

EUROPEAN ECONOMIC COMMUNITY

Commission

The Development of a European Capital Market

**Report of a Group of experts
appointed by the EEC Commission**

BRUSSELS, NOVEMBER 1966

Foreword

Article 67 of the Treaty establishing the European Economic Community provides that during the transitional period the Member States shall gradually remove restrictions and abolish discriminatory treatment affecting capital movements between them, to the extent necessary for the proper functioning of the Common Market.

This, then, was the aim of two directives, issued in 1960 and 1962 by the EEC Council on proposals from the Commission, which, for certain important categories of transaction, eliminated exchange restrictions that hindered the free movement of capital within the Community. However, because of the faster advance towards economic integration and agreement on common policies, the rates of progress in the various sectors soon got out of phase and it became evident that there would have to be a new drive to develop a European capital market.

Discussions within various Community bodies, in particular the Monetary Committee, had shown that the measures likely to encourage such progress would gain in effectiveness if worked out with the aid of a clear picture of the objectives, conditions and implications of integration in this field. The Commission therefore decided to entrust a group of independent experts with a study of the problems confronting the capital markets of the Community as a result of implementation of the Treaty.

The Group of experts consisted of the following members:

- Dr. A. BATENBURG, Managing Director, Algemene Bank Nederland, Amsterdam;
- Prof. J. L. BLONDEEL, President, Kredietbank S. A., Luxembourg;
- Prof. G. DELLA PORTA, Director, Research Department, Banco di Roma, Rome;
- Prof. A. FERRARI, Director-General, Banca Nazionale del Lavoro, Rome;
- M. R. FRANCK, Director, Banque Internationale, Luxembourg;
- Dr. L. GLESKE, Chairman, Landeszentralbank, Bremen;
- M. J. GUYOT, Partner, Messrs Lazard Frères & Co, Paris;
- M. A. LAMFALUSSY, Director and member of the Executive Committee, Banque de Bruxelles, Maître de Conférences in the University of Louvain;
- Prof. Dr. H. MÖLLER, University of Munich, Director of the Institut für internationale Wirtschaftsbeziehungen, Munich;
- M. G. PLESCOFF, Director, Caisse des Dépôts et Consignations, Paris;
- Prof. C. SEGRÉ, Director for Studies, Directorate-General for Economic and Financial Affairs of the EEC Commission;
- Prof. P. TABATONI, of the Faculty of Law and Economics, Paris.

Other experts closely associated with the work of the Group were:

- M. P. BARRE, Director, Research Department, European Investment Bank;
- M. R. BERTRAND, Director of Payments, OECD;
- M. E. ISRAEL, of the Banque Internationale, Luxembourg;
- M. G. SERTOLI, Director, Finance and Treasury Department, European Investment Bank;
- M. A. THEUNISSEN, Director-General for Credit and Investment, ECSC High Authority;
- M. P. WERTHAUER, Head of Division, Directorate-General for Credit and Investment, ECSC High Authority.

The chairmanship of the Group was entrusted to the representative of the Commission, Prof. Claudio SEGRÉ, who also supervised the preparation of the report.

The Group of experts presented the report which follows. The Commission wishes to express its thanks and appreciation to the Group for the important and valuable work it has performed. Though the report does not of course in any way prejudge the position the Commission will take on the problems examined, the Commission regards it as an excellent basis for the accomplishment of its tasks in this field.

Brussels, November 1966.

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INTRODUCTION

Terms of reference for the Group's study

1. The terms of reference laid down by the Commission for the Group's study assigned five basic tasks which may be summarized as follows:

- a) To establish and specify what needs to be done to develop a European capital market, having regard, on the one hand, to the aims of the Treaty of Rome — particularly in its financial clauses — and, on the other, to the scope for evolving joint solutions from the efforts currently being made by the various Member States to improve the functioning of the markets;
- b) To analyse present differences of market organization in the Member States, to assess the implications of these differences and thus ascertain the factors responsible for the present fragmentation of markets;
- c) To take stock of intra-Community capital flows during the current stage of fragmented capital markets, in order to assess what would be the significance of broadening the market on a European scale;
- d) To endeavour to establish what impact the establishment of a European capital market would have on the Member States' pursuit of economic policies based mainly on the use of financial instruments;
- e) To consider how the structure and the working of the financial institutions would have to be adapted so that the markets could be integrated.

The Group was invited to put forward specific recommendations on the above points in its report, which was later to form the basis for concrete measures to be taken by the Community authorities.

Scope of the study

2. In accordance with explanatory notes appended to its terms of reference, the Group so far as possible left purely descriptive themes outside the range of its studies. True, it has at times felt it necessary to describe some special aspect of the structure of a capital market, some special technique used by one particular intermediary or some fiscal or other regulation in force in a Member State. Such passages have, however, been introduced into the report only when they threw light on the precise nature of the obstacles to integration or the scope of the recommendations put forward.

No systematic analysis of national capital markets has therefore been undertaken. An analysis of this kind would at best have been of only limited value since papers

on the situation and problems of the capital market had already been prepared by certain Member States and international organizations. The OECD Committee for Invisible Transactions has for instance been invited to make a "Study on the Improvement of Capital Markets", the results of which are to be published shortly.

In addition, the underlying purpose of the Group's work differs from what was aimed at in most of these other studies, which set out to reveal certain deficiencies in the structure or functioning of the capital markets and to seek remedies exclusively at national level. The OECD study, too, although it has a wider scope as it ranges over several markets, endeavours to bring out the problems common to certain markets but does not tackle the question of their integration. The special feature of the Group's approach lies in the fact that it adopts from the outset a Community outlook and makes its analysis with an eye to the conditions, methods and probable implications of setting up a European capital market and the obstacles that will be encountered.

The Group's study covers the main financial flows and channels and devotes special attention to certain categories of institution. The specific problems of other categories of institution or financial intermediary have not been discussed in detail: this applies for example to the agricultural credit institutions, to professional or co-operative credit or social insurance institutions and to stock-brokers and stock exchange intermediaries. This does not mean that the problems connected with these financial intermediaries were regarded by the Group as being of secondary importance: in fact, the principles emerging in this report for the solution of the problems of the particular categories of institution considered are in many ways equally applicable to these financial intermediaries as well.

The Group also realized that it would not be possible, within the limited scope of the present report, to provide solutions to all the many problems posed by such a vast operation to be completed gradually over a period of years. It hopes nevertheless that its work may throw light on the path to be followed and thus make a useful contribution to the preparation of the various measures to be considered with this end in view.

Plan of the study

3. For the presentation of its study, the Group has adopted a plan centred around five main themes.

- a) In Part I an attempt is made both to define the bases and conditions for developing a European capital market and to pinpoint the problems of structure common to the markets of the Six, together with the scope of the financial links that have already come into being within the Community.
- b) In Part II the study sets out to show how the establishment of a European capital market can be facilitated by certain adjustments in the way the economic policies of the Member States are applied.
- c) Part III contains the Group's recommendations for widening the scope of the supply of medium- and long-term credit for industrial equipment and of lending to the housing sector and to local authorities.

d) Part IV studies the conditions in which securities markets can be integrated and their contribution to the financing of investments increased.

e) Part V deals with the various obstacles, basically of a technical nature, which may impede the balanced development of a European capital market, whether in the form of differences in the ways the financial institutions are regulated or in the form of obstacles that stem from exchange risks and disparities in the system of taxation.

Organization of the work

4. The care taken to balance the number of experts drawn from public and private financial institutions, from the academic world and from various international organizations illustrates the main concern of the Group in its approach to the problems: to carry out a study which, while dealing exhaustively with the matters being examined, still had the primary aim of indicating definite action to be taken.

The Group held in all twelve meetings of two days each. At the first of these meetings a programme was drawn up and working methods were decided upon. For each meeting one or two members of the Group or the Secretariat were invited — as rapporteurs — to prepare a paper on the subject to be dealt with and to open the discussion. Subjects were determined in accordance with a general outline for the final report, drawn up when work first began.

Members of the Group invited to submit a paper were assisted by the Secretariat, one of whose tasks was to produce background documents for the Group's discussions. After each meeting the Secretariat wrote up an account of the discussions showing the points that had emerged.

For the preparation of the final report, it was thought advisable to have the editorial work carried out by the Chairman and the Secretariat, who prepared a draft and submitted it to the Group; constant contacts with the various experts made it possible, however, to give the work a collective character.

The Secretariat of the Group was composed of M. R. Bistolfi, M. P. A. Rutsaert, M. M. Sarmet and M. H. Stoller, of the Directorate for Studies in the Directorate-General for Economic and Financial Affairs of the EEC Commission; the statistics for the report were prepared by M. L. Tanter, M. B. Taquet and M. F. Turli.

The following independent experts also helped with the examination of special problems: M. G. Gelders, Director at the Commission Bancaire, Brussels, M. M. Grosfils, Head of the Research Department of the Banque de Bruxelles, M. L. Jeorger, Inspecteur des Finances, Paris, M. J. G. Lieberherr, Messrs Lazard Frères & C°, Paris, and M. J. Truquet, Banque de France, Paris.

The report was approved by the Group at its meeting of 14, 15 and 16 September. The approval given by the members in their individual capacities applies to the report as a whole and not to each of its separate proposals taken out of context.

SUMMARY OF THE REPORT

Chapter 1: A European capital market: its foundations and the conditions for its development

1. Less progress has been made with the development of a European capital market than with the other elements of the economic union being established in the Community. Today, the reforms already under consideration to improve the functioning of the capital markets in certain member countries offer a chance of laying the foundations of a wider market; the focusing of effort on this wider market seems indeed to be a condition for the success of these reforms, as the present shortcomings of the capital markets are due not so much to insufficient savings as to the impossibility of adjusting correctly supply and demand on markets that are too narrow (secs. 1 and 2).

2. Market mechanism contribute best to economic growth and to the equilibrium of the economy when they operate within the framework of policies reflecting the long-term goals set for the economic and social systems. It is also an accepted fact that some methods by which financial policy is implemented in each country are more compatible than others with the gradual development of capital markets that are more open to the outside world.

In all the Member States the financing of economic growth is coming to depend more and more on the capital market, and the establishment of wider markets and close co-ordination of economic policies would facilitate this growth by:

- i) Offering enterprises new and more varied opportunities of obtaining from outside sources the financial resources that can help them expand to the size needed for efficient operation in the common market;
- ii) Bringing more into line the conditions on which finance can be obtained in the Community, and so reducing the distortions in competition due to present differences;
- iii) Increasing the supply of capital as financial savings are attracted to the market by the wider range of investment outlets;
- iv) Intensifying financial flows and so lessening the risk of the disturbances that are characteristic of excessively narrow markets (secs. 3-7).

3. A European capital market would facilitate the implementation of the common policies introduced in various sectors. Also, while there can be no monetary union in the Community without such a market, its creation is already indispensable if the present payments system, based on fixed rates of exchange and complete freedom for current transactions, is to work smoothly (secs. 8-11).

4. Though a European capital market ought to be the result of spontaneous developments, it will none the less require constructive efforts on the part of governments and financial institutions. The adjustments that the public authorities will have to make are concerned primarily with closer co-ordination of their national economic policies and shifts in the importance attached to the various instruments they normally use: their objectives, however, need not necessarily be affected.

The following points in particular deserve a thorough re-examination:

- i) The tax regimes applying respectively to home and to foreign investment, and differences in the tax treatment of the various forms of investment or of the channels utilized by the investors;
- ii) The rules applicable to certain financial mechanisms, so as to reduce the fragmentation of markets at present split up into a number of separate channels;
- iii) The eligibility rules for institutional investors which at present severely restrict their freedom of choice both on national and on external markets;
- iv) The exchange control regulations governing capital movements (secs. 12-15).

5. As these adjustments are carried out by the public authorities, the financial institutions that are currently most active in international operations will be able to set the pace for the rest of the market:

- i) Certain financial techniques not at present familiar in all member countries will come to be more widely used, with the result that the range of available investment outlets and resources will be broadened;
- ii) Financial institutions will tend to be less narrowly specialized, and this will help to restore effective competition;
- iii) At the same time the links between these institutions will be strengthened: they will set up joint services and be able to improve the allocation of their resources in the broader framework as it emerges (secs. 16 and 17).

6. The European market that stems from these developments will take the form of a network of transactions which, if at first limited, will gradually be extended to cover all the categories of financial flows. Within the Community it will not imply the supremacy of any single centre, and this evolution will help intensify rather than hinder the existing relationships with the capital markets of non-member countries (sec. 18).

7. The progress made in establishing an integrated capital market will depend first and foremost on the general stability of currencies and on the extent to which public finances are correctly managed. Only in these circumstances will it be possible to ensure the steady expansion of savings and to avoid setbacks due to conflicting measures taken by the public authorities in their endeavours to re-establish equilibrium in price trends and in external payments.

Chapter 2: Structural problems common to the markets of the EEC Member States

1. The prospect of the integration of capital markets which have hitherto been more or less isolated raises the question of the effects of possible disparities in the savings rates and in the conditions under which saving-investment equilibrium is achieved in the various Member States. Although the rates of saving differ appreciably from one country to another in the Community, they are in fact high and are unlikely to pose problems for the working of a future European capital market. On the other hand, the ways in which the financial surpluses of certain sectors of the economies are adjusted to the financial deficits of others vary fairly sharply from country to country; this fact has a direct impact on the working of the domestic capital markets and thus on the process of integration of these markets (secs. 1-19).

2. The contribution made by the capital markets to the financing of gross domestic capital formation appears to be similar and remarkably constant in most member countries. The average for the Community as a whole is close to the corresponding figures for the United Kingdom and the United States (secs. 10-13).

3. An examination of the demand for capital shows that the business sector's needs have been growing rapidly as profit margins have been squeezed by rising wages, by keener competition and, in some cases, by price freezes, while the calls emanating from the public authorities have also been increasing. This overall rise in demand for capital must, in short, be seen in the light of twin requirements which have to be faced by the Member States: their economic potential must be further developed in order to cope more successfully with foreign competition, while certain urgent steps to improve the social and economic infrastructures cannot be postponed (secs. 14-18).

4. The way available resources are distributed between the various sectors, and particularly between the public authorities, public enterprises, private business and housing, depends essentially on decisions taken by the authorities. The scale of public investment, the major role played by official financial intermediaries, and the dominant position on the market held by the public authorities leave only a relatively small area in which the play of traditional market forces can determine the allocation of resources (sec. 19).

5. The way in which financing requirements are met depends to a large extent on the composition of the funds available. It is this composition rather than a shortage of savings which explains the structural imbalance to be seen in certain sections of the capital markets in the Member States. The supply of funds reaching these markets reflects primarily the following points:

- i) Savers generally prefer to hold cash or short-term assets and it would be difficult to alter this liquidity preference radically in the short term;
- ii) Savings which take the form of deposits will remain a major factor in the supply of capital. The financial institutions which collect this form of savings should therefore be able to offer medium- and long-term loans and to use their funds on the capital market;

iii) Saving through institutional investors, particularly contractual saving, is inadequate in all member countries except the Netherlands. This inadequacy in part explains why markets are not able to function satisfactorily (secs. 20-27).

6. This state of affairs does not seem likely to undergo a spontaneous change, especially now that income redistribution to the advantage of wage-earners has raised the savings potential of social classes still unprepared to take a direct interest in the capital market. Consequently, several Member States are stimulating the consolidation of savings and the various forms of contractual saving (sec. 28).

7. In addition to government intervention, there are two sets of mechanisms which are of particular importance in adapting supply to demand on the European capital markets: the redistribution of long-term savings (secs. 29-33) and "transformation", i.e. the use of short-term funds for longer-term financing (secs. 34-37). These operations are carried out both by private institutions and by specialized financial intermediaries set up or supervised by the authorities.

8. The optimum utilization of available funds demands an easier flow of capital from one financial channel to another, alignment of the tax systems affecting the various types of investment, enlargement of the opportunities for savings institutions to employ the funds they collect and, lastly, markets wide enough to ensure in practice greater liquidity of investments. Savings entrusted to financial institutions exceed by far the sums directly invested by individuals on the securities markets. The key to improvements in the financing of productive investment and social infrastructure lies therefore in better adaptation of these institutions to their functions (secs. 38-40).

Chapter 3: Existing links between the capital markets

1. In the period 1960-1965 the net import of private medium- and long-term capital by the Community amounted to slightly more than \$6 500 million; this balance was more or less offset by net export of official capital and short-term funds. Intra-Community movements of medium- and long-term capital were relatively modest: Germany and France imported capital from the Benelux countries and probably from Italy. Financial transactions were mainly in the form of portfolio investment in the Netherlands and in Germany, and of direct investment in France and Italy (secs. 1-4).

2. The volume of international borrowing by bond issues has increased sharply, particularly since 1963, when Euro-bond issues started to expand. On the other hand issues abroad denominated in the currency of the country of issue have not shown a comparable rise. Borrowing by Community residents on the markets of non-member countries — including the Euro-bond market — was several times higher than borrowing by residents of non-member countries or by international organizations on the markets of Member States, the balance amounting to more than \$570 million for the period 1961-65 (sec. 5).

3. The official data available give a very incomplete picture of the real geographical breakdown of capital movements because of the redistribution effected through

international financial institutions, certain financial centres and the Euro-bond market. Consequently, financial relations with markets in non-member countries are over-estimated compared with those between the markets in the Member States; the true degree of integration already attained in the Community is therefore difficult to assess (secs. 6-8).

4. Intra-Community capital movements are governed by reciprocal obligations assumed by the Member States in accordance with the Rome Treaty; these are appreciably stricter than those in the OECD "Code of Liberalization of Capital Movements". Two directives have already been adopted to implement Article 67 of the Treaty. They provide for total freedom of movement of capital in the fields of direct investment, operations in listed securities, investment in real estate, transactions of a personal nature and short- and medium-term credits linked with commercial transactions or with the supply of services. For other categories of transaction, such as the issue of securities, financial loans and short-term capital movements of a purely financial nature, restrictions continue to exist in certain Member States; an outline of these restrictions is given in the annex. A proposed third directive, at present under discussion, is intended to establish a better balance between the liberalization measures taken by the various Member States in accordance with the previous directives, and at the same time to remove a number of obstacles not arising from exchange control regulations but of equally fundamental importance (secs. 9-11).

5. The exchange restrictions still in force seem to be maintained for reasons other than those for which they were originally adopted; they are now intended rather to ensure the autonomy of domestic monetary policies than to safeguard the balance of international payments. This trend, however, involves a risk of Member States moving further and further away from convertibility (secs. 11 and 12).

Chapter 4: Policies for control of aggregate monetary demand and regulation of the capital market

1. Radical changes in the circumstances influencing the implementation of policies for regulating aggregate monetary demand have been brought about by the increase in international trade and capital movements: the establishment of a European capital market will add impetus to this trend. A reappraisal of the extent to which the various instruments of short-term economic policy can still be used in the light of the changes that are occurring is urgently required if the essential objectives of this policy are to be maintained (secs. 1-7).

2. Now that enterprises enjoy increased facilities for obtaining capital abroad and links have been forged between the markets for short-term commercial credit, the range of domestic monetary policies is more narrowly circumscribed. This limitation becomes particularly evident when different economic trends lead Member States to adopt basically divergent policies. Yet until co-ordination has been carried further and certain harmonization measures have taken effect, it is natural that monetary authorities will feel concern when they see certain capital movements running counter to the objectives which they are pursuing (secs. 8-14).

5. There seems to be a need for greater speed in coping with cyclical imbalances and for more flexible and more systematic use of the instruments of fiscal policy. As a restrictive budget policy bears directly on aggregate demand and does not concentrate on the investment demand of enterprises, it is in fact less likely to engender compensatory capital movements. With this in view:

i) The public authorities should establish greater flexibility in their current expenditure on goods and services and in their transfer payments, but should at the same time take steps to ensure that their investment programmes could, if necessary, be employed more effectively in smoothing out the business cycle;

ii) The authorities should have powers of immediate action, in the interest of stabilization, by varying — within previously established limits — both direct and indirect taxes and depreciation allowances (secs. 15-19).

4. Credit policy would, however, retain a key role both in countering undesirable fluctuations in international payments and, by bolstering budget policy, in controlling aggregate monetary demand. Credit policy would be made more effective by lessening the differences that still exist between the circumstances in which it can operate in the various Member States and between the instruments by which it is applied (secs. 20-22).

5. Official intervention on the capital market and the establishment of a "queue" to avoid short-term fluctuations due to bad timing of issues could, if necessary, be co-ordinated. Meetings of representatives of the authorities supervising the capital markets could be held at regular intervals and provide the institutional framework for such co-ordination. Whatever is done in this connection, the trend of rates on the various capital markets should be kept in mind and there should be no discrimination in the "queue" against non-residents wishing to float issues (secs. 24-26).

6. The use of the "queue" for the purpose of channelling capital towards the financing of priority investments might — as will be shown in the next chapter — be replaced by other methods more likely to prove effective in the context of financial integration (sec. 27).

Chapter 5: Policies for stimulation of saving and direction of capital investment

1. In all member countries the authorities provide selective encouragement for certain types of investment, and accord priority to the mobilization of funds for specific sectors and regions (secs. 1-4). Some of the instruments used result in the fragmentation of each market into separate sectors and hamper the international mobility of capital. A co-ordinated adjustment of the techniques used, without necessarily endangering the objectives pursued, would therefore appear to be desirable (secs. 5-16).

2. Savings incentives which form part of social policy or represent counter-cyclical measures can readily be adjusted to render them more "neutral": such advantages must be secured for the saver no matter where he makes his investment or what type of outlet he chooses (secs. 17-18).

3. Incentives which tend to confine saving within specific channels can be justified only if there are serious structural imbalances — the housing sector in some countries might be quoted as an example — and on condition that additional saving is elicited by these incentives (sec. 19).

4. The development of long-term forms of financial saving is sought by most of the Member States. The incentives used, however, need to be harmonized in order that:

- i) The institutions collecting privileged savings have greater latitude in investing them outside the domestic market;
- ii) Inducements to put money into the securities markets apply to foreign and domestic securities alike;
- iii) The development of contractual savings — in particular those linked with employment contracts — is given top priority (sec. 20).

5. Measures intended to steer investment in a given direction should in principle be applied by means of instruments which influence entrepreneurs' demand for capital — such as tax advantages, investment allowances, interest subsidies and credit guarantees — rather than through direct action on the allocation of funds (secs. 22 and 23). The only condition that would have to be met if an investment is to benefit under these measures is that it should be in line with regional and sectoral objectives: administration of the funds set aside by the authorities to finance some of these incentives should not be left exclusively in the hands of one particular type of institution (sec. 25).

6. It would hardly be possible, however, to limit these instruments to those that act on the demand for capital, since such action will be of little value if the necessary funds are not available on the market. Direct government lending and, even more, lending by specialized credit institutions would not appear to be incompatible with financial integration provided that — where the necessary funds are collected by means of a loan issue — the Government and the intermediaries concerned resort to the market on conditions comparable to those that apply to other issuers (secs. 24 and 26).

7. Closer co-ordination of regional and sectoral policies within the Community should enable the High Authority of the ECSC and the European Investment Bank to make a more active contribution to these policies (sec. 29). But if action by these bodies is to be effective while remaining compatible with the operational requirements of a European capital market:

- i) Their access to the capital markets of Member States should be facilitated by governments;
- ii) The conditions governing their recourse to the various markets should be aligned on those applicable to comparable borrowers resident in the country concerned;
- iii) The granting of interest subsidies to recipients of ECSC and EIB loans should be allowed in specific circumstances (secs. 30-32).

Chapter 6: Finance policies of public authorities and public enterprises

1. The insufficiency of the savings realized by public authorities when compared with their planned capital expenditure used to be characteristic of certain member countries only, but is now becoming more general and leading these authorities to make increasing calls on the capital market (secs. 4-6). The fixing of "political" prices for certain public services means that the enterprises supplying them are not able to finance any significant portion of their investment out of retained earnings — sometimes indeed not even to meet their operating costs — and accounts essentially for their large-scale recourse to outside borrowing (secs. 7-9).
2. The advantages enjoyed by the authorities and public enterprises on the capital market often exceed those that derive naturally from the type and size of the borrower. These special advantages include the favoured position reserved for their issues in the portfolios of institutional investors, various tax exemptions, preferential treatment in the timing of issues, and low rates of commission and other issue charges (secs. 10-12).
3. An increase in the financing requirements of the public sector in one Member State may result in extra pressure being felt directly or indirectly in other capital markets of the Community. Inelasticity of demand makes it unlikely that equilibrium will be achieved by the interplay of market forces alone. The decision as to whether or not priority should be given to calls on the capital market by the public sector is of a political nature and cannot be guided by any general rules. In the present state of the economy, however, with all member countries vitally concerned in maintaining equilibrium, it seems that the public sector will have to bear the brunt of the adjustments to be made in aggregate demand (secs. 13-17).
4. An adjustment of the financing terms accorded to authorities and public enterprises would make it possible to contain the pressure which the public and the private sectors exert on each market within the limits and forms compatible with the progress of financial integration. It would be helpful, first of all, if a higher proportion of public investment were financed by tax receipts. Greater autonomy for local authorities in tax matters would mean, among other things, that they would be better able to adapt their income to their needs. Any additional calls on the capital market could be made under conditions less likely to disturb its balance if budgetary planning were extended to cover a period of years, and if the borrowing operations of local authorities were co-ordinated — either on a permanent basis or merely at periods when markets came under pressure — by a special institution whose calls on the market could be better timed (secs. 18-24).
5. Rates charged for public services must be adapted to cover, at the very least, operating costs and renewal of the plant and machinery of production enterprises. If certain public enterprises were unable to achieve, in addition to the above, the profitability required for a normal degree of self-financing, contributions should be made from public funds, financed out of taxation, in order to avoid excessive calls being made on the capital market. In any event, these calls would be more effective and less likely to upset the market if greater diversity in the types of security offered by public enterprises enabled them to avoid weighing only on the bond markets. Possible solutions would be the issue of ordinary shares, preference shares or "participating" bonds (secs. 25-29).

6. Direct access by public authorities to the capital market of another member country is governed by Article 68(3) of the Treaty, which however contains procedural provisions only. The criteria to be applied in practice can only be worked out gradually. Nevertheless, strict limits on the special advantages to be offered with loans floated abroad by public authorities could be laid down here and now, while the conditions under which the authorities in each member country have recourse to their home markets ought also to be progressively harmonized (secs. 30 and 31).

Chapter 7: Medium- and long-term credit to industry

1. Industrial investment is financed under widely differing conditions from one Community country to the next: in all of them, however, the specialization of credit institutions is tending to diminish, and the differences can therefore be expected to grow smaller. This will help to broaden the flow of medium- and long-term credit in Europe, though progress in this direction will be largely dependent on the adjustments made in the techniques by which the public authorities intervene (secs. 1-7).

2. The establishment of a European market in this field may result from an increase in the volume of direct international lending, from the interconnection of banking systems, and from international refinancing of national credit institutions (secs. 8 and 9).

3. The grant of direct international credits presupposes the removal of the exchange control restrictions now in force and a greater willingness on the part of borrowers to assume the risks attendant upon engagements expressed in foreign currencies, though these risks are themselves tending to fade (secs. 10 and 19).

4. On the institutional plane there are certain specialized public credit institutions which will probably be able to Europeanize their activities only by means of refinancing operations. Banking institutions could, however, more easily develop their foreign business, as some of them are already quite active in the field of short-term credit; an expansion of their activities might, however, raise problems of competition (secs. 11-14).

5. The problems relating to the use in international operations of the guarantees and sureties now used internally must be examined. The backing of a credit institution in the borrower's own country would facilitate his access to external sources of finance, and no obstacles should therefore be placed in the way of giving such guarantees. With regard to real estate charges, the general adoption of a uniform and flexible surety such as the German *Grundschuldbrief* (land charge deed) is to be recommended (secs. 15-17).

6. It is essential that the activities of "central risk offices" should be co-ordinated so as to increase the exchange of information on borrowing by companies (sec. 18). Finally, in the tax field, arrangements ought to be made to eliminate double taxation of interest on loans to borrowers abroad (secs. 20 and 21).

7. Apart from granting direct international loans, banks could extend their operations to other member countries by setting up subsidiaries or branches and by collaborating more closely with institutions in these countries. It would appear, however, that the founding of subsidiaries and branches is not likely to be undertaken on any great scale in the near future, even if notable advances are made with harmonization of the rules on right of establishment (secs. 22-24). On the other hand, the flexible ties provided by co-operation among financial institutions in various countries seem both better adapted to the situation today and more appropriate for extension in the future (sec. 25).

8. Refinancing by medium- and long-term credit institutions on the European market would enable these institutions to increase their "stable" resources by recourse to traditional techniques — such as public and private placing of bonds — and by employing new techniques such as European refinancing consortia or cross-frontier mobilization of medium-term paper (sec. 27).

9. Such bond flotations abroad would be facilitated if tax discrimination were eliminated and if the rules governing the operations of institutional investors were gradually relaxed. Consideration should also be given to the quotation on the exchanges of other member countries of domestic loans issued by institutions specializing in medium- and long-term credit (secs. 28 and 29).

10. The introduction of medium-term refinancing techniques, through the establishment of European bank consortia to issue securities with appropriate maturities and tailored to the preferences of the various markets, and also through the establishment of systems for mobilizing medium-term instruments of indebtedness, would help to provide financial institutions with new resources (secs. 30-34).

Chapter 8: Credit for housing and local authorities' capital expenditure

1. Because of the scale of the expenditure involved, the financing of housing and of investment undertaken by local authorities has a particular impact on the functioning of the capital market in each member country and consequently on the relationships that may be built up between them (secs. 1 and 2).

2. Subsidies given by Member States to the housing sector are granted either in support of the investment itself, thus reducing the cost to the builder, or to stimulate saving that will be applied to housing, or direct to the user, thus reducing the rent or the cost of acquiring the property (secs. 4 and 5).

3. Direct subsidizing of users seems preferable to the other forms of State aid, since this method does not involve any distortions in the choice of sources of finance and does not impede a return to a free housing market. In countries which are still experiencing a housing shortage, however, other forms of encouragement may be necessary. It would be best if subsidies which stimulate investment and saving simultaneously were used, thus preventing artificial movements of capital between the member countries. Methods such as subsidized loans financed out of public sector savings, and subsidies paid to the saver on condition that he really builds, would meet the case (secs. 4-9).

4. In certain member countries it would be difficult, in view of their nature, for institutions specializing in finance for housing and local authority works to operate outside their own country; refinancing is, therefore, the only means whereby they could be fitted into a European capital market. Although the situation is different for institutions in other member countries, the fact that they can normally accept only guarantees and sureties originating in their own country constitutes a major obstacle to the extension of their activities. A first move towards greater flexibility would consist in giving these institutions freedom, within the limits of their capital and reserves, to grant loans covered by sureties from other member countries (secs. 10-14).

5. Savings banks, their central institutions, building societies and life assurance companies also contribute — to a varying but always considerable degree — to the financing of housing and/or public works undertaken by local authorities. Greater freedom of action could be accorded the savings banks: they could be given authority to undertake in other member countries — within the limits of a small percentage of their funds — the same types of investment they undertake at home. The central institutions of these savings banks should be freed of most of the restrictions on their external investments, and flexible co-operation arrangements, especially on projects of interest to more than one country, should be established (secs. 15-18).

6. The obstacles to international refinancing are doubtless easier to overcome than those hampering the granting of credit across frontiers. In addition to the floating of loans abroad, this refinancing could be effected indirectly by allowing non-residents to invest in securities issued on the domestic market. Such purchases would be facilitated if:

- i) These securities (ordinary bonds, mortgage bonds, communal bonds) were quoted on the stock exchanges of other member countries;
- ii) Co-operation was established between the financial establishments dealing with "tap" issues;
- iii) Terms and conditions of issues were harmonized and the restrictions on advertising made less severe.

The shares of real estate companies and "property trust certificates" (*certificats immobiliers*) are particularly effective instruments for building up the international mobility of capital in this sector. The obstacles — particularly tax barriers — to the circulation of these securities should be eliminated.

Finally, the establishment of an international arrangement for mobilization of paper drawn in respect of medium-term credit might also be helpful. The technical problems — and consequently possible solutions — are substantially the same as would be encountered in a similar arrangement for industrial credit (secs. 19-25).

Chapter 9: Structure of fixed-interest-securities markets

1. The conditions in which the markets in fixed-interest securities operate are more or less strictly regulated in all Member States. The equilibrium of these markets is supervised by the public authorities in the interest of the saver and,

in certain cases, in order to ensure that what are regarded as priority needs are satisfied. It should, however, be possible to integrate these markets without prejudice to these aims (secs. 1 and 2).

2. On the supply side, better balance on the fixed-interest-securities markets would be helped by making them less isolated from each other. One way of achieving this result would be by adjusting the rules which govern the operations of institutional investors in such a way that:

- a) The differences in the treatment of industrial bonds and public-sector securities would be reduced to the minimum consonant with the nature of the risks involved;
- b) The bonds issued by borrowers in other member countries would be on the same footing as domestic securities provided they presented similar features and were quoted on a stock exchange in the lender's home country (sec. 3).

3. Insurance companies, social security organizations and local savings banks should, under the conditions set out in the preceding chapter, be authorized to invest a percentage of their available funds even in bonds quoted only on foreign stock exchanges. This percentage, which should be modest at first, could be raised gradually. The central organizations of savings banks, savings banks with a centralized structure and banks in general could already be given wider powers of this sort (secs. 4-7).

4. Encouragement should be given to the development of investment companies specializing in fixed-interest portfolios and to the distribution of their shares or certificates throughout the Community (sec. 8).

5. As yield considerations play a vital part in the choice of fixed-interest investments, disparities in the taxation of bond interest artificially affect international capital flows on the markets in fixed-interest securities and impede the integration of these markets. The abolition of double taxation of income is a priority aim: because of its urgency, an effort should be made to find solutions that will be more effective and quicker to apply than bilateral agreements. Withholding taxes should be abolished or standardized at a level not likely to distort capital flows. Internally, any tax advantages accorded to bond income should be part and parcel of measures to stimulate long-term saving and should apply to any investment exceeding a given minimum period (secs. 9-13).

6. From the point of view of demand for capital, differences in size or structure of the fixed-interest-securities markets in the Member States cannot by themselves be a reason for limiting the access of foreign borrowers to these markets. Nor, as and when these differences are reduced, can divergences in yield on the various markets be invoked to justify the maintenance of restrictions. At most there will be a transitional problem, and this could be solved by opening up the markets gradually and by making certain adjustments of a technical nature (secs. 14 and 15).

7. Existing exchange control restrictions could be removed by authorizing other member countries to place issues within limits that would be fixed on the basis of objective criteria and gradually raised (secs. 16-18).

8. Laws and regulations which discriminate against issues by the residents of other member countries should be amended and the criteria according to which the supervisory authorities intervene to even out the flow of issues should be defined objectively. By means of regular meetings between representatives of these authorities in the various countries it should be possible to co-ordinate their supervision of and action on the markets (secs. 19 and 20).

9. Even if all the restrictions hampering free, reciprocal access to the bond markets of Member States are abolished, issuers will benefit from the increased opportunities only to the extent that the material conditions for loan flotations are improved. This presupposes that:

- a) Greater use is made of certain effective and inexpensive techniques (private placing of bonds, selection by tender of the syndicate to manage the issues, etc.);
- b) The problems of competition with tap issues in the various countries can be solved;
- c) Placing of securities with institutional investors is facilitated, for instance by enabling foreign subscribers to a domestic loan to apply for bonds expressed in their own currency;
- d) The employment of techniques having special characteristics — index-linked bonds, "participating" bonds, convertible bonds or premium bonds — is standardized at Community level (secs. 21-25).

10. Although the interpenetration of markets has been relatively slow among member countries, the Euro-bond market, which has developed more rapidly, fulfils a number of functions that should be the province of a European market in fixed-interest securities; taxation factors and special circumstances linked with the policies of the public authorities in certain countries have contributed to its success. These Euro-bonds have brought additional funds into the market and provided financial institutions inside and outside the Community with an opportunity for fruitful co-operation (secs. 27-32).

11. In the past a certain instability has been noticeable on the secondary market, in part because some of the securities in circulation were financed with funds borrowed at short term and in part because institutional investors were not showing much interest. A lack of clarity concerning the operation of the secondary markets and insufficient arbitrage have also contributed to this instability. These weaknesses could be corrected to a certain extent by having the securities concerned officially quoted in several exchanges and creating broadly based issue syndicates interested in the maintenance of equilibrium on the secondary markets (secs. 33-36).

Chapter 10: Structure of the equity markets

1. In several Community countries, the equity markets are suffering both from a shortage of available capital and from a rather unsatisfactory pattern of business demand for capital, as reflected in the types of security and the terms offered. Consequently, business firms often find it hard to obtain risk capital and at the same

time the investing public does not always find attractive opportunities on the market (sec. 1).

2. Expansion of the supply of capital on equity markets should in the first instance be sought by enhancing the role played by institutional investors on these markets. For this purpose, the rules governing the activities of these investors should be amended (sec. 2).

3. The remaining limitations on purchases of foreign securities by investment companies should be removed along with the restrictions on the acquisition of their shares or certificates by residents of other Community countries. Greater alignment of the rules on management, information for the public and supervision of these companies and funds would help them to expand their business by doing away with the uncertainties caused by the present diversity of rules affecting the distribution of income and the terms on which these shares or certificates are bought and sold. Tax arrangements at the national and international levels should be so devised that income passing through these institutions should not be penalized (secs. 3-7).

4. In several member countries, insurance and provident institutions, particularly life assurance companies, still have their choice of investments in equities restricted by rules which are no longer entirely consonant with the interests of the saver. The contribution which these institutions make to the equity market could be made more substantial if they were allowed to offer — in addition to current types of contract — policies linked with investments in shares or certificates of investment companies. All discrimination between investment in national securities and investment in the securities of other member countries listed on a stock exchange in the country where the insurance or provident institutions are established could be abolished forthwith (secs. 8-10).

5. The savings banks could participate more actively in the equity market if certain adjustments were made in the regulations which apply to them. In this connection the recommendation already made to the effect that local savings banks be authorized to earmark a fraction of their assets for investment in other member countries would also promote investment in shares. A greater degree of freedom should be granted here and now to the central organizations and to savings banks with a centralized structure. The right — already enjoyed by savings banks in certain member countries — to set up open-end investment funds and facilitate investments by their customers in shares should now be extended (secs. 11 and 12).

6. The participation of banks in stock market transactions is subject in the Member States to laws and regulations often based on radically divergent principles. Although credit institutions could undoubtedly make an active contribution to the broadening of these markets at the European level and to the improvement of the supply of risk capital to private enterprise, the possibility that operations of this kind could lead to conflicts of interest should not be overlooked. It is therefore not possible without detailed study to express an opinion on the advisability of extending — or reducing — the right of banks to take participations and hold share portfolios (secs. 13-16).

7. Certain investors may have been turned away from the equity markets of the Community owing to the low yields offered. The tax incentives to which some Member States have resorted in order to increase such yields to the investor may, in principle, improve the flow of risk capital to the market; however, the fact that these tax reliefs are confined to residents or holders of domestic shares — and even more the combination of these two conditions — tends to keep the domestic markets separate and, in the end, lessens the efficacy of the measures themselves. Shareholders residing in other member countries should therefore receive advantages equivalent to the "tax credit" enjoyed by residents (secs. 17-21).

8. For a number of reasons, business firms prefer to seek loans rather than raise additional share capital. Improvement of the structural balance of the capital market calls, *inter alia*, for greater diversity in the forms of recourse to the market and better techniques for the placing of securities (sec. 23).

9. Greater recourse to preference shares with limited voting rights and, under certain conditions, to shares carrying more than one vote should enable management groups anxious to retain their controlling interest to overcome their distaste for share issues. However, a strict balance should be maintained between changes in voting rights and the advantages or restrictions involved for the shareholders. Any steps taken to deal with this problem should be harmonized at Community level (secs. 24-26).

10. The issue of convertible bonds often enables enterprises to obtain capital on better terms than by an issue of ordinary shares. Holders of convertible bonds can benefit if a company's shares rise in value, while they are protected against a possible decline in prices and assured of a satisfactory yield. Such bonds are an ideal instrument for a first approach to the markets of other member countries and also make it easier to interest institutional investors, who are not allowed to invest in foreign shares. Here too the statutory rules on this type of issue should be harmonized (sec. 27).

11. In order to provide the saver with better protection and improve the financial structure of enterprises, the public authorities should not facilitate borrowing by firms in cases where it appears that their capital and reserves position needs strengthening; decisions in this field should be based on objective criteria laid down in advance (sec. 28).

12. Financing through the issue of shares would be made easier if for tax purposes firms were, for a given period, allowed to treat dividends on newly issued shares in the same way as interest on bonds by deducting them from taxable profits. Also, the distribution of stock dividends would satisfy both the need of companies to increase their own capital and the desire of shareholders to be remunerated in a tangible form that can easily be converted into cash (secs. 29-31).

13. The improvement of distribution networks might reduce the difficulty and cost of new issues. If specialized intermediaries are to operate effectively, however, the market must be correspondingly large and they must be able to count on a substantial contribution from institutional investors: these are conditions which can more easily be achieved in the framework of a European capital market (sec. 32).

Chapter 11: Operation of a European securities market: Information for the public, dealing in and movement of securities

1. Structural changes in the supply of and demand for capital on the securities markets constitute one of a number of conditions that must be fulfilled if these markets are to be properly integrated. The quality and quantity of information made available to the public should also be improved, while for the negotiation and movement of securities of other member countries conditions similar to those obtaining on the domestic market should be established (sec. 1).
2. The problem of ensuring that full information is available to investors is a particularly important aspect of the development of a European securities market. Measures designed to familiarize the public with investment in securities and with the stock exchange mechanisms appear to be necessary; so also is the laying down of rules to ensure — apart from the annual publication of accounts — a continuous flow of information on company operations. More detailed information should be published when securities are issued or quoted on a stock exchange. Although it has been noted in recent years that the information supplied by companies has improved, entirely voluntary arrangements will probably not be sufficient to ensure further progress in this direction: for this reason several reform schemes, already adopted or still under study, seek to lay down prescribed standards in this field (secs. 2-10).
3. The content and scope of the disclosure and information rules relating to new issues and to applications for quotation on a stock exchange should be harmonized in the various member countries and given the same legal status: the model prospectus proposed in the annex to this chapter might be a suitable basis for such harmonization (secs. 11-15).
4. The institutional arrangements for independent control of the information supplied should not be neglected either; work on their harmonization could begin forthwith in a committee bringing together representatives of the various categories of institutions concerned and of the supervisory authorities. If the legal requirements and procedures used were more closely aligned in the Member States, co-operation in this field could later be given a more organic basis and its scope could be widened. The advisability of setting up at Community level an organization similar to the Belgian *Commission bancaire* of the American Securities and Exchange Commission should also be considered (secs. 16-23).
5. On account of their narrowness, the securities markets in the EEC countries are all beset with similar operating problems. These can be solved only by providing institutional investors with opportunities for expanding their operations on the capital market, by transacting on the stock exchanges business that is at present done outside the exchanges, and by establishing closer communications between the markets of the various countries. The latter aim could be pursued by listing a greater number of foreign securities and by developing international arbitrage (secs. 26-32).
6. Listing the securities of other member countries on the various exchanges would facilitate dealings in these securities and reduce costs. For this purpose, the discriminatory rulings which in certain countries make it more difficult or more

costly to secure the quotation of foreign securities than that of domestic securities should be eliminated. Requirements concerning information for the public and procedures for admission to quotation should also be harmonized (secs. 34-38).

