Capital Markets Union: A new EU policy to look out for
By Julian Müller, SOMO

Summary: The Capital Markets Union (CMU) is a new Commission project that aims to integrate and deepen capital markets in the EU28 in order to stimulate investment and diversify funding sources for European businesses. It is still in the initial stage, but public consultation will begin soon, leading to an action plan in the third quarter of 2015. Whether CMU will stimulate growth and jobs in the short term is doubtful, since its long-term structural goal is to shift Europe’s financial system away from heavy reliance on banks towards capital markets. This might even increase problems with financing the real economy and lessen financial stability.

A rather new item on the agenda of the European Commission is the Capital Markets Union (CMU). It is still in the conceptual stage, but the general idea is to integrate and deepen European capital markets with the goal of creating one single market for company shares, bonds and securitised bank loans that covers all 28 EU member states. Commissioner Jonathan Hill, who is responsible for the newly established DG Financial Stability, Financial Services and Capital Markets Union (DG FISMA), is officially tasked with establishing CMU by 2019.

There seem to be two motivations for pursuing CMU: first, making additional sources of finance available to stimulate capital investment by European non-financial businesses, especially small and medium enterprises (SMEs), and thereby stimulating growth and employment. SMEs tend to rely on bank lending, which, it is argued, has become problematic as banks give too little credit at a time when they are reducing their own debt levels and building up capital buffers, partly in order to comply with stricter prudential requirements...
introduced after the crisis. Therefore, CMU is primarily being discussed under the heading of “finance for growth”. However, there is also a second, more long-term or structural goal: to shift the European economy with its traditionally strong reliance on bank financing to a more market-financed economy with bonds and investment funds, similar to the Anglo-American model.

Of course, the idea of CMU is not entirely new and can be seen as part of the single market project in a more general sense. Measures like the mandatory introduction of International Financial Reporting Standards in 2005 already pointed in this direction. Some aspects of CMU were already outlined in the Commission’s “long-term financing” agenda (see its 2013 Green Paper and its 2014 Communication). Nonetheless, the current CMU only started with Commission President Jean-Claude Juncker’s opening statement before the European Parliament on 15 July 2014, in which he declared that to “improve the financing of our economy, we should further develop and integrate capital markets.” This was followed by a high-profile conference on “Finance for Growth” on 6 November 2014. On 28 January 2015, the Commission announced that it had started work on the CMU and that it intended to draw up an action plan by the third quarter of 2015 based on a phase of broad public consultation. A Green Paper to be adopted in February 2015 will outline the details.

Establishing CMU will require an ambitious legislative agenda, the details of which are as yet unknown. However, based on the discussion so far (see e.g. contributions by Nicolas Véron or Jacques de Larosière), some likely areas of legislative action have emerged. Nationally regulated and supervised financial markets will need to be harmonised and integrated; for example, the supervision of clearing houses that facilitate the derivatives markets. Securitisation of loans is to be encouraged and the related market for asset-backed securities is to be rekindled.

European policy makers also see CMU as an instrument for financing infrastructure investment. In a similar vein, there is already an ongoing “Europe 2020 Project Bond Initiative” which channels money from capital markets into infrastructure projects such as motorways (for a civil society critique see here). Moreover, CMU supporters warn that if regulation that aims at improving financial stability is too restrictive, the financial system will not channel funds to non-financial enterprises, and that bank lending or the involvement of institutional investors in, for instance, the financing of infrastructure, will be stifled. Therefore, CMU is also likely to include a relaxation of existing rules or exemptions for certain types of financial institutions. For example, the Commission already presented a proposal to introduce a new type of investment fund called the European Long-Term Investment Fund (for details see Newsletter February 2014). Generally, CMU may weaken the resolve to address problems of financial stability.

