

Capital Market Union: Can Europe's investment malaise be resolved by doubling down on its banking contradictions?

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ABSTRACT

This paper argues that Europe's investment malaise will not be resolved by the passage and implementation of the Action Plan for the Capital Markets Union (CMU). Materials explaining this "investment plan for Europe" portray it as a "virtuous triangle," which will unleash needed investment that was cut off in the wake of the economic uncertainty generated by the spread of the US subprime crisis to Europe. The idea is that European investment – at the peak of this triangle – will be restored through implementing the two elements constituting this triangle's base – fiscal responsibility and structural regulatory reforms. This logic is misconceived at a number of levels: it ignores contradictions in Europe's regulatory structure that preceded the subprime crisis; its call for accelerated fiscal constraint across the European Monetary Union (EMU) will deepen Europe's structural economic imbalances, not cure them; it will make European finance more dependent on the megabanks that are now less able and willing to restore credit flows to firms, especially small and medium enterprises (SMEs), while ignoring European nations' uniquely strong legacy of diverse localized financial infrastructure.

1. Introduction

This paper argues that Europe's investment malaise will not be resolved by the passage and implementation of the Action Plan for the Capital Markets Union (CMU). Materials explaining this "investment plan for Europe" portray it as a "virtuous triangle," with investment – at the peak of this triangle – being supported by the two elements constituting this triangle's base – fiscal responsibility and structural reforms. The term 'fiscal responsibility' refers to member nations' renewed commitment to the fiscal benchmarks to which they first agreed in signing the Maastricht agreement; the term 'structural reforms' here refers to plans to harmonize rules regarding financial securitization across nation states within the European Union. The idea is that securing the first element will reduce investors' uncertainty, while the second will heighten the flow of finance into Europe for the backlog of investment projects whose implementation has been delayed by the effects of the global crisis.

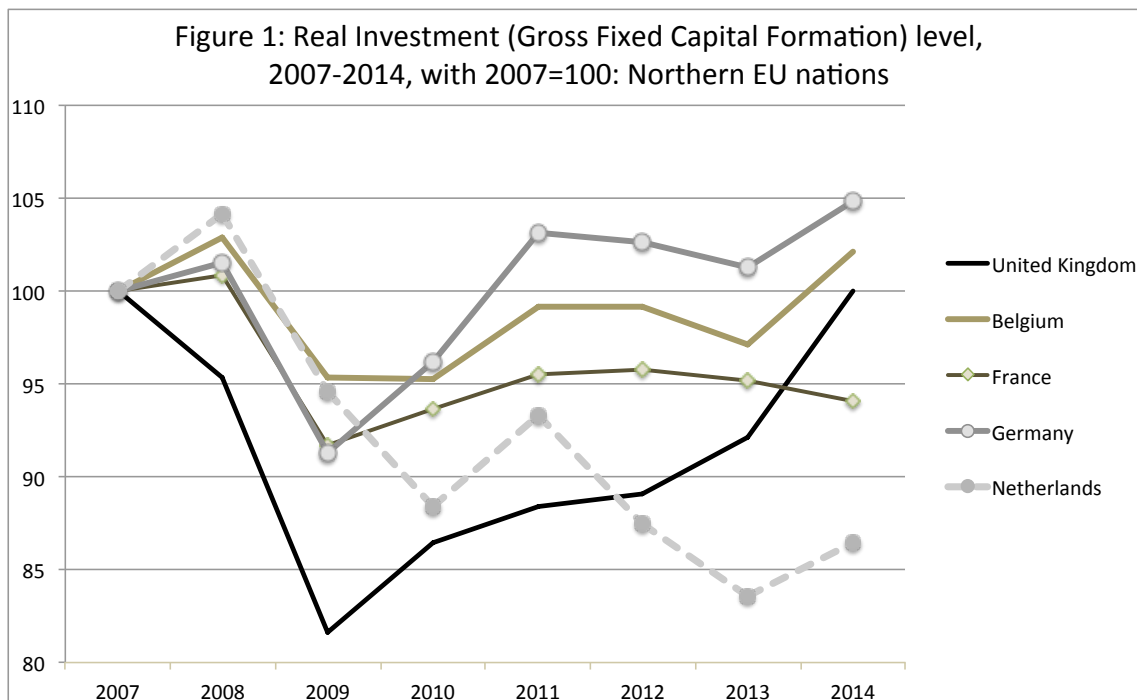
This paper unpacks this logic and finds it is misconceived at a number of levels:

- First, the crisis that has led to investment slowdown in Europe cannot be entirely explained as a contagion effect of the US subprime crisis; to the contrary, it arose because of structural flaws in the regulatory structure of European banking that were hardwired into the governance choices made in establishing the European Union and the European Monetary Union.
- Second, insisting on further fiscal restraint on the part of European Union member nations will enhance, rather than reduce, uncertainty about Europe's future, even while undercutting the

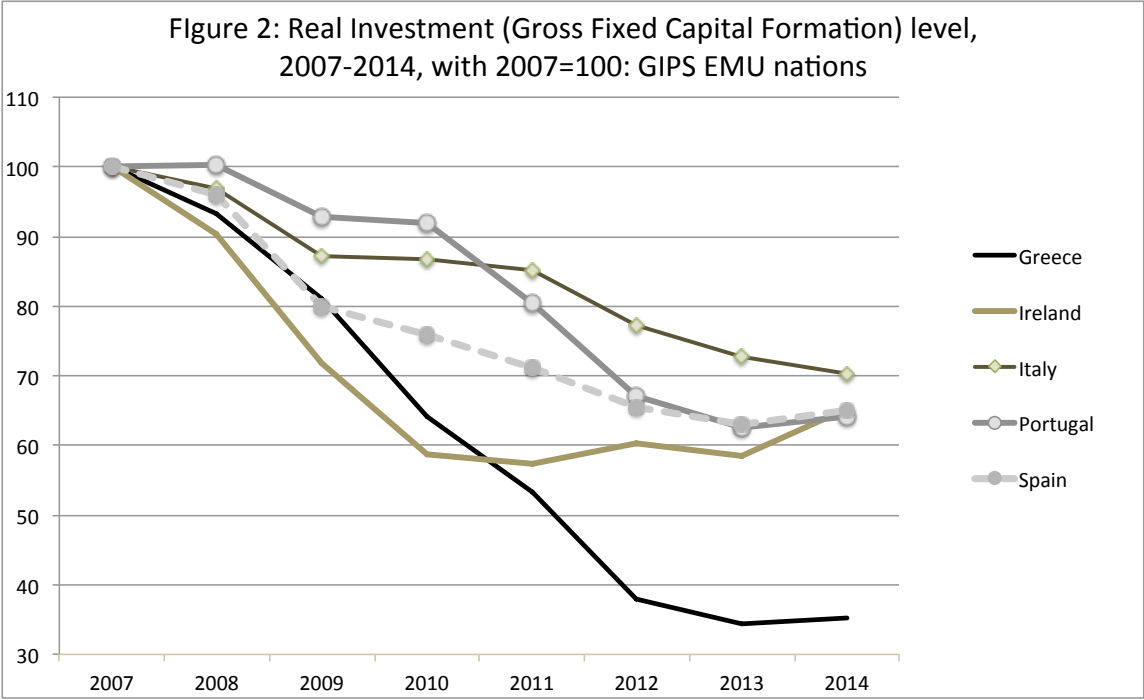
possibility of sustainable European economic and employment growth.