7. The securities of other member countries could also be quoted in larger numbers on those markets which have simpler admission procedures (*marché hors cote, ventes publiques supplémentaires, Freiverkehr, mercato ristretto*). They should be admitted without formality if they are already officially quoted on a stock exchange in their country of origin. Simplification and harmonization of the techniques of establishing and presenting quotations would increase knowledge of the markets of other member countries and would encourage arbitrage (secs. 39-41).

8. In order to facilitate the movement of and dealing in securities, certain technical adjustments could also be made. These include:

- i) The institution of European clearing arrangements for securities;
- ii) The adoption of tax measures designed to encourage the release of shares at present frozen in company portfolios, together with the reduction of indirect taxes on stock exchange transactions;
- iii) Harmonization of the rules governing credit institutions as intermediaries in transactions involving securities, and the search for answers to the problems raised by the operations of directors or executives dealing in the securities of their own companies ("insider trading");
- iv) Amendment of the measures which, in certain countries, hamper dealings in blocks of shares, so as to ensure that these operations can be carried out with a comparable degree of efficiency and safety in the various member countries (secs. 42-48).

Chapter 12: Disparities in the working and supervision of the financial institutions

1. Active participation by the various types of financial institution in the creation of a European capital market may be hampered by the rules under which they operate and the supervisory controls to which they are subjected. The differences in these rules and controls are, moreover, liable to distort competition and therefore constitute an obstacle to the process of integration (secs. 1-9).

2. The main difficulty facing the banks in the task of attracting funds is the diversity of the regulations on the rates of interest they may offer on deposits. As regards employment of the funds, the differences concern not so much interest rate regulations as the obligatory minimum and maximum holdings of certain types of asset (secs. 10-17).

3. The need to achieve a certain balance between the rules on management of a bank's liabilities and those dealing with the assets it may hold makes harmonization even more necessary: the diversity of the existing systems could, if it were not

reduced, create between the banks of different countries competition problems analogous to those which have already arisen between different institutions within the same country (sec. 18).

4. No change in the working rules of specialized credit institutions can be recommended until the activity of each institution has been examined individually, for only in this way can allowance be made for its special role in the economic and financial system of the country in which it is located. The general principle, however, could be laid down that any special advantages granted to these institutions are justified only in relation to specific burdens or obligations imposed upon them. These advantages should therefore be extended to all institutions subject to similar restrictions and obligations (secs. 19-23).

5. Owing to the size of their resources and their wide network of branches, savings banks cannot be considered to be purely local institutions: they have an essential role to play in the development of a European capital market. To this end the first step in harmonizing their investment rules should, as already pointed out in Chapters 8, 9 and 10, be to broaden their authorized range of operations. Whereas the local savings banks would — up to a specified percentage of their funds — be allowed to make exactly the same investments in other member countries as those open to them at home, the central organizations and the savings banks with a centralized structure could here and now be granted greater freedom of action for operations in other member countries (secs. 24-30).

6. The principles for harmonizing the investment rules of life assurance companies have already been set forth; one particular proposal put forward was that the eligibility requirements as far as listed securities are concerned should be liberalized. Also the rules preventing subsidiaries or branches of life assurance companies from entrusting all or part of their technical reserves to their parent companies in other member countries should gradually be relaxed (secs. 31-35).

7. The right to conclude life assurance contracts directly with non-residents could effectively promote the expansion of capital flows between Community countries. The administrative obstacles to the direct writing of contracts across frontiers and to advertising and canvassing by companies in other Member States should be removed. To prevent these developments giving rise to problems of competition between the companies of different countries certain steps would be necessary:

- i) Indirect taxes on life assurance premiums should be abolished in those Member States where they are still levied;
- ii) Any fiscal advantages granted to insured persons should be the same, irrespective of whether contracts are concluded with domestic companies or those of other member countries;
- iii) The problem of the "separation" of the various branches of insurance should be solved;
- iv) The current principles underlying control of investment should be harmonized: in the long run, the greatest possible freedom should be sought in this field, while strict requirements ought to be imposed for the information to be made available to the public (secs. 36-38).

Chapter 13: The exchange risk — an obstacle to transactions

1. Although it will gradually lessen as a European capital market develops, the exchange risk will not disappear completely until formal monetary union has been achieved. Intra-Community financial transactions will still be affected by this risk during the transitional period (sec. 1).
2. This obstacle is particularly serious for institutional investors such as savings banks and insurance companies and — in connection with medium- and long-term operations which cannot be covered by forward foreign exchange transactions — for the commercial banks as well (secs. 2 and 3).
3. The seriousness of the exchange risk has already decreased for borrowers as the variety of currencies making up their receipts has increased; as for the financial intermediaries, where they cannot themselves shoulder this risk, they can often arrange to pass it on to the ultimate borrower or to a public authority not directly party to the contract (secs. 2-4).
4. The cautious liberalization of the rules for institutional investors recommended in the preceding chapters could include authorizing them, within specified limits, to purchase securities expressed in foreign currencies, perhaps through instruments such as investment companies, that enable risks to be spread. These investors could as of now be given the freedom to purchase any foreign securities listed on the stock exchanges in their own country (sec. 5).
5. The unification of these foreign exchange markets where a distinction is still made between an "official" rate for current transactions and a "free" rate for capital transactions appears to be feasible and would be decidedly beneficial. In the longer term, the narrow margins within which the Member States' currencies are at present allowed to fluctuate with respect to one another might even be eliminated altogether (secs. 6 and 7).
6. In international loan issues, the conditions governing distribution of the exchange risk between borrowers and lenders merit close examination; this applies in particular to loans which contain a currency option (sec. 9), those denominated in the currency of the market on which the issue is made (sec. 10), loans expressed in units of account (secs. 11 and 12) and loans denominated in a "third" currency (sec. 13).
7. Experience has been helpful in diversifying the investment outlets available to savers through the adoption of forms that meet their preferences; at the same time, the ease with which capital can flow across frontiers has increased. However, the disappearance of the exchange risk should in future make it unnecessary to fall back on such currency clauses (sec. 14).

Chapter 14: Tax obstacles

1. The setting up and smooth working of a European capital market require that the systems of taxation should not militate against the creation of conditions analogous to those obtaining on a domestic market. The requisite neutrality will have been achieved when the tax system no longer affects the choice of the place

where the investment is made or the transaction carried out and does not influence the saver's choice between making the investment direct or relying on an intermediary acting as a collector of savings. This kind of neutrality also presupposes greater uniformity in the tax incentives given to various types of investment and methods of financing (secs. 1-7).

2. At present the main obstacles in the way of this neutrality are as follows:

- i) International double taxation of income from securities (secs. 8-10);
- ii) The existence of tax advantages or charges applying selectively to investments made in certain countries (sec. 11);
- iii) The different attitudes of the Member States in connection with the tax treatment of income from securities accruing to non-residents or to persons who do not file an income tax return. (secs. 12 and 13).

In order to minimize these obstacles, certain adjustments in the tax systems of the member countries are necessary.

3. Where international agreements for avoidance of double taxation do not exist or, if they exist, do not apply to income from securities or are no longer suited to present systems of taxation, fresh solutions should be sought through multilateral agreement or through the simultaneous adoption of appropriate measures by all Member States. It could, for instance, be agreed to tax these incomes only in one of the two countries concerned; or it might be preferred to share the tax revenue by imposing a withholding tax in the source country and making systematic allowance for it in the beneficiary's country (secs. 10 and 14-19).

4. As noted in Chapter 10, certain countries grant, to their residents only, a "tax credit" on the dividends of companies incorporated in that country; in fact this is a refund of part of the corporate income tax. This means a disparity of treatment between income from shares of companies incorporated in the country concerned and income from shares of companies incorporated abroad, and also discrimination between residents and non-residents. To avoid such discrimination the authorities might consider granting the same tax credit on the dividends paid by foreign companies. A solution more in keeping with the required efficient working of the market would be to establish appropriate procedures to credit non-residents with a sum equal to the "tax credit": this solution would have the same effect as the current German arrangement under which tax is levied at a reduced rate on the distributed portion of company profits (secs. 20-24).

5. Harmonization of the different types of tax treatment of income from securities accruing to non-residents or to persons who do not file an income tax return is especially important for the bond market, owing to the direct influence of yields on the choice of fixed-interest investments. This harmonization might lead to complete abolition of withholding taxes on bond interest or to the introduction of a uniform tax in all Member States. In any case, it would be advisable to examine carefully the problems which might occur when the change is made to a harmonized system of this kind, so that the introduction of these reforms should not cause disturbances on the market or distortions in the flow of capital (secs. 25-31).

6. The problem of how to refund or "credit" tax withheld in a foreign country is sometimes even less satisfactorily solved for institutional investors (insurance companies and pension funds) than for individuals. None the less, the basic difficulties are the same and in general terms the same solutions should be adopted (secs. 32-34).

7. The tax disadvantages at present attaching to investments made in other member countries through the intermediary of financial institutions, notably investment companies, should be eliminated. What solutions prove to be possible will depend on the basic choices made by the Member States concerning taxation of income from foreign securities. Furthermore, owing to the complexity of the legal relationships between the various parties involved in such investments, it will probably be possible to attain an entirely satisfactory degree of fiscal "transparency" only within the framework of a multilateral convention for avoidance of double taxation which explicitly caters for the special case of investment companies (secs. 35-44).

8. The indirect taxes which now most directly hinder the setting up of a European market are those levied on the collection and transfer of capital. These obstacles could be removed either by abolishing the taxes in question or by all countries adopting uniform rates, the other conditions being harmonized in such a way as to avoid any double taxation. Under a draft directive now before the Council, stamp duty on the issue of securities and on their admission to quotation on a stock exchange is to be abolished and is not to be replaced by any other tax; the draft also provides for a uniform low duty on the initial capital of companies or on any subsequent increase in their capital (secs. 45-48).

PART ONE

THE ELEMENTS OF THE PROBLEM

For the reader's guidance in studying the problem examined in this Report, a word must first be said concerning the nature of the needs felt at the present time, the approach recommended by the Group of experts for meeting them and the data without which it would not be possible to understand the initial situation in which action will be taken to develop a European capital market. Such is the purpose of Part I of the Report. Because of its introductory nature, this first part, unlike the others, contains no specific recommendations; it is none the less essential that the Report should contain a definition of the principles on which the Group of experts worked and the Group's assessment of the problems likely to arise from the diversity of the present situation.

CHAPTER 1

A EUROPEAN CAPITAL MARKET: ITS FOUNDATIONS AND THE CONDITIONS FOR ITS DEVELOPMENT

Introduction

1. The carefully balanced provisions of the Treaty of Rome necessitate a measure of parallel development in the realization of its economic objectives. Inevitably, however, the rates of progress made in the different fields have sometimes got temporarily out of phase: the free movement of capital, for instance, has not advanced as rapidly as establishment of the customs union, freedom of movement for person and services, or the introduction of common policies. In fact, the common market for capital is at present little more than a preliminary plan; moreover, the differences in the attitudes adopted by the various Member States regarding the problem of free movement of capital cannot be maintained indefinitely without risk.

If this situation were to continue, it could not but delay or jeopardize the establishment of a true economic union among the Member States. Just as there can be no steady and balanced expansion in a country's economy unless it has the requisite financial machinery, so too the expansion of production and trade within the Community requires a financial system adapted to an economy of European scale.

The problem would doubtless be less acute if the national markets were fully able to meet the financing needs which occur in each country. This is apparently not the case at present, to judge by the efforts being made in all Member States to improve the efficiency of their markets and so to cope with the new situation that is developing.

2. This situation can be approached from two entirely different points of view. It can be argued that the shortcomings of the national markets are an obstacle to the establishment of a Community capital market that will be difficult to overcome. Or this purely negative attitude can be rejected, and it can be argued that the reforms being planned or already put in hand by the various Governments make this an appropriate moment at which to lay the foundations of a capital market on the European scale, there being no conflict between the wish to improve the efficiency of national markets and the aim of developing a truly European market. In fact, the measures that can help to improve the national market will as a rule be exactly the same as those needed to develop a European market.

A study of the general conditions of economic balance in the Member States shows that the second approach is both feasible and desirable. The rates of saving attained in the various countries of the Common Market compare favourably with those of other countries. The shortcomings of the capital markets in the various member countries are, in reality, due not to any lack of overall savings, but rather to an imbalance between supply and demand for capital, the markets being too narrow and the investors' liquidity preference too strong.

The establishment of a broad European market would mean that the supply of and demand for funds could be equated in competitive conditions and at minimum cost. A more diversified market would offer borrowers and lenders a wide choice of type and period of transaction. Finally, an integrated market would not entail distortion or hindrance of the flow of capital on grounds of the country of residence of the operators.

3. It should not be forgotten that market mechanisms make their contribution to economic growth and balance within the framework of policies reflecting collective preferences and long-term economic and social desiderata. Consequently, a broader capital market should be accompanied by increased facilities for implementing Community economic policy. It cannot be denied, moreover, that some of the instruments of financial policy used in each country are better suited than others to the gradual creation of capital markets that are more open to the outside world. The specific measures which the experts advocate for the development of a European capital market must therefore be such that the financial structures and policies of the Member States can gradually be adapted. In part these measures will be based on a conception of the economic foundations of a European market to be outlined in Part I of this chapter; in part they will depend on the procedure envisaged to achieve this aim — and this will be dealt with in the second part of the chapter.

I. Economic foundations of a European capital market

A. BROADENING OF MARKETS AND ECONOMIC EXPANSION

4. In every Community country the capital market — i.e. the machinery through which resources are collected and channelled towards the financing of investment — is again playing a role which is considerably more significant than in the early postwar years. During the period of reconstruction, recourse to the market was of modest proportions, both the collection of funds and the choice of investment being largely in the hands of the State. The low level of personal savings meant that investment had to be financed either through direct action on the part of the public authorities, or from savings accumulated by the firms themselves. Today the situation is different.

Now that personal saving has come into its own again, the capital market is once more fulfilling its role of intermediary; governments, for their part, have progressively reduced the amount of direct assistance for the financing of enterprises. At the same time the effect of keen competition has been to narrow considerably the margins from which enterprises can find their own finance. Consequently their financing potential, and hence their ability to compete, have come to depend in large measure on how easily and at what cost they can borrow on the market, either directly or with the aid of institutions acting as intermediaries.

Under these circumstances the development of a European market would improve the situation on three main counts.

A) ADVANTAGES TO THE BORROWER

5. Such a capital market would help to meet the increased needs entailed in adapting enterprises to the new demands of the common market. The reorganizations and mergers considered desirable to enable industrial and commercial firms to reach the dimensions needed in the common market do in fact entail greater recourse to outside finance.

The competitive distortions engendered by differences between the member countries or, for that matter, within each country, as regards the supply of business finance could thus be reduced. In the still embryonic stage of international organization of the capital markets, it is in fact only the big companies that can tap foreign markets, often at rates which are more advantageous than those they would have obtained in their own country. These opportunities are for the present almost entirely denied to other companies. One of the main consequences of a greater cross-frontier flow of capital — and of the resultant equalization of the cost of financing — would therefore be the lessening of this disadvantage to the small and medium-sized enterprises, though it could not be expected to eliminate this disadvantage.

B) ADVANTAGES TO THE LENDER

6. Establishment of a European capital market is not the mere aggregation of the markets of the six Member States; the fact of offering the individual saver and institutional investor a wider choice will bring out money which, for lack of a satisfactory investment outlet, has so far been used to purchase consumer goods, to hoard, for speculation or to purchase material assets as a hedge against inflation.

If competition between intermediaries were free throughout the Community, the potential investor would be more effectively courted than before and a greater total of savings would reach the market. This has in fact been happening for some time past and has led to the introduction and development in certain countries of new forms of investment which have subsequently enjoyed great success. This has been the case, for instance, for real estate investment companies, open-end investment funds, and life-assurance policies including indexation clauses and the like. This stimulation of competition among intermediaries and a more sustained savings campaign would indeed figure among the main sources of strength of a future European market.

C) THE ADJUSTMENT OF SUPPLY AND DEMAND FOR CAPITAL

7. In economic terms, it can be said that the purpose of a European capital market would be to provide greater capacity for mutual adaptation of demand and supply than is at present to be found in the capital markets of the individual countries. Today the volume of transactions on these markets is weak, and the circulation of financial instruments is not as smooth as it should be. Consequently any unexpected variation in demand or supply produces disproportionate fluctuations in the cost of capital.

The effects of creating a broad capital market, which will be the more positive in so far as they are backed by close co-ordination of economic and financial policies, can be looked at from two angles, the structural and the cyclical.

First, it has been found that the exchange of certain classes of financial assets for others can improve the balance among various markets. Such is the case, for example, when in a given country a growing preference for liquid assets leads to higher rates on the long-term capital market: this leads to export of securities (and a corresponding inflow of long-term capital) and at the same time accumulation of short-term claims. Market conditions would obviously be subject to more violent disturbances if there were no such possibility of arbitrage, no safety-valve allowing contact with other capital markets. Such exchanges of financial assets are part of the normal activity of a market where dealing is free. There is no difference in character between them and the merchandise trade flows which have evolved since the common market was established — and no one today contests the economic advantage of this latter development.

Fears are, however, frequently expressed that in the present situation the strains that build up inside national markets — often because of their narrowness, of the differences in the way the various types of investment are taxed and of other distortions which have not yet been eliminated — could, as markets are integrated, unleash "perverse" capital movements. Some of these difficulties must be looked on as transitional problems of adjustment to a new situation; the play of the market itself would tend to whittle them away rapidly. Other risks could be reduced if each Member State of the Community were to speed up the improvements being made in the existing machinery, bring investment opportunities more into line with the preferences of savers and eliminate fiscal discrimination, particularly between investment at home and investment in other member countries.

Again from the structural aspect, the creation of an integrated market would also facilitate the balancing of long-term capital supply and demand in another way. In view of the preference shown by savers for liquid investments, this balancing would necessitate the "transformation" of short-term into longer-term investments, through financing institutions, in all member countries. This transformation is, however, limited by the liquidity requirements of the financing institutions responsible for it — requirements that are the more restrictive the smaller the volume of funds to which they apply. The creation of a financial system of European proportions would thus increase the general transformation potential of a given volume of liquid savings, by giving these establishments more scope and by stepping up capital flows from country to country.

The second angle from which the smoother adaptation of supply and demand resulting from integration of capital markets needs to be considered is the cyclical: divergences of economic trend among the various Member States are unlikely to disappear altogether, even when they have gone a long way in harmonizing their policies. This will be directly reflected in the conditions prevailing on the capital markets; the resultant fluctuations could be considerably reduced if the balance between supply and demand were sought not in the framework of national markets, which are in many cases too narrow, but within a broader framework where these trends would tend to cancel each other out.

The practical significance of these two sets of considerations is immediately apparent when the discussion moves to a highly topical problem — that of the steadily mounting cost of money noted both in the Community and in non-member countries.

This phenomenon can hardly be looked upon as something purely cyclical, as it lingers on even when expansion shows signs of levelling off. It would seem therefore to be linked with more fundamental factors such as:

- i) The increased recourse to borrowing to finance the activities of private enterprises and the investment programmes of the public sector;
- ii) Lenders' expectation of higher nominal yields protecting the real yield of their investments against the risks of erosion of the value of money;
- iii) The deliberate raising of interest rates by countries forced, on balance-of-payments grounds, to push rates up to a level that is no longer consonant with the situation at home.

In fact, in almost all the countries there has for some time been a noticeable trend — which forms the backcloth to these developments — to push public and private investment expenditure beyond the limit of available resources. A European-scale widening of the frame within which capital supply and demand are equated would no doubt help to moderate the often undesirable effects of this trend on capital markets.

First, the increase in the supply of funds and the better functioning of the distributive machinery would temper the effects produced on the cost of money by the increasing demand for capital — effects which could be particularly unfortunate if markets continue to be as narrowly circumscribed as they are today.

Secondly, a bidding-up of interest rates on balance-of-payments grounds would become pointless and, indeed, impossible in the Community. The problem of relations with markets outside the Community would of course persist, but it could be more successfully solved by joint action on the part of all Member States than by the sporadic measures taken at present.

B. REALIZATION OF ECONOMIC UNION AMONG MEMBER STATES

8. To these general comments on the assistance an integrated capital market is intended to give to economic expansion in the Community should be added certain observations on particular facets of the economic union being established between Member States. The first of these facets to be considered will be the contribution a European capital market can make to the execution of joint measures. The second question dealt with is how far such a market could improve the working of the international payments system; in this connection, however, no detailed examination has been made of the overall machinery for adjusting the balance of payments, as such a study lies outside the scope of this Report.

A) EXECUTION OF JOINT MEASURES

9. In addition to the budgetary subsidies accorded by governments as part of their regional and agricultural policy, a considerable amount of additional money is collected for these purposes through the capital markets. One need only look at the activities of the various bodies specializing in the financing of the agricultural credit institutions and of the investments made in the less developed regions. At Community level one of the functions of the European Investment Bank is to finance schemes which contribute to the development of such regions; to raise the necessary money it floats loans on the various capital markets.

The common agricultural policy, though financed predominantly by machinery outside the market, must also be able to rely on help from the institutions mentioned. Mobility of capital itself plays an important role in regional policy since, with goods and manpower circulating freely, "compartmentalization" of the capital markets could aggravate rather than mitigate existing imbalances.

Here, the Group feels that it must refute the argument fairly frequently heard that freedom of movement for capital could make the less-favoured regions even poorer because of the pull which more developed regions exert on any money available for investment. Freedom of movement for capital is an essential, but not by itself sufficient condition for the carrying out of a regional development policy; it is clear that regional policy will not be a success unless conditions favourable to investment have been established. Unless this is done nothing can prevent the flight of capital from the regions concerned even in existing circumstances; once however these conditions have been established, the greater ease with which capital can flow in from outside will considerably speed up achievement of the aims of regional policy.

A European capital market should be of great assistance in implementing the common transport policy. A great deal of capital will be needed if the expansion and improvement of infrastructure is to be carried through in co-ordinated fashion in the Community; much of the money will have to be raised by borrowing, as the execution of the programme will undoubtedly involve sums that cannot be found from government budgets. There has moreover been a growing tendency in various member countries to turn to the capital markets for the money needed to finance certain types of public works which were previously considered investments to be paid for from the budget (motorways, pipelines, inland water transport).

Mention should also be made of the financial aid which the Community has pledged to the associated African States and Madagascar, and to Greece and Turkey. This aid is in the main to be drawn from budget appropriations, but to the sums thus made available are added others from the European Investment Bank, which will have to raise the money for its loans on the capital markets.

More important perhaps, so far as relations with non-member countries are concerned, is the burden imposed on the capital markets by the considerable growth of medium- and long-term export credits, and also by financial aid to developing countries, whether this is given direct or through international institutions. In the case of export credit, differences in the conditions offered can distort

the competitive climate, and from this angle it is clear that nothing but a sufficiently far-reaching integration of the markets can re-establish equality of opportunity for those enterprises whose exports depend on the credit terms they can offer to buyers. It is evident too that only a sufficiently broad capital market can make it possible for Member States to export capital in all its forms to the less-developed countries on terms and in quantities consonant with the economic importance of the Community as a whole.

B) IMPROVEMENT OF INTERNATIONAL PAYMENTS RELATIONS

10. It is generally accepted that monetary union will have become a reality once goods, services and persons can move freely, capital movements and current financial transactions are free of all restrictions, and the members of the union have undertaken not to alter existing exchange rates between their currencies. Among these various conditions, the stability of exchange rates has not been the subject of any formal undertaking by the Member States. There are, however, ample grounds for supposing that they already attach far greater importance to the maintenance of existing parities than could have been foreseen when the Treaty came into force. Since 1959 it has been found that exchange rates can be kept stable even in an economic area where major structural changes are occurring; apart from the small revaluation of the mark and of the guilder in 1961 there have been no changes. Despite fears that certain disequilibria could prove to be permanent, these were more a matter of relations with non-member countries than of relations between the Member States. The policy pursued in Italy, for instance, during the difficulties that occurred in 1963-64 seem to show that the authorities are ready to tackle disturbances without resorting to restrictions or to altering the exchange rates. The Member States have in addition agreed that all the other conditions should be met before the end of the transitional period laid down in the Treaty of Rome.

Once freedom of movement for goods and complete mobility of capital have been achieved and the stability of exchange rates assured, it is clear that the supply of and demand for capital in each individual Member State will become very sensitive to changes in interest rates; the capital account in the balance of payments could then easily be nudged in the desired direction by appropriate monetary measures. The need to call on the reserves of central banks as an indirect result of imbalances in intra-Community payments will no longer arise; it can even be said that mobility of capital is one of the conditions for the smooth functioning of a Community economy in which exchange rates are fixed and the freedom of current transactions is absolute. The temporary financing of any imbalances that might occur would thus be arranged through movements of capital.

11. Similar considerations seem to apply to payments between the Community and non-member countries. These have sometimes been seriously affected by the inability of the European markets to meet internal demand in the desired form. Clearly, if there is to be a common monetary policy vis-à-vis non-member countries, the authorities must have at their disposal capital markets which are both efficient and responsive to any stimuli intended to elicit corrective capital movements.

In relations with these countries, it is possible that satisfactory co-ordination of economic policies will not be obtained and that the elimination of taxation disparities and achievement of exchange rate stability will not necessarily be ensured. It has been held that movements of capital can, under such circumstances, constitute an element of imbalance in international payments and it may than be necessary, in the interest of maintaining freedom of current transactions, to impose certain limits on international capital transactions.

The points made in section 7 above have already thrown light on the position which the Group has adopted in this delicate matter; here it should only be added that, where restrictive measures are taken on short-term grounds in face of immediate threats, they must not be part of a policy which systematically places the burden of adjustment on the capital account of the balance of payments. Restrictive measures of this type often take root and grow more severe in the course of time, giving rise to increasing distortions; correction of any such imbalances should therefore be sought through correction of the policies which were in the first place responsible for creating the imbalances.

II. Role of the public authorities and of the financial institutions

12. To the foregoing sketch of the role that an integrated capital market could play in the life of the Community should be added a review of the conditions which must be met by such a market.

The Treaty has done no more than fix the objectives — which, incidentally, are somewhat imprecisely defined — and indicate the procedure to be followed in freeing capital movements and putting an end to discrimination. The gradual construction of a European capital market will, however, prove a success only if certain reforms and adaptations have been made in the techniques used and in the institutional framework. While these changes should be as far as possible spontaneous, it is evident that their speed and effectiveness will depend in part on the conscious efforts made by the Governments of the Member States and by the financial institutions.

A. THE ROLE OF THE AUTHORITIES

13. The public authorities are involved in the creation of a European capital market at two complementary levels. On the one hand, the public authorities determine the conditions under which resources are allocated by the machinery of the market. In the framework of a harmonized economic policy, the "rules of the game" which have to be obeyed by the market institutions should be clarified. The drawing up of a "medium-term economic policy programme" at Community level will make it possible to plan out this framework.

New laws or regulations of various types will be needed to speed the establishment of an integrated European capital market. Their general tenor can be indicated here, fuller details being left to later chapters in this Report.

The reforms advocated by the Group are essentially technical points; they do not call into question the political objectives of governments, but only the choice of economic policy instruments.

A) ADAPTATION OF INSTRUMENTS

14. The adaptations that most urgently need to be made belong to five main fields:

- i) In the fiscal field, those measures which at present discriminate between internal investment on the one hand, and investment effected in or by other member countries on the other, will need to be revoked. It will also be necessary to adjust any differences in the tax treatment accorded to the various types of investment and to reduce or abolish certain indirect taxes on the operations by which capital is collected.
- ii) The internal segmentation of domestic capital markets will decline in importance as financial channels are broadened on the European scale. The national authorities ought, however, to encourage this trend by reconsidering the arrangements for certain specialized financing channels.
- iii) The regulations applicable to institutional investors are often out of date and therefore ill-adapted to current developments; they need to be amended. As investment through this channel is still insufficiently developed in Community countries, action should be taken to make it easier to remove certain obstacles which prevent these institutions from undertaking a wider range of investment operations both in other member countries and at home.
- iv) The exchange control regulations governing capital movements ought also to be reviewed, in the light of the full convertibility already achieved for current transactions. On the basis of this review it would be possible to assess, on the one hand, the efficacy of the existing controls, and on the other the gravity of the obstacles which these regulations may place in the way of rational and equitable ordering of financial transactions between countries.
- v) There are also certain administrative measures that involve discretionary decisions; by and large these should be replaced by clearly defined operational rules that would make it possible to eliminate any risk — real or imaginary — of discriminatory treatment.

B) HARMONIZATION OF ECONOMIC POLICIES

15. The exigencies and special features of national policies will diminish in importance as experience with Community action produces formulas for co-ordinating and harmonizing these policies, both in the field of short-term measures and in connection with longer-term growth. By pinpointing possible imbalances and spelling out the priorities to be observed, the introduction of a Community programme of medium-term economic policy will clarify the bases of financial policy. It will then be possible to make a sounder assessment of financial needs and of ways and means of meeting them.

This "financial programming" by the public authorities will enable two main objectives to be achieved. At home it will be possible to prevent excessive pressure on the market by borrowers insufficiently sensitive to changes in interest rates — either because profitability considerations do not apply to them or perhaps because their view of development prospects makes them temporarily more imprudent — from upsetting the markets and leading to a system of "rationing by cost" of those applications for finance that would really be more in line with economic policy requirements.

At the same time it will be easier to assess the likely scale and direction of any redistribution of financial resources that may occur among the Member States and, if the redistribution is considered undesirable, to take concerted measures in order to correct it. Nor should it be assumed that the redistribution of resources would be solely within the Community; this problem has already been discussed in section 11 above.

There ought also to be harmonization of the policies behind certain measures by which the public authorities act on the operations of the credit institutions or directly on the capital markets in the broad sense to ensure that funds will be available for priority or privileged borrowers. Such harmonization, which will be discussed in Chapters 5 and 6, is hampered by the difficulty of determining how far the measures taken really affect market conditions and what repercussions they can have abroad.

For this reason and for others of a strictly domestic character, any subsidies that are to be given should be clearly recognizable as such in the budget and should be allocated to the beneficiaries either directly or through approved financial institutions. As the rates of interest ruling on the various markets will then correspond more closely with the real supply and demand situation, one major objection to integration of the markets would lose much of its force. It is not as easy — and here the reasons are political rather than technical — to grant assistance from the budget as it is to intervene in the credit field. It may, however, be wondered if the very ease with which the authorities can influence the supply of credit has not contributed to the maintenance in budgetary systems and, even more, in fiscal systems of certain rigidities which are harmful both from the point of view of fairness and from that of the efficacy of economic policy.

B. THE ROLE OF THE FINANCIAL INSTITUTIONS

A) CHANGES THAT SHOULD BE MADE

16. The financial institutions can adapt their activities to the new situation in three main ways:

- i) Certain financial techniques in current use on the markets of one or more countries but unfamiliar in others could be adopted generally; they would extend both the range of investments open to savers and the methods of financing available to borrowers;

- ii) Specialization among the various categories of financial intermediary is often excessive; this not only limits their ability to attract funds, but also excludes them from certain types of business that could benefit the economy. The expansion and diversification of their operations — both as borrowers and as lenders — that will ensue once they are part of a wider market will contribute to the establishment of the conditions which are needed for effective competition between financial institutions;
- iii) The links between the financial institutions will be reinforced by the establishment of common services covering the entire Community. The widening of financial contacts will incidentally facilitate refinancing by national institutions on the European capital market and, conversely, the temporary investment of surplus funds when supply tends to outrun demand.

As the changes are made, those financial intermediaries which at present have the greatest experience in the field of international operations will set the pace for the rest. The measures taken to stimulate savings must not therefore lead to their being frozen in internal investment; to guard against this possibility, the investment rights and opportunities possessed by institutions collecting these savings should be extended to embrace the markets of other member countries.

The scope for adaptation is not, of course, the same for all types of institution; it is true that there are financial intermediaries, such as investment companies and, within certain limits, insurance companies, which naturally turn to international markets both for the collection of funds and for their investments. This is also true of certain banking institutions such as the *banques d'affaires* and for part of their activities, particularly short-term currency operations, the deposit banks.

Although other institutions may only employ the funds at their disposal within their own country, they can none the less use the refinancing facilities offered by the international market. In certain cases these facilities can be of very great importance: one example is provided by institutions which specialize in the financing of short- and medium-term loans which are re-financed by the issue of bonds on the international market — a practice which is already assuming considerable proportions. Conversely, certain types of intermediary or even "initial" lenders find on the international market opportunities for investing their own money without turning to the market as borrowers.

To sum up, there are only a few institutions which will have difficulties in extending the field of their activities to include direct operations in other Member States. Among those still encountering difficulties are the savings banks and certain insurance and provident institutions, but here too new developments are possible, as will be apparent from Chapters 8 and 12.

B) THE MARKET OF TOMORROW

17. Broader horizons, the impetus given to competition, and the introduction of techniques that are already current practice in other markets will provide the main drive in the changes that will be necessary before an integrated capital market

can be established. It must nevertheless be recognized that this process will not produce a truly single market unless and until it has proved possible to remove one of the material obstacles that is still of vital importance: the exchange risk. Only when monetary union in the true sense has been established will the financial intermediaries, borrowers and lenders be able to operate on the European capital market as if they were dealing on their domestic markets. Steps to reduce the obstacle presented by exchange risks are however possible and several have already been taken. This problem will be examined in Chapter 13.

18. The question arises whether the development of a capital market on a European scale will necessarily involve supremacy of one of the financial centres, with the other markets relegated to the role of satellites. There are two reasons why this is unlikely: in the first place, in an age of increasingly rapid communications, concentration of the institutions in one place is of less significance; secondly, certain domestic financial channels in each member country will retain much of their importance for a very long while to come. The pattern most likely to develop will be a group of financial centres retaining their "national" characters but knit by an increasingly close network of international financial links. In the more distant future this network may well embrace all financial flows and in fact constitute a European market on which more and more institutions, bursting the narrow limits of their domestic markets, will operate.

The Group feels that this clarification should remove any misunderstanding as to the nature of the emergent European market. It is not a question of encroachment by the existing "international market" (Euro-currency and Euro-bond market) on the normal business of the national markets, sapping their strength. On the contrary, as the present markets thrive and as their operations are gradually harmonized and integrated the European market will develop, stimulated by competition from the international market, which will have its place in the European market in process of development.

The tightening of financial links between the Community countries must moreover not be at the expense of the maintenance or development of relations between each of these countries and the capital markets of non-member countries. On the contrary, as was the case in the commercial sector, where the build-up of trade between member countries was accompanied by increased trade with non-member countries, the removal of obstacles to capital movements between the member countries will also encourage financial flows between member countries and non-member countries. In fact, the maintenance of links between the financial centres of the Community and those of non-member countries may even make a useful contribution to the process of integration within the EEC.

As, however, the development of a market involves more than decisions to liberalize, and calls for new organizational measures, particularly measures harmonizing taxes, administrative rules, etc., there is no guarantee that the forging of financial links will progress at the same pace between member countries as between these countries and non-member countries. Should the two developments get out of phase, some "deflection of trade" may occur; but it is reasonable to assume, on the basis of experience gained in the commercial sector, that the "creation of trade" effect will far outweigh any deflection that may occur.

CONCLUSION

19. It has already been pointed out that efforts to develop a European capital market can succeed only if a number of general economic conditions are fulfilled.

For example, the expansion of savings must be sustained and even increased. The means to this end are price stability, which must be maintained, broader markets and, perhaps, official incentives, which should however be more neutral than in the past with regard to the place where the money is invested. As and when the growing volume of savings and their greater mobility help to dispel the impression of a general dearth of capital now prevailing on certain markets (this is in fact evidence only of a lack of balance between sectors and of maladjustment between demand and supply), the authorities will be able to adopt a more liberal attitude, as they will have less reason to fear upheavals when the barriers between the Community countries are removed.

Secondly, the alignment of market conditions in the various financial centres must be pursued. The first moves in this direction were taken under the impetus of liberalization measures already adopted and of the economic integration process in general, and they have already done much to reduce the differentials between interest rates and, on certain markets, between the fees charged for services by the financial institutions. None the less, there are still pronounced disparities: it is reasonable to suppose that the intensification of capital movements will help to narrow them, but there is always a risk that divergent official measures could compromise the progress already made and so give the authorities fresh grounds for seeking to isolate their national markets. Everything must be done, then, to harmonize policy on interest rates.

The third main condition to be met would seem to be that the external payments position of the various Member States should correspond with the long-term balance aimed at by each State (this does not, of course, rule out their being structural exporters or importers of capital): the external payments situation should not constitute an incentive for the authorities to influence the conditions governing long-term international movements of capital between Member States.

20. Throughout this report the Group has endeavoured to define — from the angle of financial techniques — the conditions which it feels must be met if a European capital market is to be developed and the financial links binding the different parts of the Community are to be permanently strengthened. Although it has treated purely political considerations as lying outside its purview, it does feel that governments must keep in mind certain broad principles: if a European capital market is to be developed, vigorous action is required to promote saving, currency and price stability must be maintained and the public finances must be kept in balance.

In an attempt to pinpoint more precisely the action to be taken, the Group has examined the main features of the problems common to the capital markets of the various countries and has assessed the importance of the financial links which have already been forged between the Community countries. This survey of the present situation is contained in the remaining two chapters of Part I.

CHAPTER 2

STRUCTURAL PROBLEMS COMMON TO THE MARKETS OF THE EEC MEMBER STATES

Introduction

1. This chapter deals with those features of the capital markets which would seem most significant in connection with the development of a European capital market. The aim is not, however, to provide a description — this would lie outside the terms of reference given to the Group — and there is no attempt to give a full account of the structure and working of the Member States' markets. The intention is to bring out the main differences between the markets which might hamper the process of integration.

The analysis will focus on capital markets as defined in Chapter 1 — that is, as the complex of machinery through which funds are collected and channelled towards the financing of productive investment and of economic and social infrastructure. This means essentially the securities markets and medium- and long-term credit machinery; but it does not mean neglecting the movements of short-term capital in so far as they supplement or adjust the balance of saving and investment.

The tables annexed to this Chapter bring out the main characteristics of the capital markets and provide adequate material for assessing the scale of the phenomena under consideration, but they do not allow of detailed comparisons of the institutions or of the machinery, since definitions do not tally in all cases.

The structural problems of the member countries' markets will be examined from four points of view in the different sections of this Chapter:

- I. Savings-investment equilibrium, i.e. the problem of gross capital formation and its financing;
- II. The pattern of demand for funds;
- III. The salient features of the supply of funds;
- IV. The role of financial intermediaries in the adjustment of supply and demand.

I. Gross capital formation and its financing: savings-investment equilibrium

A. THE LEVEL OF SAVING

2. The prospect of integrating capital markets hitherto practically independent of each other raises from the outset the problem posed by the different levels of gross capital formation and the conditions under which saving and investment can be brought into balance.

Theoretically, it might be thought that these macro-economic magnitudes were not directly relevant to a study of the capital flows which will link the various markets

Once present obstacles have been eliminated. Indeed, if savings and investment are basically in balance in a given market, whether the balance is at a high or a low level is likely to have only a slight impact on capital flows.

It is only when there is a tendency to disequilibrium on the markets of one or more countries that stimuli — in the form of variations in interest rates and of changes in the level of demand for capital — are generated which encourage an inflow or outflow of capital.

In practice, it is difficult to distinguish between these two cases; statistics show only developments which have taken place and cannot therefore yield direct information on the existence of a tendency to disequilibrium. None the less, certain features can be elicited from Tables 1 and 2, which give details of gross capital formation and its financing. It is a reasonable hypothesis that the rates of investment needed to attain the growth objectives set ought not in principle to differ widely among the Community countries except in Italy and (to a lesser extent) in the Netherlands, where a higher rate of investment may be necessary to help real incomes per head catch up with those in other countries. On this assumption it may be conjectured that countries where the rate of saving is abnormally low are those where there is the greatest likelihood of strain affecting the capital market, particularly in the cases of the two countries mentioned above, where the need for an above-average rate of investment is presumed (conversely, it would be wrong to regard a below-average rate of formation of savings as a probable source of disequilibrium in "mature" economies).

The figures in Tables 1 and 2 show:

- i) Rates of saving broadly in line with this assumption, since they are appreciably higher in Italy and the Netherlands than in Belgium and France and, even more, the United Kingdom and the United States, countries with "mature" economies: most remarkable of all is the extremely high rate of saving in Germany, due in part to a high rate of public-sector saving, which however declined considerably in 1965.
- ii) A total Community saving, per annum, calculated on the basis of the average of 1962-1964, of about \$59 000 million, compared with \$109 000 million in the United States and \$15 000 million in the United Kingdom. The very size of these figures indicates how important it will be for the development of a European capital market to maintain satisfactory links with the international financial centres outside the Community.
- iii) A pattern of Community saving giving Germany pride of place with 44% of the Community total, followed by France with 27%, Italy 16% and Benelux 13%.

B. SAVINGS-INVESTMENT EQUILIBRIUM

3. There are in fact two savings-investment equilibria:

- i) In overall terms, the adjustment of gross domestic saving and gross capital formation takes place through the external balance on current account (net financial surplus or deficit of the economy as a whole) (see Tables 1 and 2);
- ii) At economic sector level, the "net financial surplus" of some sectors offsets the "net financial deficit" of others.

A) OVERALL EQUILIBRIUM

4. The "net financial surplus or deficit of the economy as a whole" represents the contribution made or received by a given country in its dealings with the rest of the world. This concept differs from what is often known as the "basic balance" in balance-of-payments analysis: neither unrequited transfers of capital to or from the rest of the world nor capital movements properly so called are included. The surplus or deficit does not therefore provide direct information on the impact which dealings with the rest of the world may have had on the capital market of a given country: it simply provides a pointer to the overall financing potentialities or requirements of the economy, with due regard to the levels of saving and of gross domestic capital formation achieved. An examination of the capital account in the balance of payments, which shows more directly the interrelationships between markets, will be made in the next Chapter.

Table 2, in which the above-mentioned surplus or deficit is related firstly to the average gross national product and secondly to average gross capital formation in the years 1962-1964, suggests that, apart from France and the United States, the relative importance of the balance has been small. However, examination of the annual figures corrects this impression slightly, since they reveal that the three-year averages for Italy and the Netherlands are in fact the result of equating relatively high surpluses and deficits.

In general, the evidence suggests that savings-investment equilibrium has been achieved almost wholly at national level: this does not however prevent there already being some degree of interpenetration of markets, as shown by the gross capital movements studied in Chapter 3. Moreover, this situation will change as the greater mobility of capital brings the objective of harmonized growth throughout the Community nearer fruition.

B) EQUILIBRIA BETWEEN SECTORS

5. The financing equilibrium that is established between economic sectors in each country is a result of adjustment between the net financial surpluses and deficits in the several sectors. This equilibrium is not achieved in the same ways in the different member countries. Now, the conditions under which it is achieved are highly relevant to the integration of capital markets: the various savings categories do not have the same fluidity. Public-sector saving is undoubtedly more tied to the country of origin than personal saving and less sensitive to market stimuli; to a lesser degree, this may be true of the saving of enterprises. Thus it may be expected that the countries where saving in the public sector and in enterprises is heavy will prove less well fitted to play the role which they would otherwise fill in view of their relatively high level of overall saving. The converse, of course, applies to the countries in which households account for the bulk of overall saving, even if the total is relatively small.