Can CMU help to stimulate investment and growth, as the Commission’s supply-side economists seem to claim? This is unlikely if, as many other economists and a recent report by Finance Watch argue, the sluggish development of the European economy has deep structural causes, especially demand constraints. If these are not tackled, deepening and expanding capital markets may in fact add to the financialisation of European economies and to a finance-driven capitalism that is correlated with weak investment in the real economy and financial instability. However, it is also conceivable that addressing the current problem of anaemic growth in the EU is not even the main reason for this project. After all, even if positive effects on growth were likely, they would still be a long way off because the legislative framework for CMU is only expected to be in place by 2019. Add to this the time it would take for such stimulus to have real consequences in terms of investment, and we are easily talking about a minimum of five years before any positive growth and job effects are felt. It seems that current concerns about growth and jobs are paid lip service to pursue a more long-term agenda: shifting the European financial system towards more reliance on financial markets and less bank lending. This follows the new strategies of banks, away from strictly regulated lending towards more profits by offering capital market services.

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No Happy New Year for the EU

By Peter Wahl, WEED

Summary: The economic and political prospects of the EU for 2015 are gloomy. Besides sluggish growth, deflation is looming, the Euro is depreciating considerably and the Greek crisis is leading to a lot of uncertainties. The massive intervention of the ECB proved to be ineffective as demand remains weak, and the investment programme of the EU Commission is too small. Political challenges such as the potential breaking away of the UK from the EU and the war in Ukraine are leading to a complex knot of crises for which EU structures lack the necessary problem-solving capacity.
Hence, the EU in 2016 will not be the same as it is today.

At the beginning of the new year, the economic figures for the EU are anything but brilliant. The permanent and multiple crises, which had started with the financial crash in 2008 and engendered a dramatic crisis of public finance in the Mediterranean with tremendous human costs, will not end in 2015. The IMF’s recent Economic Outlook from 20 January has once again reduced its October 2014 growth forecast for the Euro area by 0.2% for 2015 and 0.3% for 2016. The IMF is now expecting 1.2% growth for 2015 and 1.4% for 2016. This is less than half the rate of the US and not enough to overcome Europe’s economic problems. Nor will modest overall growth in the world be a very supportive environment. But the meagre growth rate is not the only problem:

- The currency union is at the brink of deflation, as the core inflation rate (excluding volatile prices such as for food and energy) shrank in January 2015 by 0.6%.

- Average unemployment in the Euro-zone is high at 11%, while in some countries youth unemployment remains extremely high.

- The Euro has drastically depreciated vis-à-vis the US dollar, while several other currencies are also very volatile and under pressure from financial markets, including the Swiss franc, the Australian dollar and the Russian rouble.

- Stock markets have become extremely volatile, which means that investors and speculators are swiftly changing strategies and moving money.

- Sanctions against Russia affect trade and investment, with consequences for growth and jobs inside the EU, while an economic crisis in Russia could have contagion effects for the world economy.

On the other hand, the fall of the oil price is working like a stimulus program. For Germany, for instance, the effect is estimated at 0.3% of the GDP or some $12 billion. However, as a major oil producer, the UK will suffer. All in all, the Euro-zone continues on its path towards a lost decade.

Will quantitative easing and the “Juncker Plan” turn the tide?

The only institution that currently seems to dispose of some leverage over the economic problems is the ECB. Thanks to the “one country one vote” principle, the ECB sidelined the permanent resistance of the Bundesbank to implement policies with a Keynesian touch, thus preventing more chaos. In order to react to the deflationist pressure, the ECB announced on 22 January a programme that will pump €60 billion per month into the Euro financial system by September 2016 – to the tune of a considerable €1.4 trillion overall. Each of the national central banks will buy up, in their own countries, for instance, bonds issued by governments in the Euro area and owned by banks with the aim of stimulating banks to provide more credit for the economy.

However, similar actions in the past have not succeeded in kick-starting a recovery. Already in 2010, the ECB launched its Security Markets Program (SMP), buying public bonds in the secondary market for €210 billion until 2012. In 2011, the ECB started injecting €1 trillion into the banking system for three years at very low interest rates. In the summer of 2014, Frankfurt decided to buy covered bonds and asset-backed securities (ABS) in order to stimulate the economy and fight deflation.