- Third, the structural reforms emphasized in the CMU Action Plan will make European finance more dependent on that segment of the European banking community – the megabanks – that has been the most problematic in terms of generating bad debt commitments, absorbing public subsidies, and not renewing lending in the post-crisis period.
- Fourth, insisting that the CMU is needed to permit European nations to make a transition from bank-centred systems of finance to a modern capital-market-centred system misreads European economic history and, by deepening reliance on megabanks to provide needed finance, puts further pressure on Europe’s contradictory system of bank supervision.

Restoring investment expenditure in Europe will require changes in European law quite different from those that the CMU is putting into motion. Fiscal stimulus is needed, not restraint; and it should be focused on enhancing human security and underwriting a path to sustainable growth. This can be secured either by a properly financed Europe-wide governmental entity or by member nations. Coherent financial regulation must replace the current contradictory structure of regulation now in place. This reform should focus on reducing dependence on megabanks whose power, size, and complexity make them both too big to fail and too big to save; this means reducing European finance’s implicit dependence on shadow-banking practices. In nation-states with strong traditions of locally-based financial institutions, these diverse ecostructures should be strengthened. In nation-states lacking these traditions, impulses toward democratic finance should be encouraged so as to nurture a needed bottom layer of locally-responsive financial intermediaries.



Source (Figures 1-2, 4-7): OECD.



In sum, European fiscal policy should no longer be held hostage to a fruitless policy of reassuring an imagined pool of global investors insisting on fiscal probity as a condition for releasing the financing for a flood of new projects. And European financial regulation policy should embrace and further nurture the diversity of European pathways to the provision of finance, rather than erasing it in favor of a securitization homogenization campaign that will end only in further securing Wall Street dominance of global finance.

Section 2 elaborates briefly on both the European Commission’s rationale for Capital Markets Union, and on how the CMU fits into its broader investment plan. Sections 3-5 then take up the four criticisms made above, which encompass both the European investment plan, the Capital Markets Union, and the European Banking Union as currently implemented. Section 6 briefly concludes.

2. An Investment Plan for Europe and the Capital Markets Union

The EU’s Capital Markets Union plan, the Action Plan for which was launched on 30 September 2015, is one component of a larger scheme for bolstering investment in Europe. Figure 1 verifies that investment spending has barely recovered to 2007 levels in three northern European countries; two of these, Germany and Belgium, are members of the European Monetary Union (EMU, or Eurozone), while the UK is an EU member but outside the EMU. The other two northern EMU countries shown, France and Netherlands, remain far below their 2007 investment levels. Figure 2 illustrates investment data for the five ‘GIPSI’ EMU countries; in all, investment spending remains dramatically lower than in 2007. This investment plan was proposed by European Commission President Jean-Claude Juncker on 15 July 2014, the day he took office. The plan is described in the final released version as follows:

“General uncertainty about the economic situation, high levels of public and private debt in parts of the EU economy and their impact on credit risk limit our room for manoeuvre.

However, at the same time, there are significant levels of savings and – in contrast to some years ago – high levels of financial liquidity that can be mobilised. Moreover, Europe has plenty of investment needs and economically viable projects in search of funding. The challenge is to put savings and financial liquidity to productive use in order to support sustainable jobs and growth in Europe.

“What we need is confidence in the overall economic environment; predictability and clarity in policy-making and the regulatory framework; effective use of scarce public resources; trust in the economic potential of investment projects under development; and sufficient risk-bearing capacity to encourage project promoters, unlock investment and entice private investors.” (European Commission, 2014, p. 4)

This document suggests that nation-state members proceed by “pursuing the necessary structural reforms, exercising fiscal responsibility, providing regulatory certainty and boosting investment in support of jobs and growth. Member States with fiscal room for manoeuvre should invest more. Member States with more limited fiscal space should prioritise investment and growth-related expenditure in their budgets, make better use of EU Funds and create an environment that is more conducive to investment by private actors.” (*ibid.*, p. 4)

Some €21 billion of funds from the European Investment Bank (EIB) and the EU budget is committed to a European Fund for Strategic Investments, to be administered by the EIB. EFSI funds will provide underwriting (risk offsets), between now and 2017, for an estimated €315 billion of public and private investment; long-term investments and support for SMEs and mid-cap companies are prioritized. While experiments with innovative methods of financing are encouraged, the document focuses on the need to revive:

“high quality securitisation markets, without repeating mistakes made before the crisis. The Commission will reflect on the best ways to present criteria for simple, transparent and consistent securitisation, building on recent measures in the insurance and banking sectors and international work in this area. Reviving this asset class will help developing a deep and liquid secondary market, attract a broader investor base and improve the allocation of finance to where it is most needed.” (*ibid.*, p. 15)

In addition to securitization *per se*, the Commission’s Action Plan mentions its interest in “capital markets, venture capital, crowdfunding and the asset management industry” (European Commission, 2015, p. 1) as alternative financing vehicles of possible interest. Consultation documents for covered bonds and venture capital funds, and for gaps or redundant areas of financial regulations, have been issued; comments are due on 6 January 2016.

The premise of the investment plan, then, is that uncertainty must be defeated, so that global investors and financial markets – especially those outside of Europe – perceive Europe as a desirable place to lend. And the way to defeat uncertainty is to maintain a commitment to fiscal austerity and to standardize national laws that impinge on the characteristics of securitized financial contracts.

