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Global Opportunity Index: A European Experience

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ACCESS TO CAPITAL

MILKEN INSTITUTE

OVERVIEW

As part of the Milken Institute's mission to improve access to capital, the Global Opportunity Index (GOI) was developed as a statistical tool for assessing the attractiveness of potential investment opportunities in key countries. The GOI gauges these opportunities along five dimensions: *Economic Fundamentals, Financial Services, Business Perception, Institutional Framework* and *International Standards and Policy*. The following article focuses on countries in Europe, but the full global ranking of countries can be found at www.globalopportunityindex.org.

This year's focus on recent developments in Europe builds on our past research examining capital flows and financial regulation in the region. Europe has been a driving force in financial globalization and cross-border investment, and the latest GOI shows that 2017 is no exception. The key takeaways from the new 2017 GOI data are:

- Despite many challenges—including the refugee crisis, terrorism, continued high unemployment, and political risks from rising populism—the U.K., Switzerland, Norway, and Sweden rank in the top 10 of the most attractive countries for investment globally, and 15 European countries are in the top 25.
- Given the continued low-interest rate environment and improving, albeit slow, economic recovery, changes in the GOI that boosted the standing of most European countries stemmed from economic and financial reforms.
- The region, especially the countries with preferential access to the European Union's single market, benefited from a push for regulatory harmonization, which led to major changes in *Business Perception*—especially for France and Austria—and *International Standards and Policy*—especially for Switzerland and Spain.
- *Financial Services*—specifically, access to capital—remain an important driver of European performance relative to the rest of the world.

OVERVIEW

Table 1. Global Opportunity Index 2017, Europe

1 to 34	35-68	69-102	103-136	137-170

Country	Move	Global Ranking	Institutional Framework	Economic Fundamentals	Financial Services	Business Perception	International Standards and Policy
United Kingdom	▲	2					
Switzerland	▲	5					
Norway	▲	6					
Sweden	▼	9					
Netherlands	▼	11					
Belgium	▲	12					
Ireland	▼	13					
Iceland	▲	14					
Germany	▼	16					
Finland	▼	17					
Denmark	▼	19					
Luxembourg	▲	21					
Austria	▲	22					
France	▲	23					
Estonia	▼	24					
Cyprus	▲	26					
Spain	▲	28					
Latvia	▼	30					
Malta	▲	31					
Portugal	▼	32					
Czech Republic	▼	34					
Lithuania	▼	37					
Italy	▲	38					
Georgia	▲	39					
Slovenia	▼	41					
Poland	▼	42					
Bulgaria	▲	43					
Slovak Republic	▼	44					
Hungary	▼	46					
Russia	▼	50					
Romania	●	52					
Croatia	▲	54					
Turkey	▼	57					
Greece	▼	60					
Albania	▲	64					
Serbia	▼	75					
Ukraine	▲	81					

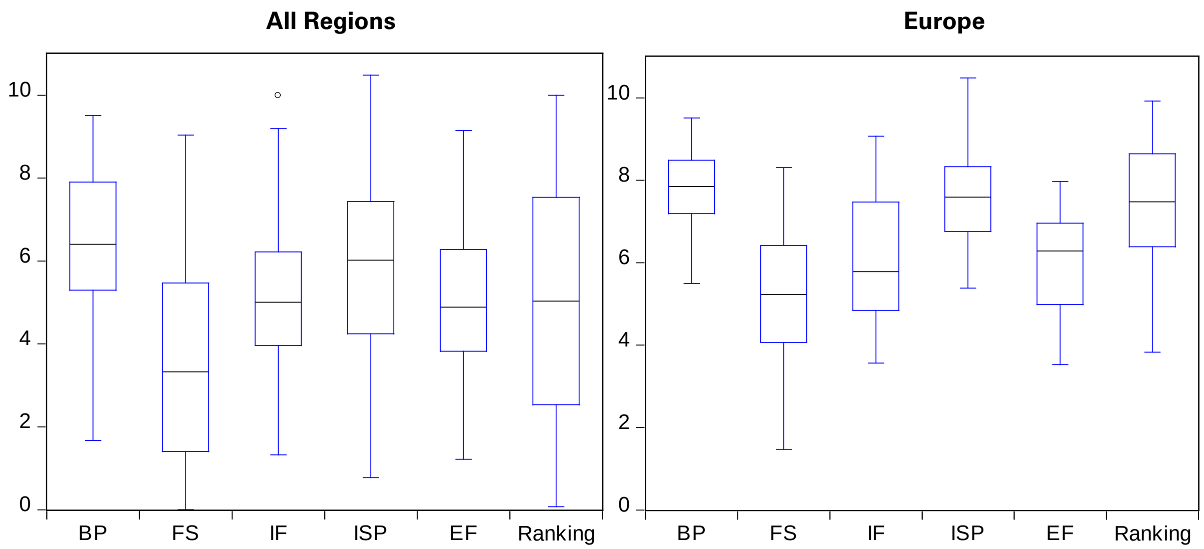
Note: The color of an arrow reflects the change in a given country's ranking compared with the previous year and does not correspond to the color of the country's ranking.