Another point is that the conditions under which equilibrium between the sectors is achieved have an impact on the rate of overall saving. There is no doubt, for example, that in a period of reconstruction, marked by a shortage of capital, overall saving cannot reach a high level unless the public sector and enterprises save heavily.

(1) General

6. The analysis of the adjustment between sectors is normally based on an examination of the financial surpluses or deficits of three distinct sectors: the administrative authorities, enterprises and households. As the boundary between the two latter sectors is drawn differently in the various countries, the two have been aggregated in Tables 1 and 2; in what follows below, however, an attempt will be made to separate the two categories. With regard to the government sector, it should be noted that Tables 1 and 2 indicate net public financial surpluses or deficits before capital transfers to other sectors; this concept is more significant from the economic point of view, since it shows what funds the public authorities would be able to supply to other sectors for financing investments, while the balance after capital transfers to other sectors eliminates some of the overall savings which the authorities could, if they wished, use for investment. For purposes of comparison, the balances before and after capital transfers are shown in Table 3.

This said, an examination must now be made of the general conditions under which the adjustment takes place between the "government" sector and the "enterprises and households" sectors. In the past, it seems, the situation of some countries appears to have been almost diametrically opposed to that of others. In Germany the authorities have had a very large financial surplus; in Belgium, on the other hand, the financial deficit of the public sector has been fairly heavy. In the other member countries, the trends have been less marked. The financial surplus of the public sector has increased steadily from year to year in France, and there has been practically constant equilibrium in the Netherlands. In the United States and United Kingdom fairly wide fluctuations have been observed. The detailed analysis by sector requires the following comments.

(2) The government sector

7. Table 3 shows the scale of capital transfers in France, Italy and Germany. In these three countries, there is a substantial difference between the public saving/public investment ratio *before* transfers and the same ratio *after* transfers. The key to this disparity is the importance attaching to the various forms of central government aid, i.e. capital assistance to enterprises — especially grants to public enterprises, support for backward areas, arrangements for compensating special costs incurred and various benefits paid to households.

Consequently, although in all the member countries save Belgium and in the Netherlands since 1963 gross saving in the public sector is more than enough to cover public capital formation, in Italy, the Netherlands (and in France in 1962 and 1963) these transfers have led to a net deficit which has had to be covered by borrowing from the capital market; more recent, incomplete data also indicate a decline in the government's financial surplus in several Member States.

These disparities could seriously hamper the establishment of a European capital market. Those member countries whose public saving is least developed are apparently also those whose overall saving is weakest. They might therefore be

tempted to prefer the contracting of debt on the markets of other Community countries to the budgetary and tax measures which would be needed if the level of public saving were to be brought into line with the volume of public investment. The danger of such action is all the greater since the volume of public investment is tending to increase rapidly in Community countries: in addition to the demands of social policy (the need to improve collective equipment) there is a growing urge to encourage more rapid economic development by improvements in infrastructure, education and research. The Group has therefore set out in Chapter 6 the guidelines which it feels should be followed in the field of public finance if capital markets are to be integrated.

(3) *The enterprises sector*

8. The level and the trend of the net financial deficit of enterprises — i.e. of their calls on the capital surpluses of the other sectors — can only be assessed on very approximate lines. Problems of definition (data available refer sometimes to all enterprises, sometimes exclude farming, or public enterprises, or self-owned businesses, or certain of these) and the varying sizes of the samples used, mean that the figures given in Table 4 can be considered only as orders of magnitude mainly useful for assessing the trend of a given series in recent years. None the less it seems that one general point can be made: the rate of self-financing in all member countries is steadily declining. Another is that there are significant differences between the situation of enterprises in the EEC and in the United States. In the United States, depreciation and the undistributed profits of companies in the private sector cover virtually all fixed investment and stocks formation. Since enterprises' need for capital is in great part met from self-financing, increases in registered capital in the form of fresh money from shareholders are on a small scale (in 1964, 0.3% of market valuation, compared with 5% in France). Consequently, industry makes very little call on the capital market and obtains funds easily from that market in time of need. In Community countries, on the other hand, enterprises run a permanent net financial deficit. It is true that the situation is not equally serious in all member countries. In Germany and Belgium self-financing rates are relatively high, in France and the Netherlands average, but in Italian enterprises they are abnormally low (see Table 4). In terms of national accounting, it is quite clear that the financial deficits of enterprises are offset by surpluses in other sectors, but the difficulties of ensuring a smooth adjustment between these deficits and surpluses are precisely what lie at the root of all the capital market problems.

Moreover, the very concept of self-financing conceals factual situations which vary fairly substantially from one country to another. In this connection, the importance of pension funds constituted within German and Italian companies as a source of the internal financing of enterprises should be stressed. Their contribution is included in statistics on self-financing, and the incomplete figures available show that it is far from negligible; in Germany, pension reserves represent 8.5% of the total of the balance-sheets of the 2 000 enterprises making up the Federal Statistical Office's sample. In Italy, for the group of 233 manufacturing companies analysed by the Banca d'Italia, this item accounted for more than 17% of the gross self-financing of enterprises in the period 1960-1964.

Lastly, to complete the picture, mention must be made of the vital influence which public enterprises in certain countries exert on the financing needs of the company sector. This applies particularly in Italy and in France; not only is the role of public enterprises in the economies of these countries very important, but the available figures for France and the estimates for Italy show that the self-financing rate of public undertakings is substantially lower than that for private enterprises; in France it fell from 30% in 1962 to 25.1% in 1964. The subsidies accorded to public enterprises for plant and machinery or for current operations do not suffice to make good this disparity; consequently, to cover their financial deficits public enterprises make considerable calls on the capital market — calls that seem very high compared with their share in capital formation: in France, in the period 1962-1964, the financial deficit of public enterprises represented 40% of the needs of the entire company sector, whereas their share in capital investment was between 25 and 30%. Similarly, under the Fifth Plan, the investments of the big public service concerns in the period of the Fifth Plan were to be less than half those of the "competitive sector" — and yet their requirements of outside finance (including subsidies) would exceed that sector's financial requirements.

The deterioration in the financial structure of production units, the divergences in the amounts which enterprises contribute to saving, and the problems raised by the financing of public enterprises are all factors making for disequilibrium in the development of a European capital market. Ways and means of remedying these difficulties will be discussed in the second part of this Report.

(4) *Households sector*

9. It is very difficult to assess accurately the level and trend of the net financial surplus of households. Apart from the difficulty of distinguishing between households and enterprises — a difficulty due largely to the many different ways in which the individual entrepreneur is treated — there is the unreliability or the sheer lack of data on the savings of households invested directly in residential construction, which is in fact the main non-financial use of savings from this source.⁽¹⁾

For this sector, then the only course open is to draw indirect conclusions from observation of the financing requirements — known to varying degrees of accuracy — of the other sectors. A consideration of the forms of financial investment by households (Section III below) will provide further material for the necessary assessment.

II. Demand for capital

10. The structure of demand for capital is determined by the needs of transactors, the ability of the various sectors of the market to satisfy these needs, and the

⁽¹⁾ It is not possible just to take the gross saving of households, to subtract the figures in Table 1 which show the scale of residential construction, and so to obtain the financing surplus of this sector. The main reason for this is that the data on residential construction cover not only dwellings acquired through the direct savings of households, but also dwellings financed by administrative authorities and dwellings acquired by households with borrowed money.

play of the various control and regulation devices established by the authorities. The present section is concerned mainly with "final demand" for funds, i.e. that of the transactors who themselves carry out real investment: the role of the intermediary institutions which draw funds from the markets for the purpose of relending is discussed in Section IV of this Chapter. Our first task, then, is to examine the overall volume and the structure of demand in the various sections of the capital market, and an attempt will then be made to elicit some information concerning the calls on the capital market made by the various sectors of the economy.

A. OVERALL SCALE OF THE CAPITAL MARKETS AND RELATIVE IMPORTANCE OF THE VARIOUS SECTIONS

A) SCALE OF THE MARKETS

11. The concept of "capital market" used in Tables 5 and 6 (discussed below) differs from that generally used in the rest of this study, where the capital market is deemed to cover medium- and long-term financing machinery only: in view of the nature of available statistics it has been found necessary to adopt here a wider definition including the short-term credits granted to the various sectors. With this reservation, which of course renders the analysis less satisfactory than if it had been possible to isolate the machinery for financing investment, the overall scale of the capital markets in the Member States will be assessed, first by comparing absolute values, and secondly in relation to gross domestic capital formation.

Table 5 shows that in Germany, France and in the Netherlands the amount of capital supplied by the market seems to have grown fairly consistently over the five years under consideration (1960-1964). In Italy and in Belgium (countries for which, however, the data are not complete) cyclical factors and factors connected with the introduction of new tax arrangements have affected trends, and no such steady expansion is discernible.

The addition of funds obtained on the various national markets is only an indication of what might be the initial scale of a future integrated European market, as has been explained in Chapter I. The funds supplied by the capital markets of the EEC countries have in the aggregate corresponded to approximately 50% of the funds supplied on average over the same period by the American market.

As for the contribution made by the market to the financing of gross domestic capital formation, the rates recorded in Germany, France and the Netherlands, have changed little over the years, and they are much the same in each of the three countries. In Belgium the capital market has made an exceptionally large contribution to the financing of real investment. In this respect, average rates in the United Kingdom and in the United States do not vary much from the average Community rate.

B) RELATIVE IMPORTANCE OF THE VARIOUS SECTIONS

12. Table 6, which analyses the funds supplied by the various sections of the capital market, shows wide disparities within the EEC and also between the member countries on the one hand and the United Kingdom and the United States on the other.

- i) Issues of securities by ultimate investors of capital (i.e. excluding intermediary institutions) have been on a relatively modest scale in all the countries except Belgium, where they account for nearly 40% of the funds supplied by the capital market, and to a lesser extent the Netherlands, where the corresponding figure is 23%. This may seem surprising in view of the scale of loans floated on the capital market by the public authorities in most of the countries: the reason is the assumption that — except in Belgium — these loans are in large measure floated by the public authorities in their capacity as "intermediary institutions". The funds supplied by the public sector are on a considerable scale in France, Germany and, outside the Community, in the United Kingdom.
- ii) The banking system accounts for roughly 20 to 40%, according to country, of the financial resources supplied to the economy.
- iii) The other financial intermediaries — savings banks, the specialized institutions financing credit for industry and housing, insurance companies and pension funds — supply about half the finance placed at the disposal of businesses and individuals in the Netherlands and in the United States.

C) ANALYSIS OF THE MARKET IN SECURITIES AND IN MEDIUM- AND SHORT-TERM CREDIT

13. To fill in this very broad outline, a more detailed treatment is given below of the various sections of the capital market, particularly of the market in securities and in medium- and long-term credit.

Table 7 gives a picture of the volume of issues on the securities markets (1960-65 averages).⁽¹⁾ A first point to be made in connection with this table concerns the comparison of the absolute figures for all securities issues in the EEC countries and in the United States. The total for the United States is shown as some three and a half times that of the Community total. But this is mainly accounted for by the very great scale of mortgage bond issues in the United States, included in Table 7 under securities issues, although they are not in fact dealt in on the market (on the other hand securities which, from this angle, are somewhat similar, such as the *Schuldscheine* in Germany and the securities representing *onderhandse leningen* in the Netherlands, are not included in the table among "securities" issued on the markets of Community States).

The breakdown between issues of shares and issues of fixed-interest securities differs very substantially from country to country. In the EEC as a whole, issues

⁽¹⁾ These data differ from those given in Table 6 on "Funds supplied by the securities market", since the latter included only the issues of final investors whereas Table 7 covers all issues, including those of "financial intermediaries".

of shares are on an appreciably heavier scale than in the United States but are of less importance than in the United Kingdom. This could well be due in the first place to the greater scope for self-financing enjoyed by United States enterprises, since even the absolute volume of issues of shares in the United States seems modest in comparison with the EEC total, and secondly, to the efficiency of United Kingdom machinery for putting on the market the shares of even relatively small companies, a factor which facilitates issuing activity on the United Kingdom market.

Within the EEC countries, it is interesting to note the effort made by French and Italian enterprises to use issues of shares to restore financial structures thrown out of equilibrium in the past by undue recourse to borrowing.

It has already been noted that issues of securities as a way of covering financial deficits are on a comparatively small scale, particularly if only those issues constituting demand of ultimate investors rather than all issues are counted.⁽¹⁾ Whatever the prospects, then, of improving the machinery of the securities markets in the various member countries, the benefit accruing directly to transactors will be relatively small in relation to the advantages they would derive from the expansion and the improved functioning of the intermediary institutions, which provide enterprises with the bulk of the outside finance needed.

B. THE DEMAND FOR FINANCE BY THE VARIOUS SECTORS OF THE ECONOMY

14. Demand for capital may come from the public sector, from enterprises, from households, or from abroad. The last two sectors are not dealt with here: the external financial relations of each of the markets are discussed in the next chapter. The recourse of households to the capital market occurs when they purchase consumer durables on credit or buy a flat or house. There are no detailed financial accounts in this field and it is therefore extremely difficult to analyse these transactions.

The demand for capital by the public sector and by the enterprises sector is discussed below.

A) THE PUBLIC SECTOR

15. The public sector's demand for capital seems to be gaining in importance in the various member countries. The authorities are anxious to make good the inadequacy of social equipment and to improve the collective infrastructure, which is the key to economic growth, and this is leading to an increasingly rapid expansion of public investment, while public saving generally rises more slowly. In addition, even where the financing of these direct investments is covered by public saving, the authorities often play the role of intermediary by borrowing capital to finance economic operations in the form of loans to private enterprise. Calls on the capital

⁽¹⁾ The issues used to amass funds for the granting of credit by financial intermediaries are analysed in Table 8.

market by enterprises directly dependent on or controlled by the public authorities can also be included in the public sector's demand for capital.

Table 9 deals with the bonds which the public sector issues to meet the needs of both central and local governments and of public enterprises. It is difficult to establish exactly where issues for central government purposes end and issues for public enterprises begin, for while certain enterprises — particularly in transport and telecommunications — enjoy financial independence in certain countries, others come directly under the financial administration of central government.

Nor has it been possible to take account in the table of the fact that certain institutions, whose primary function is to finance the public sector, distribute to the company or household sectors part of the funds which they amass. However, in view of the sectors for which the funds they borrow are intended, the intermediate institutions of the public sector are not included in the table; if it were desired to take stock of the public authorities' influence on the market, the activities of these institutions would also have to be taken into account.

In view of the above, it is interesting to look at the percentage of total issues originating in the public sector; in certain member countries this brings to light a problem of balance between the opportunities available on the market to the public sector and those available to enterprises, whose need to borrow is also rising fast. These general problems will be examined in Chapter 6.

The bulk of the financing requirements of the local authorities are covered, in the Netherlands and Germany, by obtaining credit from specialized financial intermediaries which in turn obtain their funds by issues of bonds; direct issues by local authorities are of secondary importance. But there is another source — not shown in the tables — which is very important, particularly in France and Italy: it consists in financing granted by intermediaries which obtain their funds by collecting deposits rather than by issuing bonds (the *Caisse des Dépôts et Consignations* and the *Cassa Depositi e Prestiti*). The demand for funds by local authorities, which in certain countries is a very substantial factor in the capital market, also competes more or less directly with the financing requirements of the company sector.

Similar considerations apply to the use of the market by public enterprises: the factors to be examined below in Chapter 6 (the reduced scope for self-financing resulting from a policy on charges designed to keep prices stable, and the limited opportunities for issuing shares) may mean that the importance of these enterprises on the capital market will increase well beyond their real significance in the economy as a whole. Nor should it be forgotten that the public enterprises often receive direct capital contributions from the Treasury and long-term loans (sometimes combined with special advantages) granted to them by the public authorities or by the specialized credit institutions. They therefore enjoy particularly important advantages over the private enterprises.

B) THE ENTERPRISES SECTOR

16. The net financial deficit which enterprises have to cover by borrowing, and consequently the calls they make on the capital market, have increased sharply of late. There are several reasons for this. A high volume of investment is demanded

by the tempo of technological progress and by the need to adapt to a larger market. The profits available for ploughing back are smaller now that profit margins have been reduced by the pressure on prices due to keener external competition (or, in certain member countries, by price pegging measures forming part of stabilization programmes) and higher costs. The increase in these stems from the higher wages generated by the full employment situation achieved in recent years. The immediate effect of this trend is to cause enterprises to make heavier calls on external sources of finance, at the cost, in the long run, of a deterioration in their financial structure.

Table 10 gives estimates of the pattern of the borrowing by which enterprises have in recent years covered their financial deficits (it has not been possible to separate enterprises in the public sector from enterprises in the private sector). (1)

With this reservation, the member countries can be classified in two groups: in the first — France, Italy and Belgium — the issue of securities accounts for more than a quarter of the sums borrowed by enterprises from outside sources. In the second group — Germany and the Netherlands — this method of financing is appreciably less important. The distinction would be sharper if, instead of considering only the funds supplied directly by the securities market to enterprises, account were also taken of the funds which this market supplies indirectly, thanks to the "intermediary" institutions which redistribute as loans the money they raise by borrowing.

This situation demonstrates the relative weakness of the contribution made by the securities markets to the external financing of enterprises and the importance of the role played by the financial institutions; by collecting savings deposits or by issuing bonds, these do much to ensure the financing of enterprises in certain countries. This suggests that the development of a European capital market would be of all the greater value for enterprises if it involved not only an improvement in the working of the securities market but also an improvement in the role played by the intermediary institutions as suppliers of finance.

The pattern of the financing of enterprises as it appears in Tables 10 and 11 is discussed briefly below.

1) *Issues of shares and bonds*

17. The issue of new shares varies in importance from country to country as an external source of financing for enterprises, and the use made of this method reflects circumstances which are peculiar to each of the Member States. In Belgium, where the contribution of share issues to total financing from external

(1) Two series of data are given for all countries except the Netherlands. The first includes residential construction with enterprises, the second excludes it. The second series is probably the more significant: investment in residential construction, which accounts for 20 to 30% of total gross capital formation, is generally financed by machinery differing appreciably from that used to finance productive investment. The inclusion of housing in an analysis of the borrowing by enterprises is liable to give a distorted picture of the scale of medium- and long-term credit, which constitutes the main instrument for financing housing. The problems of this particular sector will be examined in Chapter 8 and no further space is devoted to the subject here.

sources is higher than in any other country of the Community, the situation may be interpreted as a reflection of the difficulties faced by enterprises if they resort to other forms of financing, because of the pressure which the public sector exerts on the bond market. A similar explanation may well apply to France, where financing through the issue of shares is carried out on a considerable scale and fluctuates remarkably little. In Germany and in Italy, on the other hand, enterprises were at the beginning of the period under consideration procuring almost a quarter of the funds required from the capital market through the issue of shares, but here the situation has deteriorated rapidly, owing very probably to the unfavourable climate on the stock exchanges. The Netherlands is a special case, since the scale of year-to-year fluctuations in the relative importance of financing through the issue of shares is almost certainly to be attributed to variations in the calls on the market made each year by the big international companies with headquarters in that country.

It appears (as the more detailed analysis in Chapter 10 will confirm) that the supply of risk capital in the Community countries is hampered by difficulties which, added to the problem of reduced scope for self-financing, are liable to undermine seriously the financial structure of enterprises.

Table 11 shows that for a relatively early year, 1963, the structure of German, French and Italian enterprises was markedly inferior to that of enterprises in the United States or the United Kingdom.

Other evidence suggests that the disparity grew still wider from 1960 to 1964: while the indices that show the financial soundness of enterprises were unchanged in the United States and in the United Kingdom, they developed unfavourably in the three EEC countries mentioned. The ratios of debt to fixed assets, to own resources and cash flow show that the tendency for indebtedness to increase is gathering momentum: if this tendency were to continue, it would be bound to cause concern.

The issue of bonds by non-financial enterprises also varies very widely in scale from member country to member country.

In Germany and the Netherlands — in the former country mainly for tax reasons which were valid in the past, in the latter because of the lower cost and the flexibility of this form of financing — enterprises have tended to prefer private loans against borrowers' notes (*Schuldscheindarlehen* in Germany and *onderhandse leningen* in the Netherlands) to public issues of bonds. The large resources at the disposal of banks, savings institutions and institutional investors have enabled this form of financing to develop considerably, and the need for public issues has been reduced accordingly.

In Italy the specialized credit institutions, which have authority to issue bonds on privileged terms, are in a position to lend at medium and at long term on more favourable terms than those which enterprises would obtain directly on the fixed-interest securities market, given the heavier incidence of taxation on the issue of industrial bonds. The latter therefore play a subordinate role.

In France and in Belgium it is likely that two factors — regulation of access to the market by financial authorities anxious to assure priority for public or semi-public issues and the reticence of the public, who may be induced by tax incentives and investing habits to buy public-sector paper or paper guaranteed by the government — account for the relatively modest growth of bond issues by private enterprises. In the case of Belgium, it should also be said that interest subsidies granted to enterprises may apply only to loans of financing establishments and not to issues of bonds.

These factors which affect the readiness of enterprises to call on the securities market explain why borrowing from the various financial intermediaries provides two-thirds or more of the money enterprises obtain from outside sources. This characteristic — common to all the countries — should not, however, be allowed to mask important differences between the sources and the nature of the credit obtained in the various member countries. On the nature of the credits, it is difficult to say much on the differences to be found between the various countries in the ratio of short-term credit to medium- and long-term credit provided by the credit establishments and by institutional investors. It is, however, certain that in Italy the exceptionally high share of short-term credit in the total sums borrowed by enterprises from outside sources is connected with the Italian bank law which forbids ordinary credit institutions to grant advances for more than one year. Since these institutions dispose of considerable funds, it is not surprising that they grant advances to their customers on current account with no specified date fixed for repayment; these advances in fact play the same role as the formal medium-term credit granted by other institutions and thus contribute to the financing of capital investment.

2) *Medium- and long-term credit*

18. The bulk of the loans required for plant and equipment in France and in Italy reaches borrowers from public or semi-public institutions granting aid direct or acting as intermediaries. Institutional investors, particularly insurance companies, play only a subordinate role in this field. In Germany, on the other hand, most of this medium-term or long-term credit is accorded by the banks — the powerful network of savings banks being a part of the banking system — with appreciable support from the insurance companies: it is often granted in the form of Schultscheindarlehen, which are roughly comparable with bonds placed privately. In the Netherlands, institutional investors, insurance companies and pension funds are the chief source of direct medium- and long-term loans to enterprises, although the contribution from the banks is far from negligible. In Belgium, lastly, it looks as if the situation is undergoing a complete change since, although semi-public institutions still dominate the field, they have declined in relative importance in recent years now that the banks have shaken off their reserve over granting loans for more than two years.

CONCLUSIONS

19. To conclude this study of the demand for finance, two points of some importance for the rest of the analysis may be made.

In the first place, the distribution of the demand for funds among the various sectors, and notably the administrative authorities, public enterprises, enterprises in the private sector and residential construction, reflects choices made by the public authorities rather than the impact of the machinery of the market in the accepted sense of the term. The study has shown not only the importance of the investments made directly by the public authorities (or under their auspices by public enterprises), but also the role played by the semi-public financial intermediaries. It may be added that intervention by the authorities in the arrangements for issues on the securities markets leaves a relatively small area in which the allocation of resources depends on the play of machinery not directly subject to official control.

Secondly, the point made at the very beginning of this section, i.e. that the way in which financial deficits are covered depends to a large extent on the pattern of the supply of capital to the market, merits special emphasis. Hence the need for an analysis of the supply side of the market; it should yield a more detailed explanation of the origins of the machinery by which financing deficits are covered.

III. The supply of capital

20. This section is concerned not with the volume but with the pattern of the supply of capital. After a summary account of the role of the main contributors to savings formation, an analysis will be made of the composition of their financial investments, and this will be followed by an attempt to bring out clearly the problems raised by the widening of the capital market to European dimensions.

A. THE SOURCES OF SAVINGS

21. Basically the pattern of the supply of capital on the market is determined by that of the sources of savings. The following considerations are helpful to an understanding of the relation between the two:

- i) Saving by the public authorities is normally intended for investment without passing through the market, although public saving may in fact sometimes help to make more funds available on the market; this element in saving is relatively immobile in international terms;
- ii) Nor is company saving normally likely to boost the supply of capital to the market, although it may do so more than public saving. This is true only for the company sector taken as a whole: investments by enterprises temporarily disposing of idle balances may be of considerable importance. International mobility may also be quite pronounced;
- iii) Saving by households remains, however, the major factor to be taken into consideration in any assessment of the potentialities of the capital market of a given country. This is true, of course, only to the extent that non-financial investments

— investments in self-owned businesses and in residential construction — and hoarding do not absorb too high a proportion of household saving.

Subject to the above reservation it can be considered that, with saving by households forming a larger proportion of overall saving in the EEC countries than in the United Kingdom and the United States (where the share is only about 20%), the structure of overall EEC saving is satisfactory from the point of view of normal supply of the capital markets and of mobility of capital across frontiers.

However, something more is needed than this mere general statement. For example, whether public-sector saving passes through the banking system or through independent channels affects the conditions in which the market works. The situation in this respect varies appreciably from Member State to Member State. In the case of enterprises the level of their indebtedness and the nature of their relations with financial institutions also influence their capacity to make a contribution to the capital market.

Lastly and most important, the way saving by households is divided between investments on the market and non-financial investment may have more importance than the actual volume of this saving. In France, for instance, certain deficiencies in the supply of funds to the capital market are probably to be explained by the fact that direct payments for housing absorb a much larger proportion of personal savings in this country than elsewhere. The desire to own one's own home may provide a stimulus to saving, thus increasing its volume without encroaching on financial investment. Beyond a certain limit, however, the scale of the contributions necessary to the financing of construction may become such that a household has to give up any other form of investment, and as a result the capital market will suffer. The same is true where there is an undue tendency to hoard.

In this connection it is, however, important to make a clear distinction between causes and effects, since in many instances it is clear that the growth of hoarding or of investment in housing is in fact due to the inability of the capital markets to offer attractive investment opportunities. This point must be kept in mind in the following analysis of the unsatisfactory distribution of savings between the various forms of investment.

B. THE DISTRIBUTION OF FINANCIAL INVESTMENT

22. The pattern of investments made by the various non-financial sectors of the economy reveals that among the member countries there are marked differences in financing flows; these differences are brought out in Table 12, which deals with financial investment by the non-financial sectors.

A) CASH HOLDINGS

23. The proportion of cash (notes, coin and sight deposits) to all net financial investment by the non-financial sectors differs significantly between France, Italy and Belgium, where it ranges from 20 to 30%, and the Netherlands and Germany,

where it is only 12 to 14%. The difference is even more marked between the Community countries and the United States, where cash holdings account for only 6% of the annual increase in financial investment.

The reasons for the public's strong liquidity preference can be listed here but not analysed in detail. A first point is that the holding of deposits has still not made much headway with households, as is evidenced by the importance they attach to notes and coin. More generally, the tendency to hold ready money may be seen as a corollary of the public's reluctance to commit funds to long-term investments which in the past have entailed considerable losses due to erosion of the currency. The public's reaction to this threat is probably due to a desire to be in a position to cope rapidly with new situations and to take early advantage of speculative opportunities. Tax factors and defects in the working of the capital markets have also almost certainly played a role. In this connection, it may be noted that liquidity preference on this scale suggests a certain indifference among households to considerations of yield.

B) SAVINGS DEPOSITS

24. For an assessment of the scale of deposit saving, some rearrangement of the headings "Savings deposits entrusted to the banking system", "Funds entrusted to savings institutions" and "Funds entrusted to specialized credit institutions" is required, since, in Table 12, the savings banks system is included in the banking system in Germany but among the specialized institutions in France. In the banking system, time deposits are often grouped with savings deposits: but these two sorts of deposit frequently come from rather different sources, since in many cases the time deposits are merely a more profitable way for enterprises to employ their idle balances. None the less, they represent relatively stable resources for the banking sector and can therefore be properly classified with deposit saving.

It may be noted that the scale of deposit saving as a proportion of all net financial investment of the non-financial sectors varies in the several member countries between 25 and 37% and that it therefore constitutes the most important single source of funds for the capital market. It may be added that deposit saving is even more developed in the United States, where it accounts for about 52% of the total.

The item "Other funds entrusted to the banks" must also be taken into account. This item, which is relatively important in Germany and in Belgium, covers funds obtained by the banking system in the form of "credits received" and issues of deposit receipts: from the economic point of view these funds are comparable with time deposits.

If it has been possible to speak of all these funds as contributions to the capital market, this is of course because they are "transformed" into medium- and long-term investments by certain institutions; the process by which this is done will be discussed in the next section of this Chapter.

C) FUNDS ENTRUSTED TO THE PUBLIC SECTOR

25. The "Funds entrusted to the public financial sector" under forms other than the purchase of bonds are of real importance only in France (about 18% of all investment), where the role of the Treasury and of the public financial institutions as collectors of liquid savings is well known. Differences in the definitions of "public financial sector" from country to country must not, however, be overlooked, since they mean that the figures given in this line in Table 12 are not fully comparable. In this respect the importance of the "Miscellaneous" heading for Germany should be noted; it represents in the main the funds which the public sector places at the disposal of firms engaged in residential construction through public financial institutions.

D) THE SECURITIES MARKETS

26. In the Community, the funds invested on the securities markets account for proportions ranging from 15% (France) to 32% (Belgium) of all financial investment: it should, however, be recalled that these figures refer only to direct investment by the non-financial sectors and that investments made by intermediaries on the securities markets are therefore not included.

This also explains the net sales of securities shown in the United Kingdom and — in respect of shares only — in the United States, where, in the years under consideration, the non-financial sectors sold securities which were bought by the financial intermediaries. The tendency in the UK and USA for direct purchases of securities to decline in favour of indirect purchases by savers contrasts with the situation in the EEC, and particularly in Belgium and in Italy, where direct purchases still play a major role: the consequences of this situation will emerge in Chapters 9 and 10.

E) CONTRACTUAL SAVING

27. A similar situation is apparent in very marked differences to be seen in the scale of funds entrusted to pension funds and insurance companies: contractual saving of this kind accounts for scarcely 3% of the total in France, 9 to 10% in Germany and Italy, 15% in Belgium and 39% in the Netherlands. Except in the Netherlands, therefore, this form of saving is much less developed in the Community than in the United States and in the United Kingdom, where it accounts for 20% and 40% respectively of all financial investment. Such a situation calls for more detailed consideration.

The fact that in most of the countries the social insurance institutions have adopted the "assessment", method of assurance means that social security pension reserves are very small. Certain estimates suggest that they represent only about 5% of the total they would reach if the level premium method were used. These reserves represent three to five times the total of annual expenditure in the Benelux countries, are equal to total expenditure in Germany and are actually lower than total expenditure in France and in Italy. It is known that the reserves of life-

assurance companies represent, however, several times their annual expenditure. The adoption of the assessment procedure has had the result of increasing the importance of the social security pension as an instrument for the redistribution of incomes, particularly in the Netherlands and in France. In recent years, however, the current total of social security pension investment has increased in Belgium, Germany and Italy, particularly investment in government bonds and the bonds of public undertakings or of semi-public credit institutions. It should also be noted that the contribution made to the capital market is sometimes more apparent than real, where reserves are invested in public securities while the government subsidizes social security to the same or a greater extent. This is then an internal accounting circuit of the public sector, the only result of which is to swell the volume of public loan paper in circulation, but not that of the real financing resources existing on the market.

Unless changes occur in the existing trends, it seems that in the future the "assessment" method may come to be used even more extensively than at present. If this should happen, there would be little chance of a rise in social-security pension reserves and of the contribution made by social security pension schemes to the capital market. On the contrary, social security pension funds might even call for larger subsidies from the State in order to balance income and expenditure.

This fairly general trend in the Community countries is a result of political and social decisions which the Group is not required to evaluate. The public authorities, however, should be aware of the consequences of these decisions for the capital markets.

Structural factors also account for the modest contribution to the capital market made by various forms of insurance saving linked with the employment contract.

It has been thought advisable to devote special attention, even at this early stage of the report, to the problem of contractual saving, since this is one of the basic prerequisites for the good functioning of the capital market; the situation described reveals marked differences in this respect between the markets of Member States — with the exception of the Netherlands — and the British and American markets. The problem of how to stimulate contractual savings, particularly savings linked with the employment contract, will be examined in greater detail in Chapter 5.

Social insurance saving has developed in various ways in all the member countries: it is designed to ensure a supplementary retirement pension or a form of savings for employees through voluntary payments made by them and a contribution made by employers.

In the interests of the employee and of the capital market, it would be advisable that the funds set aside for the pensions of employees in the enterprise should be available through the capital markets for the financing of enterprises generally rather than being directly invested in the enterprise where they arise: in the latter case, they raise the same problems as does self-financing. To facilitate the mobility of labour, it would also seem preferable that the benefits granted to an employee should not be conditional on his remaining in the same firm until retirement.

It is certain that the various forms of social insurance saving have in any case the basic advantage, since they are voluntary (but advantageous for the employee since

he gains a contribution from the employer as well), of inculcating the habit of saving in social groups which now enjoy higher incomes but whose propensity to save has so far been low.

Structural factors also explain the difference in the extent to which life-assurance companies invest on the capital markets of the various member countries. These companies provide substantial support for the capital market in the Netherlands and in Germany, whereas their contribution is relatively low in France and in Italy, and lies somewhere between the two groups for Belgium. One of the reasons for this is that certain types of contract, particularly annuities and endowment assurance for which the companies have to build up large reserves, have developed in the Netherlands and in Germany, whereas others, like term assurance or whole-life assurance, which involve the constitution of lower reserves, are the most common in France.

C. THE DEVELOPMENT OF A EUROPEAN CAPITAL MARKET: PROBLEMS RAISED BY THE PATTERN OF SUPPLY

28. The main features of the supply of capital on the European capital markets can be summarized as follows:

- i) In several countries savers prefer to hold cash or short-term investments. This preference must be accepted as a fact and cannot be substantially changed just by establishing a European market. The efforts already undertaken to encourage progressive consolidation of personal savings must therefore be stepped up.
- ii) In all member countries, deposit saving is still an essential factor in the supply of funds to the capital market. It would seem necessary, in conjunction with development of the instruments for collecting the funds used by the financial institutions active in this field, to encourage the channelling of deposit savings towards medium- and long-term financing and employment on the capital market.
- iii) Lastly, and most important, the member countries' capital markets are still suffering very seriously from the inadequacy of contractual saving.

The situation on the supply side does not seem to have improved in recent years, and the main reason for this is that the redistribution of incomes to the advantage of wage-earners has increased the opportunities for saving open to social classes relatively ill prepared to play an active role on the capital market.

Aware of the obstacles to the smooth working of the capital markets raised by the nature of the supply of capital, the authorities in most Member States have endeavoured to encourage consolidation of savings and to promote the different forms of contractual saving. The main purpose of measures on these lines, which have assumed some importance in Germany and in the Netherlands and which have just been introduced in France, is to ensure the stability of newly constituted savings for a minimum period and so to help familiarize the saver with the idea of not keeping his funds perfectly liquid. The various measures will be examined in Chapter 5.

Secondly, the Community's first medium-term economic policy programme contains recommendations for a "property policy". Implementation of this policy alongside the incomes policy should encourage households to channel their savings into financial investments. Until this policy is implemented and is producing results, the possibility that savings will be made available in the form needed to cover capital requirements will continue to rest mainly on the work done by the financial intermediaries.

IV. The adjustment of supply and demand on the capital market

29. A useful way of examining the conditions under which the supply of capital is adjusted to demand is to make a broad distinction between the roles played by government intervention, the machinery for the redistribution of long-term saving, and the machinery for "transforming" short-term deposit saving.

A. BALANCE OF THE MARKETS AND GOVERNMENT INTERVENTION

30. In each Community country the supply of capital is adjusted more or less fully to demand with the aid of central government intervention, which supplements and corrects the distribution of funds made by the market machinery. As has just been mentioned, one of the ways in which governments influence the supply of capital is by stimulating saving and guiding it towards privileged channels. Another point that may be mentioned is the scale of the funds supplied by governments either directly or through specialized financial intermediaries; in certain countries these funds represent a substantial contribution to the supply of capital.

However, the most important operations carried out by the public authorities to adjust supply and demand take the form of direct action on investment demand and action on the cost of financing. The main instruments used to influence investment demand are the decisions concerning budgetary expenditure, the control of expenditure by local authorities and nationalized industries, and restrictions on building. The cost of financing can be adjusted by measures (especially subsidies) to affect interest rates and by tax measures.

If all the instruments mentioned above are taken into consideration it would seem that government intervention has assumed relatively greater proportions in France and Italy than in Germany and the Netherlands, with Belgium somewhere in between. But it is of course difficult to assess more accurately the scale of these public operations when they take non-quantifiable forms, such as the control of access to the market through the establishment of a "queue" of issues and by directives to the financial intermediaries.

Alongside government intervention, two types of machinery are of particular importance on the European markets: the machinery for the redistribution of long-term saving and "transformation" machinery, i.e. arrangements enabling short-

term resources to be allocated to longer-term uses. These have been operated by private institutions and by specialized financial intermediaries set up or controlled by governments. On the action taken to adapt these institutions to their functions depends the greater part of the improvements to be hoped for in the financing of productive investment and social infrastructure.

B. MACHINERY FOR REDISTRIBUTING LONG-TERM SAVING

Of the institutions engaged in redistributing long-term saving, the first to be examined here will be those which administer contractual saving, followed by those which redistribute capital collected through the securities market.

A) INSURANCE COMPANIES AND PENSION FUNDS

31. These institutions collect contractual savings directly or indirectly from households and thus dispose of technical reserves which it is their task to administer. In carrying out this task, they redistribute the savings they have collected between various forms of financial and non-financial investment. This operation can to some extent be regarded as a process of "transformation" which affects the nature of the savings since, by entrusting their money to these institutions, subscribers to life-assurance policies or supplementary pension schemes intend to secure for themselves a capital sum at or from a specific date, while the intermediary institutions in fact use this capital in a way which is not determined by the savers themselves.

It is admittedly difficult to compare the exact scale and nature of intervention by social-insurance institutions from one country to another. Certain marked differences in the way these institutions distribute their resources can, however, be discerned. Figures collected by the OECD Committee for Invisible Transactions and referring chiefly to period between 1960 and 1964 show that investments in the form of advances, mainly at medium and long term, account in Germany for about 66% and in the Netherlands for 69% of the increase in the financial assets of insurance companies and independent pension funds, whereas this type of investment accounts for between 1 and 4% of the increase in France, Belgium and the United States, and about 13% in the United Kingdom. The disparities are, however, narrower in reality than these figures might suggest, since they include for Germany and the Netherlands loans against promissory notes — a type of operation which, from the economic point of view, does not differ from the private placing of bonds made in other countries. On the other hand, investment in fixed-interest securities accounts for 63% of the increase in the assets of these organizations in France and 56% in Belgium, compared with only 20% in Germany and 9% in the Netherlands. In the United Kingdom and the United States the corresponding figures are 43% and 37%. In France and Belgium the high proportion of money these organizations put into bonds is due first and foremost to the rules governing their investments, rules which have the effect of channelling most of their funds towards the public sector.

Investment in shares accounted for between 3 and 7% of the increase in the financial assets of these institutions from 1960 to 1963 in Germany, the Netherlands and Belgium, about 20% in France, about 26% in the United States and 37% in the United Kingdom. This shows that, despite the increase in recent years, the social-insurance institutions of the EEC countries apply a relatively small proportion of their resources to risk investment compared with their counterparts in the UK and the USA.

In general, therefore, the contribution of these institutions to the financing of corporate investment in the private sector is much lower in the EEC countries, since their investment in shares is low and their purchases of bonds are mainly confined to government bonds. In addition to the above financial investments, these institutions devote a sometimes considerable portion of their resources to the purchase of real estate, particularly in Italy.

B) THE SPECIALIZED CREDIT INSTITUTIONS

32. The specialized credit institutions fulfil a double role: they carry out technical operations and serve as an instrument of economic policy.

Their economic policy function, which consists in encouraging the financing of investment in certain economic sectors, explains why they more often than not have public or semi-public status and sometimes enjoy certain privileges (special facilities for their loan issues and for dealing with institutional investors, public guarantees, tax benefits).

They also have a purely technical function, which consists in collecting funds on the securities market and redistributing them to certain users of capital (enterprises and public authorities) which have no direct access to the market, or at any rate cannot obtain favourable terms when borrowing in the ordinary way.

Another argument therefore for the above-mentioned advantages which these institutions enjoy in the Community countries is that their operations have the aim of offsetting the handicap faced by these users (for example, small and medium-sized enterprises) when they wish to draw directly on sources of finance. It would seem, in fact, that the technical aspect of the functions of the specialized credit institutions predominates in Germany and in the Netherlands, whereas the policy function is more to the fore in Belgium, Italy and France, where these institutions play a major role in collecting long-term savings or in distributing medium- and long-term credit, or in both.

The scale of their operations is considerable, and the funds they draw from the bond market account for a large proportion of total issues: for 1960 to 1964 the figure was 65% of total net issues in Italy, and more than 50% in Germany; in France, the Netherlands and Belgium it varied from 37 to 45%. This is all the more significant since the use of the funds concerned is narrowly specialized. In Germany, the institutions specializing in the financing of local authorities and residential construction are appreciably more important than those specializing in industrial or agricultural credit. The dominant place of the securities of the

specialized institutions on the market obviously affects the private sector's scope for borrowing against bond issues, and this influence is enhanced by the fact that the securities are available on tap.

C) THE TREASURY

33. In practically all EEC countries, the Treasury also acts as a body redistributing long-term capital by issuing bonds and granting medium- and long-term credit to public or private enterprises either directly or through credit institutions.

The economic policy function is particularly marked in this kind of Treasury operation. To the extent that the Government accords special terms to its own issues, the Treasury is in a position to grant funds on more favourable conditions than those available on the market.

C. MACHINERY FOR "TRANSFORMING" LIQUID FUNDS AND DEPOSIT SAVINGS

34. The financial intermediaries carry out their "transformation" function by adapting the supply of capital to demand from the standpoint of duration of the investment. "Transformation" may be defined as investment for a longer period than that of the deposits received. With a view to integration of the capital markets, this process needs to be examined from three points of view:

- a) Scope,
- b) The institutions involved and the sectors that will benefit,
- c) Its success in adjusting the supply of capital to demand.

A) THE SCOPE OF TRANSFORMATION

35. It is not easy to assess accurately the scope of transformation, and even less easy to compare its relative importance in the financial systems of the various member countries. One reason for this is the absence in three member countries — Belgium, Italy and the Netherlands — of annual accounts covering all financial operations and classifying them according to period. The second reason is that in the other member countries the definitions of "short-term" do not coincide and that in Germany figures on Treasury operations are available. A third factor is that, even if such a standard definition were available, the legal classification of the period for which funds are committed is not a standard by which the stability of deposit saving can be assessed. Lastly, systematic studies on the subject have been carried out only for France, Germany, the United Kingdom and the United States. The comparisons made below must therefore be treated with some caution.