3. The evolution of European banking and of global megabanking

In the past 30 years, intensifying global competition and successive innovations in financial markets

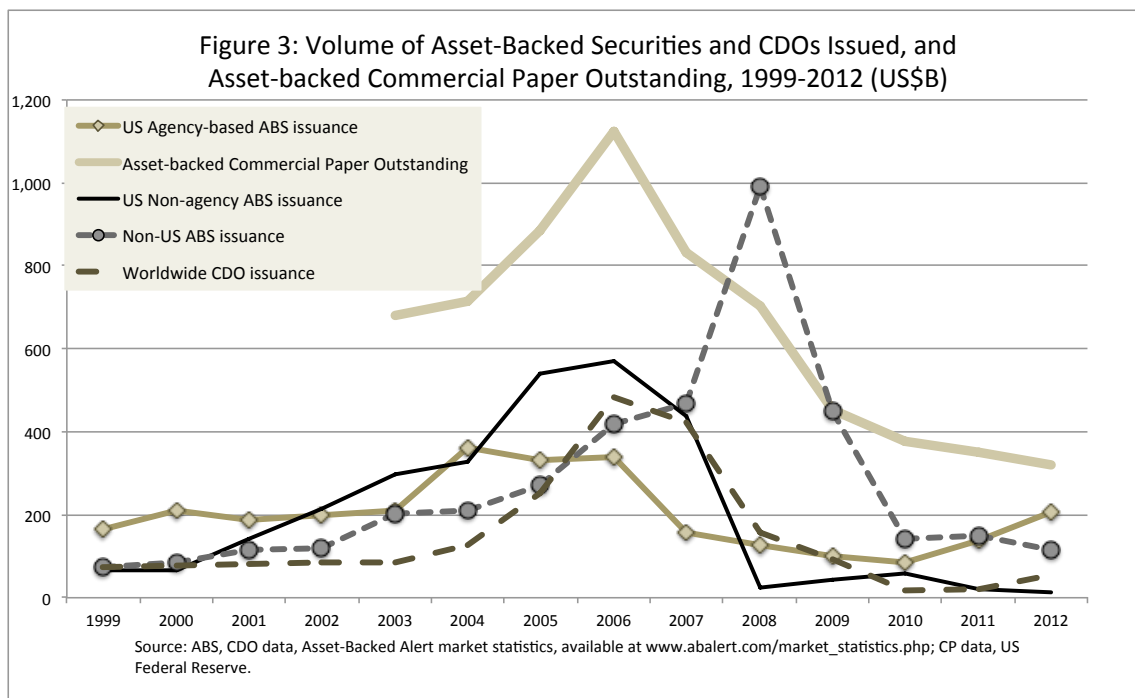
and instruments forced changes in what had been a set of heavily-regulated and distinct financial systems across the nations of Europe. Of course, these institutional changes, and the financial crises they sometimes generated, pressured national financial systems across the globe. What made Europe distinctive were the rules agreed for European economic integration in the 1990s. All nations entering the European Union (EU) agreed the principle of the ‘single market’; in the case of finance, this meant that each national market would be open to free entry by other nations’ financial-services and market practices. All EU countries also retained responsibility for defining their nationally-chartered financial intermediaries’ scope of activities, maintaining these institutions’ safety and soundness, and handling any cases of institutional failure. Further, the central banks of nations entering the Eurozone lost the lender-of-last-resort capacities they’d had prior to the introduction of the Euro: these monetary authorities no longer maintained complete control over the volume of the national currency in circulation. In turn, however, the mandate of the European Central Bank did not include a lender-of-last-resort directive; its sole mandate was to fight price inflation.

This design created special challenges for European financial systems. Its failure to offset Euro-adopting nation-states’ loss of their lender-of-last-resort capacity with a lender-of-last-resort mandate at the Eurozone level implied that the system could not have a financial crisis. This mechanism design was seen as eliminating the possibility of moral-hazard-motivated behaviour by member-nations. This implied, as well, that the Eurozone could not withstand a profound financial crisis without setting aside its own rules. This was, to say the least, a strong bet on the capacity of market forces to anticipate the build-up of excessive risk and to react in ways that defused possible crisis moments in advance.

A second set of challenges arose because Europe’s financial systems were very heterogeneous: some were based on arms-length relationships between creditors and debtors, and others on “relationship-based” lending. Some nations’ systems encompassed significant interregional differences in financial structures, whilst others were unified. In any case, most nations anticipating EU entry encouraged banking consolidation in advance of the launch of the EMU, establishing national champion banks large enough to stand up to the force of the heightened competition. Many apparent benefits flowed from Europe’s embrace of a single market in finance and strong cross-border capital flows: until the crisis year of 2009, the Eurozone as a whole experienced a uniformly low interest rate as capital moved from surplus areas to deficit areas.

Meanwhile, financial intermediation worldwide was undergoing a shift toward standardized practices and arms-length financial instruments: institutions offering customized, relationship-based intermediation shifted to niche markets. Large financial firms operating comprehensive, integrated financial service platforms on a global scale – that is, megabanks – have been best able to exploit the profit-making opportunities thrown up by this new landscape of finance.

Whilst European nations were liberalizing their banks’ scope of activities and encouraging the growth of very large banking firms, financial intermediaries in the US were creating predatory lending instruments, including subprime mortgage loans. It was, indeed, this latter market that collapsed with the subprime crisis. Figure 3 shows that both US non-agency and US agency asset-backed securities (ABS) peaked in 2006 and then declined rapidly; subprime loans were/are in the non-agency category (ABS are an alternative name for securitized loans).



The empirical experience documented in Figure 3 suggests that the European Commission’s plan to underwrite risk for new European securities issues may be necessary to rehabilitate that market. Not only do Hills and Hoggarth (2013) further document the boom-bust – that is, pro-cyclical – nature of markets for securitized credit; those authors also demonstrate that cross-border borrowing and intermediation generally declined precipitously after 2007. Further, the notion that foreign investors should be counted on to provide substantial volumes of European finance runs counter to the fact that Western Europe has had very low levels of non-EU financing (see figure for 2011 in Vause 2012, Graph 8, p. 12).

4. Limits to fiscal constraint and top-heavy financialization in Europe

A second mistaken conception underlying the logic of the EC’s investment plan for Europe and its Capital Markets Union proposal is the notion that the financing of investment in the EU will be enhanced if fiscal constraint is maintained going forward. The notion that investment demand will rise as other components of aggregate demand fall, all else equal, is based on classical macroeconomic logic, according to which credit availability is fixed by the supply of available loanable funds. The fewer other sources of demand there are for using these funds, the lower will borrowing rates be, and thus the more investment demand that can be financed. In this “loanable funds” conception, an increase in government expenditure that is financed by deficit spending represents a competing demand for finance, and will have the effect of driving up interest rates and squeezing out some investment spending.

