issue* could be tackled through initiatives like establishing a public credit registry, a proposal supported by institutions like the IMF, the Netherlands Bureau for Economic Policy Analysis (CPB), and the Social and Economic Council of the Netherlands (SER).[78]

4.3 The Netherlands must define position in European Union

Within the European Union, the Netherlands can take on a leading role. Achieving Dutch goals and priorities necessitates collaboration with other member states, which the Netherlands can foster by taking on a pioneering role within the EU.[79] This proactive approach increases the likelihood of Dutch objectives being incorporated into policy agendas and expedites progress within the Capital Markets Union. However, there is a potential risk of divergence with other member states if Dutch priorities conflict with theirs, which could incur a political cost.

As a pioneer, the Netherlands can decide to establish a leading group comprised of like-minded member states. This group can spearhead initiatives outside the EU framework to foster the development and integration of capital markets. For instance, recent efforts by Germany, France, Spain, Italy, and Belgium to create a fund for providing growth capital to European tech scale-ups exemplify such collaborative endeavors.[80] Nonetheless, forming a leading group carries the risk of creating disparities with other member states not part of the coalition.

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[75] ACM research; call for a SME bank

[76] To stimulate innovative investments, the Netherlands, for example, has the National Growth Fund. In addition to these public investments, capital markets are ideally suited to provide capital to innovative companies because, unlike banks, they do not require collateral. See, for example, Lannoo & Thomadakis (2019). Furthermore, the Capital Markets Union can contribute to the necessary (private) capital for the climate transition. It is estimated that around €1 trillion in investments is needed annually to achieve the climate goals by 2030. See Lenaerts et al. (2021) and New Financial (2023).

[77] CPB (2019)

[78] In a public credit registry, any potential lender can access information about the creditworthiness of a company. See CPB (2019) and EY (2023).

[79] In 2019, the Netherlands, together with Germany and France, took the initiative to seek recommendations from experts.

[80] Gevaert (2023)

As a pioneer, the Netherlands can advocate for a more robust role for the European Commission. Measures such as harmonizing insolvency legislation, centralizing supervision or making better use of pension capital require national policy adjustments. The instruments of the European Commission can be strengthened to induce member states to actually make these national policy changes. The European Commission can do this through the instrument of country-specific recommendations (CSRs). These currently contain few recommendations on capital markets. In addition, the LSA instrument itself can be strengthened.[81]

[81] The Commission can be given more power to use CSRs in the Multiannual Financial Framework or the Stability and Growth Pact to implement capital market reforms in member states.

Box 8: Dutch position CMU

2015

- Cabinet emphasizes in response to SER report 'Broadening and strengthening SME financing' the role the CMU plays in expanding financing options.[1]
- Cabinet appreciation Commission Work Program 2015: "*Improving financing opportunities for the real economy is, like that of the European Commission, one of the cabinet's priorities.*"[2]
- Cabinet expresses strong support for the CMU in an appreciation of the CMU green paper.[3] Three priorities:
    1. Increasing the availability of capital
    2. Improving the access to funding
    3. Stable and shockproof financial and economic system

2017

Cabinet appreciation midterm review: Cabinet supports objectives and would like to see substantiated proposals soon.[4]

2019

- Together with France and Germany, the Netherlands initiates a new expert study (*NextCMU*).[5]
- Cabinet sees five areas of attention in response to this report[6]:
    1. Encourage cross-border financing
    2. Strengthen corporate access to capital markets
    3. Strengthen consumer access to capital markets
    4. Ensuring sustainable character of CMU
    5. Utilizing FinTech opportunities

2020

Cabinet appreciation CMU action plan 2020.[7] Within the five attention areas from 2019 focus on the first three.

2023

The cabinet considers further strengthening of the CMU to be crucial for removing structural barriers to free movement of capital in the EU, to achieve the necessary investments in sustainability and digitalization.[8]

1 Parliamentary paper 32 637 nr. 166

2 Parliamentary paper 112 nr. 1940

3 Parliamentary paper 122 nr. 1950

4 Parliamentary paper 112 nr. 2362

5 Parliamentary paper 112 nr. 2798

6 Parliamentary paper 112 nr. 2829

7 Parliamentary paper 112 nr. 2535

8 Parliamentary paper 501-07 nr. 1990

5. Our advice

The Netherlands has much to gain from further development of the Capital Markets Union. Dutch companies and consumers suffer from the current fragmentation and underdevelopment of European capital markets. In addition, European member states are now missing out on economic growth and their economies are less stable. Acceleration is needed.

We recommend that the parliament encourages the cabinet to take on a pioneering role. By taking on this leadership position, the Netherlands can effectively push for substantial advancements in the integration and development of European capital markets, thereby ensuring the realization of Dutch objectives.

We advise that the parliament collaborates with the cabinet to formulate clear Dutch goals and priorities for the Capital Markets Union. It is essential for the Netherlands to articulate its own action plan to effectively engage at the European level. This action plan should encompass policy objectives geared towards promoting the integration and development of European capital markets. In Table 1 of the appendix, we have outlined some effective policy measures along with their potential impact on various stakeholders.[82] This Table also shows who the winners and losers of these measures are. While formulating these goals and priorities, it is crucial to acknowledge potential resistance from certain domestic sectors that may not benefit from further integration and development. However, given the substantial benefits associated with these advancements, resistance must be overcome.

[82] It is not within the scope of this study to analyze all possible policies for the integration and development of capital markets. Therefore, we cannot determine which policy is most effective. However, to illustrate the possibilities for the next steps, we do provide some examples of policies that could be effective in this study.

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Appendix

Table 1: Overview of policy proposals to integrate and improve European capital markets

Policy area	Proposal	Winners	Losers
Pensions	Encouraging private pension accumulation in EU member states.	**EU citizens**: higher returns on pension capital, more economic growth **Governments:** reduced dependence on public pension schemes **Companies:** increased supply of (long-term) capital **Investors:** increased investment opportunities	**Member states** that need to change their pension systems: a costly and extensive process **Member states** that have to change the pension scheme in such a way that it no longer fits (all) national desires
Insolvency legislation	Harmoninize and improve insolvency laws in EU member states	**Investors:** better access through reduced information barriers **Companies:** Increased supply of capital due to reduced information barriers	**Member states** that have to make major changes: a complicated and costly process **Member states** that have to change the insolvency legislation in such a way that it no longer fits national desires
Supervision	Centralize supervision of European capital markets by expanding ESMA's mandate and strength	**Investors:** better access through reduced information barriers **Companies:** Increased supply of capital due to reduced information barriers	**National supervisors** have less influence

Note: It is not in the scope of this study to analyze all possible policies for further integration and development of capital markets. Thus, we cannot say which policies are most effective.

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