But as long as domestic demand is kept weak as a result of austerity policies and “fiscal discipline”, the scope of the ECB initiatives will be limited. This represents the difference to the US, where quantitative easing was accompanied by complementary deficit spending on the part of the government.

In order to stimulate growth, the European Commission has launched the so-called “Juncker Plan”. This aims to increase investment, which has been lacking for several years. Investment in the EU has dropped by 15% since 2007, and, in some of the crisis countries, even significantly more. However, there remains scepticism as to whether it will work. First, the amount is too small; €315 billion is 1.7% of the GDP and the money will be stretched over three years, meaning only some €105 billion per year. Secondly, it is unclear whether the full amount can be raised, as the investment programme has just €21 billion in its own resources (through the European Investment Bank), while this amount would have to be multiplied 15 times if coming from private investors.

Greece: austerity paradigm at stake

Greece took centre stage with the Greek elections, which resulted in Syriza coming into power. Long before the elections, many economists argued that the Greek debt rate, which has increased from 107.4% of the GDP in 2007 to ca. 180% in 2014 (around €320 billion) is unsustainable and that such a debt will never be paid back.

As a first step, the new government in Athens suspended cooperation with the Troika, pointing at the Berlin-Brussels-Amsterdam type of crisis management that has precipitated the country into a human and economic disaster. Then Prime Minister Tsipras and Finance Minister Varoufakis toured EU capitals for a week in order to seek a new deal for Greece. While the French and Italian government showed sympathy for the plea of more investment, they did not risk an open opposition to the official EU position that there would be no haircut. German Finance Minister Schäuble said that Greece must press on with budget...
cutting commitments made under its existing €172 billion bailout.

On the other side, the Greeks received support not only from Nobel Prize laureates such as Stiglitz and Krugman. US President Obama himself voiced open critique of the EU: “You cannot keep on squeezing countries that are in the midst of depression.”

That same week, the ECB showed how it can use its financial power by cancelling the possibility of Greece using its bonds as collateral to provide Greek banks with liquidity from the ECB. This means that Greek banks have to seek liquidity elsewhere at a higher interest rate. This puts additional pressure on Greek banks and on the government to keep to the austerity and debt repayment programme. Even German mainstream media qualified this as “adding fuel to the flames.” Indeed, the current bailout extension for Greece is due to expire on 28 February 2015.

In order to deal with the most urgent matter of keeping public finance and the banking system running, the Greek government is asking for bridging finance until the end of May to prepare detailed plans for talks between Greece and Eurozone partners to end austerity. In a first reaction, the head of the Euro Group, Dutch Finance Minister Dijsselbloem, bluntly replied “We don’t do bridge loans.” The Greek government has backtracked from its initial demands for a debt write-down, but wants a restructuring of both the debt and the conditions. It decided to raise the minimum wage and pension funds, and stop a $25 billion privatisation, some of the conditions of the Troika. But it will enforce more strictly the condition to crack down on tax evasion by the rich and eliminate the influence of the powerful interest groups (“oligarchs”) that dominate important sectors.

The outcome of the conflict is uncertain. Looking simply at the economic balance of power, Greece is at the mercy of the EU. However, a collapse of the Greek economy and an exit from the Euro is not in the interest of the EU. Although the economic price might be tolerable for the rest of the EU, the political price would be far too high. As a last resort, the country might even threaten to seek help from Russia. The new foreign minister has already talked about his country becoming a bridge between the EU and Russia. In so far, Greece disposes of coercive deficiency, as game and conflict theory would describe the balance of power, and a compromise is not excluded.

Extraordinary political problems

The problem-solving capacity of the EU is under additional stress due to extraordinary political challenges, such as a possible referendum over EU membership following the UK elections in May. Also the independence of Catalonia from Spain remains on the agenda with a quasi-referendum in September. Furthermore, the wave of new right wing populist parties has now also reached Germany. The new party AfD (Alternative for Germany) received between 9% and 12% in elections in three federal states, thanks to its strong Euro scepticism on neoliberal and nationalist grounds.