Figure 4: Nominal long-term interest rates, quarterly data, 2006-2015, North-central EU Nations

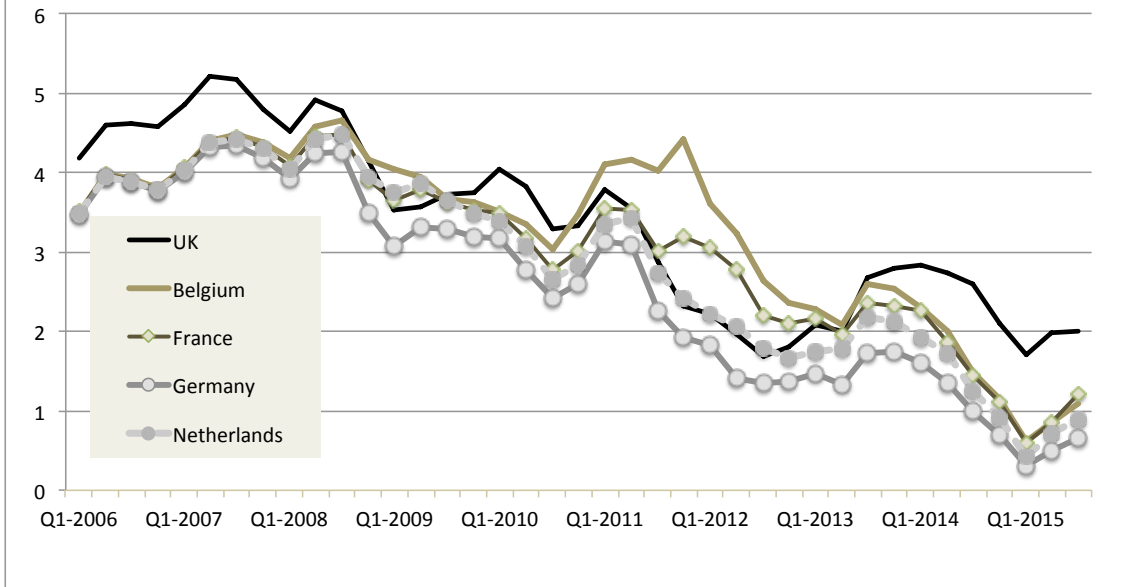
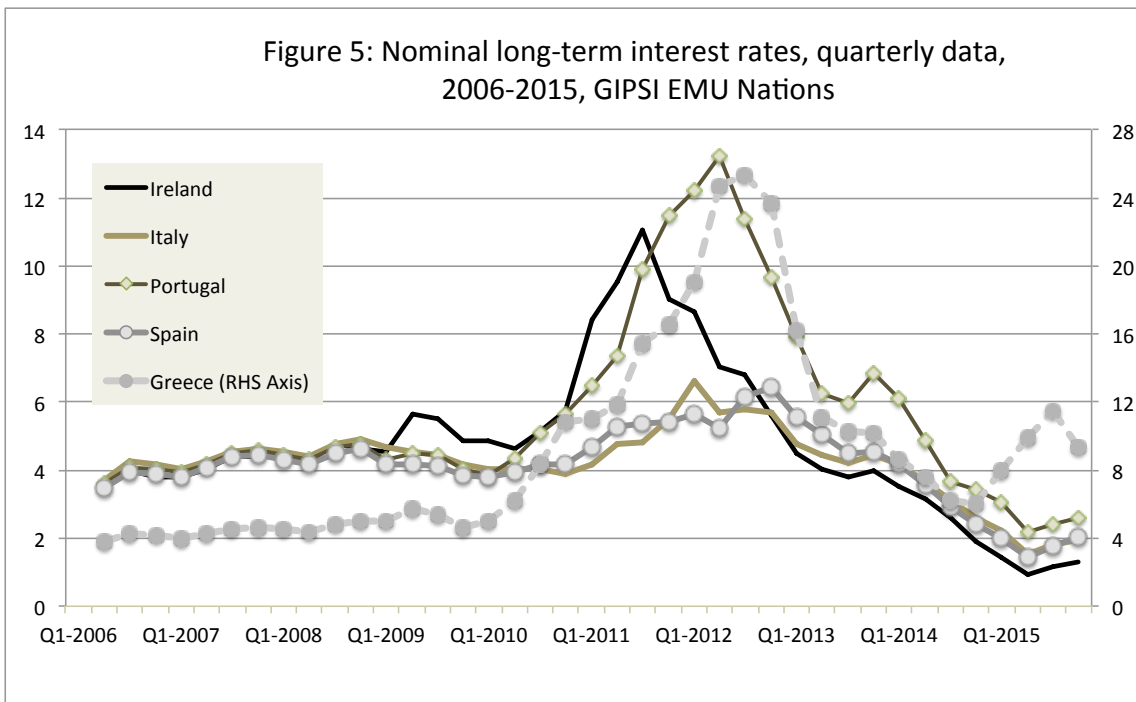


Figure 5: Nominal long-term interest rates, quarterly data, 2006-2015, GIPSI EMU Nations



This is not the place to debate the methodological premises of the classical approach to macroeconomic equilibrium. However, Figures 4 and 5 are sufficient to raise some questions about the adequacy of the loanable funds understanding of constraints on investment. Figures 1 and 2 have already shown that investment remains well below 2007 levels in seven of the ten countries whose data were shown. Figure 4 demonstrates that long-term interest rates in the five Northern European countries shown have dropped steadily, subject to some fits and starts, from 2007 onward. Figure 5 makes a similar point for the five GIPSI EMU countries. In the case of these countries,

however, interest rates remained relatively steady through mid-2010, when the Greek crisis broke. Long-term interest rates in these countries rose and peaked in 2011 or 2012, after which four of these five countries had steadily declining rates. Greece has again been the exception.

It would seem that more than steadily declining interest rates is needed. The EC's CMU plan asserts that the missing ingredient is confidence – or, to put it the other way, reduced uncertainty. There is no doubt that the uncertainty over the future of the Eurozone adversely affects business investment in EU and EMU countries alike.¹ But the assumption that the key element inducing that uncertainty is the failure of all EMU nations to commit adequately to austerity or to paying down public debt rests on the premise that the classical macroeconomic model is a reliable guide to macroeconomic dynamics.

That it may not be, and that Keynesian economic logic may be needed to resolve Europe's economic crisis, was suggested by the IMF in its Fall 2012 *World Economic Outlook*; specifically, this analysis suggested that fiscal expansion might stimulate further overall growth in the economy via a Keynesian multiplier process.² More recently, the IMF has affirmed the possible viability of Keynesian-style fiscal expansion, albeit with a warning that fiscal stimulus in times of stagnation (and not severe contraction, as in 2012) will only stimulate the overall economy if such stimulus policies are coordinated across countries (Cottarelli, Gerson, and Senhadj 2015). A majority of business economists surveyed in an end-of-year *Financial Times* economic-outlook survey have affirmed the need for fiscal expansion in Europe (Jones 2015).

Here we sketch out the bare bones of an argument for why fiscal stimulus is sometimes necessary to bolster aggregate demand and maintain the overall level of national output and employment. That is, contrary to the classical vision, aggregate demand independently affects the level of GDP achieved. We frame this Keynesian argument using an approach that relies more particularly on Michal Kalecki's approach to establishing this point. The reason is that Kalecki pays attention to the sectoral composition of aggregate supply and demand; building the model with these elements will permit us to make some important points about the overall impact of contemporary policy choices in the Eurozone.³ In any case, we work with a stripped-down model so as to make certain analytical points as simply as possible regarding what might be considered the core logic of Eurozone policy choices (from a Keynes/Kalecki perspective).