OVERVIEW

Overall, European countries tend to perform relatively well in all five dimensions of the GOI (see Table 1 and Figure 1):

- *Economic Fundamentals* (EF), which focuses on the country's macro-performance, trade openness, quality and structure of the labor force, and modern infrastructure.
- *Financial Services* (FS), which measures the size and access to financial services in a country by looking at the country's financial infrastructure and the business community's access to credit.
- *Business Perception* (BP), which summarizes business perception of explicit and implicit costs associated with doing business, such as tax burden, corporate transparency, and corruption.
- *Institutional Framework* (IF), which measures the extent to which a country's institutions provide a supportive business environment.
- *International Standards and Policy* (ISP), which reflects the extent to which a country's institutions, policies, and legal system facilitate international integration by following international standards.

Figure 1. Global Opportunity Index 2017, Distribution



Note: The box for each category shows the middle two quartiles. A horizontal line inside the box shows the median. The whiskers show the full range.

BUSINESS PERCEPTION

THE FOUNDATION OF INVESTMENT ATTRACTION

Recent EU-wide reforms have strengthened the overall *Business Perception* of the region. Among them, two are particularly noteworthy for the categories of the GOI. First, the new Insolvency Regulation Recast reduces investors' and businesses' uncertainty over cross-border insolvency disputes. There is now a more standardized set of procedures for resolving disputes when national laws disagree in cross-border insolvency proceedings. Second, overhauled anti-corruption legislation has sharpened the existing anti-corruption framework with increased monitoring. This improved monitoring is based on lessons learned from past anti-corruption efforts, sharing programs across countries, and the development of indicators to spotlight corruption. Overall, the improved anti-corruption framework facilitates the exchange of information during cross-border investigations.

While many of the top-performing European countries have implemented EU-driven reforms, France and Austria have been pursuing specific agendas that have noticeably improved their business sentiment.

Despite a relatively weak economic performance in 2016, France showed significant improvement in *Business Perception*—the largest improvement in this category within Europe. France has been capitalizing on its recent efforts to improve competitiveness. Over the past two years, reforms have focused on reducing the administrative costs of starting a business (e.g., one-stop shop to register a company and lower costs for a building permit); easing the burden of paying taxes (e.g., introduction of a credit against corporate income tax); and overhauling labor taxes and regulations (e.g., reduced labor taxes, amended regulation of work hours and mandatory contributions). These efforts are part of a broader agenda that will see further structural reforms of the labor market and fiscal policy—the Finance Bill for 2017 builds on reforms introduced over the last two years and aims to continue reducing the tax burden for companies through 2020.

Business Perception

Austria is the European country with the second-most improved score in the *Business Perception* category. As with France, its strengthened business perception compensated for a relatively weak economic performance. Recent tax reform has helped lower the cost of starting a business in Austria by reducing the minimum capital requirement for startups. It also has eased the burden of losses on businesses during economic distress by introducing some flexibility in the timing of tax payments. Some losses can be carried forward without time limits, and losses need be paid only when there are subsequent profits arising from the investments. Other reforms have focused on reducing administrative burdens in the retail sector through measures such as exempting small retailers from some administrative requirements.[1]

[1] OECD (2017a).

INTERNATIONAL STANDARDS

WORKING TOWARD COMPLIANCE

Europe compares well with the rest of the world in its ability to conform to *International Standards and Policy*. Recent financial regulatory reforms, mostly based on G-20 initiatives such as Basel III, have significantly strengthened the European advantage. This is especially true for recent changes to financial market regulations, notably the gradual implementation of the European Market Infrastructure Regulation (EMIR) and the Directive on Undertakings for Collective Investment in Transferable Securities (UCITS).[2] Implementation of this reform agenda will continue in 2017-2018. The implementation of the Markets in Financial Instruments Directive (MiFID) II, regulation of money market funds, and new securitization rules are all cornerstones of the Capital Markets Union.[3, 4] These rules aim to eliminate obstacles to cross-border investment, enhance market-based funding, and free up bank capital.