Subject to these reservations, it is clear that transformation of short-term into medium- and long-term funds is carried out on varying scales in the differing financial systems. For the years 1960 to 1963 more than 50% of the long-term capital requirements of business and private borrowers in France were met in this way, compared with less than 30% in Germany; the corresponding figures were 50% for the United States and less than 20% for the United Kingdom⁽¹⁾.

In some of these countries, in particular Italy, a number of loans shown in balance sheets as "short-term loans" or "advances" are in fact often automatically renewed and this amounts to their transformation by the users of the loans. It would seem that in recent years the volume of funds transformed has tended to increase, at least in France, Germany and in the United States, since the increase in the long-term investment of the non-financial sectors has apparently been smaller than the increase in the long-term capital requirements of the economy.

B) ORIGIN AND APPLICATION OF THE SHORT-TERM FUNDS "TRANSFORMED"

36. In theory transformation can be carried out by any financial intermediary administering sight or short-term funds who is in a position to accept the risk of immobilizing these funds for a period exceeding the period for which the deposit is received; three technical factors make transformation possible:

- i) Sight deposits have a certain foreseeable degree of stability, while time deposits are renewed and here too the extent of renewal can be foreseen;
- ii) New deposits replace withdrawals, so that the institutions have at their disposal a working fund which is to all intents and purposes permanent;
- iii) The volume of deposits increases, so that there is a tendency for this working capital to increase.

In practice, three types of financial intermediary actually carry out transformation: savings institutions, banks and, in certain member countries, the Treasury.

The savings institutions are the most important, since their share in the total of these operations ranges from 60 to 100% in the various member countries. The nature of the resources (almost exclusively savings deposits) accruing to them, as experience shows, with marked regularity diminishes the importance of the liquidity problem, while the public guarantee they enjoy explains why they are particularly well placed to transform short-term funds. Their activity in this direction is also a natural result of the regulations which encourage them to invest in bonds, mortgage claims and long-term loans to public authorities.

The distribution of the saving institutions' resources among the various form of investment is influenced to a great extent by the nature — which varies in liberality from country to country — of the regulations referred to above. In most EEC

(¹) Source: "Etude de la transformation des capitaux à court terme en emplois financiers à long terme dans les divers pays" drafted by a Working Party in the Caisse des Dépôts et Consignations, Paris 1966 (unpublished).

countries these funds are channelled mainly towards the financing of housing and public authority investment, and sometimes towards the investments of public undertakings, either in the form of long-term loans or through purchases of bonds. The extent to which the savings institutions assist in the financing of productive investment in the private sector is therefore somewhat limited. The restriction of the funds made available by transformation to certain types of investment sets a serious problem, of course, in the context of a European capital market: on such a market the conditions in which the savings institutions work should vary less from country to country than they do at present.

The banks contribute in smaller measure to total transformation. This is mainly due to the stricter liquidity rules applied to them, particularly in Italy and, until recently, in France. They use the funds derived from transformation mainly to finance private and sometimes public enterprises.

If economic policy considerations, which in certain circumstances may require special liquidity rules to be imposed on banks, are disregarded, it would seem, from the purely technical point of view, that more short-term funds might be transformed by banks in certain member countries where the scope is particularly limited by regulations concerning the employment of funds. More flexible rules would help to increase the volume of transformed funds channelled towards the financing of productive investment.

In the EEC countries the Treasury plays an active part in this transformation process only in France; outside it does so in the United Kingdom and in the United States. But even in France the part played by the Treasury has in fact declined steeply over the last ten years, dropping from 70% of total transformation to only 10%. The funds transformed by the Treasury have been channelled mainly into housing and public enterprises and, at times, to local infrastructure.

C) TRANSFORMATION AND THE SUPPLY AND DEMAND SITUATION ON THE CAPITAL MARKET

37. In what way transformation helps to balance the supply and demand situation on the capital market depends largely on the conditions in which the process takes place. According to whether the transformed funds are applied to investment in securities or to medium- and long-term loans, the equation of demand and supply in one or other of these sections of the capital market is facilitated.

Investment in securities offers the advantage of greater liquidity, but may lead to the security market trend becoming excessively dependent on monetary policy. This risk is all the greater because of the possibility that the institutions carrying out the transformation may find their own liquidity directly affected by decisions of the monetary authorities, and also because they transform resources (sight and time deposits) the trend of which itself reflects changes in monetary policy. On the other hand, transformation has enabled several Member States to make good a temporary shortage in the supply of long-term capital, and has thus come to play an important role in determining the general business trend. In Italy, for example, at a time when the public's interest in bonds had waned, banks invested in them on a large scale.

Investment in medium- and long-term loans has the disadvantage of immobilizing funds for too long, although this disadvantage can be mitigated by the organization of a market or by the existence of mobilization facilities. On the other hand, these investments often have a higher yield than investments in securities.

Thus, if the transformation of short-term funds is to take place in conditions offering the requisite level of liquidity, safety and profitability, a combination of these two types of investment is needed; and there should also be some spread of individual investments among the various sectors of the economy. The development of this machinery in a European capital market would be facilitated if the transformed funds were not tied to specific uses. However, transformation cannot be regarded as an end in itself; it is merely an expedient to counteract the public's undue liquidity preference. It is therefore important that the institutions which transform short-term funds should at the same time encourage the public to make more use of the longer-term forms of investment.

Conclusions

38. To conclude this analysis of the main features and structural problems of the capital markets in the various countries of the Community, it is important to consider the real nature of the defects which, as is generally agreed, hamper the operation of most of these markets.

a) The examination of demand brought out the rapid growth of the financial deficits which enterprises, because of the narrowing of profit margins caused by wage increases, keener competition and — in some cases — frozen prices, have to cover by borrowing. To these requirements of private enterprise must be added the also steadily mounting demand of public authorities. This growing demand for capital is in the last analysis due to the fact that the Member States must rapidly move up to the level of the best-equipped economies with which they are nowadays in direct competition, without being able to put off indefinitely expenditure on social requirements and on economic infrastructure.

b) As for the supply of capital, the inadequacies that have been noted certainly cannot be attributed to any general lack of savings, the growth of which is satisfactory. The fault lies rather in the extent to which and the way in which these savings feed the supply of capital on the market; it is these factors which have caused the structural disequilibria that exist between demand and supply on the capital markets of several Member States.

39. It has already been shown that the supply problems are essentially connected with the excessive bias towards liquidity and the reluctance to engage in risk investment and contractual saving.

It is not certain, however, that these features of saving really reflect the preferences of transactors so much as the nature of present financial structures. It is contrary to the very logic of a market to speak, without amplification, of a "shortage of long-term capital". For this would imply a very marked inelasticity of saving in relation to the terms offered and would suggest that any attempt to restore the

balance by improving the return on long-term saving would have to increase the cost of capital so much that investment would almost certainly be discouraged.

In point of fact, it is not possible to relate elasticity simply to yield; there are a whole series of other factors of importance to the saver (liquidity, ease of investment) which are difficult to quantify and so to express simply as "elasticity".

It would seem, then, that optimum use of available capital depends on four main factors: the mobility of capital from one financial channel to another, greater neutrality as regards fiscal treatment of the various types of investment, improved scope for the collection and employment of funds by the financial institutions which collect and redistribute savings, and, lastly, the development of market techniques which will enable savers to realize their investments more easily.

40. The organization and operation of these markets today is the outcome of a great many factors which emerged from two periods of fundamental imbalance. The first was in the nineteen thirties and led to restriction of competition in the field of credit and to rigid compartmentalization of the various national markets. The second was the reconstruction period after the war, when the dearth of savings in relation to the swollen requirements led the authorities to introduce measures for compulsory direction of available resources.

For the most part, the measures adopted were unavoidable at the time. The problem arises because they still survive though the need for them has largely disappeared.

The present arrangements are therefore being subjected to increasing criticism. The measures taken in the past succeeded in adjusting demand and supply within each market, and the authorities hesitate to abandon machinery which, though it may not be entirely satisfactory, did enable the rapid growth of the European economies to be adequately financed. None the less, a review of these arrangements has in recent years appeared necessary if the markets are to cope with the requirements arising within each of the Member States and to allow for the new circumstances and new prospects opened up by the establishment of the European Economic Community.

CHAPTER 3

EXISTING LINKS BETWEEN CAPITAL MARKETS

1. The existing relations between, on the one hand, the capital markets of the Member States and, on the other, between these markets and those in non-Community countries, will be examined from two main viewpoints.

First an attempt will be made to calculate the scale of those medium- and long-term private capital movements now already well-established between the various countries and to define their principal characteristics.

Secondly, an account will be given of the decisions taken, or about to be taken, by the Governments to facilitate capital movements, in implementation of the principles set out in the Treaty of Rome, and to describe the nature of the remaining obstacles which must be overcome in order to further the progress of financial relations in the European framework.

I. Analysis of movements of private medium- and long-term capital

A. INFORMATION FROM OFFICIAL SOURCES

2. This information is obtained from balance-of-payments statistics and from data provided by the Member States under Article 72 of the Rome Treaty.

A) GENERAL

The official data given in Table 13 provide an overall view of private capital movements from 1960 to 1965 between each member country and other countries; the figures for operations with other Community countries only are also given. The data obtained seem to be satisfactory for three countries; Federal Germany, France and the Netherlands. For Italy the official figures for 1962 and 1963 are greatly distorted by spurious capital movements.⁽¹⁾ The Belgo-Luxembourg Economic Union communicates only the balance of capital operations with foreign countries without details of the movements themselves, except for transactions in securities.

⁽¹⁾ From 1962 to 1964 Italian residents made large transfers in banknotes to Switzerland. These transfers have been estimated to be \$762 million in 1962, \$1 456 million in 1963 and \$557 million in 1964. The bulk of the funds transferred (75% in 1962 and 65% in 1963 according to the Bank of Italy's annual report) was repatriated, by the owners under the cover of Swiss names, to finance portfolio and direct investment in Italy. This procedure greatly increased, in a purely artificial manner, the volume of long-term capital imports recorded in Italian official statistics.

Allowing for these imperfections, the table calls for the following comments:

i) *Overall capital movements with foreign countries*

The official figures for private long-term capital movements reveal that from 1960 to 1965 the EEC countries as a whole were net importers of capital to the tune of \$8 100 million. In fact, if the spurious Italian imports are allowed for, the net figure would almost certainly be no more than some \$6 500 million. But even reduced to this level the figure still looks very high. It must be remembered, however, that it applies only to movements of long-term private capital and that the overall balance of the Community's capital operations also includes movements of public and short-term private capital. If all these movements are taken into account, there remains a net capital import of some \$50 million.

ii) *Capital movements within the Community*

The volume of capital movements between the Community countries is relatively modest. In contrast with commercial trade flows, intra-Community capital movements form only a small proportion of the total capital movements to which each member country is a party. The only exception to the rule is the Netherlands. Dutch residents have exported more capital to Community countries than to non-member countries.

Two countries had a net inflow of private long-term capital: Germany, some \$736 million, and France, a little over \$439 million. Over a third of the total, about \$432 million, came from the Netherlands; in the absence of precise data it may be estimated that the rest was supplied by the Belgo-Luxembourg Economic Union and to a lesser extent by Italy.

3. It is difficult, in conclusion, to discern in capital movements between the Member States and non-member countries trends which may be associated with the process of economic integration in the Community, in particular the development of commercial trade. Nor can the influence be distinguished of certain fundamental economic factors, such as the different degree of economic development in the six Member States; cyclical factors are reflected more clearly, it is true, but still not very clearly.

It would, however, be a mistake to infer that capital movements are the result of purely accidental factors in the economic life of the Member States and that consequently they should be kept in check as far as possible or submitted to controls intended to force them into a given direction. It appears, on the contrary, that this characteristic of capital movements must be attributed first and foremost to the lack of harmony between the policies applied by the Member States in this sphere — total freedom in some and a restrictive attitude in others — and to the effects of certain measures, mainly fiscal or monetary, which on occasion have unleashed heavy movements of capital which were neither foreseen nor perhaps desirable.

It is therefore certain that the trend of capital movements — in the past apparently erratic — would undergo a radical change if the liberalization and harmonization measures recommended in this report were put into effect.

B) ANALYSIS OF THE VARIOUS CATEGORIES OF CAPITAL MOVEMENT

4. Table 14 breaks down by sectors capital transactions made by residents and non-residents. They fall under four headings:

- i) Direct investment;
- ii) Portfolio investments;
- iii) Credits and loans for over one year;
- iv) Sundry (for example, investments in real estate).

The following observations can be made:

- i) For all countries direct and portfolio investments account for the bulk of capital transactions. Portfolio investments are particularly important in the Netherlands and in Germany. In France and Italy direct investments predominate (for the latter country an estimate is made which eliminates the spurious movements already referred to).
- ii) The trend of direct foreign investments, inward or outward, is steadier than that of portfolio investments; in all the countries they have increased regularly, in contrast with the considerable fluctuations in long-term capital transactions as a whole.

Analysis country by country calls for the following comments:

In the Netherlands capital has been imported chiefly in the form of portfolio investments while the operations of Dutch residents have often taken the form of direct investments. This difference reflects both the importance of the Netherlands as an international financial centre and the considerable role played there by certain big international companies.

Non-resident portfolio investment in Germany was very substantial from 1960 to 1963. The movement slackened considerably from April 1964 following the establishment of a 25% withholding tax on the income from German bonds paid to non-residents (*Kuponsteuer*).

In France operations in securities by residents resulted in relatively heavy net disinvestment due to the weakness of new investments and the sale of considerable holdings of securities previously built up abroad.

The incomplete data available for the Belgo-Luxembourg Economic Union concern solely the net purchases of foreign securities by residents and of domestic securities by non-residents. Throughout the period there was a heavy deficit on these transactions.

As mentioned above, official data for Italy do not show the real movements of long-term capital. It must be noted then that while Italy, according to the figures given in Table 2, has been the recipient of a growing volume of direct investment, Italian residents, contrary to the trends indicated by the table, have made relatively substantial portfolio investments abroad.

c) ISSUES OF BONDED LOANS

5. The placing of bonds on foreign markets, which is the traditional instrument for integrating capital markets, has made particular progress in recent years. It has therefore been considered useful to make a special analysis of capital movements under this form. The information available in this field is more complete and more satisfactory than that on other capital transactions.

Two statistical tables have been prepared: Table 15 gives a breakdown year by year of public loan flotations made for foreign account from 1961 to 1965 on the European and American markets; Table 16 breaks down these issues into two main groups: according to the nationality of the borrowers and according to the markets on which the loans are raised.

In order to define the different categories of issue more clearly a distinction has been made in the two tables between "foreign loans in local currency" and "Euro-bond issues". The latter term needs some explanation. By Euro-bond issues are meant issues to be placed mainly on markets other than that of the reference currency (see note at the foot of Table 15 and fuller details in Ch. 9, III). The scale of such issues has increased considerably in recent years and the issue syndicates have made efforts to extend their international clientel constantly. That is why it is extremely difficult to break down issues geographically according to the place of residence of the actual subscribers; it has been found preferable to use the term "Euro-bond issues", which covers loans with very similar conditions governing remuneration. These loans are the beginning of an international market.

Tables 15 and 16 call for the following comments for the EEC countries:

i) *The volume of issues*

The volume of foreign issues has increased sharply since 1963 as a result of the development of Euro-bond issues while "traditional" issues denominated in local currency have not advanced.

Loans issued by Community residents on the markets of non-member countries or on Euro-bond markets have in recent years reached a volume several times greater than that of loans issued by non-member countries or by international organizations (excluding the European Investment Bank and the ECSC, which are counted as borrowers resident in the Community) on the markets of the Member States. The balance in favour of the Community is over \$570 million. This figure, however, must be interpreted with caution in view of the contribution of Community residents to the Euro-bond market, and does not therefore represent net real imports of external capital through foreign issues.

Issues by Community residents — including the EIB and ECSC — on the markets of other member countries have been relatively small. From 1961 to 1965 they totalled \$320 million, or some 6.7% of all foreign loan issues in the period, which totalled nearly \$4 800 million.

ii) *The beneficiaries*

The EIB and ECSC are the leading issuers among Community residents. Loans placed by them represented 35% of all issues by Community residents; Italy, whose share amounted to 18%, was the next largest beneficiary of such loans.

iii) The main subscribing countries

If an exception is made for Germany, for which country issues since April 1964 have been included in the total of Euro-bond issues, the Netherlands is the country in which by far the largest volume of foreign issues was placed. It is, moreover, the only country for which loans floated by non-residents exceed those issued by residents in foreign markets.

B. THE INADEQUACY OF OFFICIAL DATA FOR ANALYSIS OF CAPITAL FLOWS

6. The interpretation of official data on international movements of capital sets difficult problems. Statistics account for direct transactions, but provide no information on the part played by redistribution or what may be called the "turntable" role of international financial bodies and certain financial centres. We therefore have a very imperfect knowledge of the geographical distribution of capital movements.

It is also clear that numerous transactions are by-passed by official records, thus making the volume and range of financial relations effectively established seem smaller than they are.

A) THE REDISTRIBUTION ROLE OF INTERNATIONAL FINANCIAL BODIES AND OF THE CAPITAL MARKETS IN NON-MEMBER COUNTRIES

7. From 1954 to 1964 the EIB and the ECSC together granted long-term credit to a total of \$1 000 million and raised nearly \$650 million in loan capital, in addition to the \$250 million making up the EIB's paid-up capital.

Of the loan funds taken up, \$300 million was raised in the markets of non-Community countries, while almost all the credit granted went to beneficiaries residing in the Member States. In this way the two bodies channelled considerable external resources into the Community. In the Community itself they played a very important role in redistributing capital placed at their disposal either by the governments in the shape of capital payments or by subscribers to bonded loans.

The other international financial bodies — the World Bank, the Inter-American Development Bank, the Council of Europe Resettlement Fund, Eurofima — played a similar part as redistributors, but the bulk of the funds lent by them went to non-member countries.

Certain financial centres play a traditional role in the redistribution of capital. This is the case of Switzerland, which figures largely in capital transactions between Community residents and in movements between the residents of Member States and those of non-member countries.

The need to adjust the statistics relating to Italy in view of the movements of notes through the Swiss banks has already been mentioned. It must be added in

this connection that the fraction of Italian funds transferred to Switzerland which amounted to a true export of capital was not used on Swiss territory; actually, much of this money made its way to the markets of non-member countries and to countries in the Community, especially, it seems, Germany and the Netherlands.

The Euro-issues market sets similar problems in connection with the determination of the origin and true geographical destination of the capital passing through it. Table 16 shows that up to the end of 1965 issues totalling about \$1 800 million had been placed on this market. Out of this sum borrowers resident in the EEC obtained nearly \$400 million, of which no less than 40% went to the EIB and ECSC. To this amount must be added at least part of the issues placed by holding companies in order to finance the European subsidiaries of American companies; while such borrowers are not as a rule EEC residents, it is certain that a considerable part of the capital raised in this manner has financed investment in the EEC.

It is impossible to estimate the effective contribution to this market in the shape of subscriptions by EEC residents. It can only be said that the Euro-issues market has played an important role as a centre for the distribution of capital in the Community; but there is no way of determining whether these operations have resulted in a net export or a net import of capital by the EEC countries.

Finally, reference must be made to a further "turntable", which is even more important from the angle of volume, the Euro-currency market. Operations in this market are generally short term and do not fall within the scope of this study. Transfers of funds for more than a year, however, are not unusual and it must be borne in mind that short-term facilities have been systematically renewed by borrowers and must be considered as long-term financing. Estimates have been made by the Bank for International Settlements of contributions and recourse to this market by lenders and borrowers resident in the EEC. The position of the several Member States with regard to this market, however, has varied considerably, particularly where Italy is concerned, a country which has successively appeared on the Euro-currency market as creditor, debtor and again as creditor. This is another important element in the financial relations between the member countries of the Community which does not always appear clearly in official data.

B) DEFECTS OF OFFICIAL DATA

8. Most of the Member States have made notable progress in developing their statistical machinery over the last few years. The situation now appears satisfactory in Germany, France, Italy and the Netherlands. As has been noted, this is not the case for the BLEU. At any rate much remains to be done here in the field of harmonization, especially as regards the distinction between the various types of capital movement and their geographical breakdown.

Another point is that there are many gaps in official statistics which are apparently difficult to eliminate. The most serious are not omissions of a technical nature (minimum amounts, errors of classification) but intentional omissions in the reporting of transactions. The motive is sometimes the desire to avoid red tape, but much more often tax and exchange-control evasion.

II. Measures taken or planned under the Treaty of Rome to facilitate capital movements

9. A brief account will be given here of the reciprocal undertakings agreed to by Member States, or being planned, in order to make capital movements freer. It will hinge on the problems of relaxing exchange control regulations — problems upon the solution of which depends the development of relations between the capital markets of the Member States. Fiscal obstacles will be dealt with in Chapter 14.

A) PRESENT SITUATION

10. At present direct investments, operations in listed securities, investment in real estate, personal transactions and short- and medium-term credits linked with commercial transactions or the rendering of services are all completely free of restrictions. For other categories of transactions, such as the issue of securities on the markets of the other Member States, medium- and long-term "financial" loans (i.e. not connected with commercial transactions), transactions in unlisted securities and movements of short-term "financial" capital, restrictions survive in certain Member States. A brief list of the restrictions in question is given in an annex to this chapter. It must be pointed out, however, that the situation is changing all the time and that now liberalization measures are being planned. They will be examined in section 11.

The measures already adopted to implement the provisions of the Rome Treaty concerning the elimination of exchange restrictions are contained in two directives for the application of Article 67 which were adopted by the Council on proposals from the Commission on 11 May 1960 and 18 December 1962 respectively⁽¹⁾.

From the technical point of view these directives constitute minimum commitments which the Member States have honoured by changing their domestic legislation. Certain Member States have gone far beyond this. Most of them, furthermore, have extended to non-member countries the liberalization measures adopted to meet Community commitments.

The resulting system of liberalization differs appreciably from that set out in the "Code of Liberalization" for capital movements adopted by the OECD Council on 28 July 1964. The Community commitments are distinctly stricter from the legal angle. A Member State is not free to withdraw the measures of unconditional liberalization established by the Council except in accordance with the safeguard clauses contained in Articles 73 and 109 of the Treaty. These clauses can be invoked only on specific conditions and following Community procedures. In the OECD system, on the other hand, a member state may unilaterally withdraw liberalization measures already adopted "if they result in serious economic or financial disturbance" and may temporarily suspend their application "if the balance of payments position ... develops adversely at a rate and in circumstances which it considers serious ..."'

⁽¹⁾ See official gazette of the European Communities, 12 July 1960 and 22 January 1963.

The different forms of capital operations are broken down in the directives referred to into four categories, each subject to different rules:

- i) "Unconditional" liberalization, which can be revoked only on the strict conditions set out in Articles 73 and 109 of the Treaty, applies to capital movements listed in the first and second categories. These two categories basically consist of direct investment, operations in listed securities, personal capital movements, investment in real estate and short- and medium-term credits linked with commercial transactions or with the rendering of services.
- ii) A "conditional" system of liberalization is in force for the capital movements of the third category: the issue of foreign securities on the capital markets and financial loans and credits. The Member States may apply restrictions to such operations or maintain restrictions existing on the date of entry into force of the directive "if these movements are such as to impede the achievement of the objectives of their economic policy". Three Member States — France, Italy and the Netherlands — have taken advantage of this clause and continue to maintain partial or total restrictions on such capital movements; general licences are, however, granted for transactions for sums and periods not exceeding certain limits fixed in advance (see Annex). For the other Member States, which had already fully liberalized these operations by 11 May 1960, liberalization has become irrevocable unless the safeguard clauses previously referred to are invoked.
- iii) For capital movements of the fourth category, which includes short-term financial operations, including the constitution of deposits abroad, no particular obligation regarding liberalization has been laid down and therefore the matter is still open; such operations are in fact fully or almost fully liberalized in three of the Member States.

B) FURTHER PROGRESS

11. As three of the Member States still apply exchange-control restrictions, a third directive under Article 67 has been considered necessary and is at present under discussion. The object is to establish a better balance among the commitments of the various Member States and to eliminate at the same time a number of obstacles which do not arise from exchange control but are of equally fundamental importance.

More specifically, the proposed directive provides for a relaxation of exchange control in France, Italy and the Netherlands, first with regard to the admission of foreign issues on the national markets up to a specific ceiling, and secondly concerning the granting to residents of medium- and long-term financial loans and credits.

The directive is also designed to eliminate laws and regulations discriminating against the access of issuers of other member countries to the several capital markets or against the admission of foreign securities to official quotation on the stock exchanges. It provides, in addition, for the elimination of discrimination with regard to the purchase of foreign securities by financial institutions, a necessary corollary of EEC integration. Liberalization of the rules governing investment by

financial institutions is indispensable if the measures liberalizing foreign issues already in force or proposed in the third directive are to be effective. By allowing financial institutions to buy foreign securities denominated in the domestic currency or free of exchange risks by virtue of special clauses, the directive will help towards building up a sufficiently large market for these issues.

12. The Group would like the regulations impeding the free movement of capital to be removed progressively. Such restrictions as survive seem all the less justified where they appear to be maintained for reasons other than those for which they were originally adopted. Exchange-control restrictions have, as a rule, ceased to be used to safeguard the balance of payments and seem nowadays intended mainly to ensure the autonomy of domestic monetary policies. Besides the traditional exchange control instruments, i.e. the ban on the purchase by non-residents of certain kinds of money market paper and on the contracting by residents of loans abroad, and rules governing time-limits for payments to abroad and the repatriation of foreign currency acquired, measures have been introduced which specifically belong to the domain of monetary policy: they fix limits to the banks' foreign currency holdings, provide for minimum reserve requirements or rediscount ceilings at the central bank depending on the banks' net foreign liabilities, and establish terms — which vary in generosity — governing the swap operations of the banks.

The consequences of this tendency were explained in the 36th Annual Report of the Bank for International Settlements:

"Currency convertibility requires that domestic demand, cost and credit conditions be consistent with balance-of-payments needs. For monetary policy, which is relatively more effective in influencing the particular channels through which funds move than the actual level of expenditure, this normally implies an orientation primarily towards curbing excessive inflows or outflows of capital. By the same token, convertibility induces countries to make greater use of fiscal and incomes policy in trying simultaneously to achieve both domestic and external objectives. In these ways it tends to direct the various policy instruments towards their most efficient uses, thereby contributing to sustainable expansion."

"In practice, however, most countries have been reluctant or unable to accept the discipline inherent in convertibility. Instead, in order to make more use of monetary policy for domestic purposes, they have sought in various ways to weaken the links between domestic credit conditions and external flows of capital. The result has been a gradual drift away from convertibility, confined up to now largely to selective controls over capital transactions".

Conclusions

13. The present state of knowledge of the extent of integration between the capital markets of Member States is very imperfect. Data are incomplete and definitely underestimate the scale of intra-Community capital movements; the geographical breakdown the figures indicate is radically distorted by a group of factors which tend to overweight financial relations with the markets of non-member countries as compared with those between Community markets.

It is true that measures adopted within the Community to give greater freedom to financial flows have already been appreciable. However, the development of the European capital market requires further progress both in respect of exchange controls and of domestic controls of the machinery of the markets in the several Member States. Such progress can only be achieved if certain adjustments are made to economic policy instruments now in use. The second part of this report is devoted to these adjustments and in it an effort is made to establish the conditions under which economic policy instruments can be made effective in the framework of a capital market extended to European scale.

ANNEX TO CHAPTER 3

Survey of exchange-control systems applicable to the main categories of capital movement between the Member States

GERMANY

Direct investment: unrestricted

Operations in listed securities: unrestricted

Operations in unlisted securities: unrestricted

Issue and placing of securities of a foreign company on the domestic capital market: unrestricted

Issue and placing of securities of a domestic company on a foreign capital market: unrestricted

Investment in real estate: unrestricted

Short- and medium-term credits linked with commercial transactions or with the rendering of services in which a resident participates: unrestricted

Medium- and long-term loans and credits not linked with commercial transactions or the rendering of services: unrestricted

Short-term loans and credits not linked with commercial transactions or the rendering of services: unrestricted

Opening of and transfers to current accounts, deposit accounts and other short-term investments on the money market:

i) By residents on a foreign market: unrestricted

ii) By non-residents on the domestic market: the opening of and transfers to current and deposit accounts are free of restriction; however, German credit institutions are forbidden to pay interest on time deposits held on behalf of non-residents (whether they belong to the banking sector or not), with the exception of saving accounts held by individuals. As for other short-term investments, non-residents may not buy German treasury bonds or similar paper (this rule is designed to prevent the circumvention of the ban on the payment of interest on short-term deposits). Nor may residents buy fixed-interest-bearing domestic stock with a clause providing for redemption at a specified price.

BELGIUM — LUXEMBOURG

Direct investment: unrestricted ⁽¹⁾

Operations in listed securities: unrestricted (For residents settlements for such operations must be made through the free market. For non-residents the settlement may be effected at choice via the official or the free market. In order to transfer abroad the proceeds of a sale of securities it is necessary to go through the free market even if the funds for the purchase had originally been imported into

the country through the official market. The redemption proceeds of B.L.E.U. listed bonds denominated in Belgian or Luxembourg francs may be transferred through the official market. The only formality is a verification procedure).

Operations in unlisted securities: unrestricted (For residents these operations must be effected through the free market. For non-residents they can be effected at choice through the official market or the free market. In order to transfer the sale proceeds abroad the free market must be used even if the funds for the purchase had originally been imported into the country through the official market).

Issue and placing of securities of a foreign company on the domestic capital market: (From the point of view of exchange control, issues on foreign account are unrestricted. However, any public issue of foreign securities or their sale to the public by foreigners is subject to authorization from the Ministry of Finance.)

Issue and placing of securities of a foreign company on a foreign capital market: unrestricted

Investment in real estate: unrestricted ⁽¹⁾

Short- and medium-term credits linked with commercial transactions or with the rendering of services in which a resident participates: unrestricted. ⁽¹⁾ Transfers by non-residents to resident suppliers under the heading of advance payments or the rendering of services must be effected via the official market.

Medium- and long-term loans and credits not linked with commercial transactions or the rendering of services: unrestricted (The corresponding transfers are effected via the free market; for non-residents, transfers may be made via the official market or the free market.)

Short-term loans and credits not linked with commercial transactions or the rendering of services: unrestricted (The corresponding transfers are effected via the free market; for non-residents, the transfers may be made via the official market or the free market.)

Opening and supply of current accounts, deposit accounts and other short-term investments on the money market:

- i) By residents on a foreign market: unrestricted (The settlement must be made through the free market);
- ii) By non-residents on the domestic market: the opening of current accounts and deposit accounts is unrestricted. Where other short-term investments are concerned, non-residents may not buy Treasury bonds.

⁽¹⁾ Since 1 October 1963, B.L.E.U. residents have been free to effect transfers linked to these operations at their option either via the official market (i.e. at rates established within the limits laid down in the framework of the EMA), or via the free market (i.e. where rates may fluctuate outside these limits). Transfers made via the official market require individual authorization by the Belgo-Luxembourg Exchange Institute; applicants must give reasons for their request and authorizations to transfer via the official market are subject to certain conditions concerning, in particular, the repatriation of income and capital through the official market. For non-residents, transfers linked to these operations may be made via the official market of free market as the investor chooses.

FRANCE

Direct investment: unrestricted

Operations in listed securities: unrestricted apart from operations in the certificates of open-end investment funds.

Operations in unlisted securities:

- i) Purchase abroad by residents: unrestricted apart from the certificates of open-end investment funds;
- ii) Purchase in France by non-residents: unrestricted apart from foreign securities held on French territory.

Issue and placing of securities of a foreign company on the domestic capital market: special authorization

Issue and placing of securities of a domestic company on a foreign capital market: special authorization

Investment in real estate: unrestricted

Short- and medium-term credits linked with commercial transactions or with the rendering of services in which a resident participates: unrestricted

Medium- and long-term loans and credits not linked with commercial transactions or the rendering of services:

Import: special authorization, except for operations where the amount does not exceed FF 1 000 000, the rate of interest is not higher than 4% per annum, and the life of the loan does not exceed 2 years. The total amount of loans obtained by a resident under the general authorization may not at any moment exceed FF 1 000 000.

Export: special authorization, except for banks, which on their own responsibility may use foreign currency balances held for their account with correspondents abroad for their own investment operations abroad and for all investment operations effected abroad on behalf of non-residents.

Short-term loans and credits not linked with commercial transactions or the rendering of services:

Import: special authorization, except for operations where the amount does not exceed FF 1 000 000 and the interest rate does not exceed 4% per annum. The total amount of loans obtained by a resident under the general authorization may not at any moment exceed FF 1 000 000.

Export: special authorization, except for banks, which on their own responsibility may use foreign currency balances held for their account with correspondents abroad for their own investment operations abroad and for all investment operations abroad effected on behalf of non-residents.

Banks may also, without limit as to amount and whatever the purpose of the operation, grant loans in francs to non-residents in the form of overdrafts on external franc accounts on the sole condition that their commitments do not exceed 6 months (but at the end of the 6-month period there is nothing to prevent a further credit being granted for a further 6 months).

Opening of and transfers to current accounts, deposit accounts and other short-term investments on the money market:

- i) By residents on a foreign market: special authorization, except for banks, which may hold direct balances abroad and use their own foreign currency available with their correspondents abroad;
- ii) By non-residents on the domestic market: the opening of and transfers to current and deposit accounts are unrestricted; French banks, however, are prohibited from paying interest on time deposits held on behalf of non-residents other than central banks and international organizations. Short-term investments are subject to special authorization.

ITALY

Direct investment: unrestricted

Operations in listed securities: unrestricted

Operations in unlisted securities: special authorization

Issue and placing of securities of a foreign company on the domestic capital market: special authorization

Issue and placing of securities of a domestic company on a foreign capital market: special authorization

Investment in real estate: unrestricted

Short- and medium-term credits linked with commercial transactions or with the rendering of services in which a resident participates: unrestricted

Medium- and long-term loans and credits not linked with commercial transactions or with the rendering of services:

Import: special authorization, except for operations where the amount does not exceed Lit. 50 million, the life of the loan does not exceed 5 years and the interest rate does not exceed 6% per annum.

Export: special authorization, except for operations where the amount does not exceed Lit. 50 million and the life of the loan does not exceed 5 years. (Financial institutions may not engage in such operations.)

Short-term loans and credits not linked with commercial transactions or with the rendering of services:

Import: special authorization, except for operations where the amount does not exceed Lit. 50 million and the rate of interest does not exceed 6% per annum;

Export: special authorization, except for operations where the amount does not exceed Lit. 50 million.

Opening of and transfers to current accounts, deposit accounts and other short-term investments on the money market:

- i) By residents on a foreign market: special authorization except for banks;
- ii) By non-residents on the domestic market: unrestricted

NETHERLANDS

Direct investment: unrestricted

Operations in listed securities: unrestricted (Non-residents may buy securities by selling foreign currency on both the official market and on the K-account free market; guilders obtained from the sale of these securities must be credited to K-accounts and may be transferred only via the free market. Residents may buy foreign securities only with currency held in reinvestment accounts or guilders which must be credited to the K-account of a non-resident; on the other hand, foreign currency obtained from the sale of securities is convertible on the official market. There is the possibility of switching between the two categories of account and hence, in practice, there is a single standard rate. Liberalization does not cover bonds listed abroad, denominated in guilders or linked in any other way to the parity of the guilder, which are not listed in the Netherlands.)

Operations in unlisted securities: special authorization

Issue and placing of securities of a foreign company on the domestic capital market: special authorization

Issue and placing of securities of a domestic company on a foreign capital market: special authorization.

Investment in real estate: unrestricted

Short- and medium-term credits linked with commercial transactions or with the rendering of services in which a resident participates: unrestricted

Medium- and long-term loans and credits not linked with commercial transactions or the rendering of services:

Import: special authorization except for an annual total not exceeding Fl 10 000.

Export: special authorization except for an annual total not exceeding Fl 10 000.

For banks: special authorization and on condition that the life of the loan or credit does not exceed 5 years.

Short-term loans and credits not linked with commercial transactions or with the rendering of services:

Import: special authorization except for an annual total not exceeding Fl 10 000.

For banks: unrestricted.

Export: special authorization except for an annual total not exceeding Fl 10 000.

For banks: unrestricted.

Opening of and transfers to current accounts, deposit accounts and other short-term investments on the money market:

i) By residents on a foreign market: special authorization except for banks;

ii) By non-residents on the domestic market: unrestricted.

PART TWO

CONDITIONS FOR EFFICIENT USE OF ECONOMIC POLICY INSTRUMENTS IN AN INTEGRATED MARKET

The problem of developing a European capital market has to be seen first and foremost as a matter of economic policy rather than of adaptation of financing channels. Financial measures loom so large in the pursuit of the planned objectives of government in all Member States that there would be little value in discussing the technical aspects of the problem without prior examination of its economic policy aspects.

But this logical sequence of priorities should not be interpreted as implying that policy harmonization must take precedence also in time over the broadening of financial channels. Experience in other fields of Community life has shown that policy harmonization comes about only under the pressure of new problems, such as are bound to arise in connection with the establishment of a large capital market on the European scale. The broadening of the financial channels and harmonization of economic policies must therefore proceed in step.

The development of international capital movements requires adaptation of the economic policy instruments now in use, some of them to be given up altogether and the use of others to be intensified — in short, a new pattern in the choice of techniques and methods of application. By contrast, it has been found that the development of a European capital market would in no way affect the policy objectives served by the control of overall demand, the regulation of the capital market, savings incentives and investment guidance, and the financing of government and public undertakings.

CHAPTER 4

POLICIES FOR CONTROL OF OVERALL MONETARY DEMAND AND REGULATION OF THE CAPITAL MARKET

Introduction

1. The development of a European capital market will necessitate a revision of regulations which, by the restrictions and discrimination they entail, hamper or distort capital movements. The channels through which capital flows will also have to be enlarged and improved. Whatever the methods of the process may be, it will give firms greater independence in the choice of finance as a result of the improved scope for recourse to capital markets in the other member countries whenever domestic sources of finance prove either insufficient or comparatively more costly.
2. While recent years have seen some progress, discriminatory provisions and obstacles to capital movements persist on most markets; most often it is argued that these have to be kept for reasons of economic policy. In this Chapter, the Group endeavours to define the precise nature of the problems which full freedom of capital movements might set for these policies, assuming them to be conceived and applied solely on the national level. Having marked out the relevant limitations, the Group suggests improvements and adaptations which it might be possible and desirable to introduce into the measures adopted by monetary and financial authorities so as to safeguard the efficiency of their policies in the context of an integrated market. The Group's comments on this nexus of problems must be considered only in this context.

Credit policy, balance-of-payments policy and capital market policy overlap a great deal. This applies especially to the first two, and for this reason these are grouped together in what follows in a first section dealing with the control of aggregate monetary demand, and a second examining the role of the public authorities on the capital market.

I. Control of aggregate monetary demand

A. THE NEW CONTEXT OF SHORT-TERM ECONOMIC POLICY

3. The process of economic integration among Member States has made fluctuations of the business trend more and more interdependent. But while the gradual removal of obstacles to the free movement of goods, services and labour has greatly reduced the likelihood of divergent trends, there may still be differences of timing as between one country and another. Indeed, these differences are likely to be particularly pronounced so long as insufficient co-ordination of economic

policies leaves Member States free to take, each for itself, such measures as may influence short-term developments, while the growth of intra-Community trade at the same time steadily makes each economy more directly sensitive to the fortunes of the others.

The interdependence of the economies may automatically help to facilitate the correction of such imbalances as may appear. Thus, in 1965 excess domestic demand in the Netherlands and Germany was comfortably met by increased imports from other Member States, and for Italy and France, where business at the time had become sluggish, the expansion of sales to other member countries proved a valuable stimulus to recovery.

However, cases have also been seen where the imbalance is exported. This happened, for instance, in 1963, when the trade balances of France and Italy deteriorated sharply under the impact of domestic inflationary pressures, and the Belgo-Luxembourg Economic Union (BLEU) and Germany, which up to then had remained stable, consequently saw their trade surpluses with other Community countries almost double, with the obvious danger that inflationary pressure would spread by contamination.

Clearly, therefore, the present lack of uniformity in the business trend in the different countries is a potential problem since it may, at a given moment, require relatively contradictory corrective measures in the countries in question. It is hence necessary to examine whether the instruments employed to control overall demand and adjust it to the desired level can still be used in a system under which freedom of capital movements enhances the independence of demand. The problem is most clear-cut when the instruments involved are those of credit policy.

4. The fear that an inflow of foreign capital may weaken the impact of restrictions on credit supply and/or demand has, in fact, long been advanced as an argument in favour of the maintenance of obstacles to freedom of capital movements. It is true that the kind of capital in question here is short-term and therefore not the main concern of the Group; however, even restrictions on movements of medium- and long-term capital are often defended by reference to the necessities of credit control policy.

Capital movements would, no doubt, be a source of less concern to the monetary authorities if the fundamental economic data determining such movements were less disparate in the different Member States. As things are, these economic factors are conditioned, in varying degrees from country to country, by differences in public intervention arrangements, in the institutional framework and in the tax system. Disparities in the levels and structures of interest rates likewise originate in differences in the ways in which overall monetary demand is controlled. To a great extent, these national disparities will lessen or disappear altogether in the integration process; nevertheless, the policies of the public authorities will also need to be adjusted, and suggestions on how this should be done are given in the remaining part of the Group's report. Thus the role of non-economic factors in capital movements could be reduced and the fundamental economic data aligned. One of the arguments used to justify certain restrictions on capital movements would thus lose in importance.

In the meantime it would be wrong to ignore the concern caused to the monetary authorities by the fact that certain capital movements run counter to the objectives of their monetary policy.

5. Even now, in spite of surviving limitations, international financial operations are considerably more developed than they used to be. Whether they relate to portfolio investments, direct credits on the Euro-dollar market, or commercial credits in the form of "leads and lags", capital movements are already such that they can undermine a policy of demand restraint acting solely through credit restriction.

How far financial integration has already progressed is shown clearly by the extent to which arbitrage operations between the national capital markets and the Euro-bond market result in the spreading of interest rate movements from one country to another, and especially by the interdependence of short-term credit conditions on national markets and on the Euro-bond market. Capital movements are directly geared to the growth of international economic relations. To restrict them in order to restore domestic liquidity control to the monetary authorities would not only jeopardize the measures already taken to liberalize financial transactions, but would also entail a reversion to restrictions on current transactions — a move which is hardly feasible.

6. As economic and financial integration between the Member States proceeds, there is much less scope for independent monetary policies in the several countries. In some situations this change is more apparent than in others. It becomes particularly evident when differing economic trends lead Member States to pursue basically divergent policies of credit control. The value of maintaining partial restrictions on the freedom of capital movements is therefore open to doubt.

To do so might seem justified if — through credit restrictions applied on the domestic scale — it enabled Member States more effectively to forestall any major divergences in their economic trends. In this case it could be argued that it is more important for the progress and functioning of the Common Market to keep economic developments better in step throughout the Community than to do away with such restrictions as still apply to certain categories of capital movements.

The Group realizes that in this respect restrictions on capital movements may sometimes have been useful. The lessons of recent years, however, suggest that there has in fact been little scope for strengthening monetary policy in this way. This will apply more and more as the Common Market gradually nears completion.