¹ Gordon (2015) documents the negative impact of a possible 'Brexit' (departure of Britain from the EU) on UK investment.

² See International Monetary Fund (2012), especially "Box 1.1. Are We Underestimating Short-Term Fiscal Multipliers?", pp. 41-43.

² See International Monetary Fund (2012), especially "Box 1.1. Are We Underestimating Short-Term Fiscal Multipliers?" Bangalore Winter School, sponsored by the Indian Center for Theoretical Sciences.

³ The model constructed here borrows heavily from two lectures delivered by Amit Bhaduri on 22-23 December 2015 at the Bangalore Winter School, sponsored by the Indian Center for Theoretical Sciences. Professor Bhaduri's lectures represent work in progress which he is conducting with Dr. Srinivas Raghavendra of NUI-Galway. See Bhaduri, Raghavendra, and Guttal (2015) for a recent model developed along similar lines.

Consider an economy with two sectors, a consumption-goods and an investment-goods sector. Suppose there are workers and manager/owners in each sector, their respective shares of income in these sectors are W_C and R_C , and W_I and R_I . For simplicity, we abstract from the government and foreign sectors. Suppose these four income shares are denoted, respectively, a , b , c , and d . There are two possible uses of national income received: it can be consumed or saved. Now assume that workers do not save, and manager/owners do not consume.

Then the distributional problem at the heart of this simple model is as follows: the consumption of the workers in sector I can be provided only through their securing that portion of the output of the consumption sector not required for workers' consumption in sector C. The potential demand for the output of the consumption sector ($a + b$) is $(a + c)$; the potential demand for that of the investment sector ($c + d$) is $(b + d)$. Equilibrium requires that $(b = c)$, that is, $C_M = R_C$. The size of this economy thus depends on manager/owners' decisions about how much investment good to purchase; for once this is set, then a multiplier process will unfold over successive rounds of expenditure/income earning until sufficient savings have been generated to pay for the investment expenditure. This approach, made famous by Kalecki, entails the result (in Kaldor's paraphrase of Kalecki's logic) that "capitalists earn what they spend, and workers spend what they earn" (Kaldor 1955-56, p. 96).

Now suppose we add a government sector. Government employs workers, paid W_G ; these employees administer a welfare state which makes transfer payments \underline{W} to retired workers and children. Let the income shares paid to these two populations be denoted e and f , respectively. The resources needed to support this augmented demand are secured through the imposition of a uniform tax rate t on all workers and owner/managers. The government budget is balanced; so t is set such that $t = (e + f)/(a + b + c + d + e)$. Now the demand for consumption goods equals $((a + c + e)(1-t) + f)$. Now the (demand = supply) condition in the consumption goods sector is $((a + c + e)(1-t) + f) = (a + b)$. The (demand = supply) condition in the investment goods sector is $((b + d)(1-t) = (c + d))$. It is readily shown that the tax-rate-adjusted equilibrium in the investment goods sector, $b = (c+dt)/(1-t)$, is necessarily greater than the b which satisfied the $b = c$ condition in the absence of the government sector.

In effect, given that the core "productive apparatus" of this economy, the C and I sectors, must generate more output to feed more mouths, the entire economy must grow faster than previously. The implicit multiplier in the model with government is lower than previously, but the new public sources of aggregate demand more than compensate for that. This result has an immediate implication for the argument at stake here: a cut in government spending will result in a lower equilibrium rate of investment-sector growth. Investment will fall, not rise.

This conclusion should be carefully considered in light of relevant data for the EU on government expenditures on individuals. Figure 6 sets out real government spending on individuals for a sample of northern European countries, using 2007 as a base-year. The pattern is uniformly one of stability and modest growth. Figure 7 illustrates the trends for this variable in the GIPSI EMU countries. And here, with the exception of Ireland, real government expenditures on individuals have fallen after 2009 – precipitously, in some cases. That is, precisely the countries which are targeted by the CMU initiative are those whose contracting government sectors makes them less attractive sites for increased investment expenditures.

Figure 6: Government spending on individuals, in constant PPP USD (2007 = 100), 2007-2014 North-central EMU Nations

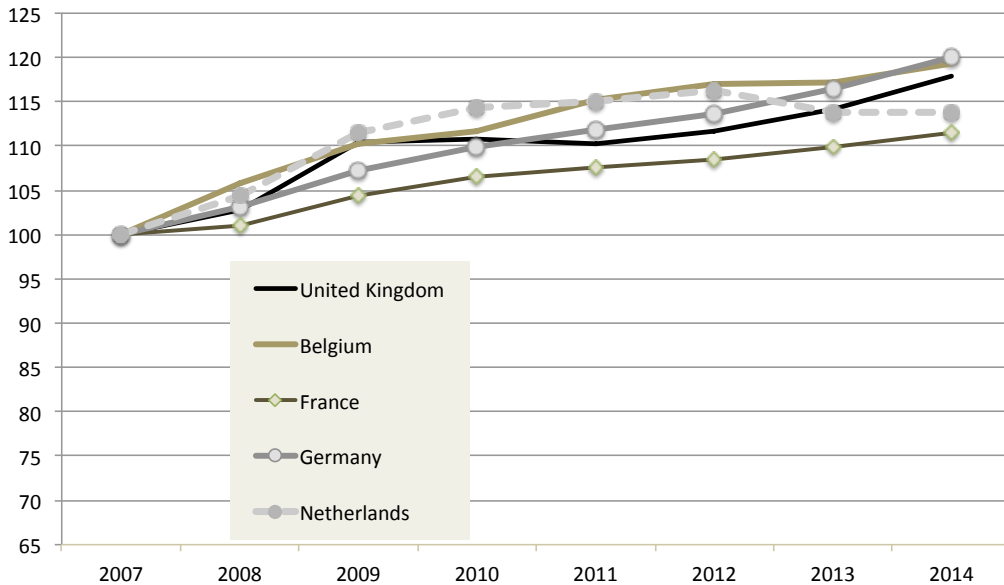
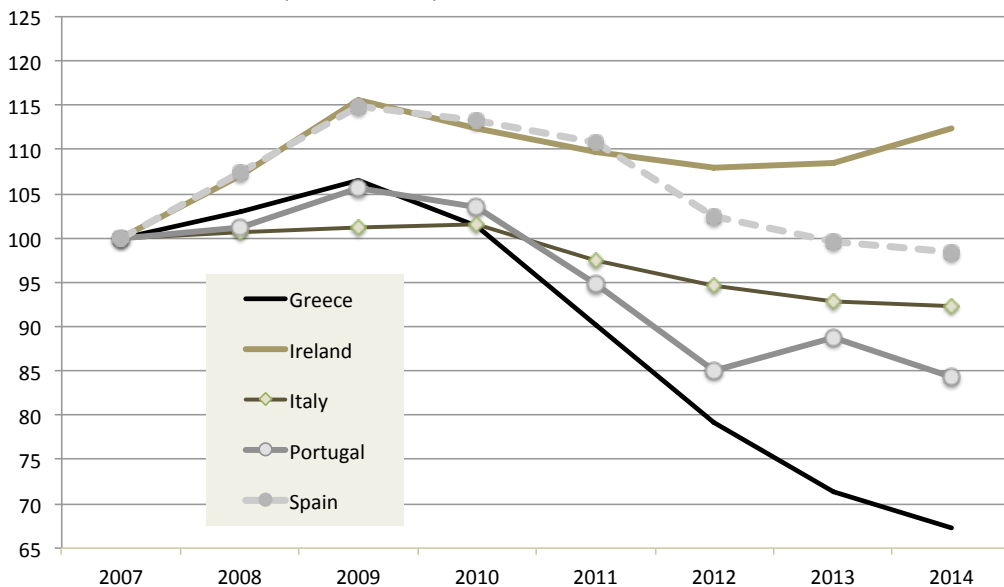