The war in Ukraine is also an enormous economic and political burden, creating internal tensions and a direct external threat with unforeseeable consequences if a political solution is not found soon.

Taken all together, these challenges are overstraining the capacities of EU governance structures. The warnings – among others in this newsletter – that there is no “pure” economy and that economic and social crises will sooner or later spill over into politics is now unfortunately coming true. 2015 will see extraordinary challenges for the Eurozone and the EU as a whole. Whatever the outcome will be, the EU will no longer be the same in 2016.

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Brief Updates

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Little restructuring of too-big-to-fail banks by the European Parliament and Council of Ministers

On 22 December 2014, Gunnar Hökmark, the European Parliament’s rapporteur for the EU’s reform to restructure too-big-to-fail banks, released his draft report. The report will amend the Commission’s proposal (for details on the reform see Newsletter December 2014). The Parliament’s responsible committee (ECON) will vote on the report on 23 March and a plenary vote is indicated for 28 April.

According to Finance Watch, the Hökmark amendments would prevent separation between basic banking and speculative banking activities because they would “make bank structure reform ineffective” and “substantially weaken the objectives, scope, definitions, mechanism and sanctions in the Commission’s original proposal.”
The amendments would have the following effects, amongst others:

- The bank restructuring law will not be applied equally in all EU countries because national authorities will be allowed to decide on important differences.
- Many fewer banks would be covered by the law, possibly only five in the entire EU.
- A separation of a bank would only be required in cases in which the resolvability of a particular bank is threatened, but not if there is a general threat to financial stability.
- The risky relations between banks and investment funds, including speculative hedge funds, would be relaxed.
-Derivative trading would be separated less from basic banking, which would mean higher risks for the part of the bank that is to be bailed out in times of crisis.
- Rules reducing the risks from large credits to other banks would be significantly weakened.
- Prohibition of trading and speculation at the bank’s own risk (“proprietary trading”) would be significantly weakened.

The ECON committee is under heavy pressure from the financial lobby. Therefore, the Hökmark draft raises concern that the committee will buckle under this pressure. The parallel deliberations at the Council of Finance Ministers might weaken the proposed law further, as different governments have openly voiced opposition to the further restructuring of banks. The entire law is even at risk of being withdrawn.

Proposed standards for commodity derivatives weaken the law (MiFIDII-MiFIR)

After the new EU laws on commodity derivatives – MiFIDII and MiFIR (see Newsletter February 2014) – started to come into force in July 2014, still quite some technical details to implement these laws needed to be decided on. The European Securities and Markets Authority (ESMA) has proposed the first part of the technical standards at the end of December 2014, that need to be confirmed or amended by the European Commission and approved by the European Parliament and Council – a cumbersome process.

Technical details can strengthen or weaken the laws on (food) commodity derivatives (see for instance here). The current ESMA proposals are enhancing loopholes in the law, for instance by extending the definition of oil derivatives that get many exemptions from the regulations. The proposals also undermine transparency by preventing the condition of lower tax rates than the EU Commission had proposed (0.01%).

The change in the French position is the result of pressure both from civil society in December 2014, which was widely covered by French media, and from the Social Democrats in Austria and Germany on their French sister party.

In the meantime, the “Coalition” has set up an informal structure, with Austria as a political facilitator and Portugal as a facilitator for technical issues. Such a structure, which had been missing until now, is meant to dynamise the process and should lead to a decision point by the end of the year.

The French concessions are a clear success for the supporters of the FTT, while the banking lobby is disappointed. In a leaked letter to the Latvian finance minister – Latvia holds the EU Presidency in the first half of 2015 – they lament: “Given the clear evidence of the potential damage of an FTT to investment, growth and jobs, we urge you to withdraw the proposal.”

Apart from the fact that the Presidency does not have the right to withdraw the proposal, the informal structure of the “Coalition” makes negotiations independent from any influence of any non-participating government.

New momentum for the Financial Transaction Tax

In the December issue of this newsletter, we reported that the negotiations on the Financial Transaction Tax (FTT) among the eleven countries participating in the project (the “coalition of the willing”) had been stalled due to the resistance of France to include derivatives in the tax base.