In step with the growing interdependence of the markets for goods and services, with the free movement of persons and freedom of establishment, the economic trend in any one Member State will make itself felt in the partner countries much faster than in the past. The complete freeing of capital movements is therefore scarcely likely to speed the spreading of disequilibria, nor — conversely — could the maintenance of restrictions enable monetary policy to be sufficiently insulated from outside influences. In view of this trend, some signs of which are already discernible, close co-ordination of the measures of monetary and short-term economic policy would be called for: this would be the only way of preventing,

at an early stage, the spreading of disequilibria to the other Member States. In the past these measures were taken on a national plane, and often at a time when serious difficulties had already arisen. In such circumstances capital movements and credit policy tended to conflict.

7. When all is said and done, free movement of capital would alter only some of the general conditions for balanced policies — conditions which the development of the Common Market has in any case already radically changed. The Group discusses below the specific limitations which freedom of capital movements may impose upon traditional monetary policy, and the measures of adaptation therefore needed in the choice of instruments of short-term economic policy and in the way this policy is applied.

B. THE EFFICIENCY OF CREDIT CONTROLS IN AN INTEGRATED MARKET

8. In the countries of the Community, control of aggregate monetary demand works usually through a combination of measures designed to influence credit demand and credit supply — the former through changes in rates of interest and the latter through tightening of bank liquidity or direct restrictions on the volume of bank credit. With progressive integration of the capital markets and in the absence of a common monetary authority, the conditions under which credit policy is implemented are gradually changing, producing a paradoxical situation in which monetary powers are still exercised by national authorities, and yet the financial resources they are seeking to control can be shifted more and more easily, particularly within the Community area.

9. In a situation of free movement of capital, borrowers would be free to draw on foreign sources of finance, and would especially tend to do so if interest rates abroad were lower than on the domestic money and capital market. Now, a contraction of domestic supply as a result of monetary measures will normally tend to force interest rates up, and will thus become an additional inducement to borrowers to look for cheaper funds abroad.

It is true that up to a certain point the credit supply may sometimes be curtailed without causing interest rates to rise. Banks usually charge their customers a rate more or less closely linked with the discount rate of the central bank; when the central bank restricts the credit capacity of the banking system without at the same time raising discount rate, this can no doubt have the effect of making credit scarce without making it dearer. When official regulations or banking usage establish a fixed link between discount rate and the maximum lending rates charged to customers, the banks are of course free to keep their rates below the permissible upper limit, but in practice they usually charge the maximum rates on most of their small and medium-sized loans. Consequently, if bank liquidity is reduced or a direct ceiling is imposed on bank credit, the borrowers who already pay the top rate will not be charged a higher rate, but there is every likelihood that the volume of credit extended will be cut. In this case too, therefore, borrowers may ultimately be led to look for funds abroad, even though no cost considerations point in that direction, given that domestic interest rates cannot rise.

For the rest it must be noted that any quantitative restriction on credit supply is bound to raise the cost of money after a time. No complete separation is possible, at all events for any length of time, between interest rate policy and policies imposing liquidity controls or credit ceilings. In all cases these latter must normally induce the banks to revise the terms they previously quoted their customers.

Even though the time-lag and the intensity of the effect may differ, therefore, credit restrictions will strengthen the tendency for borrowers to satisfy credit demand by turning to foreign sources of finance — and will do so whether they work through changes in interest rates or through action on bank liquidity or the volume of credit.

10. Admittedly, not every borrower has ready access to foreign markets. Usually only large firms find it easy to raise funds abroad. Therefore, where the first to suffer from the higher costs of domestic credit are small and medium-sized firms, and where restrictions on bank liquidity or the volume of credit mean that loans to these categories of customers will be the first to shrink or expand less fast, it would seem possible, if not to avoid capital imports, at least to contain them within fairly narrow limits. In most cases the banks will, in fact, be led to give priority to the requirements of their major customers, for fear that they may turn to foreign competitors instead.

But this situation is itself tending to change. In the first place, as integration proceeds firms are being induced to develop their business contacts in other member countries, so that they can not only elude domestic credit restrictions by drawing more heavily on trade credits, but also make arrangements for direct borrowing from foreign credit institutions. Certain other practices not unknown in the past are also gaining popularity. Certain firms, for instance, which do not have easy access to foreign sources of finance, can yet draw on the latter through the bank with which they usually deal; if this bank should, for liquidity reasons, be unable to accommodate its customers, it can arrange for credit from a foreign bank against a guarantee which does not affect its liquidity. When the central bank tightens bank liquidity, the banks can use this means of raising resources for lending and thus avoid losing some of their customers to competitors. Although these practices seem at first sight no more than temporary expedients, they may give rise to durable financial relations between the beneficiaries of these credits — even if they are only medium-sized firms — and certain foreign banks.

11. As regards large firms, with their numerous business and financial contacts abroad, the slightest deterioration in domestic credit terms is often enough to divert them to foreign markets. Although in general relatively few firms actually do raise funds abroad directly in times of a domestic credit squeeze, the quantitative impact of their behaviour on business and bank liquidity may be quite considerable. By eluding quantitative credit restrictions, large firms have an appreciable influence on the effectiveness of the central bank's policy in matters of interest rates and bank liquidity.

12. There is yet another way in which freedom of capital movement may alter the conditions governing the control of liquidity. In most countries central bank policy does in fact play a part in determining the conditions on the market for

long-term capital; as a general rule, its influence is specially marked where commercial banks engage not only in ordinary credit business but also invest in securities or lend at long term. Other things being equal, the banks respond to tighter liquidity by cutting down on the latter operations, and this will have the consequence of raising interest rates on the capital market. Transactions in securities, especially, may then stimulate capital imports which will tend to expand the liquid resources of banks and to hold back the rise in interest rates.

13. Finally, it is only to be expected that, in times of monetary stringency, the banks will take steps on their own account to procure liquid resources abroad. To this end, they may repatriate assets hitherto employed on foreign money markets or borrow directly from foreign credit institutions.

There will be all the more encouragement for transactions of this kind as money market rates themselves will tend to rise as a result of tighter liquidity.

14. To sum up, with the growing integration of capital markets the efficiency of credit control measures is coming to depend more and more on credit conditions abroad.

This does not mean, however, that national monetary policies have lost all efficacy. As long as domestic monetary policy does not run counter to the tendencies on foreign markets, it remains effective. Even if this is not the case owing to a counteracting inflow of foreign capital, it may still have a temporary and limited impact on foreign trade.

In several countries current business conditions give the central banks relatively broad scope for intervention, arising, on the one hand, from the existence of current payments deficits and, on the other, because — as a result of deliberate policy or simply of an international contamination effect — there is a tendency for credit conditions to line up with those obtaining on the principal money and capital markets abroad.

The fact remains that in recent years such situations have been rather exceptional in the Member States and that conditions in which central bank policies can have only limited effect may, and probably will, return. In the long run, of course, progressive integration and the gradual formulation of Community economic policy objectives will make periods in which business trends in the six countries are markedly divergent more and more infrequent. It can therefore be expected that the sources of conflict between the monetary policies of the individual Member States will decline in gravity; in addition, in the spacious and integrated economic unit the Community will eventually present, a co-ordinated monetary policy is likely to be much more effective than it would be in present conditions.

The main problems will, therefore, arise during the transition period when disparate developments are inevitable. The discussion below concerns ways and means of solving these problems.

C. SHORT-TERM ECONOMIC POLICY: THE RIGHT "POLICY MIX"

15. In the opinion of the Group, three conditions must be met if the control of overall monetary demand is to have the desired degree of efficiency in the setting of an integrated European capital market. The first condition concerns the prompt timing of action. The second and third conditions, on the other hand, concern the "economic policy mix" and involve, first, a more diversified and more systematic use of the budget, and secondly, a choice among the different instruments of monetary policy with the emphasis on those which are free from the shortcomings described above.

16. The ability to take corrective action more promptly is of vital importance in all cases. Given the susceptibility of each economy to influence originating in other member countries, measures should be taken to correct an imbalance immediately it is seen to be more than incidental and ephemeral. Such measures ought to be more and more closely co-ordinated at Community level. Once an inflationary process has gone beyond a certain point, selective measures which might have been effective initially are powerless to hold back its further course. In such cases, the longer corrective action has been delayed, the more vigorous it has to be, and it is precisely at this juncture that untimely capital movements might develop and frustrate the purposes of short-term economic policy. Prompt action is equally necessary for the reason that, in an open economy, price rises may spread very quickly throughout all member countries. Apart from its domestic ill effects, therefore, an inflationary process not brought under control fairly quickly would constitute an immediate threat to the stability of other member countries and might thereby jeopardize not only the achievement of the Community's objectives but even the cohesion of the six countries.

17. More intensive use of the budget as an instrument of short-term policy appears both necessary and desirable in a situation in which, at one and the same time, there is more need of prompt and vigorous action to correct imbalances, the application of credit policy encounters new limitations and the use of certain instruments heavily relied upon in the past — such as import quotas, export aids, exchange control — is in its turn frustrated because it is in direct contradiction with the letter and the spirit of the Treaty of Rome. By refining and developing the use of the instruments of budget policy, each Member State could to advantage offset these limitations and keep its general policy for control of business trends at maximum efficiency within the framework set by the integration process. Quite apart from the above considerations, a number of other factors and arguments also support this view.

A policy of demand restriction based mainly on monetary instruments can achieve its objective only by means of a reduction in bank lending. The "squeeze" mainly affects private firms and hence their investment. Were it only from the point of view of growth, it seems a questionable procedure to have to depress investment in order to rein in consumption — at second hand only and often in insufficient degree. Research carried out by the Medium-term Economic Policy Committee suggests that in the course of the next few years it will be necessary to contain the expansion of consumption but not of investment expenditure. There is therefore

a case for adopting a system by which part of the public's purchasing power is skimmed off directly through fiscal policy measures rather than through monetary policy.

Recommendations along these lines have been put forward more than once both by the Monetary Committee and the Short-term Economic Policy Committee of the EEC. These committees emphasize that the budgetary instrument has not always been used to the desired extent and that, for this reason, the process of adjustment has had to depend essentially on credit restraint.

18. From the specific point of view of capital market integration, direct action on overall demand is less likely to engender an inflow of foreign capital than are credit restrictions. Taxation policy has too little influence on credit terms to cause such an inflow. The opposite may indeed happen where the authorities finance a larger proportion of public investment by raising taxes and can thus reduce their calls on private savings on the money and capital markets. In terms of international capital movements, therefore, this instrument of budget policy is clearly preferable to monetary measures.

In other respects, too, budgetary policy can provide a suitable basis for measures capable of influencing overall demand without harming capital movements. For example, in the framework of short-term economic policy, effective pressure can be brought to bear on private investment through changes in fiscal depreciation allowances. This is a useful alternative to dearer credit.

19. While a wider use of budget policy in controlling business fluctuations seems desirable, a number of obstacles will have to be overcome. The most important of these are of a political nature and derive, among other things, from the fear of certain social groups that the distribution of the tax burden may be permanently altered by measures represented as temporary and defended by reference to the current business trend.

Even with these political obstacles out of the way, there would still remain some technical impediments — closely associated, incidentally, with the former. These derive, first of all, from the habitual cumbrousness of fiscal and budgetary procedures. In this connection it would be highly desirable for the authorities to be given the right to vary, in line with the requirements of the business situation, certain direct and indirect tax rates and depreciation allowances. In certain non-member countries the authorities already have this right — naturally within precise limits laid down by Parliament — and it is receiving increasingly careful consideration within the Community as well.

Other problems derive from the steady increase in the consumption and income transfer expenditures of the authorities. Their automatic expansion, which is almost universally taken for granted, narrows the authorities' room for manoeuvre and forces them to concentrate their action on investment expenditure. On this point the Group feels that an effective and at the same time balanced use of the budgetary instrument requires greater flexibility in adjusting current expenditure; otherwise there is the risk of neglecting the foundations of future growth for the sake of the immediate requirements of economic balance.

20. The importance which the budgetary instrument assumes in the context of economic integration does not, however, mean that exclusive reliance can or should be placed upon it in redressing imbalances. Although the authorities should cease basing action to control business fluctuations on credit policy alone, this policy does retain an essential function. The aim should be to use the various instruments in combination so that they help to even out fluctuations of trend and mitigate as much as possible disturbances generated by the balance of payments, for example, as a result of capital movements. Given these objectives, it may well prove useful and necessary to lay the emphasis on the instruments of credit policy in some circumstances and on those of budget policy in others. But even in the latter case it may often be necessary to buttress measures of budget policy by monetary measures.

21. Monetary policy has an uncontested part to play in counteracting undesirable fluctuations in external payments. It is true that unilateral application of the instruments of credit control may in many cases give rise to capital movements conflicting with the purposes of short-term economic policy; it is equally true, however, that in other cases credit policy, and more particularly interest rate policy, can guide capital flows in specific directions. There may even be a case for helping to redress temporary payments imbalances by provoking capital movements in the opposite direction in order to protect the domestic economy from the liquidity effects of these disequilibria.

The choice of instruments for use in such cases will depend on the origin of the imbalances in capital movements. A policy of allowing currency reserves to fluctuate more widely than is now acceptable would seem to commend itself to countries with a deficit on capital account. On the other hand, authorities wishing to offset the effects of temporary capital inflows on the volume of domestic liquidity might be well advised to engage in open market operations and especially to encourage investment abroad by the banks, as has been the practice in several EEC countries in recent years.

If such capital movements were to become too large, the countries concerned should act together, so that ground gained in the field of integration would not have to be given up. Such co-operation might consist in more widespread international recourse to the practices mentioned above, which are closely akin to open market operations.

22. In general, measures of monetary policy ought to be subject to certain conditions concerning the choice of instruments; they should, in other words, more than in the past, have a direct impact on consumption rather than on investment.

Action to control the supply of credit to business enterprise must not on that account be ruled out, but it should not be allowed to jeopardize growth objectives. Action to adjust consumer credit, on the other hand, has the effect of restraining or expanding demand without directly impairing the equilibrium of the credit market, and so has no harmful side-effects. In the opinion of the Group this instrument should, therefore, be used more often for stabilization purposes.

What is certain is that alignment of the conditions in which credit control policy is implemented is required to iron out certain differentials in the level of interest rates prevailing in member countries which appear to be structural but are in fact

due to differences in the use of available instruments. Some member countries, like Belgium, the Netherlands and Germany, choose relatively more often to manipulate discount rate, while others, like France or Italy, more often take direct action to influence the credit supply to firms. The result may be an inducement to capital transfers.

Similar problems may arise in connection with minimum reserve requirements. In France and Italy, for instance, the immobilized bank assets earn interest, whereas they do not in the Netherlands and Germany, and do so only partially in Belgium. There are also differences in the size and composition of these reserves that may give rise to differentials in the rates charged for credit and paid on deposits.

Finally, the rules — sometimes widely divergent — which govern borrowing and lending rates may in turn engender interest rate differentials which have nothing at all to do with current business conditions. In some member countries, like the Netherlands and Belgium, interest rates are left entirely or very largely free to find their own level, this freedom being limited only by the practice whereby the banks link their charges to the official discount rate. (In Belgium, however, there is an arrangement under which maximum rates for interest on deposits can be introduced.) Other member countries have a variety of systems; in Germany there are limitations to the banks' discretion in fixing lending rates, while interest on deposits is strictly subject to certain maxima; in France lending rates are subject to regulations while deposit rates are free; in Italy both are ruled by interbank agreements and minimum rates are fixed for interest on deposits.

This report is not the place for a detailed examination of these problems and their technical aspects; nevertheless the Group feels that there is a need for more co-ordination of credit policies and closer co-operation among central banks with a view to standardizing the various instruments of credit control and the interest rate regulations.

CONCLUSIONS

23. Examination of the new circumstances determining policies for control of overall money demand has brought to light profound changes rooted in the expansion of international trade and financial relations. The development of a European capital market is bound to speed up this trend. In the Group's view the new situation calls for reconsideration of the pattern in which the instruments of short-term economic policy are combined so as to safeguard its essential objectives, namely, price stability, stable employment and external payments balance. The following conclusions may be drawn:

- 1) Given that firms now have increased opportunities to draw on foreign sources of capital and that the markets for short-term trade credits already interconnect, it is often difficult to control overall monetary demand by action on the volume and cost of credit.
- 2) This object could, however, be achieved by instruments of budget policy without entailing comparable disadvantages.

- a) These instruments would bear directly on the volume of overall demand and, since the effect would not be concentrated upon the investment demand of firms, a restrictive policy would not automatically engender offsetting capital movements;
 - b) The authorities should introduce more flexibility into their consumption and transfer expenditures and take fuller advantage of the opportunities of using their investment programmes as an anti-cyclical weapon.
 - c) To enable them to act with the necessary speed, the authorities should be empowered, for stabilization purposes, to vary direct and indirect taxes and depreciation allowances within certain limits.
- 3) Nevertheless credit policy retains an essential function, both in counteracting undesirable fluctuations in external payments and in helping to control overall monetary demand by buttressing the measures of budget policy. To this end it would be wise to give more weight to instruments which directly affect the public's demand (control of consumer credit); furthermore, efficient monetary control calls for co-ordinated action by central banks to reduce certain divergences which still exist in the conditions in which credit policy is implemented and in the instruments used in various Member States.

II. Capital market policies

24. The capital markets are still fairly rigidly separated from one another and official action may have differing objectives. Although official measures will more often than not have several aims, it would seem that one or other of the following is as a rule the primary concern: control of interest rate movements, insulation of these movements against outside influences, or direction of investible funds to specific uses by means of demand rationing. The removal of dividing barriers will automatically get rid of some of these worries, while necessitating, in respect of others, an adaptation of intervention techniques to the new situation of a European market.

A. CONTROL OF MARKET TRENDS

25. One of the commonest objectives of official intervention on the capital market is to curb short-term fluctuations in bond prices. The authorities take care not to interfere with more long-term trends and most often concentrate on the market in government stock. It is mostly a question, therefore, of forestalling the dislocation that might result from bad timing of flotations and of cushioning violent fluctuations when investors are temporarily holding off from the market.

Problems of stabilizing the bond market trend will no doubt arise even after the capital markets are integrated. Their solution should then present no difficulties other than technical ones; so long as the purpose is not to channel the supply of capital in any particular direction nor to interfere deliberately with the price trend

but merely to dampen fluctuations due to ill-planned bond issues, the establishment of a co-ordinated issue queue would make it easy enough to achieve this limited end.

A number of obstacles must, however, be overcome during the transition period. *A priori*, the progressive liberalization of intra-Community capital movements should not, it would seem, raise any particular problems in connection with the type of policy under discussion. It is true that the intensification of international financial transactions is almost bound to affect the long-term trend of interest rates on each market; but provided that no attempt is made to oppose this spontaneous trend, official measures to steady the market would be perfectly compatible with progressive integration. Nor should there be any difficulty in inserting the claims of foreign borrowers into a queue of loan issues.

Nevertheless, an effort should be made to standardize the methods used by the Member States to influence the short-term trend of interest rates on the markets. If it were decided to appoint a special authority to handle official intervention on the market, the Group feels that such action should be closely concerted.

B. AUTONOMOUS INTEREST LEVELS

26. Beyond the mere dampening of short-term fluctuation of bond prices and yields, capital market policy may try to influence interest rates with a view to keeping them at a level deemed in line with economic requirements. In the past, attempts have sometimes been made to achieve this result through direct control of interest rate and other terms of bond issues. In none of the member countries, however, has official action of this kind proved really effective.

Certain countries have also sought to insulate the domestic capital market from outside influences. Instead of acting directly on interest rates as in the preceding case, official intervention left the rates free to find their own level through the apparently free play of capital demand and supply. However, while domestic lenders and borrowers were subject to no kind of restriction on the domestic market, the grant or refusal of exchange permits was used as a means of acting on domestic demand for foreign securities and on foreign demand for domestic funds.

Such policies, resting as they do on the retention of barriers designed to safeguard the autonomy of domestic interest rates, are incompatible with the establishment of an integrated capital market. External influences cannot exert their full force where arbitrage facilities are unsatisfactory. Though there are still obstacles and intra-Community financial channels are still imperfectly organized, international capital movements have already developed to the point of rendering policies of this kind quite ineffective and of considerably reinforcing the tendency towards alignment of interest rates. Thus, interest rates on the Dutch capital market, which were long kept very low by the authorities intent on protecting the market from outside influences, did ultimately rise to the international level — under the impact, it is true, of a restrictive credit policy, but also because of an expansion of external financial transactions stimulated by the interest rate differential.

Although there is a natural tendency for the capital markets to merge, certain Member States might be unable to abandon overnight their objectives in the field of long-term financing and leave it to market forces alone to determine the international allocation of finance funds. During a transitional period it will be necessary to adapt capital market policies to such progress as has already been achieved in liberalizing capital movements and to prepare the subsequent stages of integration. This will entail less direct intervention and, at the same time, the well-ordered opening of the domestic markets. On this point, the Group refers to Chapter 9 below, where it discusses the principal techniques (including the establishment of ceilings, which could be raised and within which the Member States would undertake to permit foreign security issues) by which such barriers between the markets as still exist can be gradually removed.

C. DIRECTING THE SUPPLY OF FUNDS

27. Most European capital markets suffer from one fundamental weakness, namely, a chronic excess of demand for long-term capital over supply, and this is why the authorities intervene to secure part of available funds for favoured borrowers. The idea behind this kind of intervention is that, acting on a given level of supply, the selective function of interest rates may lead to unsatisfactory results or, at least, to results which do not fit in with the government's scale of priorities. Hence steps are taken to facilitate access to the market to those borrowers whose projects are of a particularly pressing nature. These borrowers are generally of two types: first, those whose investment is likely to increase the productive capital equipment of regions or sectors which, in the absence of government action to channel resources to them, would be at a disadvantage when competing for funds on the market in the ordinary way, and, second, public-sector organizations.

Broadly speaking, means used to this end go far beyond anything that can be done within the limits of capital market policy in the strict sense of the word. For this reason the Group discusses below, in Chapters 5 and 6, the whole nexus of policies concerned with investment guidance and the financing of public authorities and enterprises in the context of integration. The Group has suggested instruments which could in this framework be used to guide investment. Certain measures affecting the functioning of the capital market may, even under the new arrangements, usefully serve such policies to the extent that a direct control over borrowers' access to the bond market sifts applications for funds in accordance with predetermined standards.

In many cases, the issues queue will in fact be so established as to satisfy simultaneously two important requirements: namely, that of forestalling fluctuations in prices and yields, and that of channelling funds to chosen uses. The use of the queue for purposes of "rationing" demand for capital is much more developed in some countries than in others. In France, a system under which the Finance Ministry's *Comité du calendrier* worked out a queue of public and private issues according to technical considerations has gradually developed into a system of individual licences obtained from the Treasury, which in each case assesses the economic and financial expediency of the proposed issue. The Italian system,

operated by the Joint Ministerial Committee on Credit and Saving (*Comitato interministeriale per il credito e per il risparmio*), has a working mechanism fairly similar to the French system.

In so far as they tended explicitly to set aside, for domestic uses, part of the domestic capital supply, such practices would hardly be compatible with the correct functioning of a European capital market. The growing freedom of movement of capital within the Community will in any case deprive the instruments considered of their efficacy, if not of their *raison d'être*. Rationing of issues of bonds would be liable to fail as firms would have an opportunity to obtain abroad the funds refused to them on the domestic market. Conversely, part of the supply of funds may be diverted from the domestic market to foreign investments.

The fact remains that, during a transitional period, the effective integration of capital markets could be delayed indirectly through the establishment of issue queues. If a low priority were deliberately allocated to foreign issues and to domestic ones judged to be less urgent, it would, in practice, be possible to delay the opening-up of domestic markets and at the same time to keep domestic capital demand subject to a certain selective rationing. In these circumstances crucial importance attaches to the nature of the institutions responsible for scheduling international and national issues and for making room for the former among the latter, and to the techniques employed in preparing the queues.

The Group holds the view that queues should in all cases be established by objective standards and that their sole restrictive objective should be to avoid excess pressure on the market, to be achieved through the technical co-ordination of all prospective domestic and international issues. To fulfil these conditions will require reform of the system now current in certain member countries and the willingness of governments to accept a certain degree of co-ordination in their capital market controls. In Chapter 9 below, the Group specifies what reforms are desirable in this field.

CONCLUSIONS

28. Policy instruments for the control of the capital market, like those for adapting monetary demand, require certain adjustments.

1) As regards short-term fluctuations due to bad timing of issues, no particular problems are involved in curbing these fluctuations by official market intervention and the establishment of an issues queue, provided that:

- a) Official market intervention makes due allowance for the impact on interest rates of developments on other capital markets, and
- b) Foreign recourse to the market is fitted into the queue without discrimination.

2) In the past, the authorities have sometimes sought to counteract the long-term trend of interest rates by insulating capital supply and demand on the domestic market from outside influence; this objective is in conflict with the very concept

of a European capital market. Therefore, such barriers as still exist should be removed. They have in any case already lost much of their effectiveness.

3) The technique of directing funds — notably through issue queues — with a view to facilitating the financing of investments accorded priority, might be dropped in favour of other, equally effective instruments designed to stimulate investment demand in specific regions and sectors while providing funds by means which do not entail any rationing of supply.

CHAPTER 5

POLICIES FOR STIMULATION OF SAVING AND DIRECTION OF CAPITAL INVESTMENT

Introduction

1. In none of the Member States does the matching of supply of and demand for capital take place in "market conditions" in the traditional sense of the word. Before they ever reach the market, capital supply and demand are influenced by the public authorities through selective encouragement of certain types of investment and direction of the country's saving to particular sectors and regions. These measures, taken to meet certain needs, led to the formation of privileged financial circuits differing in extent and nature in the several Member States. Though most apparent — as will be seen in the following chapter — where funds have to be found for investment by governments or public enterprises, the system none the less also exerts an important influence in determining the conditions in which investment is financed in other sectors of the economy.
2. The objectives in view and the instruments used in stimulating saving and guiding investment are not necessarily of identical scope and nature in the different Member States; consequently, the adaptation of financial structures for the purpose of developing a European capital market may come up against obstacles, especially as the implementation of the measures concerned has been conceived in a strictly national setting.
3. It would doubtless be unrealistic to try to remove obstacles originating in the diversity of government intervention by questioning the policy aims themselves. This is why this chapter concentrates on trying to discover by what instruments Member Governments can pursue their structural policies without thereby hindering the broadening of financial flows within the Community. In one particular sector — residential construction — the instruments used overlap at a number of points with those employed more generally in the guidance of private investment. Nevertheless, the forms of government action in this field are of a special kind and thus seem to warrant separate treatment. This will be found in Chapter 8.
4. The present chapter contains an analysis of the financial instruments customarily used to encourage saving and channel part of private investment to certain sectors or regions.

Head I of the chapter deals, first in general terms and then for each Member State, with the objectives and instruments of savings and investment policies.

In Head II, the Group discusses:

- a) The adaptation of savings incentives;
- b) Improvements in the methods of investment guidance;
- c) The ways and means by which the Community's financial institutions guide investment.

I. Selective incentives for saving and investment

A. OBJECTIVES AND INSTRUMENTS

A) SAVINGS INCENTIVES

5. Savings incentives may serve social-policy objectives, improvement of the structure of supply for long-term financing and even, in some cases, the immediate needs of cyclical policy. In the first case, they are used to encourage saving in certain social or occupational groups (wage- and salary-earners, civil servants) and, more generally, the low-income groups. In the second case, the aim is to encourage a switch from liquid savings into longer-term investments. Finally, of less importance because they are geared to short-term problems rather than long-term policy needs, certain measures designed to encourage saving by households are to be found in incomes policies. Where rises in income seem inevitable but threaten to cause an undue expansion of consumption, the authorities may try to sterilize increases temporarily by means of a growth of savings balances.

6. Policies to encourage longer-term saving by households usually favour certain forms of investment, such as purchase of securities, time deposits and life assurance. The incentives themselves vary and may include:

- a) Tax benefits (as, for instance, sums saved may be allowed as a deduction from taxable income, or income from the investment may be exempt from income tax);
- b) Capital premiums;
- c) Preferential interest rates;
- d) Sale of securities on terms favourable to small investors (Volksaktien);
- e) Matching contributions by employers under savings schemes linked to labour contracts.

These benefits are usually subject to certain technical requirements and conditions — such as specified periods for immobilization of savings, a ceiling on the benefits accruing to any individual, a yield ceiling for savers — which are intended to keep down the financial costs of the operation and to limit its benefits to certain social groups.

7. As regards the overall level of saving, incentives seem to have had only a limited effect so far. Higher yields — the usual device for substantially increasing the propensity to save — are incompatible with the aim of providing borrowers with additional funds at moderate cost. Technically, savings incentives can have immediate effects on the overall position, but once the required period of immobilization is over, their usefulness seems at best marginal. Finally, account must be taken of the harmful effects on the level of interest rates (or on savings formation in the public sector) which follow when the government raises funds to finance its incentives policy (or forgoes certain tax revenues).

As regards the distribution of saving, on the other hand, incentives have proved much more effective. If special advantages are offered to one or other type of

investment, the structure of household saving can eventually be altered. Consequently, if the authorities concentrate on different forms of investment in different countries, a problem arises as to how these incentives are to coexist within an integrated market.

B) DIRECTION OF INVESTMENT

8. All Member States have investment guidance policies, by which they direct investment to certain sectors and regions, and policies encouraging certain categories of producer (small and medium-sized firms, for instance).

9. The methods by which the authorities guide investment may be indirect. Special importance attaches to public investment in infrastructure, which creates the conditions for the subsequent expansion of directly productive investment. Similarly, public contracts may play a by no means negligible part in promoting the growth of certain industries.

However, the principal instruments used are financial. Those employed most frequently work through the credit mechanism:

- a) Directives to credit institutions enjoining them to accord preference to lending for the desired types of investment. This action is sometimes assisted by improved facilities for refinancing at the central bank;
- b) Direct central government loans;
- c) Interest-rate subsidies;
- d) Government guarantees to back credits.

At least as important as instruments of investment guidance are the operations of special credit institutions, which more often than not are public or semi-public bodies enjoying particular privileges.

Financial instruments other than those coming under credit policy include:

- a) Investment premiums paid by central government;
- b) Tax benefits for the investor;
- c) Priority ranking in the timing of issues.

10. Broadly speaking, the effects of these measures on the volume and structure of capital formation are of two kinds. First, these measures tend to shift to the beneficiary regions and sectors investment projects which would normally have been carried out elsewhere. Secondly, they tend to increase the aggregate volume of investment. This second effect is generally the more marked the greater the number of firms qualifying for the financial incentives and, consequently, the bigger the expansion of capital demand on the market.

By contrast, the change in the investment pattern tends to be considerable, but the ultimate expansion of the volume of investment small, whenever a limited

number of regions and sectors enjoy preferential financing facilities and the measures to this end go beyond offsetting existing handicaps and put investment in these initially less-favoured sectors and regions in a privileged position. Regardless of the actual effects of these policies on the volume and distribution of investment, there is here again, as in the case of savings incentives, the problem of the compatibility of the various instruments with the smooth functioning of a European capital market. But before examining the methods of encouraging saving and directing investment from this point of view, the Group felt it necessary to describe the policies pursued in the Member States, where — though the objectives pursued have become less varied — the range of instruments employed remains very wide indeed.⁽¹⁾

B. SAVINGS INCENTIVES AND DIRECTION OF INVESTMENTS IN MEMBER STATES

11. In Germany, savings incentives were used during the immediate postwar years mainly as a means of expanding the supply of resources but now saving is promoted as part of social policy and all sections of the population are encouraged to participate. Various means are used to stimulate interest in the longer-term forms in particular:

- a) In the case of life-assurance policies and building-society savings schemes, the premiums and deposits are deductible from taxable income within certain limits and on certain conditions;⁽²⁾
- b) Savings deposits and security purchases are eligible for premium payments, provided the balances are immobilized for a certain time;
- c) Shares in denationalized firms are offered at preferential prices to low-income earners;
- d) Save-as-you-earn schemes are encouraged by tax benefits and matching contributions by employers.

For the purpose of directing investment, the public authorities (Federal and Land) rely chiefly on tax benefits, guaranteeing of credits and provision of low-interest credits. The latter are handled by public and private credit institutions which to this end are supplied with funds allocated through the budget; in addition to their responsibilities as intermediaries (they administer the funds assigned to them, scrutinize loan applications and obtain the necessary security), these institutions have wide discretionary powers in the loan operations financed by these funds. Interest-rate subsidies from the Government complete this range of instruments.

(1) For a more detailed analysis of methods of investment guidance, especially at regional level, see: European Economic Community, *La politique régionale dans la CEE*, Brussels, 1964, Report of Group 3.

(2) To encourage saving for housebuilding purposes, low-income depositors are given the option between the above tax relief and receipt of a premium.

12. France recently adopted a systematic policy of encouraging saving, with particular emphasis on lessening the preference of savers for the most liquid forms of investment. The means employed to this end are mainly of two kinds.

a) First, policy affecting interest rates has tended to make longer-term investments (for more than two years) more attractive by a better grading of yields.

b) Secondly, a number of tax changes were introduced whereby income from fixed-interest securities is now taxed at not more than 25% and distributed company profits bear a considerably lighter tax burden than they used to.

Measures have also been taken to stimulate long-term saving commitments (the minimum period being ten years) and saving for house-purchase.

The general direction of investment is laid down in the Economic and Social Development Plan. Investment in line with the Plan's objectives is fostered by a number of techniques. These mainly take the form of capital grants or cheap loans supplied either by central government (through the intermediary of the Economic and Social Development Fund) or by public-sector credit institutions. Special benefits to investors also include investment premiums and tax reliefs, including in particular the advantage of treating 10% of investment expenditure as an allowance for purposes of company tax.

13. In Italy there is no systematic policy to encourage saving, but only a few specific measures, such as preferential rates of interest on "small savings" accounts and "special small savings" accounts — with limitations, respectively, on size of deposits and on categories of savers; in addition, life-assurance premiums are allowed as a deduction from taxable income.

By contrast, a far-reaching system of investment guidance has been adopted, to the benefit mostly of the less-favoured regions. The main instruments of this policy are outright grants and tax benefits, but above all credit facilities. Loans are financed either from public funds or from funds raised on the market, and they generally carry a preferential rate of interest; they are distributed by quasi-governmental financial institutions either of general scope or specialized by region or industry.

14. In Belgium, too, incentives to personal saving are rare and take the form of tax benefits: interest on savings deposits up to a certain sum is tax free, and life-assurance premiums are deductible from taxable income.

In this country, semi-public credit institutions also play a key part in implementing investment guidance policies. Although these policies operate through a number of other means also — tax reliefs and investment premiums, for instance — the most usual are credit facilities such as direct state loans on preferential terms, government guarantees covering repayment of principal and/or interest payments, and interest-rate subsidies. The extent of the government guarantee varies according to the nature of the lending institution and is only partial when the latter is a private credit establishment. Interest-rate subsidies are independent of whether the lender is a private or semi-public credit institution, and their amount may cover

a large part, but not all, of the normal cost of the money lent. When a private financial establishment grants a preferential loan which qualifies for the subsidy, the amount of the latter is paid directly to the establishment in question.

15. In the Netherlands, stimulation of savings stems almost exclusively from social considerations and is therefore confined to relatively few classes of beneficiary (young civil servants, wage- and salary-earners in the private sector); but the range of qualifying investments is very broad, including savings deposits, security holdings by low-income investors, group life-assurance policies, and saving for house-purchase. Capital premiums constitute the major incentive, since the authorities consider them more likely to encourage the formation of personal wealth than indirect means, such as tax exemption for income from property already accumulated, would be.

For the direction of investment the authorities rely exclusively on capital grants for regional development. As regards specific sectors, the government acts by acquiring participations, granting tax reliefs and, above all, underwriting certain financial operations. Such government guarantees are limited to projects of national interest or projects justified by social considerations and are provided either directly, as in the case of industrial loans extended by two specialized credit institutions, or indirectly, to two finance companies which raise funds on the bond market in order to meet the risk-capital requirements of firms which do not themselves have easy access to the market.

16. Luxembourg applies selective savings incentives for some types of investment, including savings for house-purchase — which qualify for an interest supplement and a capital premium — and life-assurance policies, the premiums for which are treated as a tax allowance.

A large number of instruments for direction of investment are provided for in current legislation. Apart from government guarantees of loan operations, mention may be made of interest-rate subsidies (paid out through the intermediary of credit institutions), investment premiums and a wide range of tax benefits.

II. Harmonization of instruments

A. ADAPTATION OF SAVINGS INCENTIVES

17. The effects of measures to encourage saving on the overall volume of saving may be totally disregarded. As already pointed out, these effects can be no more than slight, and in any event they would not create any major problem for the development of a European capital market.

The "distribution effect" resulting from the selective character of the incentives considered might well raise problems, however, if these incentives should:

- a) Hinder the structural alignment of the capital markets of the member countries or even accentuate existing divergences, or
- b) Benefit only domestic investments or cause savings to be concentrated in financial institutions obliged to invest the bulk of their resources at home.

The Group studied what measures were currently employed to encourage saving in the Member States and considered how far they were likely to raise problems of this kind.

18. When the only objectives are to further social policy or to contain consumption as part of incomes policy, selective savings incentives are unjustified: these ends can more suitably be attained by stimuli of a general nature not likely to upset the smooth working of the capital market. Member States should therefore be led quite naturally in their own interest to refashion their present instruments, quite apart from the problem of market integration, which is our primary concern here.

But stimulation of saving may also be prompted by other considerations which do in fact call for selective incentives. This is the case:

- i) When savings are channelled to specific uses in order to facilitate the financing of investment assigned a high priority;
- ii) When the intention is to correct deficiencies in the structure or functioning of the capital market, such as, notably, an undue preference of savers for liquid assets and their reluctance to invest in securities or enter into contractual commitments.

19. In the Group's view, the separation of financial flows that may result from selective measures encouraging placing of capital with certain specialized financial intermediaries may seriously compromise the development of an efficient capital market in Europe. Selective incentives can, however, be justified in certain special circumstances; a case in point is the serious delay in satisfying demand for housing in certain Member States, which is the reason why such importance has been attached in those countries to various systems of saving for housing purposes. Selective savings stimuli of this kind also have the peculiar feature that the distribution effect, which predominates in other measures, is here usually accompanied by an expansion of the volume of saving. Nevertheless, a careful watch needs to be kept on such measures to make sure they are not maintained longer than is required to satisfy the needs for which they were adopted and thereby become an additional factor making for compartmentalization of the market.

20. On the other hand, measures designed to correct savers' excessive liquidity preference seem beneficial in the light of the needs studied here, since this is a problem common to the capital markets of all Member States, though not of equal intensity everywhere. Nevertheless, Member States will still have to make an effort at harmonizing the different types of measures applied and at reducing to a minimum the barriers these measures might create.

To put it more exactly, given the forms of investment which are most frequently to be encouraged, the following observations may be made.

- a) In the case of savings deposits, the immobilization of funds so collected with financial intermediaries whose scope is strictly limited should be avoided. In present circumstances this often happens; the remedy, as will be seen more particularly in Chapter 12, lies in broadening the range of assets in which these intermediaries may invest. If this were done, the domestic financial institutions

which receive privileged savings would, admittedly, still enjoy a favoured position in international competition, but at least the movement towards integration would not be compromised.

- b) In the case of measures encouraging investment in securities, it must be borne in mind that their primary purpose is to accustom new groups of the population to this form of investment. In the light of this "educational" purpose and of the growing internationalization of security markets, it does not seem warranted to exclude investment in foreign securities from the inducements given.
- c) Incentives to contractual saving should be given a key part, because the inadequate contribution of resources from the institutions collecting these savings sets problems for the smooth functioning of most capital markets in the Community. These problems will become particularly acute in connection with securities markets and, more especially, the placing of blocks of securities with institutional investors — a technique which might result in large cost reductions and more flexible access to the market. True, these are primarily problems of providing institutional investors, especially life-assurance companies, with greater opportunities for collecting and investing capital (for more details see Chapter 12). But this does not make it any less desirable that incentives to savers entering into agreements with these institutions should be both amplified and harmonized within the Community.
- d) Savings incentives in labour contracts — pension funds, supplementary retirement pensions and severance payments — have become increasingly important in Community firms. Secs. 8 and 27 of Chapter 2 noted respectively the importance of pension funds, especially in Italy and Germany, and the delicate problems raised when they are used within the firm rather than being deployed, under independent management, on the capital market.

Again, several Member States have studied or brought into force various schemes aimed at expanding wage- and salary-earners' savings by channelling them into long-term investments, at giving employees a greater stake in the firm's prosperity by promoting a community of interests and a good psychological climate, and at ensuring that wage increases do not necessarily lead to greater demand for consumer goods.

These questions have been studied in depth, especially in Italy, where the CISL (*Confederazione Italiana Sindacati Lavoratori*) has proposed the introduction of a system of negotiated savings written into the labour contract and administered by a National Investment Fund. In France various solutions have been put forward by a committee set up to study the problem of employees' rights to a share in the increase of assets due to self-financing (the Mathey Committee), which reported in 1966. But so far it is only in Germany that discussion on these matters has led to material results. Here, fiscal concessions are now available for this type of saving and a group savings contract was written into a 1965 wage agreement in the building trade.

The practical arrangements for the many formulas suggested, though outside the scope of this report, will obviously be a decisive factor in determining how far this form of saving can play a part in a European capital market.

In the immediate future the amounts saved in this fashion will probably be small, but they must be expected to grow, and methods should preferably be selected that will not allow such savings to be shut off in strictly national channels.

CONCLUSIONS

21. The Group recognizes that neutrality between the different forms of investment encouraged can only be a long-term aim to be approached by stages. But the internal divisions of each market and the obstacles to international capital flows resulting from savings incentives currently applied could be considerably diminished here and now.

1) Where the stimulation of saving is no more than a facet of social policy or an attempt to counter a worrying business trend, the measures could easily be refashioned so as to encourage property formation and contain the expansion of consumption without distinction as to the assets in which additional savings are placed.

2) Incentives which have the effect of channelling savings to specific uses cannot easily be reconciled with the desired broadening of financial flows. However, the inducements given to encourage saving for house-purchase can be justified in certain countries where there is a very marked lag between housing supply and demand, especially if they do in fact call forth additional saving.

3) The development of long-term forms of financial saving seems to be an aim common to most Member States and may therefore warrant selective incentives. However, the measures adopted to this end should be so harmonized that:

a) The institutions collecting privileged savings have greater latitude for investment outside the domestic market, and

b) Inducements to invest in securities do not involve discrimination regarding the origin of the securities but are applied to foreign and domestic securities alike.

4) Contractual saving is not playing its full part in ensuring the smooth functioning of the Community's capital markets. It could be encouraged by giving wider investment powers to the institutions handling it; and this would broaden the appeal of the contracts offered. Various incentives to this kind of saving could be provided, and it would be well to harmonize them throughout the Community.

Incentives written into labour contracts and representing an aspect of incomes policy are suitable for promoting the saving habit among population groups whose income is increasing and for tapping new resources for the financing of investment. If this form of saving is to be geared to a European capital market, the result of the formula selected must not be to shut the funds in within enterprises or specific national channels.

B. THE INSTRUMENTS FOR DIRECTING INVESTMENT AND THEIR PLACE IN A EUROPEAN CAPITAL MARKET

22. Member States employ a very wide range of instruments for directing investment. In fact, they may make yet more and more diversified use of them as the Community develops, in order to speed up the correction of regional imbalances and to bring about the necessary structural adaptation. In the context of the present study, the problems raised by the use of financial instruments to guide investment must be seen in terms of two questions, as follows.

