

COLLEGE OF EUROPE
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SHOULD THE EU CONTINUE INTEGRATION TOWARDS A CAPITAL MARKET
UNION?

A comparative Case Study on Market- and Bank-Based Economies' Impact on Non-
Financial Corporations Investment Behavior

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Abstract

Throughout the last decade, the European Union (EU) was hit by two interconnected crises. Although the crises have been surmounted, EU's post-crisis economic performance remains dismal, until today. Scholars link today's bleak economic performance to the impact of the banking and sovereign debt crisis, which severely damaged monetary financial institutions' profitability, inhibiting their ability to extend new loans to non-financial corporations (NFCs). However, European NFCs cover on average 70-80% of their financing needs via bank-based financing.

This sparks among some economists the fear of a decade of secular stagnation, as private savings are high, but investment remains low. In response, the commission launched a green-paper to prepare enactment of a true Capital Market Union, in order to strengthen market-based, cross-border financing in the EU. This thesis will henceforth examine if:

market-based economies as e.g. the USA, which rely upon a less bank-based financing structure of its NFCs are consequently able to achieve higher investment to gross value added ratios, compared to many EU member states, independent of macroeconomic circumstances.

To verify above research hypothesis the author specified an empirical panel data model, covering 20 EU member states plus the United States of America, collecting data from 2003 until 2012. Main insights derived in this paper are supposed to give a first indication, how NFCs investment behavior is impacted. In brief the four key-results are: (1) market-based NFCs invested pre-crisis more than bank financed NFCs; (2) NFCs that rely mainly upon bank financing are more sensitive to changes in the magnitude of available, external funds; (3) NFCs which predominantly rely on bank-based funding experience funding constraints and (4) market-based NFCs appear to exploit short-term trade-offs of boosting reported earnings at the expense of dropping investment projects

The research discussed in this thesis validates the measures proposed by the commission in order to achieve a more market-based economy, via the implementation of a Capital Market Union.