However, on 5 January 2015, French President François Hollande announced a U-turn, stating that France would accept taxing derivatives under
weekly public reporting of trade in a particular derivative. ESMA proposes to stop public reporting 3 months after there are less than 30 participants having an open contract in a derivative, which is a situation that is, or might be, the case for many derivatives contracts e.g. for cocoa.

ESMA is consulting on its website on the second part of technical standards to be decided on, such as how to concretely limit the speculation in commodity derivatives (detailed standards for position limits), detailing transparency requirements for all trading (shares, derivatives), and defining when a commodity company is to be treated as a speculator. The deadline for the written consultation is 2nd March 2015. A hearing on the same issues will be held on 19th February 2015 in Paris.

Ownership register agreed in EU Anti-Money Laundering Law

The European Institutions reached a final agreement on the reform of the EU’s anti-money laundering law end of last year which was formally endorsed by the two responsible Parliament committees on 27 January (for background Newsletter March 2014). Now only some last technical details need to be settled and the final text needs to be officially published. The law will then be directly valid throughout the EU as it is a regulation.

The revised law will bring several enforcements of anti-money laundering policy. The most important is a duty for all member states to set up a register indicating the natural persons owning, controlling or benefitting from a company, foundation or trust. However, the register will not be fully public, as has been called for before and criticized afterwards by civil society during the negotiations: Instead, the information on companies and foundations is only available to persons that can prove a “legitimate interest”. And, the information on trusts will be only available to authorities. Finally, there is also the risk that the coverage of trusts is not sufficient due to a clause that there needs to “generate a tax consequence”. This loophole was even officially criticized by Austria.

The new law will also bring various other improvements such as a better sanctioning, the better tracing of transfers of funds, and the stricter dealing with “Politically Exposed Persons”, i.e.

high ranking politicians or other powerful people committing a money laundering crime. However, there are also other shortcomings, for example sanctions will not be regularly published.

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EU Regulation on how to calculate important price indicators in the financial markets

A new legislation in the EU attempts to prevent scandalous behaviour by the financial industry, which was exposed after the financial crisis. Banks had been manipulating the indicators of the interest rate which they were paying when they were borrowing themselves. Not only these so-called ‘benchmarks’ or ‘indices’, such as the LIBOR and EURIBOR for interest rates, but also some benchmarks for foreign exchange rates and even commodity prices were being manipulated (see also December 2014 Newsletter). These benchmarks are used in financial instruments and financial contracts, including mortgages and derivatives, so that millions of clients paid higher prices than would have been needed while banks, amongst others, were profiting.

In order to avoid manipulation due to conflicts of interest as well as badly and non-regulated processes, contributors and governance to decide on the daily indices, the European Parliament is deciding on a Regulation ‘on indices used as benchmarks in financial instruments and financial contracts’ and will vote on the report by the European Parliament’s ECON committee on 5 March 2015 after a hearing was held on 11 November 2014. In the meantime, decision making in the Council of Finance Ministers is also progressing according to a compromise text on 21st January 2015.

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Calendar

For background to the official agenda of European institutions, see the following websites:

- European Commission (EC)
- Economic and Financial Affairs Council (ECOFIN)
- European Council
- Economics and Monetary Affairs Committee (ECON) of the European Parliament
- Financial Stability Board

The links below give the website with updates and overviews of documents and dates related to the EU decision making process.

February

- 9-12, EP (Strasbourg): Plenary
- 11, Euro Group (Brussels): Emergency meeting about new Greek plans
- 12-13, European Council (Brussels): Meeting of heads of state
- 12, CSO (Dublin): Conference on Tax and Human Rights
- 13, ESMA (Paris): Deadline for consultation on Article 9 of EMIR
- 13, Basel Committee on Banking Supervision (Basel): Deadline for consultation on identifying simple, transparent and comparable securitisations
- 16, Eurogroup (Brussels): Meeting
- 17, ESMA (Paris): Deadline for consultation on MiFID II/MiFIR
- 17, ECOFIN (Brussels): Meeting
- 18-19, UNDP e.a. (Accra): Conference Financing the Future
- 23-24, ECON (Brussels): Meeting
- 24-28, CSO (Tunis): World Social Forum
- 25, EP (Strasbourg): Plenary
- 25, EBA (London): Deadline for consultation on minimum requirement for own funds and eligible liabilities (MREL)
- 25, EC (Brussels): EC Civil Society Dialogue Meeting on the Trade in Services Agreement (TiSA)
- 27, ESMA (Paris): Deadline for discussion paper on The Use of Credit Ratings by Financial Intermediaries Article 5(a) of the CRA Regulation