Figure 7: Government spending on individuals, in constant PPP USD (2007 = 100), 2007-2014, GIPSI EMU Nations



It will be useful for our purpose here to add a financial sector to this model. For simplicity, we again abstract from government. Following Professor Bhaduri's lectures (see footnote 3), let there be a sector F which employs a workforce paid W_F and which has owner/managers who claim an income share of R_F . Let these two shares be denoted g and h , respectively. Now the (demand = supply) equilibrium for the consumption-goods sector is $(a + c + g) = (a + b)$. Assume that the financial sector is considered a legitimate component of the supply of investment capability; that is, this is

now a financialized economy.⁴ Then (demand = supply) equilibrium for the investment-goods sector is $(b + d + h) = (c + d + g + h)$. The required condition for equilibrium is now $(b = c + g)$. Insofar as $g > 0$, this economy too grows faster than the counterpart economy with no F sector.

It would seem at this point that permitting this financial sector F to grow without limit is an obvious solution to any problems of economic stagnation this imaginary world might experience. We could complicate this overly simplistic conclusion by noting that the income of the F sector is based on deriving interest payments from other units in the economy through the extension of loans. Such an extension would show that permitting F-sector expansion could, under different circumstances, either augment or undercut demand in the C and I sectors, depending on whether loan growth or repayment obligations predominated. This in turn would depend on variables not introduced into our model, such as asset prices, household and firm balance sheets, and so on. Hyman Minsky (1986) has taught us that maintaining balances amongst required cash-flows and asset values is virtually impossible, as ‘stability is destabilizing’, as his pet phrase has it. And along the way, income inequality would be vastly increased as the price for using the F-sector as a fallback investment sector.

We leave a fuller exploration of the C-I-F economy for another time. A further reason for adding the F sector to our simple model is simply to consider (without setting forth the requisite algebra) a scenario in which both the government (G) and financial (F) sectors are included. Not just any scenario, but this one: suppose G is being cut, while the F sector maintains its size and scale or expands. Note the unstable and contradictory pressures that this double movement would exert on the macroeconomic dynamics of this imaginary economy. This should be kept in mind in light of the focus of attention within European Union policy directives on its *Horizon 2020* projects as the source of its future economic resilience. *Horizon 2020* turns on the capacity of local governments to lead the way for Europe’s economy through generating jobs through ‘smart, sustainable, and inclusive’ growth. Asking localities to play this role in a macroeconomic context favoring incoherence and stagnation, however, hardly bolsters confidence in the future.

5. The Capital Markets Union proposal versus the structure of European banking

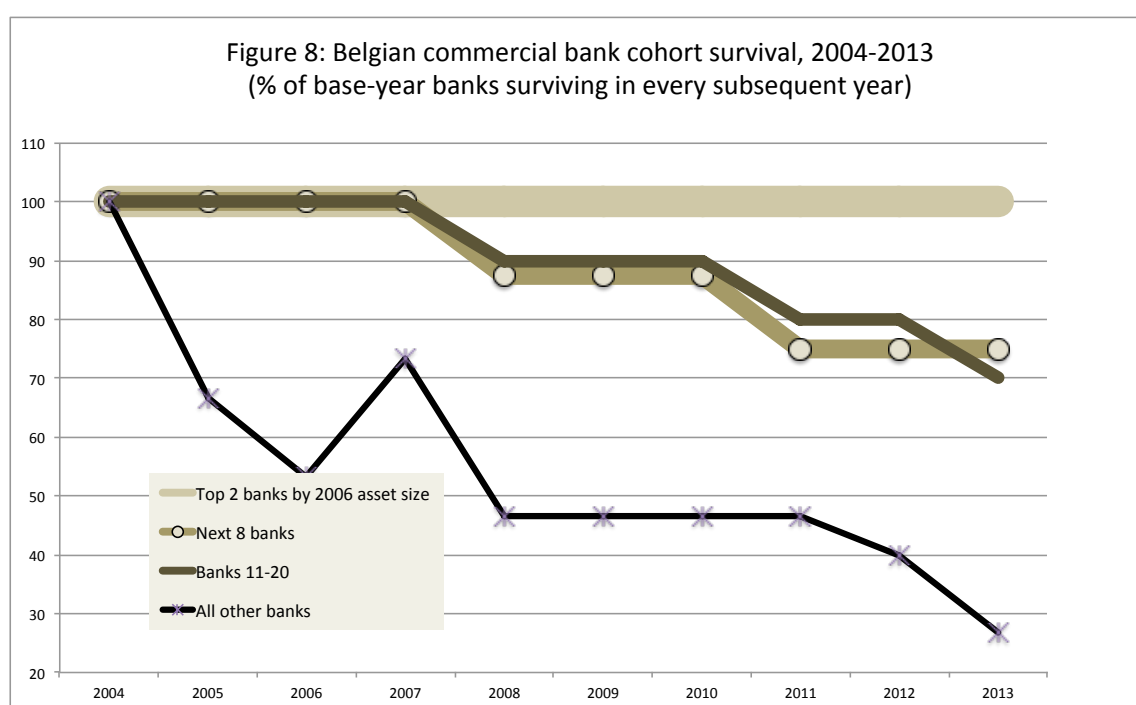
This section discusses the third and fourth criticisms of the CMU Action Plan made in the introduction to this chapter. The third point was that the structural reforms emphasized in the CMU Action Plan will make European finance more dependent on that segment of the European banking community – the megabanks – that has been the most problematic in terms of generating bad debt commitments, absorbing public subsidies, and not renewing lending in the post-crisis period.