- a) Does not the use of such instruments necessarily perpetuate the divisions which now separate capital markets?
- b) Which of these instruments can retain their efficacy, and hence make it possible for policies steering investment to specific regions or sectors to be continued, within a capital market enlarged to the European scale?

These questions can be answered only by examining the method of application and effect of each separate instrument.

23. The foregoing description of policies in Member States has shown that the instruments most frequently used are:

- a) Investment premiums, which are not actual funds but an incentive to investors;
- b) Interest-rate subsidies, which reduce the cost of borrowing;
- c) Government guarantees of credits granted to certain investors;
- d) Tax benefits, which can take the form of allowance of all or part of the investment expenditure for tax purposes, or quicker depreciation allowances, or reduced rates of tax on income from investment.

The use of these instruments does not normally affect the investor's choice between different finance sources and has only slight repercussions on the structure of capital markets. They can be used either in the setting of a purely domestic market or in a broader, European-scale market. In the context of this study, therefore, these instruments seem at first to show up in a favourable light, but it is not always easy to apply them, nor is it certain that they will be effective when used in isolation.

24. The second category of instruments examined has the distinguishing feature of directly promoting the supply of funds for investment in the regions and industries to be aided. The main instruments in this group are:

- a) Direct central government loans;
- b) Loans by special credit institutions, which most often enjoy various privileges and tax reliefs to help them raise funds for lending;
- c) Directives to credit institutions, sometimes accompanied by special facilities for rediscount at the central bank;
- d) Priority access to the capital market.

On the whole, it may be said that these instruments have a more direct effect than those which do no more than stimulate demand for investment. On the other hand, by virtue of the very nature of their effect on the distribution of capital supply, their application entails the creation of non-communicating financing channels; to make them communicate within a European capital market would involve some difficulties, but it could be done. The Group tries to suggest below what instruments can most readily be adapted to the new situation.

A) INSTRUMENTS ACTING ON INVESTMENT DEMAND

25. To turn to a more detailed examination of the characteristics of the various instruments mentioned, certain distinctions should perhaps be made as regards their compatibility with the development of a European capital market.

Among the instruments designed to stimulate demand in specific sectors, investment premiums have the advantage that they show up plainly the extent of the contribution from the authorities and the overall cost to the economy. This makes them especially suitable for such harmonized action as may be undertaken at Community level, perhaps in collaboration with the financial institutions discussed below.

The same considerations apply to interest-rate subsidies, which can likewise be applied in such a way as to minimize any distorting effects on the choice of financial sources. However, these subsidies do raise three specific problems.

First, they may, by reducing the cost of credit, stimulate the use of borrowed funds in preference to self-financing or capital increases through the market. To this extent they may cause distortion in the financial structure not only of firms but also of the market as a whole.

Secondly, interest-rate subsidies are usually administered by credit institutions which have to verify that the borrower uses this assistance in accordance with the purposes for which it was granted. To give one particular credit institution a monopoly of the administration of these subsidies is tantamount to creating a specialized finance channel. Their administration should therefore — subject to precise government directives — be in the hands of specialized institutions and ordinary banks, and also financial institutions in other Member States which might be able to supply funds on better terms.

Thirdly, the total cost of using interest-rate subsidies may not be immediately evident. Because of this, intensive recourse to this instrument may become the easy way out, at the cost of an excessive burden on future budgets.

Government guarantees to back credits to certain investors also raise the problem that they might encourage borrowing; in addition, the required formalities take so long and are so complicated as to be a very real hindrance; and finally, their effectiveness is not always certain when the borrower encounters difficulties of access to the market other than those deriving from his financial standing and solvency. But even with these reservations, there is no doubt that this instrument is one of those that can be most easily reconciled with a broadening of the capital

market to European scale. Furthermore, since such guarantees do not, at the outset, involve any fund-raising by the authorities, they are less likely than other instruments to disturb the functioning of the market.

Tax benefits connected with specific investment projects can take such varied forms that it is impossible to go beyond a few general observations here. The one point to be made is that tax benefits are probably the instrument which least affects the investor's choice of both the method and the source of finance.

Admittedly, some tax reliefs have their incentive power reduced to the extent that they apply to future profits and the firm cannot, therefore, correctly calculate their incidence on production cost. Nevertheless, if part of the investment expenditure can be deducted from taxable income, these tax benefits take on something of the character of a capital grant, which is generally regarded as more effective. It should be added, however, that non-discriminatory application of such tax benefits may give rise to a particular problem. The principle that should be observed without exception, making the benefits dependent solely upon the nature of the investment regardless of the nationality or domicile of the investor, would be difficult to apply in this case, unless the foreign investor were already established in the country and thus had a taxable income there eligible for the relief.

To sum up, the whole range of instruments discussed above seems equally capable of use without serious difficulty in the setting of a European capital market as on existing national markets. But these instruments presuppose that the beneficiaries can draw either on their own resources or on the market for the funds required for the proposed investment. This condition is not always fulfilled in practice. If, therefore, the direction of investment consisted solely in investment premiums, interest-rate subsidies, official credit guarantees or tax benefits, it could not always achieve the desired end. It is this shortcoming which has in most cases been the reason for the adoption of instruments acting directly on the allocation of funds for financing investment in specific regions and sectors.

B) INSTRUMENTS AFFECTING THE ALLOCATION OF FUNDS

26. In these circumstances it is inconceivable that governments will simply refrain from using instruments which by their very nature seem likely to perpetrate certain divisions between capital markets. Nevertheless, although public intervention in the allocation of funds seems to be essential if policies are to be effective, an improvement in methods is desirable and may, to a large extent, remove the conflict between such action and the aim of creating a large European capital market.

Direct central government lending, financed by market issues, and the operations of specialized credit institutions are clearly a potential impediment to integration of capital markets. Indeed, certain member countries might argue that the volume of their market recourse and the various privileges and tax benefits attaching to the issues of the authorities and specialized credit institutions would preclude fair competitive conditions. The objection is valid enough, but it may be pointed out in reply that there is no reason why these privileges and tax benefits — where

they are judged indispensable — should not be aligned at Community level. This possibility is not merely theoretical, since the tendency is to reduce these privileges and benefits, and so to bring them into line throughout the Community. Belgium and, more recently, France have already taken steps to reduce some disparities between the terms granted to privileged and other issuers.

It needs to be recalled that, subject to the above improvements, special institutions for medium- and long-term credit can make a most useful contribution not only to investment guidance, but also to the proper functioning of the capital market as a whole. Direct access to the capital market through bond issues is confined to a small number of large firms. The others may, of course, raise funds from such banks as are authorized to lend at long term. But the links which in some countries exist between banks and certain firms may result in very imperfect conditions of competition for sources of finance, at least as far as independent firms are concerned. Institutions specializing in medium-and long-term credit and raising the bulk of their funds on the market on behalf of their customers are therefore a means of establishing more equitable conditions for entrepreneurs' access to finance.

There is no need to dwell at length on directives instructing credit institutions to give certain investors priority in obtaining loans: it is indeed hard to imagine that an instrument of this kind could still be used in an integrated market where, among other things, banks so obliged to neglect some of their customers would risk losing them to lenders in other member countries.

The problem of priority access to the market for certain borrowers was discussed in the previous chapter. It remains to be added that the efficacy of this instrument in the direction of investment will probably decline as financial channels expand. To the extent, however, that it is still widely used to influence the mechanisms of the capital market, the timing of issues should at least be based on clearly stated priorities and should in no way discriminate between prospective issuers meeting the stated conditions, whatever the investor's country of residence.

27. The above analysis of the various instruments should not be allowed to obscure the problems which might attend the orderly development of links between capital markets as a result of present differences in the intensity and efficiency of investment guidance policies in the various Member States. However, the conflicts of interest — particularly those that arise because all forms of investment guidance tend to drive up market rates — will no doubt diminish under the impact of economic policy co-ordination, which today is recognized as one of the essential conditions for the continuing advance of the Community.

CONCLUSIONS

28. In the view of the Group, a redistribution of the weight given to the various instruments of investment guidance and a reform of certain of the methods by which they are applied would make it possible to pursue an effective investment guidance policy without foregoing the development of a capital market on the European scale. With this in view:

- 1) Selective incentives to stimulate capital demand by investors seem preferable to any other technique for guiding financial investment, and there is a case, therefore, for improving their effectiveness.
- 2) The concessions should be granted regardless of the investor's country of residence or of the origin of the funds, the sole criterion of eligibility being whether the project will help attainment of the regional and sectoral objectives in view.
- 3) To enable these policies to go forward in conditions of fair competition between financial institutions, the administration of the financial facilities provided by the authorities should not be entrusted exclusively to one category of institution. The investor should remain free to approach the lender of his choice, and the latter should apply the general criteria laid down by law with complete impartiality and should also make sure that the investment concerned is carried out in conformity with the approved project.
- 4) Governments intent on enhancing the efficacy of investment guidance cannot limit the range of usable instruments to direct or indirect subsidizing of investment demand, for the efficacy of the subsidies depends on the ease with which the necessary funds can be obtained on the market. In view of the frequent difficulty of access to the ordinary sources of finance, achievement of the objectives of specific regions or sectors is often dependent upon preferential or supplementary credits from public or semi-public special credit institutions, or indeed upon direct central government loans. If such credits are to be compatible with capital market integration, any bond issues on which loanable funds are raised should be floated on the market on terms comparable with those applicable to other issues.

C. COMMUNITY FINANCIAL INSTITUTIONS AND INVESTMENT GUIDANCE

29. The aim of the individual countries' policies of investment guidance is to bring about a different distribution of investment. A problem of the same kind arises in the European context; with international competition becoming keener and the mobility of labour increasing, the already developed regions and sectors exert more and more power of attraction on the factors of production and thus aggravate existing inequalities. Intra-Community capital flows are already expanding in spite of the continuing existence of obstacles. Although the complete removal of barriers between capital markets is not likely to aggravate the previous imbalances fundamentally, it does lend added urgency to the need for co-ordination of national guidance policies.

This point is stressed in the Preliminary Draft of the First Medium-term Economic Policy Programme, which the Commission submitted to the Council in April 1966. The objectives and methods of regional policy are essential aspects of this programme, while recognizing that "responsibility ... lies mainly with the Member States", it goes on to say that "the co-ordination of regional policies at Community level is particularly necessary [in order to] contribute to harmonious economic development...". Likewise, "although a detailed treatment of policy on the

structure of industry is being held over for a later programme", the general principles outlined in this first document emphasize the need for measures to be adopted and applied by joint agreement.

The gradual definition of Community objectives in no way alters, at the level of Member States, the conditions in which the use of financial guidance instruments remains compatible with the development of a European capital market. But once common objectives are defined, European institutions will be able to expand their financial operations alongside those of central governments and institutions in the member countries.

As regards the effects of their operations on the capital market, a distinction may be made between two types of institution. The activities of some, like the European Agricultural Guidance and Guarantee Fund, remain outside the market mechanism inasmuch as the Fund's guidance operations are financed by import levies. By contrast, institutions like the ECSC High Authority or the European Investment Bank draw heavily on the market for refinancing and keep their operations in line with market conditions.

30. The ECSC Treaty requires the High Authority to encourage the co-ordinated development of investment in the industries for which it is responsible. The High Authority periodically establishes "general objectives"; these are drawn up in consultation with all interested parties and with governments, and help to guide their actions. It is in the light of these general objectives that the High Authority issues opinions on firms' investment programmes and assists the implementation of some of them by long-term loans.⁽¹⁾ This special concern with investment guidance is explained by the nature of the sectors coming under the Treaty: they are basic industries, where investment expenditure is exceptionally heavy, and their production trends are closely geared to the general trend of the economy.

Investment loans are covered by the proceeds of bond issues floated, for some years past, mainly on European capital markets. By raising a growing proportion of its resources directly on these markets, the High Authority anticipates a situation in which integration of capital markets will be an accomplished fact and the connection between where savings are formed and where they are employed will become increasingly tenuous.

Arrangements of this kind, making it possible — without separation of markets — for investment to be directed to key industries chosen for their specific characteristics, in line with a medium-term economic policy defined at Community level, could only be to the Community's advantage.

31. The European Investment Bank has only two types of operation open to it — lending and guaranteeing. Although the Bank operates on a non-profit-making basis, it has to adapt the price it charges for its services to market conditions: in no case may the Bank itself reduce the interest rate on its loans. The proceeds of loan issues floated on the Community's capital markets account for a growing proportion of the Bank's resources. Thus, the EIB complies with the machinery

⁽¹⁾ ECSC budgetary aids to finance research are also an instrument of investment guidance, but they are beyond the scope of this report.

of the capital markets and yet finds finance for projects considered to be deserving of priority.

So far the absence of any co-ordinated structural policy within the Community has meant that the only basis on which the EIB could rely for the direction of investment was the general directives of Article 130 of the Treaty of Rome. For this reason, the Bank has mainly been concerned with helping the implementation of regional policy objectives pursued independently by the several Member States. The draft medium-term economic policy programme suggests that the time has now come to expand the operations of the Bank, which is to contribute, in close collaboration with the various institutions in the member countries, to the implementation of regional programmes that have first been "confronted and as far as possible co-ordinated at Community level". To this end it is suggested that Member States take steps to give the Bank easier access to the capital market and thus enable it to adapt its resources better to policy requirements. The programme also proposes a study to determine whether the charges and interest rates paid by the Bank's borrowers should be reduced.

On this point, and with reference to a provision in the Bank's Statute authorizing Member States or a third party to grant rebates on the interest on loans extended by the Bank, the suggestion had been made that the Commission might assume this third-party role. In its first memorandum on regional policy Commission submitted to the Council, the Commission mentioned this proposal and envisaged a study of the technical aspects of the application of such interest rebates. The Group considers that this proposal should be taken up again, in so far as it would enable the EIB to contribute more actively to the realization of future common policy objectives.

32. It is true that neither the High Authority nor the EIB is on an absolutely equal footing with other financial intermediaries: they enjoy fiscal and financial privileges and can therefore approach the capital market in exceptionally favourable conditions. By and large, the privileges conceded to the ECSC and the Bank correspond to those allowed in each Member State of the most-favoured public issues. This deliberate assimilation is justified by the fact that the High Authority and the EIB likewise have functions to fulfil which private establishments could not cope with to best advantage. Given, then, that these Community institutions and certain specialized financial intermediaries of a public character are in a similar position, it would be best if the market problems they set were solved in identical manner. It was seen, in preceding sections of this report, that the gradual elimination of internal market divisions presupposed the achievement of more equitable treatment of issuers. It would therefore be logical if any improvements the Member States might introduce to this end were followed up by alignment of the conditions on which the High Authority and the EIB now have access to the market.

Conclusions

33. 1) Closer co-ordination of regional and sectoral policies within the Community should enable the ECSC High Authority and the EIB to make a more active contribution to realization of the objectives.

- 2) If action by these institutions is to gain in effectiveness and at the same time remain compatible with the operational requirements of a European capital market:
 - a) Their access to the capital markets of Member States should be facilitated by the States concerned;
 - b) The conditions governing their operations on the various markets should be aligned on those applicable to comparable issuers resident in the country concerned;
 - c) The granting of interest-rate rebates to recipients of ECSC and EIB loans should be considered in specific circumstances.

CHAPTER 6

FINANCE POLICIES OF PUBLIC AUTHORITIES AND ENTERPRISES

Introduction

1. The extension of the powers and responsibilities of central and local government and the development of public enterprises have brought with them in all member countries an increase in public calls on the capital market.

Administrative authorities and public enterprises affect the structure of the market directly through their borrowing and lending operations and through redemption or conversion of public debt. It is because of the scale and nature of these operations that central government and institutions in the public sector are such a crucial factor in the capital market; where they also establish the priorities for access to the market, thus indirectly regulating the allocation of funds to the private sector, they largely determine the level and pattern of interest rates.

2. Although they make themselves strongly felt in all member countries, official financial policies do not have the same impact everywhere. While public-sector recourse to the market is small in some member countries, where taxes yield sufficient revenue and the rates charged for public services are at an adequate level, the situation is quite different in others. Countries in the first group, then, might fear that, if progress towards financial integration were too rapid, it might result in excessive calls on their own markets; and they might therefore be tempted to drag their feet.

It seems, then, that the creation of a European capital market, and the ability to forestall obstructive disequilibria generated in the process, implicitly depend on the adoption by the authorities and public enterprises of harmonized financial policies that will enable the differences in the development of the individual markets to be reduced.

3. The present study of the financing of the public sector, approached from the angle of the impact of public financing on the equilibrium of the capital market, is obviously not intended to tackle all the problems raised by public borrowing, much less to provide conclusions laying down general rules for the administration of public finances. The object is solely to establish certain principles which, if complied with, would ensure harmonious operation of the markets in the member countries and thus facilitate their gradual integration.

Head I will examine the principal features and trends of public-sector recourse to the capital market. Head II will review the financing of the administrative authorities and public enterprises in the light of the requirements of financial integration. This last will entail a study of:

i) Ways in which imbalances associated with excess aggregate demand for funds and the inadequacy of automatic correctors spread from one market to another;

- ii) The special role that may be played by public institutions, by adjustment of their financial policies, in preventing or correcting these imbalances;
- iii) The organization, under the Treaty, of direct and gradual access to the European capital market by central and local government.

I. Recourse to the capital market by public authorities and public enterprises

4. The transactions of central and local government and public enterprises on the capital market can be so arranged that their overall impact harmonizes with that of the private sector. In many cases, however, capital calls by the public sector are often — whether because of their size or of the terms arranged — at the root of disequilibria in the structure and operation of the market. Prior to an examination of these problems, the current situation in the member countries and its likely development in the coming years, if present tendencies are not adjusted, are reviewed below.

A. RE COURSE TO THE MARKET: CURRENT TRENDS

A) CENTRAL AND LOCAL GOVERNMENT

5. The rapid and general increase in capital expenditure by central and local governments explains why they are drawing more and more on private saving to meet their financial requirements. These growing expenditures, linked with the expansion of economic and social infrastructure (itself the key to sustained growth of the economy), can be covered by funds from a variety of sources. This report is not designed to provide a theoretical analysis of the reasons why one or other of these sources of finance — particularly borrowing or taxation — should be preferred. But one fact cannot be ignored: the inadequacy of public saving in relation to planned capital expenditure and the growing recourse to the capital market that is entailed, while restricted to some of the member countries hitherto, are phenomena now tending to become general.

6. These are the conclusions to be drawn from the Budget Policy Committee's forecasts for 1966-70, referred to in the proposals for the harmonization of public financing policies in the Community contained in the "Preliminary Draft of the First Medium-term Economic Policy Programme". "Public expenditure as a whole ... should grow rapidly in all the Member States; in general it is expected that its growth will exceed the increases in the gross national product". If the tendencies already noted persist, "the rapid growth of public capital expenditure will be particularly pronounced in all the countries".

"Current expenditure is expected to increase less rapidly than capital expenditure; none the less it is in most cases likely that it will continue to grow more rapidly than gross national product..." It is also quite possible that the expansion of current expenditure in several member countries has been estimated at too low a rate because of the methods used and the initial assumptions, in which case the balance of the budget will of course be affected.

"The main source of danger to the balance of budgets is likely to be the fact that, according to the estimates, revenue will be increasing more slowly than expenditure: most member countries have assumed essentially unchanged tax rates, with the result that revenue from taxation will develop on lines roughly parallel to the trend of the gross national product, or at best — given the progressive nature of some taxes — will grow a little more rapidly.

"The assumptions used therefore point to a substantial increase in public financing needs. At the same time a noteworthy deterioration in the current accounts of almost all member countries is to be feared, so that public saving as a means of financing capital expenditure will tend to decline in importance".

If things remain as they are, especially tax legislation, it will therefore be necessary in all the member countries "to borrow even larger sums to cover the growing need for public infrastructure investment; this will be necessary even in countries like the Netherlands, where central government investment is in principle to be financed out of current revenue, by far the greater part of public investment being generally carried out by the local authorities". This need is not stated as a general thesis, of course, since the structure and financing of the budgets should in principle be determined by the economic situation: the Committee is simply stating its views in connection with inflationary pressures arising from an excess of public spending over income. The conclusions of the draft medium-term economic policy programme are therefore that the interests of the public authorities as issuers of loans will compete with those of industry, which may also need to make increased calls on the capital markets to finance its investment".

B) PUBLIC ENTERPRISES

7. The diversity of the conditions in which public enterprises have developed, the large number of industries in which they operate, and the multiplicity of legal and administrative regulations governing them are all factors explaining why the financial problems of these enterprises differ widely and why it is not easy to classify them all on the basis of their financial situation.

The legal status of the public enterprise always affects the means whereby it can cover its financial requirements. Where the central or local government is engaged directly in an economic activity, the enterprise concerned has individuality only in a technical sense: its assets and financial operations merge with those of the central or local government involved. Sometimes the public enterprise is given a limited degree of independent management; here, however, there is generally an organic link with the finance department of the authority so far as the covering of finance requirements is concerned. In both cases the incidence of the financial administration of the enterprise on the capital market may be reflected in increased official indebtedness. A different situation arises with public enterprises that have their own legal personality and operate on the same footing as private firms. As this type of public enterprise has a budget and a finance department quite separate from those of the supervisory authority, it has a clear problem of choice in the matter of outside finance: it can call either on the Treasury or on the capital market.

A more important distinction is that made between the public enterprises that compete with private enterprises, and those providing a public service, which are frequently monopolies. In the light of this distinction the general considerations set out in Chapter 2 (secs. 8-16) can be qualified and given more particular application.

8. Generally, there are no real differences in kind between the financial problems of public enterprises competing on the market and those of private enterprises of the same type. Although the variety of situations and the inadequacy and lack of uniformity in financial accounts make any generalization impossible, certain constant factors in this matter can be derived from as yet incomplete data collected for a survey carried out under the auspices of the *Centre européen de l'entreprise publique*. This shows that in some cases self-financing by public enterprises competing on the market is developing on much the same lines as that of private enterprises in the same sector. Additional needs for outside funds are met either by central government contributions, or by recourse to the capital market, or by some combination of the two. Central government contributions most often take the form of long-term credits or capital contributions (participations in the enterprise's capital or contributions to an endowment fund, conversion of previous loans to endowments). As such assistance has been on a small scale in recent years in both absolute and relative terms, direct recourse to the market has usually been the chief method of borrowing adopted by this type of public enterprise. However, procedures whereby these enterprises obtain access to the capital market have certain special features to be examined in secs. 11 and 12.

9. The situation of public enterprises providing a public service is completely different. The policy with regard to charges pursued by these enterprises — or imposed on them — is at the root of their financial problems. These charges may be "political" i.e. not based on ordinary economic and financial criteria alone, but regulated by the public authorities with due regard to the probable social and political effects of a given pattern of charges for public services. Consequently, policies vary not only from country to country, but even from public enterprise to enterprise in a single country. The multiplicity of differing situations may be reduced to a few typical cases. The two extremes are (a) where charges are too low even to cover operating costs and (b) where the charges ensure that the enterprise has sufficient revenue to meet costs and to finance additions to plant and equipment. Since the fixing of charges for public services is generally determined by extraneous factors — particularly the need to keep the cost of living steady — most public enterprises providing a public service come into the first category. As they have no real means of self-financing and sometimes even have to operate at a loss, these enterprises draw substantially on the capital market.

B. BORROWING PROCEDURES

10. When required to make capital expenditures and transfers that cannot be financed from the surplus on current account, the administrative authorities, as we have seen, have to call on private savings. Through financing channels that vary

from country to country but serve identical purposes, the authorities can tap certain kinds of saving — post office saving, saving through social security schemes, and so on. A process of "transformation" enables excessively liquid savings to be made suitable for long-term financing. However, the scale of official requirements and the limited use to which such liquid savings can be put explain why the flotation of loans on the capital market is still the main channel through which private saving flows to the public authorities.

11. When obliged to resort to the capital market, public enterprises can use a variety of approaches, not all of them of the same importance. Apart from a few exceptions — among which Italy may be mentioned — the bank credit that constitutes the normal source of financing for small and medium-sized firms is usually only a subsidiary source for public enterprises — generally used for preliminary financing. With the financing of the enterprises forming the IRI concern, financing by means of issues of stock to the public is a technique which has been most fully developed and carefully defined in Italy. In most cases, however, public enterprises generally borrow from the public by issuing bonds.

12. For several reasons, recourse to this market by administrative authorities and public enterprises takes place on special terms: the issue and distribution of securities enjoy benefits and privileges intended to ensure that they have priority with investors.

Some of these advantages derive solely from the nature and size of the issuer. Other things being equal, securities offered by public borrowers are superior to bonds issued by the private sector in that holders have an investment in which they run no risks other than monetary. Because of its size, the market in public bonds also tends to suffer less from sudden fluctuations. Certain agencies — the Belgian *Fonds des rentes* and the French *Caisse des dépôts et consignations* — intervene in any case to steady prices.

As well as these natural advantages enjoyed by public borrowers, there are certain facilities and privileges whose chief purpose is to ensure that their issues are given priority. These facilities and privileges vary from one member country to the next. They may even vary as between central government, local government and public enterprises. The benefits available to all are numerous:

- a) Laws and regulations facilitating the placing of securities with institutional investors;
- b) Various tax exemptions, particularly as regards certain direct taxes and estate duty;
- c) Reduction of or exemption from stamp duties;
- d) Central government guarantees for interest payments and/or capital repayments;
- e) Priority as regards timing of issues;
- f) Exemption from certain bank commissions, and moderate advertising and flotation costs.

II. Financing of public authorities and enterprises and development of a European capital market

13. Though it is the bond market that bears the brunt of public-sector financing, the trend of the capital market as a whole is directly or indirectly determined by it. Consequently, the advantages accorded authorities and public enterprises and their leading position on the market place upon them a special responsibility to forestall and correct any disequilibria, though this does not mean that they alone are responsible for adjustment.

A. INADEQUACY OF MACHINERY FOR REGULATING THE MARKET

14. Freedom to borrow on the capital markets of the other member countries would enable some member countries to satisfy their public and private finance requirements more fully and on better terms than on their own home markets.

One possibility would be for the public sector to be the principal borrower on foreign markets. As the "transformation" of cash savings through public finance channels is subject to quantitative limits, central and local government might then regard borrowing abroad as the only acceptable alternative to either tightening up credit facilities for private enterprises (which might be undesirable) or obtaining additional funds on the money market (which might also prove undesirable).

Under a policy tending to reserve an adequate proportion of the domestic supply of capital to private enterprise, public enterprises might likewise be urged to borrow on foreign markets, which they could enter relatively easily because of their size and the implicit or explicit guarantee provided by the central government.

The cost of capital, which largely determines the indebtedness of private enterprises, affects the borrowing decisions of administrative authorities and public enterprises to a limited degree only, since their demand for funds is relatively inelastic. With the home market already strained, considerable use could be made of the facility of borrowing abroad.

The converse might be likely to occur even more frequently: the authorities and public enterprises raising their finance requirements on the home market and private enterprises borrowing abroad. This borrowing might be no more than the logical consequence of the strain and rising interest rates imposed on the home market by the public sector's priority claims, or it might be the outcome of deliberate government policy. It must be pointed out that in case of a relative rise in interest rates, disequilibria can also spread through the purchase of bonds on the market of one country by residents of other member countries. In practice, this contamination process will often prove even more important than the direct issues made by the country involved on the markets of other Community countries.

15. Irrespective of the means by which they finally spread, strains on the home capital market would thus be reflected in the transfer of some of the demand for funds to other Community markets.

It is possible that on one or more of these markets, on which the supply of funds is normally thin, funds will temporarily be plentiful. In that event the arrival of foreign borrowers would not only cause no upset in the market resorted to, but their transactions would also make it possible to reduce the strain on their home markets.

This additional demand, however, may reinforce existing disequilibria on certain markets or cause disturbances on others where the balance is precarious.

A rapid increase in supplies of capital on the European market would be the only means of combating these risks by meeting the combined requirements of all central and local government authorities and public and private enterprises. Yet even on the assumption that the propensity to save in the Community grows and that the volume of savings available for long-term investment increases more rapidly — in step with the process of financial integration — it would still remain problematic whether the desirable balance could automatically be achieved.

16. Consequently, if the European capital market is to expand without serious strain, work on aligning conditions on the various markets must be continued, in order to minimize disturbance as the markets merge. This seems all the more necessary because in recent years, despite the existence of definite obstacles to the movement of capital, where strain has occurred on one market or another, it has spread with increasing rapidity through the Community. Hence, when the gap between overall demand for funds from the private and public sectors and the supply of capital tends to increase on a given market, the restoration of balance becomes a problem of common interest to all member countries.

The key problem to be solved in restoring equilibrium is whether demand from administrative authorities and public enterprises should still be given more or less priority treatment or whether this should be given to private enterprises instead. The choice is a political one: it may bring the chief burden of adjustment to bear on either the public or the private sector by inducing a reduction in their demand for capital. The prevailing situation in the Community — and budgetary analysis and forecasting show that it is part of a long-term trend — indicates that at the present stage of the business cycle the burden of adjustment should fall chiefly on the public sector. The "Preliminary Draft of the First Medium-term Economic Policy Programme" shows that this would not entail a reduction of public investment — for growing collective needs make public investment indispensable — but only an overall adjustment of the terms and conditions on which investment as a whole is financed. This adjustment, essential if there is to be lasting growth without strain, requires, among other things, a slowdown in the rise of consumers' expenditure and the acceptance of certain principles by administrative authorities and public enterprises. However, a certain part of public expenditure regarded as consumer expenditure (education, research, etc.) is clearly attributable to policies aiming at structural reforms and therefore merits the same priority treatment as investment expenditure. An essential in the establishment of greater budgetary stringency is therefore a breakdown of public spending showing the total additional capital and operating expenditures eligible for financing by priority.

The fixing of these principles — the rules for the administration of public finance and for covering the financial requirements of public enterprises — is the central element in the passages on public finance policy contained in the Draft Programme.

CONCLUSIONS

17. More rigorous financial restraint on the part of central and local government and public enterprises would make a real contribution to preventing or slowing down the development of local strain and its spread to other capital markets. This conclusion by the Group is based on the following considerations:

- 1) The intensification of contacts between the capital markets of the member countries may enable any excess demand for capital by the public and private sectors to be satisfied and at the same time lessen the risk of strain that might arise on an isolated market.
- 2) However, the extent of potential demand is not such as to justify the assumption that balance on the European capital market can be attained automatically. The integration process consequently seems to be dependent largely on the reduction of the strain on national markets engendered by the various types of borrower.
- 3) In the present economic situation the burden of the adjustments needed on each market should fall chiefly on public agencies, which should reappraise certain aspects of their finance policies.

B. THE INFLUENCE OF FINANCING PROCEDURES ON MARKET BALANCE

18. The situation on most of the capital markets is such that conclusions can be drawn as to the spheres in which central and local government and public enterprises should exercise restraint for the next few years: first, the *scale* of their borrowings, which should be reduced where they are so heavy as to restrict the opportunities of private enterprises to draw funds from the market; second, the *methods* by which they borrow, which should be modified so as to reduce the differences in the terms laid down for the various categories of borrower and to introduce a greater degree of diversification in methods of attracting private savings.

A) CENTRAL GOVERNMENT

19. A reduction in central government demand on the capital market cannot be effected merely through market machinery. For a restriction — however necessary and desirable — of the special privileges that help to give priority to the placing of government securities cannot remove from the public authorities the natural advantages they enjoy in any case. Moreover, the options underlying the government's finance requirements are political in nature: public demand for capital will not therefore be significantly affected by the trend of interest rates.

20. A diminution of government pressure on the market must therefore proceed from a political choice intended to improve budgetary equilibrium.

Since public investment is given priority in most member countries, this aim can only be achieved through economies on public consumption and through better-

balanced social security systems. However, there are limits to restriction of the growth of certain public expenditures, and increases in taxation may well be inevitable. This higher taxation, needed "from the point of view both of general economic equilibrium and of the particular financial requirement", should, as the "Preliminary Draft of the First Medium-term Economic Policy Programme" recommends, be raised at the cost of private consumer spending, "so as to avoid as far as possible compromising the formation of private savings and the industrial investment drive".

Considering the adjustment of central government finances, the Group believes that budgetary planning extending over a number of years and relating particularly to public investment in the broader sense would be a useful means of enabling the combination of taxation and recourse to the market to be planned over long periods. This could lead to a distribution of public investment in two groups. The first would include investment which, forming part of a determined effort to carry through vital structural reforms, could not be postponed and for which funds must definitely be found, either by taxation or borrowing. The second, on the other hand, would include investments which would be implemented only in the light of the situation on the capital market: loans to cover those would not be issued unless they were unlikely to encroach unduly on capital available for other sectors of the economy. A distinction of this kind between two kinds of public investment would satisfy the requirements of economic policy and make it possible to steady the trends on the capital market.

B) LOCAL GOVERNMENT

21. The attainment of these aims presupposes rigorous discipline on the part of *all* public authorities. Certain obstacles may be put in the way of this by the financial autonomy of local governments: the requirement of a balanced budget and the general rule in local government finance that expenditures should be fully covered by revenues do not provide a real guarantee against structural disequilibria occurring. Normally the quantity of funds to be amassed is geared to the expenditures deemed necessary. However, the broad measure of autonomy actually enjoyed by local government in the matter of expenditure is not matched by similar freedom in choosing means of ensuring that expenditure is covered, and in most cases local tax systems cannot readily be adapted to changes in requirements. The amount of central government subsidy is also beyond the control of local authorities, so that the only means of supplementing inadequate resources is by borrowing.

Irrespective of means employed, local government demand is at present a factor that adds greatly to the pressure on the capital market. While this is quite evident when borrowing is in the form of a bond issue, it is no less real, though less apparent, when local authorities call on specialized public or semi-public credit institutions, savings banks and their central institutions, or private bodies such as insurance companies or mortgage banks. For the resources of public credit institutions and savings banks are themselves largely built up from capital drawn from the market by bonded loans or funds which, mustered through specific financing channels, could have contributed directly to supply on the capital market.

22. Some limitation of the incurrence of debt by local government should be sought, taking due account of the twofold necessity for the local authorities to adapt their borrowing constantly to the general economic situation and for priority investments to be carried out whatever the circumstances. The problem can be tackled from two angles.

23. First of all, increased autonomy in taxation matters would enable local governments to reduce the sums they would have to borrow for any given total of expenditure.

24. Secondly, there is a good case for a more rational arrangement of the power to borrow additional capital needed. A relevant factor here is the low elasticity of demand for capital by local government in relation to market conditions: local authorities often have to call on the market as a result of political imperatives even when the market situation is unfavourable. The existence of a specialized credit institution as an intermediary to centralize demand from local government and to satisfy it by refinancing on the capital market might help to improve the borrowing methods open to local authorities, as is done by the agency operating in this field in the Netherlands — the *Bank voor Nederlandsche Gemeenten*. This would have the advantage of showing precisely what requirements had to be satisfied, and the institution could then arrange the capital drawings, simultaneously taking into account overall demand from local authorities and the need to avoid any disturbance on the market. An organization of this kind could also refrain from operating on the market other than in special situations, defined on the basis of objective criteria such as the trend of interest rates or the rate of increase of local government borrowing. In situations of this kind, even authorities that normally finance themselves by floating loans would be invited to turn to this organization, which would borrow on the market within limits compatible with the maintenance of equilibrium and then allocate the funds among the various local authorities.

Two problems remain which can probably not be ignored: in the first place this procedure should not be restricted to local government authorities alone but should include companies in which local government has a majority interest. Secondly, there should be powers to impose similar restraint on the recourse to sources of finance other than bonded loans.

While technically feasible, the organization of a specialized credit institution for the local authorities would nevertheless have the disadvantage of changing the relations between central and local government. Moreover, in a Member State of a federal structure such as Germany it would only be practicable if organized at Länder level. Nevertheless this solution would be conducive to greater restraint on the part of the public authorities, in spite of the obstacles which stand in its way and in spite of the fact that it would create a specialized financing channel. The refinancing operations of this specialized institution might also have favourable effects on the development of a European capital market, where the issues of a borrower of considerable financial weight and very probably equipped with a central government guarantee would attract investors even on markets other than its own.

C) PUBLIC ENTERPRISES

25. Bond issues are an important means of financing public enterprises for reasons that vary with the nature of the enterprise and its operation: a reduction in their overall recourse to the bond market, which, as will be shown below, is a desirable objective, presupposes that adjustments adapted to each case will be made in their financial administration.

Fundamental in this respect is the distinction between public enterprises competing with private firms and those providing a public service and having charges fixed irrespective of operating costs.

26. Public enterprises of the first type often have self-financing margins approaching in size those of their private counterparts.

Public enterprises providing services at charges not determined by costs are the more numerous. They include gas and electricity producing and distributing companies and state railway systems. Research should make it possible to distinguish those managerial decisions determined by the logic of the market and those dictated by considerations of social and political distribution. Consequently, enterprises may be divided into two groups.

The first of these includes all enterprises which could move gradually from a system of fixed, "political" charges to a system of market prices geared to the cost of services rendered. Eventually the revenue of these enterprises should, in addition to ordinary operating expenditures, cover normal depreciation and even provide a net margin for self-financing.

If, for the enterprises in the second group, the maintenance of "political" charges still seemed necessary, the problem of covering operating expenditure and of financing investment would remain, as would the problem of limiting their recourse to the capital market. On this assumption, the revenue authorized by the level of charges should at least cover operating expenditures, and if this minimum cover should in certain cases not even be ensured, the deficit should be financed from taxation.

A slight or non-existent margin for self-financing would leave the problem of covering capital expenditure. Finding the necessary funds, whether by grant from the supervisory authority or by a direct call on the market by the enterprise concerned, implies pressure on the market in both cases: at the moment grants from central or local government necessarily entail, in view of the deficits on their overall capital transactions, increased drawings on the capital market. Direct bond issues by public enterprises produce identical results.

In sum, given that the maintenance of "socio-political" charges for various public services is inevitable and there is a need to limit excessive incurrence of debt by enterprises providing such services, it may be considered that this latter objective will be the more easily attainable if certain basic rules of administration are respected. For instance, it would be particularly desirable for charges to be fixed in such a way that, in addition to covering its operating expenditure, the enterprise would be able to renew its plant and equipment.

27. Even if borrowing by public enterprises were reduced to tolerable proportions in this way without excessive strain on the capital market, the problem of procedure would remain in that borrowing would still be chiefly on the bond market. In this respect the recent example of ENEL in Italy is particularly significant. Since the electricity industry came under government control, ENEL has acquired funds exclusively by means of loan issues, whereas before its constituent companies issued shares in much greater volume than bonds. The consequence of nationalization has thus been to introduce an element of imbalance onto the capital market.

The strain on the capital market arising from the financing of public enterprises by bond issues alone might be reduced if securities were issued which, while having some of the features of the shares to which the public is accustomed, would nevertheless not detract from the principle of public control of these enterprises.

Of the procedures tried out, the one linking the loan capital and/or interest to the performance of the public enterprise is perhaps the most interesting. These devices will be examined in Chapter 9.

28. With the same objective of diversifying and balancing the various ways of borrowing on the capital market, public enterprises should make more systematic calls on the share market. But, except where the enterprise is to be restored to private ownership and where, in consequence, there would be no quantitative limit on the issue of ordinary shares, habitual recourse to risk capital presupposes the issue of securities with some original features. The issue of preference shares and non-voting shares would be a way of enabling public enterprises constituted as joint-stock companies to finance themselves extensively on the stock market without the problem of public control being posed. At all events — and there are many convincing examples of this in Italy (IRI companies) and Germany — the maintenance of public control is by no means incompatible with a large measure of private participation in such enterprises.

This arrangement seems to be particularly suited to enterprises competing directly with private firms. Conversely, it seems less suitable for the financing of enterprises providing a public service. For even if the fixing of their rates is not influenced by extraneous social and political factors, these enterprises are not managed with a view to the interests of shareholders. Consequently, in certain cases the dividends that they could offer holders of their shares might differ only moderately from the income guaranteed to mere bondholders. If this were so, the issue of such securities would make only a small crack in the general predominance of financing by bond issue.

29. However this may be, the financing of public enterprises by bond issues would remain essential for public enterprises, and it would therefore be necessary to minimize the potential dislocation of the market caused by the method and terms of recourse.

Of the various advantages enjoyed by issues by public enterprises, some (low advertising costs, exemption from bank commission, etc.) are not due to the fact that the borrower is a public agency but to the fact that the borrower is a big one. Private borrowers of equal size benefit from advantages of the same order, so these advantages cannot be regarded as constituting any form of discrimination against the private sector.

The grant of tax or financial privileges and or the use of procedures — such as adjusting the issue queue — do, however, result in discrimination where they favour public issues. It will be difficult simply to abolish these advantages, nor would it necessarily be advisable, for they may constitute the counterpart of charges or specific liabilities burdening the public enterprise. In this case, far from arbitrarily favouring the public enterprise, they compensate it for the drawbacks occasioned by special operating conditions. In consequence, the maintenance of these advantages can be justified in this particular case. In order to eliminate discrimination between borrowers and the disequilibria that might result on the market, however, it would be advisable to extend their benefits to the private enterprises subject to the same constraints and obligations and to ensure that — once these constraints and obligations have disappeared — the compensatory advantages are modified accordingly.

C. ORGANIZATION OF THE ACCESS OF CENTRAL AND LOCAL GOVERNMENT TO THE EUROPEAN CAPITAL MARKET

30. The Group sees harmonized reduction of the pressure exerted on member countries' capital markets by the aggregate demand of the public and private sectors as one of the essential factors in the attainment of integration. The current business situation in most member countries suggests, as recommended above, that calls on the market by public agencies should be reduced.

This prior condition of access by these agencies to the markets in other member countries is not sufficient, however, to guarantee that their recourse to the additional financial facilities thus offered can be effected without strain unless there is voluntary, and subsequently concerted, restraint on the part of those countries.

There is room for doubt about the exact scope of Article 68 (3) of the Treaty of Rome, which provides that "loans intended for the direct or indirect financing of a Member State or of its territorial sub-divisions may not be issued or placed in other Member States save when the States concerned have reached agreement in this respect": as has already been pointed out, any disequilibrium on a domestic market due to excessive borrowing by administrative authorities and public enterprises may — without these agencies themselves issuing loans abroad — spread to other markets as and when private enterprises are obliged to shift their demand for capital to these markets. It therefore appears that the Treaty clause quoted above governs only the procedure for mutual opening of markets to public borrowers and that the problem remains as to what criteria should be used, within this fixed procedure, to determine the timing and ways and means of opening them up.

One possible objective criterion is the degree in which the "public" foreign loan conforms to the general objectives of economic integration. But in practice this degree of conformity cannot itself be assessed except in the light of the aims of an economic policy defined in a Community context. In other words, the possibility of referring to an objective criterion depends on how far such a policy has been elaborated. The actual criteria are bound to vary in step with the

formulation of policy: during the transition period, during which the elements making it possible, at Community level, to assess the advisability of issuing public loans abroad are gradually taking shape, a pragmatic approach to the problem would seem the only valid one.

31. Nevertheless, some of the conditions and procedures governing access to the European capital market by central and local government can be adjusted now.

Harmonization of the benefits and privileges accorded public securities seems to be an essential condition. A first step would be to establish joint agreement on the special advantages linked with issues of public loans on the market of a partner country; this would prevent rival borrowers from outbidding each other on the market. There is also a case for harmonizing the privileges linked with the issue of public securities on domestic markets. In this the point would be to prevent differences in the nature and degree of privileges from distorting the distribution of securities and to prevent any given member country from using these advantages to place a proportion of its issues with investors resident in the partner countries, though without actually having direct recourse to the capital markets of those countries.