Beyond the underlying regional improvements, Switzerland and Spain have noticeably improved their rankings in the category of *International Standards and Policy*.

Switzerland's improvement in the category helped propel it to a ranking of second in Europe and fifth globally. Swiss authorities' financial regulatory agenda and their efforts to align Swiss policies with European and international standards have played a key role in making Switzerland the category leader. More specifically, Swiss regulation of derivatives, namely the Financial Market Infrastructure Act (FMIA), which came into effect in 2016, was a major stepping stone toward deeper integration with EU financial

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[2] UCITS is the major European directive to regulate investment funds in securities markets. Although it was introduced in 1985, it continues to evolve. The most recent directive, UCITS V, aligns fund depositories' duties and responsibilities and fund managers' remuneration requirements with those of the Alternative Investment Fund Managers Directive.

[3] MiFID II comes into effect in January 2018. Efforts to prepare for compliance have been underway for some time, as MiFID II was originally scheduled to take effect in January 2017.

[4] The regulation on money market funds was adopted by the European Council in 2017. In May 2017, the European Commission reached an agreement on implementation of the securitization regulations. These rules, introduced in 2015 as part of the Capital Markets Union Action Plan, aim to simplify and strengthen securitization in the EU.

markets.[5] Besides regulating the derivatives market, FMIA regulates all financial market infrastructures and establishes rules congruent with international standards, particularly the EU regulatory framework.[6] Such harmonization was required to enable the extension of the EU passport to Switzerland—a necessary step to avoid regulatory duplications for cross-border transactions.[7] This major development will help to ensure Switzerland's status as a leading country in global cross-border asset management, with a 25 percent global market share.[8]

Although it experienced a slight weakening of its macroeconomic performance and business sentiment in 2016, Spain showed continued improvement in the realm of policy harmonization. Besides measures related to structural fiscal consolidation (shifting from direct to indirect taxes and reducing tax system inefficiencies), it carried out a significant effort toward reforming its banking laws in recent years. Among the most recent changes, Spain now operates with the general capital requirements regulation and directive (CRR/CRD IV), mostly under European Central Bank direct supervision. Despite postelection political gridlock in 2016, Spain did manage to implement other EU initiatives, such as the new Market Abuse framework.[9]

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[5] FMIA is the equivalent of EMIR for the EU and Dodd-Frank for the U.S.

[6] An amendment to the Financial Market Infrastructure Ordinance, entered into force on August 1, 2017, will bring the Swiss regulations on the exchange of collateral in line with EU regulations.

[7] Following the implementation of FMIA, the European Securities and Markets Authority (ESMA) has advised the European Parliament, Council and Commission in favor of the extension.

[8] Swiss Bankers Association (2016).

[9] After the December 2015 election, it took 10 months for Spain to have a fully empowered government.

FINANCIAL SERVICES

CREATING INVESTMENT OPPORTUNITIES

Financial conditions in most European countries remain favorable via continued credit extension to the private sector and a highly accommodative monetary policy stance.[10] The lasting impact of the ECB's quantitative easing measures helped companies in Europe, especially small and medium-sized enterprises, improve their access to finance in 2017.[11] Banks' credit provision remains the most important source of external funding, and developments such as better capitalization of banks and reduction in non-performing loans contributed to the robustness of the banking system.[12] The non-bank financial sector has also maintained its important role, with its funding provision increasing by 4 percent in 2016.[13]

[10] ECB (2016).

[11] ECB (2017b).

[12] ECB (2017a).

[13] The ECB (2017a) indicates that in the third quarter of 2016 these entities were providing nearly $3.8 trillion in funds to euro-area non-financial entities. In addition, $4 trillion was provided to the euro-area financial sector in the form of loans, debt securities, and equity financing.

TOP PERFORMERS

U.K., SWITZERLAND, NORWAY, AND SWEDEN STAND OUT

The U.K., Switzerland, Norway, and Sweden rank in the GOI top 10. Interestingly, all have special relationships with the EU. The U.K. and Sweden are part of the EU but not the euro area, while Norway, which does not belong to the EU, is part of the European Economic Area (EEA) and has access to the EU's single market.[14] Switzerland is not part of the EEA or EU but still has access to the single market. Some of Switzerland's strengths have been highlighted above; here we focus on the U.K., Norway, and Sweden.