Throughout Europe, diverse national ecosystems of banks have provided financial services, including credit, in a tiered way: specialized institutions have supplied different market niches. At the risk of overgeneralizing, it can be said that megabanks in each country ballooned to excessive sizes on the strength of wholesale funding, taking on a wide range of opaque assets and speculative position. When the subprime and subsequent European crises broke out, these institutions survived

⁴ Lest this seem strange, we should remember the complaint registered by Barry Bosworth (1985) regarding the mismeasure of investment: that is, a bank of computers purchased by, say, General Electric Corporation to help keep track of GEC’s far-flung foreign-exchange operations is counted as investment, as are the computers it purchases to design new machine tools.

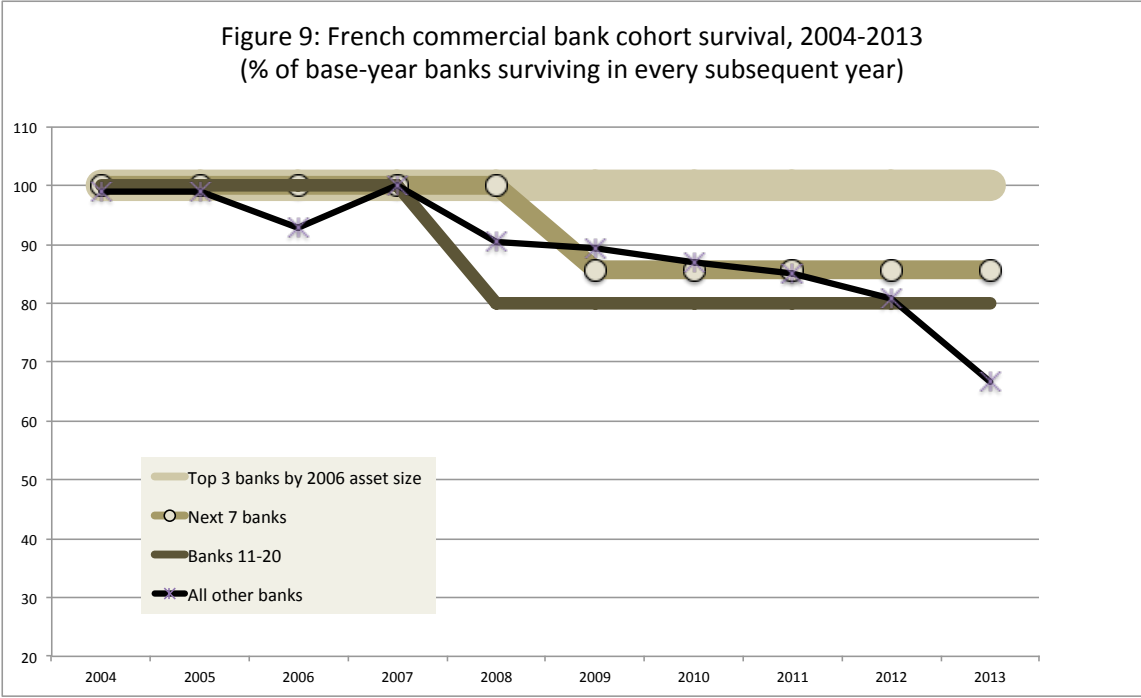
due to nation-states' provision of too-big-to-fail support, without having to declare the precise extent of their non-performing asset problems. A significant number of middle-market banks, usually undergirding regional economies, experienced large losses due to investing unwisely in collateralized debt obligations that went bad. These banks too mostly survived – the case of the *cajas* in Spain is the most problematic in this market niche. It is the small banks in many local markets throughout Europe that failed in significant numbers.

These financial firms are now rebuilding their capital and, in the case of the megabanks, refocusing their business models; few are able to expand their credit. Certain structural problems remain unsolved – in particular, the dependence of the entire European market on leveraged wholesale money-market funds from US markets. Much of the lending now being done in Europe is due to unregulated hedge funds. This is hardly a reassuring picture. The economic functionality of institutions whose ways of operating have always been diverse has yet to be restored.



Source (Figures 8-11): Bankscope database, author's calculations.

Annina Kaltenbrunner and I (2014, October 2015, December 2015) have argued in several recent papers (and also see Dymski 2013) that what makes Europe's banking system distinctive is its diversity, and its roots in the complex and intertwined histories of Europe's ever-evolving nation-states and regions. The Spanish *cajas*, the German *Sparkassen* and *Landesbanken*, and the cooperative banks in many nations all reflect logics of historical development and of business incubation built up, in many cases, over centuries.



We go on to argue, however, that European banking systems are increasingly dominated by megabanks deemed too big to fail. These megabanks' origins are diverse, as well: Germany's Deutschebank was set up to service cross-border business, while France's large banks were created to carry out government-coordinated economic development plans; and Spain's two largest banks – Santander and Banco Bilbao Vizcaya Argentaria – grew through supporting the economic development of the Basque country. That said, these megabanks have for the past decade or more been exposed to coercive financial competition at the global scale. The competition between Wall Street and the City of London, as Kaltenbrunner and I have argued, involves these two centres' leading banks' efforts to dominate global financial markets. The large German and French and Dutch banks (and those of other nations, in turn) try to keep up either through imitative behavior or through initiating their own sometimes reckless efforts to pioneer new markets. At the same time, it is often the smaller banks and cooperatives in these banks' home nations that finance most SMEs and mid-size businesses.

Figure 10: Belgian commercial bank asset and loan growth, 2006-2013
(year-over-year % change, largest 2006 banks vs all others)