March

- 2, ESMA (Paris): Deadline for consultation on MiFID II/MiFIR
- 4-5, UN (New York): CSO hearings Financing for Development
- 6, Basel Committee on Banking Supervision (Basel): Deadline for consultation on Net Stable Funding Ratio
- 9, Eurogroup (Brussels): Meeting
- 9-12, EP (Strasbourg): Plenary
- 10, ECOFIN (Brussels): Meeting
- 17-18, UNDP e.a. (Accra): Conference Financing the Future
- 19-20, European Council (Brussels): Meeting
- 5, ECON (Brussels): Meeting
- 23-24, ECON (Brussels): Meeting
- 24-28, CSO (Tunis): World Social Forum
- 25, EP (Strasbourg): Plenary
- 30, ESMA (Paris): Deadline for consultation on European Electronic Access Point (EEAP)
- 31, ECON (Brussels): Meeting
- 31, ESMA (Paris): Call for Evidence Competition, Choice and Conflicts of Interests in the CRA Industry
- ??, G7 (Frankfurt): Financial Sector Regulation conference

April

- 14, ECON (Brussels): Meeting
- 15, EP (Strasbourg): Plenary
- 17-19, WB/IMF (Washington): Spring meetings
- 20, ECON (Brussels): Meeting
- 22, UN (New York): ECOSOC meeting on international cooperation in tax matters
- 24-25, ECOFIN (Brussels): Informal Meeting
- 29-30, LATINDADD-GATJ (Lima): Conference International Tax Justice & Human Rights

May

- 5-7, Eurodad (Copenhagen): International conference. Focus: Financing for Development (FFD)
- 6-7, CSO: Events on Women and Tax Justice
- 6-8, G20 (Istanbul): International Tax Symposium
- 7, UK: General election
- 11, Eurogroup (Brussels): Meeting
- 12, ECOFIN (Brussels): Meeting
- 18-21, EP (Strasbourg): Plenary
June

- 27-29, G7 (Dresden): Finance Ministers and Central Bank Governors meeting
- 27, EP (Strasbourg): Plenary

July

- 7-8, G7 (Schloss Elmau, Germany): Heads of State Summit
- 8-11, EP (Strasbourg): Plenary
- 16, Eurogroup (Luxembourg): Meeting
- 19, ECOFIN (Brussels): Meeting
- 24, EP (Strasbourg): Plenary
- 25-26, European Council (Brussels): Meeting

August

- 2, EP (Brussels): Plenary
- 14-16, European Council (Brussels): Meeting
- 26-29, EP (Strasbourg): Plenary

September

- 7-10, EP (Strasbourg): Plenary
- 16, EP (Brussels): Plenary

October

- 5-8, EP (Strasbourg): Plenary
- 9-11, World Bank/IMF (Lima): Annual meetings
- 14, EP (Brussels): Plenary
- 14-16, European Council (Brussels): Meeting
- 26-29, EP (Strasbourg): Plenary

November

- 11, EP (Strasbourg): Plenary
- 15-16, G20 (Antalya): Summit
- 23-26, EP (Strasbourg): Plenary
- 25, EBA (London): Public Hearing on simplified obligations

December

- 1, G20 (Chima): China takes over G20 Presidency
- 2, EP (Brussels): Plenary
- 14-17, EP (Strasbourg): Plenary
- 17-18, European Council (Brussels): Meeting
- 31, G7: End of German Presidency

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