This twofold harmonization — which itself should eventually bring into line the terms governing issues of public loans on the domestic market and on foreign markets — would thus help to establish rules to be followed by the public borrowers of one member country in calling on private savings in other member countries within an integrated market.

Conclusions

32. The Group considers that the adjustment of the conditions on which the public authorities and enterprises are financed should make it possible to contain the overall pressure of public and private borrowers on the various markets within limits and forms compatible with the development of their financial relations. Some of the arrangements needed to give central and local government direct access to the European capital market should be made at the same time. The following measures might make a useful contribution to the attainment of these aims:

- 1) Financing a bigger proportion of the investment of the administrative authorities from their own saving;
- 2) Reconsideration of the special treatment given to loans issued by these authorities;
- 3) Greater flexibility in programmes of public investment in the broader sense, which would either defer certain projects if financing them might unbalance the securities market, or encourage them if the economic situation permitted;
- 4) Granting local authorities wider tax autonomy;
- 5) Centralizing local authority borrowing by means of a specialized institution that would refinance itself on the market; this could be done solely in times of strain or alternatively could be a permanent arrangement;

- 6) Fixing the charges of public service enterprises in a way that enables them at least to cover operating expenses and renewal of plant and equipment;
- 7) Contributions of government capital — to be financed by taxation — where the public enterprise cannot provide a normal margin of net self-financing;
- 8) Diversifying the securities offered by public enterprises, which would enable them — especially those competing with private enterprise — to have recourse to risk capital;
- 9) Reducing discrimination between bond issues of public concerns and those of the private sector;
- 10) Strictly defining the special benefits admissible for public loans floated on the market of another member country and harmonizing the terms of issue of public stock on the domestic markets.

PART THREE

WIDENING CREDIT CHANNELS

One of the outstanding features of the structure of the capital markets in the Community countries is the importance of medium-term and long-term credit as a source of investment finance.

This suggests that there can be no real European capital market until the institutions and channels supplying such an important part of the finance for economic expansion in the Community countries are closely interlinked.

There are, however, a number of obstacles to surmount.

Credit techniques and, in particular, the institutions using them have in many cases differing objectives. The contribution of the public institutions, which, in Belgium, France and Italy, work alongside the banking system in providing medium- and long-term finance, raises particularly delicate institutional problems, because their main concern is with domestic operations.

Moreover, if the problems are looked at from the angle of the sectors benefiting from medium- and long-term credit assistance, namely industrial and agricultural equipment, building and the capital expenditure of local authorities, it soon becomes apparent that in several of the countries housing and urban and rural infrastructure still remain problems for the solution of which the authorities bear the principal responsibility.

In addition to these institutional or political obstacles there are difficulties peculiar to international financial operations — the exchange risk and the question of the security offered to lenders.

Two studies have been made: the first concerns the development of industrial investment credit; the second deals with credit for housing and local authorities' capital expenditure.

CHAPTER 7

MEDIUM- AND LONG-TERM CREDIT TO INDUSTRY

1. The medium- and long-term investment credits obtained by European industrial enterprises from banks, specialized institutions or other financial institutions are among their most important sources of external finance. In all the member countries, industry's need for external finance at medium and long term has grown in recent years, mainly because profit margins — and therefore the scope for self-financing — have shrunk and because the rather excessive short-term indebtedness incurred over several years of rapid expansion has required consolidation.
 - i) The first section of this chapter describes the main features of the distribution of medium- and long-term credit and discusses official influence on the granting of such credit.
 - ii) The second section describes the techniques likely to ensure the development of international credit and the interpenetration of banking networks.
 - iii) The third and final section deals with the field in which the advantages of a European capital market may well become most rapidly obvious: the utilization of refinancing techniques.

I. The distribution of medium- and long-term credit

2. Medium- and long-term credit to industry is provided not only by the banks. Specialized institutions (very often public or semi-public), savings banks or their central institutions, insurance companies, and the central government (where it intervenes directly) also make their contribution.

It is not part of the purpose of this report to analyse in detail the medium- and long-term credit markets in the various member countries. Certain particularly significant factors should, however, be pointed out.

A. THE FINANCIAL INSTITUTIONS

A) THE BANKING SYSTEM

3. In order to meet the increased demand for business finance, the banks have endeavoured to step up their medium-term lending as far as the often restrictive regulations would allow them.

In Luxembourg, virtually all the external finance obtained by industrial enterprises in the form of medium- and long-term credit seems to be provided by the banks.

The medium- and long-term credit supplied to industry by banks proper accounts for a high proportion of the total (about a third, in fact) in Germany, France and the Netherlands. In France, the bulk of the assistance granted is in the form of rediscountable medium-term credit.

Italian and Belgian banks commit funds at medium or long term on a relatively limited scale. In Italy, for example, banks may not engage directly in medium-term lending, but indirectly they help to finance investment by regularly renewing short-term credit and by contributing to the funds of the specialized institutions through the purchase of their bonds and by channelling to them deposits made by the public. In Belgium, the banks began operating in this field only relatively recently.

B) THE SPECIALIZED INSTITUTIONS

4. The work of institutions specializing in medium- and long-term credit to industry has expanded, particularly in Italy and Belgium, but also in France. In Italy, this trend has been strengthened by the establishment, alongside the more general institutions, of special institutions for the furtherance of regional development. In Belgium, on the other hand, the system of specialized institutions remains heavily concentrated, with a single institution answering for about three quarters of the total credit. In France, various specialized institutions extend medium- and long-term credit direct to enterprises, particularly the nationalized undertakings, from their own funds, from resources placed at their disposal by the central government (the Economic and Social Development Fund) and from borrowed funds; they also act as centres for the mobilization of medium-term bank credit. The importance of the specialized institutions declined, in relative terms, in Germany and the Netherlands, once the traditional credit establishments were again able to muster enough funds for the purpose; but the public or semi-public financial institutions continued to play a major role in Italy, Belgium and France — a role strengthened by the fact that they serve as the main, if not the only, intermediary for the distribution of public capital or investment subsidies provided by the central government. This was the case in Belgium until 1959 and is still largely the case in Italy and France.

C) THE SAVINGS BANKS, INSURANCE COMPANIES AND PROVIDENT INSTITUTIONS

5. Throughout the Community, the bulk of the funds of these institutions is directed to the financing of local authorities' capital expenditure and housing, since these requirements have official priority. Another reason for this investment pattern is that laws and regulations originally intended to protect the saver limit the extent to which the resources of institutional investors can be lent to industry. There are, however, notable exceptions to this general rule: thus, in Germany the savings banks, and particularly their central institutions, are the most important sources of medium- and long-term finance for small business.

In other member countries too there seem now to be signs of a tendency towards greater participation by savings banks in industrial financing.

6. The life-assurance companies and pension funds are the main sources of industrial investment finance in the Netherlands, their loans against borrowers' notes (*onderhandse leningen*) accounting for about half the total credit provided. In Germany, life-assurance companies provide about a quarter of industrial equipment loans, using a technique with similar flexibility (*Schuldscheindarlehen*).

It may also be noted that the contribution of these institutions to the financing of business enterprise is not confined to direct lending, since they also provide industry with capital by purchasing securities.

B. THE PUBLIC AUTHORITIES

7. The authorities help to finance industry either by direct lending or by making credit available indirectly through specific institutions. Privileged conditions in the form of tax benefits, guarantees, or priority access to the capital market are often granted to such institutions by the authorities. In almost all the Member States the interest-rate rebates allowed for certain classes of borrower have a strong impact on industrial financing.

If some of the privileges enjoyed by public or semi-public specialized institutions in the collection of their funds were withdrawn, the conditions of access to the market by the various financial institutions would naturally become better aligned. The Group is, however, conscious of the needs which prompted the creation of institutions for the specific purpose of aiding investment in certain economically retarded areas or in industries needing special help. The harmonization of these measures is covered by the Treaty clauses on state aids, which lie outside the framework of this report.

As suggested in Chapter 5, any system that makes the provision of aid in the form of interest rebates solely dependent on the use of a specific institution or type of institution should be avoided. In view of the scale of these rebates in all the member countries, action to remove this direct link would appear to be an essential condition for the establishment of effective competition between credit institutions on a European market.

Lastly, the Group has noted that medium- and long-term credit is supplied to industry in conditions differing widely from country to country in the Community: however, there is a tendency for credit institutions to specialize less, and this will make it easier for them to take their place in a system of international capital movements. This trend remains, however, largely dependent on the way in which official intervention measures in this field are adjusted.

II. International bank lending and the interpenetration of banking systems

8. The main aim of broadening the medium- and long-term credit supply is to offer Community enterprises better opportunities of obtaining credit for purchases of plant and equipment on comparable terms and at the same time give the various financial institutions equal chances of expanding.

In this context the Group studied two particular aspects of the problem:

- i) The development of direct international credit;
- ii) The interpenetration of banking systems by establishment of branches or subsidiaries in the other member countries, by development of relations with correspondents and by other forms of co-operation.

A. THE DEVELOPMENT OF DIRECT INTERNATIONAL CREDIT

9. International credit operations are current practice in the short-term field, especially on the Euro-currency markets. There are also examples in the medium-term credit sphere, where the last two years in particular have seen a growing number of German firms borrowing direct from foreign banks.

However, apart from credit drawn to finance commercial transactions, financial operations between banks and enterprises located in different countries have remained relatively few in number.

The obstacles to be overcome and the solutions which the Group recommends for the development of this type of lending are examined below.

A) PROBLEMS CONNECTED WITH EXCHANGE CONTROL AND RESTRICTIONS DERIVING FROM LAWS, REGULATIONS, CHARTERS, MEMORANDA OF ASSOCIATION, ETC.

10. Without wishing to revert here to the points made in Chapter 3 on exchange-control restrictions, the Group does feel that the maintenance of such restrictions in certain countries is liable to prevent resident enterprises from obtaining access to the most profitable sources of finance and thus to put them at a disadvantage in international competition.

The removal of these restrictions must therefore be contemplated. To avoid any risk that capital movements occasioned by such action might upset market balance, the objective should be approached by stages through progressive raising of the limits of operations subject to authorization, as provided for in the draft third directive, now under discussion, for the implementation of Article 67 of the Treaty.

11. Major obstacles to the extension of the cross-frontier operations of financial institutions may also derive from laws or regulations other than exchange control, or even from the charters or memoranda of association governing these institutions. This problem particularly affects the credit transactions of the public or semi-public institutions specializing in medium-and long-term credit, and it seems likely to limit their role in international capital movements to refinancing operations. On the other hand, there is little evidence that obstacles of this nature generally hamper operations abroad by the banking institutions.

12. The "leasing" technique recently introduced into Europe and developing rapidly in some of its countries allows of operations analogous to the granting of

international credit: equipment can be purchased and hired out to an enterprise domiciled in a foreign country. This type of indirect credit is free from some of the problems of direct international lending at medium and long term, since it takes the form of either an export of equipment or a purchase of equipment abroad, followed by the payment of rentals constituting "current transactions". The obstacles to the development of this technique lie mainly in the limited resources of the "leasing" establishments, in legal problems raised by the maintenance of the ownership rights of these enterprises to the equipment leased, in differences in fiscal legislation and, where it arises, in the exchange risk connected with the transfer of rentals.

B) PROBLEMS CAUSED BY DIFFERENCES OF FINANCIAL STRUCTURE

13. It is not only with specialized institutions that problems may arise because of the diverse financial structure which has developed over the years; different banking systems are to be found also in the competitive sector. Here, alongside systems based on the principle of complete separation of short-term credit, medium- and long-term credit, and the acquisition of participations (as in Italy), we find others in which the all-purpose bank is still the most widespread (Germany, Netherlands, Luxembourg), and others again in which *banques d'affaires* — very similar to all-purpose banks — operate alongside the commercial banks (France).

14. The Group is aware of the problems which may arise from these structural differences. None the less, the present tendency in certain Community countries towards less specialization of banks should add to the variety and flexibility of the methods of collecting savings and extend the range of services offered to customers. This trend may well make a substantial contribution to reducing the dangers of distortion of competition in this sector at European level.

Hitherto discussion of the problems of specialization of banking institutions seems to have concentrated almost exclusively on internal aspects. In the Group's view there is now a case for considering the matter from the viewpoint of the integration of capital markets and for devising arrangements that will allow banks to exist side by side even though their institutional organization and operating rules still differ appreciably. These problems will be discussed in Chapter 12, which deals with disparities in the functioning and supervision of financial institutions.

C) PROBLEMS RESULTING FROM THE DIVERSITY OF SYSTEMS IN FORCE AS REGARDS SECURITY AND GUARANTEE REQUIREMENTS

15. For many years credit was granted mainly on the strength of the security offered; and though nowadays lenders attach more importance to considerations of profitability than they used to, the question of the guarantees and security put up still remains an important factor.

The Group has approached this problem with a view to examining what difficulties the international application of techniques currently used at domestic level may occasion and which, if any, among the current domestic practices are likely to facilitate international transactions.

The guarantee of a credit establishment belonging to another Member State is the most commonly used form of guarantee in international credit operations. There are virtually no obstacles, apart from a few exchange-control restrictions, to the giving of a guarantee on behalf of a non-resident; this form of guarantee therefore often takes the place of other types of guarantee or security the use of which in international credit operations might raise difficulties. This procedure makes it possible for a guarantee such as a mortgage — which the borrower can provide without difficulty to the establishment backing him, but could not easily place directly at the disposal of his creditor — to be "transmitted" to the foreign bank. The interposition of the guarantee also facilitates solution of the problem of mobilization.

Other guarantee techniques, such as, for instance, an assignment of future claims or other restrictions on a debtor's freedom of action⁽¹⁾, or the working capital arrangements through which a parent company's undertaking to support its subsidiary financially is sufficient guarantee to the lender that the subsidiary can at any moment discharge its obligations, would seem particularly well adapted to international credit operations. Nevertheless, the provision of such guarantees by the parent company is sometimes hampered by tax obstacles or by the rules on the presentation of the company's accounts.

In addition to the problem of their cost — which is often high — the granting of these guarantees is subject, in certain Member States, to an exchange-control permit which restricts their use. However, it seems likely that these restrictions will disappear as exchange-control regulations concerning the granting of credit are relaxed.

16. In all the Member States, real-estate charges play an important role as security for long-term credit, despite the problems which may arise in enforcing a claim where the buildings or land mortgaged form part of an industrial complex that is difficult to split up.

German experience suggests a technique which may be of particular interest in international credit operations. In this country the mortgage has largely been supplanted by the land charge (*Grundschuld*) for industrial financing and for the financing of housebuilding.

This procedure has proved simpler than that of mortgage registration, which is often both lengthy and costly. The land charge is an abstract lien on real estate, which arises or is extinguished independently of the claim it secures. Where a land-charge deed is issued, it may be assigned without necessitating any new entry in the land register (*Grundbuch*). In the same way, once the loan has been repaid, the deed is again transferred to the owner of the asset and is available to secure a further credit. The land charge is divisible. It also lends itself to the securing of credit operations on current account.

(1) Many variations have been used, such as charter contracts for shipping companies and the technique — as used when the two international loans were floated by the Portuguese company SACOR — under which a company may issue new loans only on the authorization of a trustee. The latter technique is often used by American companies.

As the land charge technique has proved so useful in Germany and elsewhere (Switzerland, Austria), the Group feels that the feasibility of introducing a comparable form of security in all the member countries should be studied. The existence of such an instrument, which is particularly flexible in international financial operations, would be an additional factor helping to fuse the Member States' capital markets.

A closely related question is that of denominating mortgages in currencies other than that of the country in which the asset is situated. In Italy and Luxembourg this can already be done; if similar legislation were introduced by the other member countries, the conclusion of international lending transactions backed by real-estate liens would become easier.

17. Rights of lien on movable assets also play an important role, in particular where medium-term loans are granted for the purchase of equipment. The diversity of the legal regulations governing the pledging of such assets, particularly as regards the holding of the security and notification of the public, may give rise to difficulties when the pledged assets are utilized in a country in which different legal arrangements obtain.

Four member countries — France, Italy, Belgium and Luxembourg — have given preference in this respect to arrangements providing absolute certainty as to the interpretation of the law: except in special cases, a mere agreement (e.g. between a bank and its debtor) under which a right of security is recognized for the bank though the chattel secured remains in the possession of the debtor is not enough to constitute a guarantee.

On the other hand, in Germany and in the Netherlands, the existing legal systems are simpler to apply and closer to practical requirements. In these countries, case-law has contributed to the development of the *Sicherungsübereignung*, a form of guarantee which, in the field of credit for industrial equipment, has almost supplanted the traditional lien (where the object pledged must pass into the actual possession of the creditor or of a third person). However, experts in Germany and the Netherlands regret the lack of certainty as to the interpretation of the law in this connection.

The Group feels that both systems have their advantages and disadvantages. It might therefore be possible to combine the advantages of the German and Dutch system, i.e. its broad application, with the advantages of the rules governing public notification applied in the other member countries.

There is already a precedent for an arrangement such as this — the Geneva Convention of 19 June 1948 on the International Recognition of Rights in Aircraft, which all the member countries have signed.

D) PROBLEMS CONNECTED WITH POSSIBLE CO-ORDINATION OF "CENTRAL RISK OFFICES"

18. "Central risk offices" have been set up in all the member countries except the Netherlands and Luxembourg to provide lenders with information on the total indebtedness of their customers.

The technique is the same everywhere: financial establishments undertake to provide the central bank with information on loans granted, while the central banks provide the financial establishments concerned with information on the total debts of their customers. These "central risk offices" confine their activities to the domestic sector; thus, for example, a French bank granting credit to an Italian enterprise can ascertain only whether other French banks have also extended credit to it and will have no information on its *total* indebtedness in respect of outstanding credits.

To prevent excessive accumulation of risks by enterprises borrowing from several banks in different countries, fuller exchange of information is necessary. The Group recommends co-ordination of the various central risk offices already existing in the EEC; this would enable information to be exchanged when a firm borrowed outside its home country. The simplest arrangement would consist in requiring all declarations concerning a given enterprise to be collected at the central bank of the country in which it has its headquarters. This central bank would then periodically inform all the financial establishments concerned, including those in the other Member States. In order to increase the effectiveness of the co-ordination within the Community, it is desirable that central risk offices should be set up in both of the member countries where they to not yet exist.

E) PROBLEMS ARISING FROM THE EXCHANGE RISK

19. The exchange risk involved in the granting of international credit is one of the reasons most commonly adduced for the weak development of direct lending across frontiers.

The financial institutions which lend abroad at medium and long term in practice do so solely in currencies they already hold, so as to comply with the generally accepted principle of balancing resources and commitments in any given currency. Consequently, it is difficult, in the case of credit operations, to devise suitable techniques for spreading the exchange risk between the borrower and the lender, as is often done for bonded loans. The borrowing enterprise must therefore shoulder the exchange risk in its entirety, unless it can get a third party to intervene. Third-party action of this kind, enabling the authorities where necessary to take over the exchange risk, could conceivably be brought into more frequent use than at the present time. Though the authorities, conscious of the increased monetary stability deriving from the interdependence of the economies, would probably be reluctant to make arrangements of this type, the idea need not be shelved on that account.

As will be explained in more detail in Chapter 13, the exchange risk is probably not an insurmountable obstacle to industrial borrowing in foreign currencies.

F) PROBLEMS DERIVING FROM FISCAL LEGISLATION

20. The fiscal obstacles to international lending include double taxation of interest on direct loans and on securities used in international financial relations (bills of exchange, promissory notes, etc.). The latter factor, however, is of only marginal

importance. Another obstacle is to be found in the duties and charges connected with guarantees and the putting up of security.

With regard to the taxation of interest on direct loans, a double-taxation problem arises similar to that described for interest on bonds in Chapter 14, where ways and means of avoiding this particular difficulty are suggested. In France and Belgium all interest paid to non-residents is normally taxed, though certain exceptions are made for loans granted by foreign credit institutions. In Italy, where tax on income from movable wealth is a schedular tax, interest paid by an Italian debtor is generally taxed twice, though there are numerous exceptions to this rule. On the other hand, there are no double-taxation problems in Germany or Luxembourg, countries which make a deduction at source for interest on bonds only. In the Netherlands there is no withholding tax on interest.

21. The duties and charges levied on the constitution of mortgages are particularly heavy in France and Italy. In France, the *taxe de publicité foncière* is 0.6% on registration of a mortgage and the same percentage on entry of satisfaction of the mortgage. In Italy, the *imposta ipotecaria* is charged only once, on registration, but amounts to 2.5%. A number of credit institutions and co-operatives are exempt from this tax in Italy: these exceptions may be harmful to competing foreign establishments and should therefore be modified under EEC harmonization arrangements.

B. THE INTERPENETRATION OF BANKING SYSTEMS, AND OTHER FORMS OF CO-OPERATION

22. Most banks confine their foreign operations largely to short-term lending and participation in investment syndicates. It would be quite possible for them to move into medium- and long-term credit operations by setting up subsidiaries or branches and by strengthening their co-operation arrangements with foreign banks. This is particularly the case with a good many deposit banks which are hampered in their countries of origin by limitations on the granting of medium- and long-term credit and which are not familiar with the often complex credit machinery in force abroad or are kept out of these channels by local regulations.

A) THE ESTABLISHMENT OF SUBSIDIARIES OR BRANCHES IN THE EEC COUNTRIES

23. Foreign banks were maintaining subsidiaries or branches in the Common Market countries long before the Treaty came into force; it was reasonable to expect that the creation of the Community would lead to an appreciable increase in the number of new establishments of European banks in each of the partner countries. This does not seem to have been the case, however, although more branches or subsidiaries of American banks have been opened.

There are several reasons why banks in the EEC have set up few branches or subsidiaries in other Community countries. There are, first of all, legal and administrative obstacles: to establish agencies in certain member countries, foreign

banks have had to obtain official authorization and, in general, to comply with certain conditions relating to the nationality of the directors, the form of the company, and its capital. Their operations are sometimes subject to special controls and restrictions because they are partly or wholly foreign-owned companies.

A directive designed to abolish restrictions on the establishment of, and supply of services by, banks and certain other financial establishments is now being examined by the EEC Council. The aim is to abolish the discriminatory conditions ruling in this matter, both in the country of origin and in the host country, in so far as they affect residents of Member States. Once this discrimination has been removed, co-ordination of the at present fairly divergent conditions of establishment and operation in the various member countries will be necessary, with a view to enabling equal establishment opportunities to be provided in all the member countries.

24. It is not certain, however, that the banks will take advantage of the opportunities offered to them. There are obstacles other than legal and administrative ones to an increase in the number of branches and subsidiaries.

The very same reasons that explain the expansion of American banks in the Community are to some extent, by their absence, the reasons why European banks have been backward in opening new establishments.

The establishment of American banks in Europe went hand in hand with the establishment of European subsidiaries by the major American industrial companies. American firms, anxious to avoid seeing their trade handicapped by the common external tariff, set about acquiring production centres in the Community countries. By contrast, the major industrial firms of the Six have not felt the same need to set up in the other member countries, since they know that the obstacles to the movement of goods within the Community will disappear altogether before long. Thus, American banks have followed their customers, whereas there has been no corresponding inducement to European banks to expand, industrial enterprises of the Six having set up relatively few subsidiaries in other member countries. The existence of a ready-made clientele may be considered a prerequisite for profitability; the deposit and lending business that can be worked up with small local customers will not by itself provide a firm enough base for establishment abroad.

It may also be noted that while the lending capacity of American banks has in the past exceeded their scope for domestic investment, banks in Community countries have sometimes found difficulty in satisfying the demand for credit from their domestic customers. It has been pointed out above that this factor may have hampered the development of direct international credit. It is probably less relevant as an explanation of the paucity of new establishments, since foreign branches or subsidiaries generally receive only small sums from the parent company and are normally intended to operate with funds obtained locally. None the less, it is certain that when a bank's lending capacity is stretched at home, it has little inducement to make efforts to extend its activities abroad, whatever their form.

Another point is that the interest rate differentials between the American market and the Community markets implied high profits for American banks setting up in the Community. Conversely, as the disparity in interest rates between one

Community country and another is less than it is between the Community and the United States, the incentive for European banks to set up in other member countries has not been as strong.

There are also differences connected with the concentration of the funds available to European banks and to American banks, and again these differences tend to favour the latter. It is certain that the setting-up of a network of branch offices abroad entails operating on a scale that has been reached by a good many American banks but by few European banks so far.

Recent mergers, notably in Belgium, France and the Netherlands, have enabled certain establishments to expand their lending business to a size commensurate with the credit demand of the big industrial firms which are their customers, while at the same time continuing to respect the principle of risk-spreading.

Progress made by the Community may in the future lead to mergers of banks in one member country with banks in another, but flexible forms of co-operation seem to be best suited to the present situation.

A last reason why Community banks have set up relatively few branches abroad is their hesitation to adopt direct methods of operating on foreign markets, with all the uncertainties this entails, in preference to the well-tried method of transacting business through foreign correspondents.

It should, however, be noted that the expansion of the business being carried out by existing branches and competition from American banks may well induce European banks to step up their activities in other member countries. The large number of representatives' offices set up in the various member countries is evidence of the anxiety of the banks to expand operations in these countries.

B) CO-OPERATION BETWEEN BANKS

25. There has long been some degree of systematic co-operation between banks in a number of current, and even a few medium- and long-term transactions. This arrangement has the advantage of enabling a bank to benefit from its correspondent's network of offices and experience, and of ensuring any necessary spreading of risks. It is also a method of tempering the disadvantages arising from lack of full information as to the foreign debtor's creditworthiness.

Since the entry into force of the Treaty of Rome, the exchange of information on customers and other aspects of inter-bank liaison have been the subject of general agreements the scope of which is difficult to ascertain exactly, but which do suggest that habits of particularly close co-operation have developed between the establishments subscribing to them, for the various forms of co-operation almost always extend beyond the framework of the EEC.

- i) In certain cases, groups of banks have combined to set up companies to grant investment credit.
- ii) Syndicate credit is a practice that makes possible a spread of risks in major financing operations.

- iii) Financial establishments have sometimes grouped to set up clubs (the Amstel Club, for example) through which the international distribution of their services can be improved; this form of co-operation often makes it possible to replace a credit granted to an exporter by one granted directly to a purchaser by an establishment in his own country. There is a similar type of co-operation between leasing companies.
- iv) Joint research bureaux have been set up by financial institutions of several member countries; not only banks but also insurance companies and other establishments are concerned.
- v) Arrangements have been made for regular contact between administrative personnel of some of the big institutions.
- vi) Co-operation between bank boards has at times been put on a more direct footing by reciprocal acquisition of small participations. Lastly, there are many cases of participation in jointly owned banking subsidiaries, in holding companies and in companies managing open-end investment funds.

CONCLUSIONS

26. Lending at medium and long term to other member countries, it seems, is a problem to be viewed in the light of the complicated inter-bank relationships which the banks hesitate to jeopardize by competing more keenly among themselves. Moreover, from the point of view of profitability, it often happens that business in a given country is not sufficiently developed to justify the establishment of a subsidiary or branch, or that the handling of transactions through correspondents is so smooth and reliable that there is little point in abandoning them in favour of an agency which may or may not succeed.

None the less, the Group feels that:

- 1) The dismantling of currency restrictions barring domestic enterprises from access to the most advantageous sources of finance should be set in motion by gradually raising the limits of operations allowed.
- 2) Leasing already offers considerable scope for indirect granting of credit across frontiers.
- 3) The guarantee of a credit institution in the borrower's country allows readier access to external sources of finance; it is therefore desirable that these guarantees should be easier to obtain. The same recommendation needs to be made for guarantees furnished by parent companies to establishments financing their foreign subsidiaries.
- 4) The introduction of a standard real-estate lien in all the Member States would contribute to the integration of the capital markets. A general suggestion here is a flexible technique comparable to that of the German land charge.
- 5) The extension and co-ordination at European level of the "central risk offices" system would facilitate the exchange of information on enterprises using several capital markets.

- 6) Double taxation of interest on direct loans to foreign countries must be completely eliminated where it still exists. There is also a case for harmonization of mortgage taxes.
- 7) The removal of restrictions on the establishment of, and supply of services by, foreign banks and certain other financial establishments should be followed up by co-ordination of the regulations on banking, thereby ensuring that banks have real opportunities and incentive to set up in any member country.

III. Development of refinancing techniques on the European market

27. The refinement of refinancing techniques may well prove less of a hurdle than the solution of the problems dealt with in the preceding section.

In response to the growth in domestic demand for medium- and long-term finance, credit institutions have made efforts to attract resources other than sight or short-term deposits. Among the methods chosen to intensify the inflow of longer-term funds are the opening of savings and deposit accounts and the issue of medium-term deposit certificates. In general there has also been more "transformation" of funds, although it is often difficult to assess how far this has gone.

The collection of these funds has so far been mainly confined to individual countries. The expansion of the activities of medium- and long-term credit institutions on a European market presupposes that these establishments will have access to new sources of finance in member countries other than their own:

- i) By the development of traditional techniques, i.e. the issuing of bond loans for public subscription or private placing;
- ii) By the employment of new techniques such as "European refinancing consortia" or by enabling medium-term instruments of indebtedness to be mobilized abroad.

A. TRADITIONAL TECHNIQUES

28. The bond is an instrument particularly well suited to dissemination abroad. Wider European markets working more smoothly would enable financial institutions to make more use of this type of refinancing. The problems of the integration and expansion of bond markets are dealt with more fully in Chapter 9 and will therefore be discussed here only in so far as the markets help the refinancing operations of the medium- and long-term credit institutions.

The technique of bond flotations abroad has been used by certain Italian governmental institutions and holding companies, notably the *Cassa per il Mezzogiorno*, IMI and IRI, but the main proponents of this technique have been the ECSC High Authority and the European Investment Bank, which culled nearly \$215 million from the member countries' capital markets from 1961 to 1965. The

credits financed by this technique are nowadays one of the most important ways of transferring long-term capital between member countries.

This refinancing technique has also been used by financial institutions of non-member countries on the capital markets of the Community and by establishments domiciled in the Community on the New York, London and Zurich markets and, more recently, on the Euro-bond issue market.

29. In addition to the issuing of loans abroad, the specialized financial institutions also obtain capital from foreign markets when non-resident investors subscribe to their domestic issues. Such investments could well be considerably encouraged by the quotation on stock exchanges in other member countries of domestic loans issued by the main institutions specializing in investment credit, which often enjoy special prestige among international customers because of their semi-public status.

Development of the facilities open to financial institutions for refinance from institutional investors in other member countries is a further point to bear in mind. This form of refinancing has already been employed by the ECSC, the European Investment Bank, the Belgian *Société Nationale de Crédit à l'Industrie* and the *Istituto Mobiliare Italiano*; the simplicity and the flexibility of this arrangement make it a natural instrument for approaching a market. Private placing of bonds in this way is a frequent method of raising funds on the markets of certain non-member countries where institutional investors are prominent and is acquiring growing importance even on markets such as the German and Dutch. Recourse to this instrument is by no means limited to the refinancing of credit institutions, since industrial borrowers are active participants in these markets. There have also been more and more private placings on the Euro-bond market.

B. NEW MACHINERY FOR MEDIUM-TERM REFINANCING

30. The issue of long-term loans is regarded by the banks as lying outside their traditional activities, mainly because the cost of such long-term borrowing would be too high compared with that of the other ways in which banks can attract savings. There might also be a conflict between the placing of their own loans and their participation in syndicates for placing other loans.

However, since the inadequacy of their "stable" resources is the main factor preventing them from expanding their medium- and long-term lending, it is probable that the banks would show interest in new methods of refinancing.

The Group has considered certain new types of machinery which might meet these requirements.

A) EUROPEAN BANK CONSORTIA

31. The establishment of European bank consortia might provide a useful source of refinance. Their aim would be to issue securities with spread maturities and on terms adapted to the conditions ruling on the various markets. The consortium

would have the advantage of knowing the needs and capacity of a diversified clientele embracing several markets. Under the arrangement contemplated, the consortium would issue securities to a given amount, and with a currency of, say, eight to ten years, on an international market or on each of the markets of the member countries, and apply the proceeds to industrial loans for a corresponding period backed by adequate guarantees.

The placing of this paper direct with institutional investors would obviate the need for a public issue; at the same time the participant banks would have to maintain an active secondary market to ensure a high degree of liquidity for the investment.

Two choices would then have to be made: the nature of the collective guarantee offered by the consortium to the subscriber, and the currency in which the consortium would operate.

32. With regard to the guarantee, a useful arrangement might be for the banks to form a company, with low paid-up capital and a relatively large amount of subscribed but not paid-up capital, this part being on call to cover the consortium's commitments should a borrower default. It is obvious that this capital would constitute the maximum limit of the loans which the consortium could contract on the market.

Another arrangement would be for the banks to use a technique already employed in France for "grouped loans", which consists in setting aside a specific proportion (for example, 10%) of the proceeds of the issues to form a guarantee fund invested in gilt-edged securities.

33. With regard to the choice of the currency in which the securities would be issued and the loans made, it would be too much to ask the banks participating in the consortium to assume the exchange risk, given the small margins on which they would be working. Consequently, the currency in which the securities would be issued and the loans granted should be the same.

Initially, transactions could be in dollars, to which the banks and enterprises are already accustomed on the Euro-dollar and Euro-issues markets. Subsequently, operations carried out in a specific currency of the Six (as is sometimes the case already) or in units of account could become general. The choice of the currency in which the consortium would operate could also be guided by considerations arising from the situation of prospective subscribers or borrowers.

B) THE MOBILIZATION OF MEDIUM-TERM SECURITIES OUTSIDE THE ISSUING COUNTRY

34. The Group has also considered the establishment of a European market for refinancing of securities. This could be done by facilitating the acquisition by financial institutions of paper representing medium-term credit granted in other member countries. One way of covering the exchange risk, the main obstacle to the use of this technique, could be through an *ad hoc* body financed by premium payments, on much the same lines as arrangements already used for export credit guarantees.

Endorsement of these securities by some institution — the European Investment Bank, perhaps, or the *ad hoc* body mentioned above — would also facilitate the mobilization of paper; and the endorsement could be made conditional on the "European interest" of the scheme financed.

The circulation of these European securities would make possible an alignment of European financial institutions and the gradual development of techniques and experience which would be very valuable for the functioning of an integrated market.

Mobilization would have the advantage of providing a more flexible procedure than recourse to a loan issue and of linking the financial operation to a specific investment.

However, this system, based on French and Belgian experience, would be of less value to countries with all-purpose banks which are not in the habit of relying on mobilization of their medium- and long-term loans. In Germany, for example, the practice is to grant credits in current account (*Buchkredite*) which, not being represented by a security, are not mobilizable. It would not, however, be impossible to find an instrument lending itself to mobilization: the *Schuldscheindarlehen* in Germany or the *onderhandse leningen* in the Netherlands are in fact loans against promissory notes already negotiable within these countries, and they could serve as mobilizable securities under the arrangements suggested. In the Netherlands there is indeed an organized market for these securities. In other Community countries, notably Belgium, private issues are common practice, but the securities so placed are not normally mobilizable until maturity, unless otherwise agreed by the parties concerned.

As for costs, it is likely that the charging of a commission to cover the exchange risk and a guarantee commission would make this type of mobilization relatively costly in comparison with the other means of financing open to banks. None the less, this arrangement could widen the range of their activities.

CONCLUSIONS

35. All the refinancing techniques that could be implemented at European level would in fact be an extension of practices already currently used — mainly within individual countries.

- 1) With regard to refinancing by the issue of bonds abroad, the Group has set out in Chapters 9 and 13 recommendations relating to the problems posed by present restrictions on these issues and by the exchange risk.
- 2) The purchase by non-residents of securities issued within a given country by financial institutions specializing in investment credit should be encouraged, especially by the quotation of loans issued by these institutions on the stock exchanges of other member countries.
- 3) The establishment of new machinery, such as European bank consortia, or the introduction of techniques for mobilizing medium-term securities outside the country of issue, could be of appreciable benefit to institutions looking for new sources of refinance.

CHAPTER 8

CREDIT FOR HOUSING AND LOCAL AUTHORITIES' CAPITAL EXPENDITURE

Introduction

1. Credit for housing and credit for local authorities' capital expenditure are considered together in this chapter. These two items have several features in common: they both involve immobilization of funds over relatively long periods, they are both major components in the demand for long-term credit, and many of the establishments and types of saving contributing to their financing are the same.

In the six Member States considered as a whole, investment in residential construction alone was running at an annual average of nearly \$13 800 million during the period from 1960 to 1965 (Table 17). As a proportion of gross fixed investment, it ranged from 17.7% (in the Netherlands) to 31% (in Italy). In four of the Member States — France, Italy, the Netherlands and Belgium — the percentage reached its highest point in 1965. The population growth and the present situation as regards the available housing and its quality suggest that demand for long-term capital for residential construction will remain buoyant in coming years, particularly in these four countries.

No figures susceptible of country-to-country comparison are available in respect of investment by local authorities (schools, hospitals, water supply, etc.). Nor is any information available on how the financing of this work is broken down into budget resources and borrowing.

2. The fact that credit for housing and local authorities' capital expenditure serves to finance basic needs explains why such special political importance attaches to decisions on investment and, more particularly, public programmes to encourage investment in this field. In present circumstances there is the risk that the balance of investment may be upset on this account, either by deferment of investment schemes in other sectors of the economy or, where this does not arise, by overburdening of the capital market and consequent dislocation of the markets in other Member States. Should such a situation develop, the general principles set out in Chapter 6 for the finance policies of administrative authorities and public enterprises would apply *mutatis mutandis*.

3. The special problems connected with government intervention in the field of residential construction are considered under Head I of this chapter. The Group feels that official policy on residential construction should be dealt with in particular detail, for the techniques employed often have a pronounced impact on the capital market.

Head II of this chapter deals with problems arising from the development of European credit machinery for housing and local authorities' capital expenditure.

It looks at the obstacles which establishments operating in this sector would have to surmount and at ways and means of promoting wider scope for their action. Head III deals more especially with the question of international refinancing of housing and local authority credit. Proposals are made whereby the interpenetration of capital markets can begin in this segment, where barriers separating the different countries are still particularly high.

I. Official assistance in the financing of housing

4. Begun during the war, government intervention in the housing sector has persisted longer than most of the other forms of wartime support of the economy. It has enabled the share of expenditure allocated to housing to be kept down in all household budgets in certain countries and in a proportion of them in the rest. At the same time, rent controls have generally necessitated official measures to encourage construction and thus ensure that the supply of housing was not unduly affected thereby.

Although public opinion in most member countries now accepts that the government has special responsibility in this field, it is sometimes difficult to discern any direct cause-and-effect link between the strength of official intervention measures and the number of dwellings constructed. In Italy, for example, subsidies for residential construction have lagged behind those paid out in most of the other Member States, but construction in this country seems to have kept up fairly well with that achieved elsewhere in the Community.

5. In the other member countries, however, where they have almost supplanted the usual market incentives, subsidies for residential construction have an appreciable impact on investment and, given the scale of investment, also a direct impact on the links between the capital markets of the Community. The Group has therefore tried to ascertain which of these techniques could best be reconciled with the operational requirements of a European capital market.

Housing subsidies are of three types:

- i) Subsidies to investment, granted to persons wishing to have a house or flat built;
- ii) Subsidies to the formation of saving — tied to certain forms of saving from which the housing sector benefits;
- iii) Subsidies to demand, in the form of lower rents (for rented housing) or financing charges (for owner-occupied housing).

A. SUBSIDIES TO INVESTMENT

6. For this form of subsidy, the situation in the EEC is one of remarkable complexity and diversity. The following types of incentive may be noted:

- i) Credit at reduced interest rates (found in all the member countries);

- ii) Outright capital grants (Netherlands, Belgium);
- iii) Premiums granted for specific periods, including interest rebates (Germany, France);
- iv) Exemption from registration fees on conveyancing (mainly Germany and Italy) or on mortgages (France);
- v) Exemption from or temporary reductions in land taxes (Germany and, more particularly, Italy);
- vi) Authorization of higher annual depreciation allowances against income tax than are normally claimable (Germany);
- vii) Guarantees giving housing investors easier access to credit (mainly Netherlands and Belgium).

B. SUBSIDIES TO THE FORMATION OF SAVING

7. In Germany, deposits with building societies (*Bausparkassen*) attract premiums or, at the option of the saver, tax reliefs, whether he commissions the construction of a dwelling himself, or whether he leaves his savings with the society for a period of at least six years.

In France, on the other hand, this kind of deposit attracts premiums only when the saver actually commissions the construction of a dwelling.

C. SUBSIDIES TO DEMAND

8. Subsidies of this kind are paid in Germany and in France. In Germany, where they were introduced in 1963, they are on a substantial scale and are granted both to tenants and to families in owner-occupied housing. The level of the subsidies depends mainly on social considerations: normally the authorities pay all that part of the rent or of the financing charges exceeding a certain percentage of the family's income⁽¹⁾.

In France a "housing allowance" is granted in the form of a personal contribution paid by the *caisses d'allocations familiales* to occupiers of new or old houses or flats. There are certain stipulations connected with the rent and the income of the beneficiary.

⁽¹⁾ For example, the rent or financing charge which a family of four with a monthly income of DM 900 is considered able to pay is DM 180, i.e. 20% of the monthly income; a higher rent will normally be fully subsidized, but that part of the dwelling area exceeding 80 square metres does not attract a subsidy. If, on the other hand, a family with the same income is made up of nine persons, the "statutory" rent or financing charge is only 11% of their income, i.e., in the present example, DM 99, and the area attracting a subsidy is 130 square metres.

CONCLUSIONS

9. The Group feels that it is not part of its task to assess the value and effectiveness of the policies pursued in the various Member States with regard to residential construction. However, there is a move back towards full or partial freedom on the housing market, and the Group wishes to emphasize the advantages the progressive restoration of liberty could bring for the integration of the capital markets. In any case, harmonization of the forms of government intervention in this sector would doubtless help to break down the walls separating the capital markets of the different countries. In addition, the existing relations between the national property markets would be strengthened by allowing member countries to carry out building operations or conclude property purchase transactions in the others.

1) A free housing market would help appreciably towards integration of the capital markets. Preference should therefore be given to subsidies allocated in such a way that they are not likely to impede a return to free conditions on the housing market. Hence the Group takes the view that it is better to subsidize demand. This method helps towards the establishment of a free housing market by disposing of the argument that people with small incomes would not be able to afford the high rents asked in a free market. It also has the advantage of being an arrangement free from ambiguity, which is essential when, as in all the member countries, official policy is to reserve subsidizing for certain classes of the population. Last, and most important, this type of subsidy obviates any distortion in the choice of sources of finance.

The Group is, however, aware that the application of demand subsidies in preference to other forms may entail revision of certain aspects of housing policy in the member countries and that this revision cannot be put through quickly.

2) Where the Member States make use of investment subsidies, the methods employed should at the same time stimulate saving, in order to prevent the subsidies generating artificial movements of capital between the member countries. Of the subsidies meeting this requirement, credit at reduced interest, backed by corresponding public saving, would appear to be the most "neutral". In certain circumstances the authorities might also contemplate the appropriation of budget resources to residential construction sponsored by the central government or by the communes, with the resale of part of the houses constructed ensuring the replacement of public saving by private saving.