The U.K. remains the highest-ranked European country with its No. 2 global ranking. It performs quite well in most categories, and it leads the financial services category.[15] While the 2016 referendum to exit the EU increased uncertainty about future arrangements on financial services, the Bank of England has proactively supported credit conditions by introducing numerous accommodative measures. These include further lowering the policy rate to a historic low, reducing banks' counter-cyclical capital buffers, a new Term Funding Scheme, and the purchase of U.K. corporate bonds as part of the quantitative easing policy.[16] Furthermore, U.K. financial markets in 2016 were buoyed by numerous global factors. These include the U.S. presidential election and associated pro-growth fiscal measures and continued moderate inflationary expectations.[17] Finally, several reforms—such as cuts to corporate taxes and enhanced anti-corruption capabilities—have improved business perception in the U.K.[18]

Norway entered the GOI top 10, mostly due to steady improvements in its credit provision to the private sector and its strong performance in terms of business

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[14] The Single Market allows free movement of goods, capital, services, and people between member states.

[15] The Bank of England (2016) estimates that the size of financial systems, defined as total assets of the financial corporations sector, in the U.K. is 1,200 percent of GDP. Next on the list is Switzerland, with 900 percent of GDP.

[16] The Corporate Bond Purchase Scheme began in September 2016. The Term Funding Scheme was introduced in August 2016 and runs from September 2016 to February 2018.

[17] Tyler (2017).

[18] As a result, the U.K. has a lower main rate of corporation tax than any other country in the G-7.

perception. As in most of Europe, bank loans are the most important source of external funding for Norwegian businesses, and the country's banking sector has been performing well.[19] The central bank lowered its key policy rate to half a percent in 2016 to combat weakened growth prospects and the subdued inflation outlook. This facilitated the easing of bank credit and enhanced bank profitability, which, together with fewer non-performing loans, helped enable Norwegian banks to provide credit to the economy.[20] Norway's leading position in business perception reflects the country's simple and effective approach to business regulations. Norway continues to strengthen this position by implementing reforms such as electronic filing to facilitate contract enforcement and altering hiring rules to allow the use of fixed-term contracts for permanent tasks.

Sweden maintains its position in the GOI top 10 with a robust institutional framework and adherence to international standards. The general strength of its institutions results from a decade of efforts focused on improving transparency, efficiency, and accountability, with initiatives such as eGovernment, a Web portal that facilitates access to information and services.[21,22] Beyond the country's following the G-20 and EU lead on financial regulations, recent involvement of Sweden's securities regulator, Finansinspektionen, in the rulemaking process at the international level has facilitated the integration of Swedish rules with the EU's.[23]

[19] Banks account for more than 80 percent of domestic credit to Norway's non-financial sector (Norwegian Ministry of Finance 2017).

[20] IMF (2016).

[21] European Commission (2016b).

[22] Eurostat Information Society Indicators show that, while eGovernment is an EU-wide initiative, Sweden has performed considerably better in most of the eGovernment indicators than the rest of the EU.

[23] The director general of Finansinspektionen has been a board member of the International Organization of Securities Commissions (IOSCO) since 2014, and in 2016 was elected vice chair of IOSCO's European regional committee.

WHAT'S NEXT?

LOOKING AHEAD

Europe's macrofinancial conditions have been improving in recent years. That said, Europe is still facing numerous challenges that could potentially reveal its underlying vulnerabilities in coming years. Key issues include uncertainties surrounding the Brexit negotiations, Spain's political challenges, the timing and speed of monetary policy normalization by the ECB, and remaining structural rigidities in the labor market. From across the globe, potential external shocks may arise from the U.S. fiscal policy agenda and the potential for heightened geopolitical conflicts.

The GOI shows that key economic and financial reforms drove the major changes in the rankings in 2017.

The GOI shows that key economic and financial reforms drove the major changes in the rankings in 2017. These reforms led to significant improvement in business sentiment and compliance with international standards, as well as the recovery of the financial services sector. Among the key reforms that have contributed to this success, two trends stand out: the harmonization of rules for the capital markets within the member states and with other major counterparties such as the U.S., and the increasing flexibility of labor markets. As capital flows into Europe continue to accelerate and drive up asset prices amid improved perceptions toward European policy reforms, it is important to watch vigilantly for factors that may slow or reverse the current policy momentum.

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ABOUT US

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