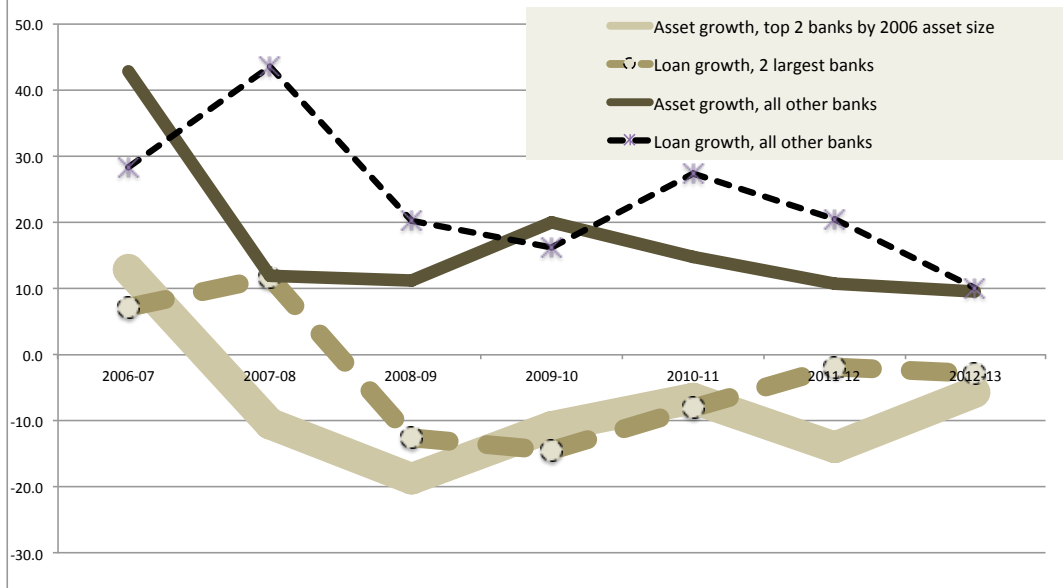
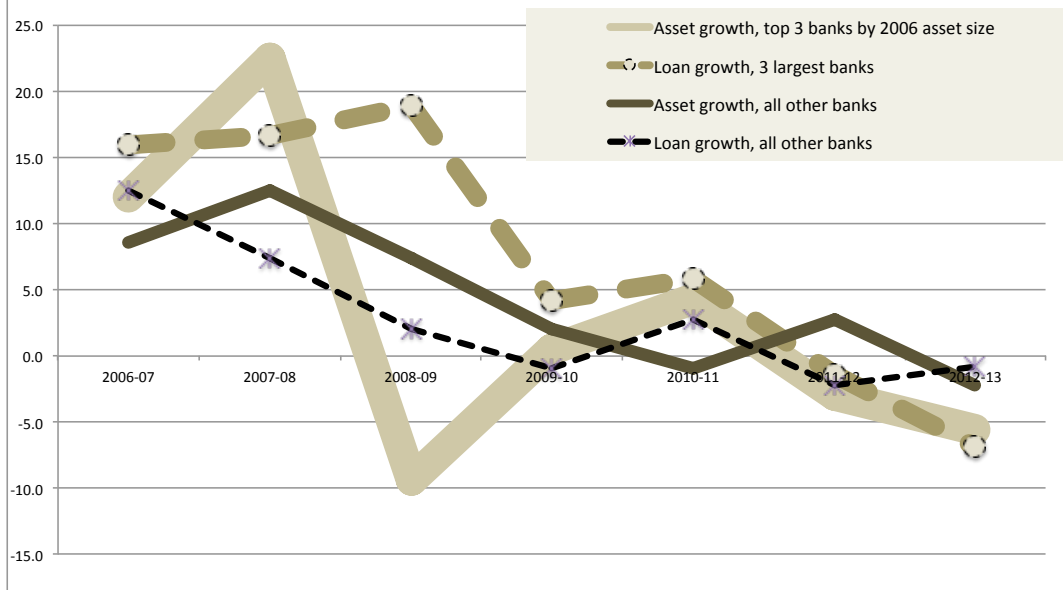


Figure 11: French commercial bank asset and loan growth, 2006-2013
(year-over-year % change, largest 2006 banks vs all others)



Data on cohort-survival by bank size, drawn from the Bankscope database, readily illustrates that large banks have higher survival rates than smaller banks in many European nations, even while loan growth rates are higher for small than for large banks. Figures 8 and 9 show cohort-survival patterns for the past decade for Belgian and French banks, by bank size; each figure indicates that larger banks have enjoyed more continuity – and less risk of failure. Figures 10 and 11, in turn, contrast rates of asset growth and loan growth for the very largest (mega) banks in Belgium and France, as compared with the remainder of these nations’ banking systems. In Belgium, large

banks' loan and asset growth rates are well below those of smaller banks throughout the entire period shown (2004-13). In France, large and other banks' loan and asset growth rates are comparable. A review of Bankscope data for the nations highlighted in this paper's earlier figures shows that the more common experience is that of Belgium.

The fourth point of criticism of the CMU that was registered above is that the very notion that European nations need to make a transition from bank-centred systems of finance to a modern capital-market-centred system so as to be competitive in the global economy of today is mistaken. For one thing, as has been demonstrated in section 4, it is very possible to build up an F-sector as a key component of industrial investment policy without considering the possibly coercive longer-run effects of a deeper national commitment to liberalized financial forces. More to the point, Beck (2013) and many others have begun to challenge a previous consensus that more finance – and more liberalized finance – translates into a faster pace of economic growth. Further, we have already pointed out that the EU's economic growth strategy hinges on establishing cities and city regions as hubs of “smart, sustainable, and inclusive growth”; it should be noted that many of these cities and city regions depend on local financial institutions whose growth has paralleled that of these cities themselves. The final point to be made is that deepening reliance on megabanks to provide needed finance puts further pressure on Europe's contradictory system of bank supervision. As Kaltenbrunner and I (2014) point out, banks remain nationally chartered in Europe and compete in a single market against too-big-to-fail rivals, even while their host nation-states have no access to a lender-of-last-resort. The European Central Bank has emerged as a regulator for larger European banks; and while this is a step forward, the European Banking Union, by insisting on bail-in solutions for troubled banks, lets member nations that this regulatory overload takes no responsibility for insuring their survival. Consequently, bank customers and equity markets shy away. It is not surprising that European banks are choosing to withdraw from one market and one financial activity after another. They have no backstop they can trust, and are confronting globally-scaled megabanks backed up – as they are not – by central banks with access to hegemonic global currencies.

7. Conclusion

Europe's banking and financial system is currently in disarray. Taken as a whole, it is unable to provide the finance needed to fuel a European recovery – either the short-term working capital needed to permit businesses to fund their operations, or longer-term capital for building new productive capacity and realizing innovations. It can be argued that investment demand – and hence long-term financing demand – is in any case low due to the stagnation that hangs over the European economy. Empirical evidence bears this out. But were investment demand to recover, Europe's financing structures could not now deliver.

The Capital Markets Union whose Action Plan has just been approved by the European Commission argues that Europe should implement deep-seated changes in financial laws and regulations, so as to homogenize European capital markets and permit the origination and exchange of fixed-income and equity instruments on a far larger scale. This, it is argued, will enhance the efficiency of these transactions. It is further claimed that the ground-clearing needed to establish this union will demonstrate to offshore investors that Europe has made itself conformable with the demands of globally-mobile capital: so there will be a rush of new investment across Europe – thus reigniting robust economic growth.

This conclusion has little basis in reality. More securitization will worsen, not reduce, problems of opacity and trust, especially since Europe's largest institutions will benefit most from this new initiative. These changes in national laws and regulations will not induce a flood of new wealth to flow into Europe in search of assets to buy; nor will the proposed capital markets union resolve the crisis of investment demand. Legal changes aimed at reducing the costs of capital and of borrowing, in an economic region in which these are not the constraints undercutting the adequacy of aggregate demand, do not add up to a policy fix. The primary concrete step will be to further reduce the operating space for the small and medium-size banks on which firms and households in regional sub-areas have traditionally relied. This will enhance the entrenched advantages of the overleveraged megabanks that have already presented bills to European taxpayers, and are likely to do so again.

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