3) In respect of subsidies to saving for housing, the Group has already noted a major difference between the techniques used in Germany — whereby the saver benefits from premiums or tax relief even when he does not actually build a house or flat — and those used in France, where premiums are granted only to a saver actually constructing a new dwelling. The first system is a form of general subsidy to saving which may enable the housing sector to tap capital which the saver did not intend for construction; it therefore conflicts with the principle advocated in Chapter 5, i.e. that measures designed to stimulate saving should be neutral. The second technique is one of subsidizing investment in a sector in which there is a large volume of unsatisfied demand: the above objection is therefore not applicable.

II. Extension of credit machinery for housing and local authorities' capital expenditure

10. Here the Group confined its examination to financial institutions operating in this sector: it dealt neither with loans issued by the communes — these being discussed in Chapter 6 — nor with the granting by individuals of mortgage loans for residential construction. This last type of credit is of some importance in France and in Belgium.

A. THE SPECIALIZED INSTITUTIONS

A) STRUCTURE AND FUNCTIONS

11. The institutions specializing in credit for housing and local authorities' capital expenditure have certain noteworthy technical characteristics: their claims are normally backed by mortgages or by the guarantee of a public corporation. Statutory rules or provisions in these institutions' regulations specify in detail what transactions are permissible and in what geographical areas they may operate.

12. Apart from these general features, the specialized credit institutions differ notably in structure and size from one member country to another.

In Germany, where the two types of credit under consideration are closely linked, the specialized institutions are bigger than anywhere else: almost all the private and public mortgage banks, the State banks (*Staatsbanken*) and the central giro institutions (*Girozentralen*) offer both types of credit. These establishments, of which there are more than 60, collected an annual average of \$1 400 million through the issue of bonds from 1960 to 1965. About 60% of this sum was devoted to residential construction and about 20% to local authorities' capital expenditure, in the form of loans extending over 30-40 years.

In Italy credit for housing is not as closely related to credit for local authorities' capital expenditure. Housing credit is granted by special credit institutions and by seven *Sezioni Speciali* of certain major banks and savings banks. These departments are subject to the same legislation and are all in fact genuine mortgage banks. From 1960 to 1965 they contributed on average more than \$300 million a year to the financing of residential construction.

The most important sources of credit for local authorities' capital expenditure are the Treasury and the *Cassa Depositi e Prestiti*; the specialized institutions (*Consorzio di Credito per le Opere Pubbliche, Sezioni Speciali*, real-estate credit institutions) are only of secondary importance.

In Belgium and in the Netherlands, the establishments specializing in loans to local authorities are separate from those financing housing. The former have a long tradition in their field (the *Crédit Communal de Belgique* and the *Bank voor Nederlandse Gemeenten*), while the contribution of Belgian and Dutch mortgage banks to the financing of housing, unlike that of their German and Italian counterparts, is relatively unimportant.

In France and Luxembourg, the flow of credit from the specialized credit institutions for financing housing and local authorities' capital expenditure has been modest since the end of the war, apart from low-interest credit granted in France, mainly from public funds, by the *Crédit Foncier*.

B) PROBLEMS CONNECTED WITH LENDING ABROAD

13. In present circumstances, the extent to which the specialized institutions in any member country help in the financing of housing and local authorities' capital expenditure in other member countries is bound to be negligible. These institutions are not designed to provide help of this kind abroad, and in any case the granting of guarantees and the assumption of an exchange risk (discussed in Chapter 13) raise additional problems.

In Germany, the proceeds of mortgage bond sales can only be used for the financing of credit secured by first mortgages on property in Germany. The proceeds of "communal bonds" must be used to finance German public corporations or credits guaranteed by such bodies; the 1963 revision of the special laws in this field introduced a single exception to this rule by authorizing the specialized establishments to refinance loans granted to the ECSC High Authority by issuing communal bonds.

In France, the *Crédit Foncier* is prevented by its statute from granting loans against any security other than domestic.

In Italy, the scope of the specialized credit establishments in financing housing is in any case confined, under special laws, to the territory of the Republic. Some of these establishments are actually confined in their activities to specific areas within Italy.

In Belgium, the mortgage banks are free to invest only up to the amount of their capital and reserves; if their loans abroad were to exceed this amount, they would encounter administrative difficulties when issuing bonds.

In the Netherlands, there are no legislative restrictions on the activity of mortgage banks, but all those of any size are required by their articles to confine their operations to mortgages on real estate situated in the Netherlands.

CONCLUSIONS

14. In view of the situation revealed by the above remarks, the Group's recommendations for extension of the international lending operations of institutions specializing in the financing of housing and local authorities' capital expenditure are bound to be of limited scope. It is in fact largely by means of refinance machinery that these establishments can be fitted into a European capital market. Before passing to examination of this problem under Head III, however, the following points should be noted:

- 1) The approximation or harmonization of the legal status of the real-estate sureties required in the Member States should be given priority. More flexible and less burdensome than the mortgage, the "land-charge deed" technique described in the preceding chapter is an instrument which might usefully be adapted to the financing of building. And arrangements should be made so that mortgage or land-charge deed registrations can be expressed in currencies other than that of the country of registration.
- 2) Not only should the specialized credit establishments have power to accept sureties from other Member States, but there should also be a relaxation of the rules on how these establishments may employ their resources. The first step could be general adoption of the Belgian laws, which leave them completely free in their investing, even abroad, up to an amount equal to their capital and free reserves.
- 3) It might help to protect saving and consequently the stability of the capital markets if certain rules were applied to the operations of establishments specializing in credit for housing and local authorities' capital expenditure. These rules should not, however, hamper the establishment of firms engaging in mortgage bank business; the Group therefore approves legislation on the pattern of the German outline law on mortgage banks, which it prefers to the special laws common in other countries.

B. THE OTHER FINANCIAL INSTITUTIONS: SAVINGS BANKS, BUILDING SOCIETIES, LIFE-ASSURANCE COMPANIES

A) SAVINGS BANKS AND THEIR CENTRAL INSTITUTIONS

15. The bulk of the credit for housing or local authorities' capital expenditure deriving from the "transformation" of short- and medium-term funds is provided, in most of the member countries, by the savings banks or their central institutions. Those banks which also accept savings deposits generally place the resources accruing at the disposal of other sectors of the economy.

In the Netherlands and in Belgium, the savings banks and their central institutions give preference to the financing of residential construction. In France, where the opposite was the case until recently, the situation is changing: funds marshalled by the savings banks and administered by their central institution, the *Caisse des Dépôts et Consignations*, are still used mainly to finance capital expenditure by the communes, but allocations to housing, particularly publicly assisted housing, are swelling rapidly. In Germany, Italy and Luxembourg, both types of credit have an important place in the transactions of the savings banks and of their central institutions. In addition, in all the Member States, the savings institutions contribute indirectly to the financing of housing and of local authorities' capital expenditure by purchasing bonds issued for this purpose; Italy is the country in which this form of investment plays the most important role.

B) BUILDING SOCIETIES

16. Building societies are financial institutions receiving money from their members at interest and lending money to them when they wish to build or buy a dwelling. So far the only Community country in which they occupy an important position is Germany, where they account for about a fifth of the financing of residential construction by the granting of loans or by withdrawals from the savings accounts they administer. A particular point to note is that they grant loans even on second mortgages; this enables them to supplement the credit granted by lenders on first mortgages, with whom they often co-operate. Overall, 40 to 65% of building costs are covered by building-society loans.

C) LIFE-ASSURANCE COMPANIES

17. In all the Member States save France, life-assurance companies are an important source of funds for residential construction and capital expenditure by local authorities. In the Netherlands, Germany and Luxembourg, they contribute as much to residential construction as to investment by communes, whereas in Belgium and Italy they concentrate on the direct or indirect financing of construction.

In the Netherlands, they are, ahead of the savings banks and the mortgage banks, the main providers of mortgage loans. In Italy, they invest directly about half of their money in flats or houses for letting, which they either purchase on completion or have built for their own account.

CONCLUSIONS

18. In the main, the conclusions and recommendations on the extension of the activities of the specialized institutions contained in section 14 apply to the institutions considered above as well. However, the following points should be added:

- 1) Although restrictions on lending abroad by savings banks were justified when these banks were set up, the question does now arise whether a wider field of action should not be opened to them; they could be allowed to carry out abroad all the operations permitted to them at home up to, say, a modest 1% of the funds available to them. But in any case it would be wrong to expect any considerable flow of funds in the form of direct lending abroad by savings banks; it is mainly by purchasing bonds that they can contribute to the refinancing of external operations and thus come to play an appreciable role on a European market.
- 2) In view of the important role played in long-term financing by the central institutions of the savings banks and by the savings banks with a centralized structure — including certain large savings institutions which, in size and organization, are quite distinct from the traditional type of local savings bank — and in view also of the prudent methods of management prescribed in their statutes, and the

composition of their supervisory boards, the Group feels that most of the restrictions imposed on their external transactions could gradually be abolished. They already have been in Germany, where the regional *Girozentralen* and the *Deutsche Girozentrale* are virtually free to enter into transactions abroad, and in France, where the *Caisse des Dépôts* has broadly similar powers.

3) The Group has also given thought to the question of co-operation between the central institutions and agencies and to the scope for extending such co-operation: financing consortia for investment schemes "of European interest" (motorways, rivers and canals, housing for foreign workers, etc.), investment or acquisition of bonds issued by European institutions, exchange of information between central institutions and member banks on developments connected with the EEC capital markets.

To pave the way for such organized co-operation, a first step might be the establishment of flexible contacts. Experience gained in this initial stage would show whether a more lasting basis for co-operation could be established in the form, for example, of a common financial organization. If this were the case, the EEC saving banks could be given the right to invest with such an organization a specified proportion of the funds deriving from their savings deposits.

4) With regard to life-assurance companies, the proposal put forward in Chapter 12 that they should be given the power to invest abroad up to a given percentage of their internal investments should also include the granting of mortgage loans and loans to the communes and the acquisition or construction in other member countries of flats or houses intended for letting.

III. Refinancing techniques on the European market

A. CURRENT REFINANCING TECHNIQUES

A) BONDS

19. The issue of bonds is the main source of funds for credit institutions specializing in the financing of housing or the capital expenditure of local authorities. These institutions are often not allowed to accept deposits.

In Germany, the institutions operating on the mortgage market issue "mortgage bonds" secured by first mortgages and "communal bonds" issued to finance credits to public corporations; these bonds, which are usually listed on the stock exchanges, generally have a currency period of 30 years and can be for periods as long as 50 or 60 years — thus exceeding the already relatively long duration of the credits to corporations. Both types of bond are sold through the same channels, and their prices show that the lenders regard them as having much the same value.

Italy is the second member country in which refinance via the bond market plays a special role; the specialized credit institutions issue mortgage bonds which account for about a fifth of the bonds issued on the Italian market.

In Belgium, the institution specializing in credit to finance local authorities' capital expenditure — unlike its counterparts in other member countries — refinances its long-term credit through the issue of medium-term bonds.

In France, the volume of mortgage and communal loans of the *Crédit Foncier* refinanced by the issue of bonds is relatively small. It should be noted that this has nothing to do with the nature of the institution, since the German mortgage banks, which were modelled to a great extent on the *Crédit Foncier*, do carry out their refinancing operations by this means.

B) TRANSFORMATION

20. Most of the credit for housing or local authorities' capital expenditure deriving from "transformation" is provided in all the Member States by the savings banks or their central institutions. As has been noted above, however, there are exceptions to this general rule, especially in Belgium, where the mortgage banks finance most of their loans by the "transformation" of savings deposits, particularly since the tax reform, and where a special credit institution for local authorities' capital expenditure, the *Crédit Communal*, amasses a large proportion of its resources in the form of savings deposits.

B. PROBLEMS POSED BY REFINANCING ON A EUROPEAN CAPITAL MARKET

21. It would be too costly, and would conflict with the traditions of the savings banks, for them to establish branches or subsidiaries in other member countries to collect savings deposits from persons residing there, even if they were empowered to do so; no such obstacles stand in the way of the insurance companies, but their operations in other Member States are limited, on the one hand, by rules preventing their foreign subsidiaries or branches from transferring funds to the parent company and, on the other, by the fact that in practice they are not free to enter direct into insurance contracts abroad.

Consequently, the main instruments used in international refinancing of credit for housing and local authorities' capital expenditure remain:

- a) Bonds and loans against promissory notes,
- b) Shares of real-estate companies and "property certificates",
- c) Rediscountable medium-term paper

A) BONDS AND LOANS AGAINST PROMISSORY NOTES

22. Apart from an issue by the *Crédit Foncier de France* in New York in 1959, there are very few examples of issues of loans abroad made by establishments specializing in credit for housing and local authorities' capital expenditure. Nor is

it very probable that this type of loan will gain much in importance, for the special credit institutions often issue their securities on tap, a technique which does not lend itself to flotations abroad.

Purchases of domestic bonds by non-residents, on the other hand, are not without importance in certain countries. For example, until 1964, when the *Kuponsteuer* was introduced, Benelux residents were regular buyers of German mortgage bonds and communal bonds; and another instance, observable since 1965, is non-resident investment in bonds issued by the *Bank voor Nederlandse Gemeenten*.

It is very likely that purchases of this kind will grow. These bonds have in fact acquired more importance on the capital markets of several Member States than most other categories of bond, including central government issues. In the period from 1960 to 1965, they accounted for 60% of net domestic issues in Germany and about 50% in the Netherlands. In Italy, bonds for the financing of residential construction (*cartelle fondiarie*) account by themselves for 20% of the total.

With regard to refinancing by means of loans against promissory notes, it should be noted that this type of loan is important only in the Netherlands, where it serves as a source of finance for mortgage banks and the *Bank voor Nederlandse Gemeenten* and as a principal investment outlet for savings institutions.

B) THE SHARES OF REAL-ESTATE COMPANIES AND "PROPERTY CERTIFICATES"

23. The issue of shares of real-estate companies and of "property certificates" is not usually for the purpose of refinancing credit. But since the funds collected by means of these instruments also help to finance residential construction, the special problems they raise need to be dealt with here.

The *sociétés anonymes immobilières* and the real-property funds offer investors much the same advantages as ownership of property without its disadvantages; on the one hand they take over the constructional and administrative work entailed, while on the other they make real-estate investments easier to liquidate and enable risks to be spread. They provide a response to the desire of certain savers to invest in real assets. These advantages may be particularly appreciated by savers interested in investment in real estate abroad but with little experience and knowledge of foreign markets.

In France, joint-stock companies (*sociétés immobilières d'investissement*) have been set up in recent years for the construction and administration of housing and have enjoyed some success. The abolition of double taxation of their profits and certain abatements on estate duties gave them fresh impetus.

In the other Member States, the double taxation effect of corporation tax has generally proved prohibitive, since it often halves the already low yield on investment in residential construction.

The real-property fund, which has become, particularly in Switzerland, an important factor in the financing of investment in housing, has a rather complex legal structure,

necessary in order to avoid double taxation of profits from letting and to ensure accurate and regular valuation of assets.

Within the EEC, there are no real-property funds save in Germany, where the first one was set up in 1959 and had collected DM 190 million by the end of 1964.

In addition to shares of real-estate companies and "property certificates", there are other similar securities, such as the "real-estate certificates" issued for the first time in Belgium in 1965 and the "house ownership deeds" (*Hausbesitzbriefe*) in Germany. A feature which these financing instruments have in common and which distinguishes them from property certificates is that they do not effect a spread of the investment. This disadvantage is not, however, a very serious one, since the need to spread risks is not as essential for investment in property as for investment in shares. In all other respects, these forms of investment have the same features as those indicated above for shares of real-estate companies and for "property certificates".

C) REDISCOUNTABLE MEDIUM-TERM PAPER

24. In certain Member States, medium-term bank credit plays an important role in the financing of residential construction. This is particularly so in France, where part of this credit is used to issue mobilization certificates, rediscountable under the usual rules. But it cannot be ruled out that in the long run these techniques may be replaced by conventional financing methods. The introduction of machinery to ensure that mortgage-loan securities are negotiable is evidence of the authorities' concern to improve and diversify the general conditions applicable to finance for building.

CONCLUSIONS

25. 1) As recommended in the previous chapter for the institutions specializing in industrial credit, the Group feels it desirable that securities issued by the institutions financing housing and local authorities' capital expenditure should be quoted on member countries' stock exchanges.

2) Most of these institutions issue their bonds on tap and, since they do not normally have a network of subsidiaries, they use the services of banks or other financial establishments that act as sales agents. To facilitate such operations it might be useful to establish co-operative links between the establishments performing this function in the various Member States. Similarly, in those Member States where the sale and advertising of such bonds are still subject to special authorization, this should be replaced by blanket authorization, particularly in the case of bonds whose soundness is guaranteed by the severity of Member States' legislation.

3) The terms and conditions applicable to these bonds vary even more widely from one member country to another than they do for government loans. As an example of this it is sufficient to compare the German mortgage or communal bonds with the Italian *cartelle-fondiarie*. Some degree of harmonization of the issue terms of bonds would certainly exert a favourable influence on the integration of capital markets.

- 4) Shares of real-estate companies and "property certificates" can be particularly effective instruments for enhancing the international mobility of capital in this field. However, their distribution is still hampered by unnecessary obstacles. To obviate double taxation stemming from corporation tax, complicated legal devices are often necessary; now that the housing market is tending to become free again, the Group feels that double taxation should be eliminated. Such a measure would probably not involve heavy revenue losses since the corporation tax has in this case a very low yield.
- 5) The Group feels that in so far as medium-term financing is used for residential construction, it should be possible for paper representing such credit to be mobilized outside the country in which it is drawn. The problems arising are identical with those raised by the mobilization of loans for the equipment of industry, since the technique used is the same and it is only the purpose of the credit that differs. The reader is therefore referred to the material on this subject given at the end of the preceding chapter.

PART FOUR

THE INTEGRATION OF SECURITY MARKETS

Security markets are amongst those sections of capital markets where an appreciable degree of interpenetration has already been achieved and where further progress can most easily be envisaged in the near future. They are, moreover, markets whose efficiency can be notably improved by integration.

Various official studies and reforms recently carried out or projected show that the public authorities are fully aware of a number of problems arising from the unsatisfactory state of the stock markets and above all from their narrowness. The aim is to restore to the security markets their former role as a magnet for savings and a source of finance for investments.

The growth of these markets cannot be gauged solely from the volume of net issues of shares and bonds taken up by the public, for their efficiency also depends on the "secondary markets", i.e. on the conditions in which investors can compare the quality of the various securities in circulation and deal in them. The study of these two closely linked aspects of the problem is the main concern of this part of the report.

Chapters 9 and 10 deal with the means of improving the capital supply and demand structure on the "primary" fixed-interest securities market and on the share market, respectively.

Ways of improving the working of the markets are studied in Chapter 11, which is devoted to problems connected with the supply of information to the public and with dealings in and movement of securities on the "secondary markets".

CHAPTER 9

STRUCTURE OF FIXED-INTEREST-SECURITIES MARKETS

Introduction

1. In all Member States the authorities regulate the working of fixed-interest-securities markets and keep a close watch on their balance.

Official action bears primarily on issues; these are limited by means of various techniques designed to adjust them to the supply of capital available for investment in bonds.

The authorities also take measures affecting the supply of capital, especially from institutional investors; exchange-control regulations, rules governing the management of certain institutions, or other methods are used to channel available resources to the market in a way that satisfies what are deemed to be priority requirements, and in particular those of public-sector borrowers. In some countries, official intervention on the bond market has also involved direct control of interest rates, which the authorities have endeavoured to maintain at relatively low levels, in the belief that a rise in yields would not bring about an appreciable increase in the supply of capital.

2. This situation sets limits to the methods which could be employed to promote the development of a European bond market. It would be unrealistic to expect that all the restrictions on the issue of bonds by non-residents could quickly be dismantled when they remain in force even for certain residents, or that all the obstacles to investment in foreign bonds could disappear while there are still a good many restrictions on the investments of certain institutions on their home markets.

Moreover, it will still remain necessary for issues to be carefully timed so that market conditions are not upset, and for the interests of savers to be protected and their confidence in institutional investors preserved by setting certain management rules for the latter.

Measures to promote integration of the various national markets without jeopardizing the equilibrium of any of them or the interests of savers would appear, however, feasible.

For this purpose, the Group has first of all examined ways and means of lowering the barriers hampering the flow of capital available for investment in other member countries' fixed-interest securities; the main requirement here would be a revision of the investment rules applied to institutional investors and an adjustment of tax legislation.

Further, the issue of bonds on markets in other member countries necessitates not only a relaxation of existing restrictions, but also a revision of issue terms and techniques.

However, an international market which partly fulfils the functions to be performed by a true European bond market already exists. In the present phase, little headway has been made in developing the placing of foreign issues on any of the domestic markets of the partner countries, and the development of this international market has, in quantitative terms, been the more impressive. The Group has accordingly examined, at the end of this chapter, the main features, and reasons for the expansion, of the "Euro-bond" market and its relations with the markets in the Member States.

I. Supply of capital on fixed-interest-securities markets

3. On most of the member countries' fixed-interest-securities markets, certain investors are apt to prefer particular securities, with the result that a separate market is developed for the latter. Cases in point are bonds exempted from certain taxes, government stock and — in certain countries — mortgage bonds. As a result each domestic market tends, to a greater or lesser degree, to split into separate compartments.

This compartmentalization effect is still more pronounced as *between* the markets of the several member countries, since investors are frequently encouraged to prefer investment in home securities.

Although it is difficult to compare the extremely diverse statistics on net purchases of fixed-interest securities (see Table 18), it is clear that the clientele for these securities differs appreciably in structure from country to country. In France and Belgium, the largest purchasers are the personal sector and enterprises. In the Netherlands, insurance companies, pension funds and other institutional investors dominate the demand for such securities. Banks, including saving banks, are leading purchasers of bonds in Italy and, to a lesser extent, Germany.

A. THE ROLE OF INSTITUTIONAL INVESTORS⁽¹⁾

4. Although already considerable, the supply of capital to the bond market by institutional investors — in the broad sense of the term — seems at times capable of increase, and their tendency to concentrate investment on certain classes of security could be discouraged.

The limited resources at the disposal of certain institutional investors in the EEC countries are no doubt a serious impediment to their activity on the capital market. Without reverting here to the structural reasons for this state of affairs, which have already been examined in Chapter 2, an attempt is made below to identify the other factors which curb institutional investment in bonds.

⁽¹⁾ The arrangements governing the operation and supervision of institutional investors are dealt with in Chapter 12; in the present chapter, therefore, only those problems arising in connection with their investment in bonds are discussed.

A) INSURANCE COMPANIES AND PROVIDENT SOCIETIES

5. The variety of insurance and provident organizations in the member countries and the diversity of the legislation applicable to them make it difficult to assess the contribution which these institutions make, or could make, to the fixed-interest-securities markets. Besides the life-assurance and liability and accident insurance companies, there are a great many specialized insurance or provident institutions, of a national or occupational character, and also the pension funds of private firms, administered either by the firm itself or by a financial institution. The opportunities available to these various organizations to invest in bonds are governed either by law, by officially prescribed statutory provisions, or by contractual investment rules.

Though it is impossible to deal with all the problems raised by the investment activity of these organizations, a close look does at least need to be taken at the life-assurance companies, because of the importance an increased and more diversified contribution of capital from this source could have for the fixed-interest-securities market.

The support that life-assurance companies bring to the bond market is all the more important because of its regularity, thanks to the constant progression of the resources at their disposal.

For the EEC countries as a whole, the life-assurance companies' investments between 1960 and 1964 averaged about \$1 400 million annually, i.e. approximately 2.5% of gross capital formation during this period. Depending on the countries considered, however, the percentage ranges from 1.2% to 7.4% — differences which reflect the very unequal role of the life-assurance companies as sources of investment finance (see Table 27).

The variations in the life-assurance companies' total annual contribution to the fixed-interest-securities markets, however, are less great than the differences in their contribution to the capital market as a whole. In the Netherlands and Germany, where these institutions are the most highly developed, the bulk of their investments consist in mortgage loans and loans against promissory notes; in France and Belgium, on the other hand, fixed-interest-securities investments are by far the most important, and they also account for a high proportion of the companies' investments in Italy. In France, where the total contribution of life-assurance companies to the financing of investments is among the lowest, the proportion of their total investments represented by fixed-interest securities is the largest.

The problem in most of the countries, then, is not so much to increase the total volume of the insurance companies' investment in fixed-interest securities as to adjust the distribution of the investment and avoid undue discrimination against private-sector issues and issues by borrowers resident in other member countries, in relation to those floated by domestic public-sector borrowers.

This is, moreover, a problem with which the provident institutions and the savings banks also have to contend. These institutional investors are obliged to apply a

substantial proportion of their reserves to purchase of government or government-guaranteed stock and in many cases have only limited funds available for investment in private or foreign bonds, which furthermore have to compete with other forms of investment (shares, real estate, etc.).

6. While the regulations in the Netherlands are liberal in this matter, in the other Member States restrictive management rules are imposed on the companies and the supervisory authorities have more power to intervene. Investments in public-sector bonds are the only outlet available to insurance companies without any fixed "ceilings". Some countries go so far as to fix "floors" for investment in government stock. Investments in private bonds, on the other hand, are subject to various limitations. These are supplemented in the case of external investments, which in Germany, Belgium and Italy require, without exception, the approval of the supervisory authority,⁽¹⁾ whereas in the Netherlands there are no restrictions at all on the insurance companies in this field.

In France, the regulations governing insurance companies are now being reviewed. The effect will be to widen the scope for the companies to invest in industrial and foreign bonds quoted in the official list of a French stock exchange by allowing half the value of such holdings to be treated as "first-category" stock, in which insurance companies are required to invest 50% of their technical reserves. This amendment will make for a more balanced spread of insurance companies' investments and open up the way for them to participate in the development of a European capital market.

The long-term aim must be to ensure that each member country treats investments on its own market on an equal footing with those in the other Community countries, whenever the risks incurred are identical. This principle is embodied in the draft third directive implementing Article 67 of the Treaty, which is now being examined by the Council.

Insurance companies could be authorized at once to devote a small percentage of their technical reserves to foreign investments of the same type as those permitted on the home market. Further, foreign securities quoted on the stock exchanges of the country in which the company is domiciled could without restriction be accorded the same status as domestic securities.

A liberalization, even in a limited degree, of investments in foreign bonds would undoubtedly have the advantage of encouraging insurance managements to take a greater interest in the development of the Community markets and would open up the way, if desired, for a subsequent extension of their investments on these markets; moreover, it would not in itself be likely to present any greater risk for life-assurance policy-holders than do the share investments already authorized in certain countries, the expansion of which is recommended below (see Chap. 10, sec. 8).

⁽¹⁾ Needless to say, however, investments in foreign securities are invariably authorized when it is a question of covering a risk in the same foreign currency. In some countries, the companies are obliged to maintain a strict correlation between investment currencies and commitment currencies.

B) INSTITUTIONS COLLECTING DEPOSIT SAVING: BANKS AND SAVINGS BANKS

7. A similar problem arises in the case of the savings banks and their central organizations, though the investment rules relating to them are aimed not only at protecting savers but also at ensuring that the investments of these institutions are sufficiently liquid, given the nature of their resources. In some countries, however, the rules initially designed to serve these purposes now have the effect mainly of channelling the liquid savings collected by savings banks to the financing of local authorities' capital expenditure and housing (see Table 28).

The investments of the local savings banks in private bonds are normally subject to more restrictive conditions than those in government bonds. Investments in foreign bonds are either prohibited or subject to special authorization, which in practice is tantamount to placing very severe restraints on them.

The central institutions of the savings banks, on the other hand, enjoy a substantial degree of freedom in their investments, including investment abroad. Relaxation of the regulations applying to the savings banks might help them to exert a stabilizing influence on the bond market and play a part in the integration of the financial markets. This relaxation should be based on the same principles as those suggested above for the life-assurance companies.

The deposit banks play an active role on the bond market in Italy and Germany. Their operations, while admittedly helping to widen the market, render it particularly vulnerable to restrictive monetary policy measures. In Belgium, on the other hand, the banks' investments in bonds other than those issued by the public sector have so far been limited by regulations adopted in the 'thirties. A bill now tabled in Parliament, however, provides for the elimination of this restriction. In France there are no obstacles to the acquisition of fixed-interest securities by the banks, provided the liquidity ratio and the special minimum reserves requirement are duly observed; in point of fact, the banks do not take an active part on the bond market, except when such securities are first issued.

On the whole, more latitude for operations in all classes of fixed-interest securities would enable the banks to exert a stabilizing influence both on the national bond market and on the European capital market, where they are already very active because of their participation in international underwriting syndicates. A necessary condition for this, however, is that the monetary authorities pay particular attention to the effect of their liquidity policies on the attitude of banks towards investment in bonds.

C) INVESTMENT COMPANIES (OPEN- AND CLOSED-END)

8. Open- and closed-end investment companies can within limits contribute to the activity of the bond market, even though their original and normal line of business

lies in equity investments.⁽¹⁾ There are, however, investment companies which specialize in the holding of fixed-interest securities.⁽²⁾

These companies have a number of advantages for the small investor. They give him a wide spread of investments, however small his holding; they select the securities for admission to the portfolio after a searching comparison of yields and other terms, a comparison which the individual investor often cannot easily make himself; in the countries in which subscribers to substantial blocks of bonds enjoy more favourable conditions at the time of issue, the can pass these benefits on indirectly to the small investor; finally, they considerably simplify the collection of coupons and the various other administrative formalities.

In addition, investment companies have an especially useful international role to play, in view of the dearth of information available to small investors on the subject of foreign bond markets. In this respect they can make a very real contribution to the development of intra-Community investments.

It would accordingly be desirable to remove the obstacles which, in some countries, still limit either the holding of securities of other member countries by investment companies or the circulation of their shares or certificates among the investing public in the other member countries; how this problem can best be tackled is examined in Chapter 10.

B. TAXATION OF BOND INCOME⁽³⁾

9. With the gradual dismantling of exchange controls and legislative and statutory impediments to investment in securities issued in other Member States, the influence of taxation on international movements of capital assumes increased importance. This is particularly true as regards the acquisition of foreign bonds, for here the yield aspect is a more decisive factor than it is in a share investment; and obviously it is the comparison of yields net of tax that guides the choice between various types of domestic or foreign bonds.

In order not to distort the yield structure for the investor, taxation should be neutral as regards the place of investment in a European bond market; this goal could be approached by various routes.

(1) Ways and means of developing the activity of investment companies in general, and more particularly their participation in the business of the share market, are examined in Chapter 10.

(2) Institutions of this type exist in France and have recently been introduced in Belgium and Germany. In Germany, the companies undertook, when they were established, not to allow their certificates to circulate abroad; even so, the fiscal considerations which dictated this restrictive attitude, i.e. the desire to prevent evasion of the 25% *Kuponsteuer*, should not in the longer term prevent these institutions from disseminating domestic bonds among small investors in the other member countries.

(3) Only the fiscal problems peculiar to the fixed-interest-securities market are dealt with here; a comprehensive survey of the fiscal problems affecting the European capital market is given in Chapter 14.

A) ELIMINATION OF DOUBLE TAXATION

10. In spite of bilateral agreements intended to eliminate it, double taxation of income from foreign bonds still survives, to a partial but by no means negligible extent, in relations between certain member countries, and is a serious disincentive to the acquisition of foreign bonds. This tax deterrent has become the more severe the more gross yields on the various Community markets have tended to move into line; thus, differences in yield, which formerly might have been an incentive to investment in bonds issued in other member countries, are now frequently cancelled out by the extra tax payable compared with investment in domestic securities.

The existence of double taxation is incompatible with the development of an integrated fixed-interest-securities market, the more so as the majority of investors, especially individuals, regard tax deducted at source abroad as lost and take no account, in their yield calculations, of any possibilities of refund, because of the complexity of the formalities this would involve.

In Chapter 14, various technical solutions to the general problem of double taxation are suggested.

B) THE PROBLEM OF "ANONYMOUS" CAPITAL

11. Another serious tax problem arises because the opportunities for tax evasion are not alike in the various member countries and certain bond markets may for that reason be particularly attractive to "anonymous" capital.

The factors underlying these disparities are the different rates of deduction at source and the varying degrees of efficiency of control exercised by the fiscal authorities. There is a general consensus that the "coupon schedule" (*bordereau de coupons*) system used in France — involving notification of the value of coupons paid, and the names of persons collecting them, to the tax authorities — is the only foolproof arrangement.

Admittedly the deduction at source is as a rule no more than a payment on account. It is, however, of a definitive character for certain investors such as the superannuation funds or insurance companies in France. In this case, and every other where there is an opportunity for tax evasion, the deduction at source is the only tax paid, and its rate has a decisive influence on the attractiveness of a bond investment in a specific country to domestic or foreign "anonymous" capital.

In Chapter 14, various solutions are examined which are already being or could conceivably be employed in order to remedy the dislocatory effects of this situation on the circulation of capital and an attempt is made to assess the extent to which these solutions are compatible with the prospects for the integration of the capital markets. Anticipating the conclusions reached in that chapter, it will suffice to remark here that the problem of tax evasion can be solved only by harmonization of the tax systems and strengthening of co-operation between the fiscal authorities of the Member States. However, if the methods employed to identify and tax income from bonds in the Community were toughened, and as a result the level of

taxation became higher than in certain non-member countries, there might be a flight of capital to tax havens outside the Community and a corresponding depletion of the European bond market.

It should therefore not be overlooked that there will always be markets offering fiscal refuge to "anonymous" capital. The Group accordingly considers that any strengthening of controls should be accompanied by a reduction, or even abolition, of tax deductions at source on bond income. If it were not, the tightening of the control in any one country would merely force up the rates of interest which would have to be offered on issues in that country to compensate for the deduction at source and thus give subscribers net yields comparable with those obtainable on other markets. It seems, moreover, that the recent development of Euro-bond issues (a subject dealt with further on), which offer a regular flow of securities having the features sought by "anonymous" capital, has strengthened the tendency towards international harmonization of yields net of tax deducted at source.

C) PREFERENTIAL TAX TREATMENT FOR BOND INCOME

12. The Group considered, however, whether new problems would not arise if the tax treatment accorded to bonds were relatively more favourable than that applied to other forms of investment for savings. In this context the question arose whether taxation ought to be wholly neutral and thus make the investor's choice immaterial from a fiscal standpoint, or whether it ought not rather to be selective and favour particular forms of investment along the lines considered the most desirable by the public authorities.

Monetary stability is, of course, the necessary precondition for a sound and balanced development of the bond market. Unfortunately, there is no evidence that monetary stability is being achieved nowadays any more than in the past. Table 19 on fixed-interest security yields shows that in real terms, i.e. after allowing for price rises, bond yields are substantially lower than the yields at current prices. At the end of 1965, real yields varied, depending on the member country concerned, from 1.24% to 4.82% in the case of public-sector securities (yields at current prices from 5.50% to 7.70%) and from 2.1% to 4.73% in the case of private-sector securities (yields at current prices from 5.95% to 7.6%).

In some countries, therefore, the real yield after deduction of taxes paid on interest was clearly low — or even a minus quantity — in certain years. It might be imagined that the operation of market forces would in the normal course have the effect of restoring real yields to an attractive level, through an improvement in interest rates or other advantages offered by borrowers, or through a fall in bond prices; on account of institutional factors and official action on the market, however, this compensatory mechanism is functioning only very imperfectly. Such a situation cannot be maintained indefinitely without giving rise to the switching of capital to other markets or other forms of investment. This is why it has sometimes been suggested that the hardships caused by erosion of the currency and the shrinkage of real bond yields should be offset by special advantages of a fiscal nature. It has been argued that compensation of this kind would also be warranted by the fact that the public sector is the chief issuer of bonds in all the

Member States and therefore the main beneficiary of a limitation of the yields offered to investors.

There are a number of obvious political objections to this proposal. Furthermore, any preferential system of taxation that might be introduced could not be confined to bond income but would have to be extended to other fixed-interest investments, since the problem is a similar one in their case.

On the other hand, there is a case for encouraging longer-term investment in fixed-yield securities, for liquidity preference is already too strong in all the member countries.

The Group accordingly takes the view that this aim, to which the two above-mentioned objections would not apply, should be pursued along other lines, through incorporation of any tax concessions that might be allowed on bond income in a fiscal system offering incentives to all long-term investments; since to single out bondholding as long-term and treat deposits as short-term investment would be open to argument, these advantages would have to apply to every fixed-interest investment maintained over a specific period.

It is also clear that such fiscal advantages should not be accorded solely, as is the case in some member countries, on income from investments in domestic bonds, as this would have the effect of introducing yet another division between markets.

CONCLUSIONS

13. The balance of the markets in fixed-interest-securities could be significantly improved by lessening the divisions within the markets. This result could be brought about by an improvement to the conditions governing the supply of capital through amendment of:

- i) The eligibility rules for institutional investors;
 - ii) The tax treatment of bond income.
- 1) In a general context, in order to enable institutional investors to set the pace — as they should — in market integration, the Group suggests a revision of eligibility rules that would:
- a) Cut the differences in treatment between industrial bonds and government stock to the minimum needed to ensure that the institutions do not incur excessive risks;
 - b) Facilitate investment in bonds issued in other member countries by treating them in the same way as domestic securities whenever they have comparable features, and in particular whenever they are quoted on a stock exchange in the country of the investor.

2) In addition:

a) Insurance companies and local savings banks should be free to invest a modest percentage of their resources in other member countries, in any securities of the same type as those permitted on the domestic market, and in particular in other member countries' bonds not quoted on a stock exchange of the country in which these institutions are domiciled. Later on, the percentage could progressively be raised.

More liberal powers in this respect could be granted forthwith to the central institutions of savings banks, savings banks with centralized structure, and banks in general;

b) Investment companies should be free to invest in domestic and foreign bonds in whatever proportions they please and be authorized to sell their shares or units in other member countries.

3) In the fiscal sphere, the Group recommends that:

a) Double taxation, which is a particularly serious impediment to the integration of markets in fixed-interest securities owing to the importance of yield considerations in these investments, should be eliminated;

b) Tax systems in the various member countries should be harmonized, in particular by fixing withholding-tax rates on bond income at the same level — a level which should not be such as to divert capital to non-Community markets;

c) Whatever fiscal advantages are granted in favour of bond income should fit into the framework of measures for stimulating long-term saving and should be applied without discrimination to all investments exceeding a specified term.

II. Issues of fixed-interest securities

A. PROBLEMS RELATING TO THE STRUCTURE OF DEMAND FOR CAPITAL IN THE FORM OF ISSUES OF FIXED-INTEREST SECURITIES

In connection with the desired integration of the member countries' fixed-interest-securities markets, the Group considered whether differences in the size of the markets, and in the relative importance of the various classes of issuer, were likely to influence the development of a European bond market.

A) DIFFERENCES IN THE SIZE OF THE VARIOUS MARKETS

14. Statistical dissimilarities make it difficult to compare the various stock markets in terms of size; in the official statistics on issues of medium- and long-term fixed-interest securities, definitions and methods of compilation differ from country to country. Although any attempt at reconciling such disparate data for the

purposes of international comparison is inevitably open to criticism, it is nevertheless possible to indicate the main differences that emerge (see Table 20).

It will be seen that, for the period 1960-65, the total volume of net internal issues, expressed as a ratio of gross domestic capital formation, was about 22% in Italy, 20% in Belgium, 10% in Germany and France and 7% in the Netherlands. It was not possible, however, for want of sufficient information, to take account of privately contracted loans against promissory notes, which were on a very large scale in Germany and the Netherlands. To do so would have had the effect of increasing the Dutch and German percentages appreciably and of providing a more accurate picture of the real differences in size between the various markets, which are less great than the figures quoted suggest. However, even if these differences exist at the present time, it does not follow that bond issues will maintain the same ratio to investments in the future: the differences reflect the situation on rapidly expanding markets.

B) DIFFERENCES IN THE RELATIVE IMPORTANCE OF THE VARIOUS CLASSES OF ISSUER

15. On each of the Community markets the chief obstacle to an expansion of other member countries' issues is that the domestic market is already over-extended by resident borrowers. The issues of public or semi-public institutions dominate to a greater or lesser extent all the markets; thus, in the period 1960-65, the fixed-interest securities issued for the financing of the central government, local authorities and public enterprises accounted on average for approximately 65% of total net domestic issues in Belgium and the Netherlands, 47% in Germany and France and 36% in Italy. If account were also taken of issues placed by semi-public credit institutions, it would be seen that private recourse to the bond market is in general very modest in every Community country.

Private issuers, then, are already finding it difficult to obtain a place on the bond markets; it may therefore be wondered whether the opening of member countries' markets to issues by the partner countries would ease these difficulties or aggravate them.

On the whole, it would be easier for private enterprises to gain access to the bond market if they were no longer restricted in their borrowing by conditions peculiar to their home market but able instead to take advantage of any favourable circumstances occurring on other markets.

The large concerns, internationally known because they enjoy wide markets, because their shares are quoted on more than one stock exchange, and for other reasons, are particularly well placed to launch bonds likely to appeal strongly to foreign investors. Again, because of the diversified nature of their investments and currency earnings, issuers of this type are less reluctant to assume exchange risks. In present conditions, however, it might well be that the large international companies would be the only ones to avail themselves of these additional sources of finance. Medium-sized firms are in fact already having difficulty in drawing on their own market because of their inadequate financial structure. In some cases, this obstacle has been overcome by setting up groups to issue loans the proceeds

of which are distributed among the members, while in others specialized institutions have been brought in to act as borrowers on the market. The likelihood is that the problem as regards the necessary minimum size and necessary standing for launching a bond issue will be felt still more acutely when it is a question of resort to other Member States' markets; the extension of the group flotation techniques and borrowing by specialized institutions would consequently be of undeniable value in the framework of a European market.

However, the central governments and other authorities might also consider issuing loans on foreign capital markets. The special problems arising from such recourse have been examined in Chapter 6, which deals with the financial policies of public authorities and enterprises.

B. REMOVAL OF RESTRICTIONS ON ACCESS TO MARKETS

16. In most of the member countries, there are obstacles to the issue of foreign loans. They derive from, on the one hand, exchange-control regulations and, on the other, legislative obstacles and special administrative authorization procedures to which foreign issues are subject over and above the formalities prescribed for the issues of residents.

A) DISMANTLING OF EXCHANGE-CONTROL RESTRICTIONS

17. As has been stated in Chapter 3, issue operations have been liberalized in accordance with the first directive implementing Article 67 of the Treaty only in Germany, Belgium and Luxembourg, the other member countries having availed themselves of the right to retain exchange-control restrictions for such operations; despite the balance-of-payments surpluses achieved since then by the countries concerned, and despite the steady growth in the volume of issues on their own domestic markets, there has been no official policy change. Foreign issues have, however, been authorized fairly frequently. In Germany and Belgium, on the other hand, despite the liberalization, various circumstances have made it impossible for foreign issues to be placed with residents of these countries to the extent anticipated.

Interest rates have tended to move closer together during the past few years. In addition, co-ordination of economic policies in the Community framework has lessened the danger of the Member States following contradictory policies in the budgetary, monetary and investment-guidance fields. The situation, which at one time might have justified a cautious attitude on the part of certain Member States, seems therefore to have changed, with the result that these countries could now drop their exchange-control restrictions more easily than at the time when the first directive was issued. It would, moreover, always be possible for any Member State in difficulty as a result of the derestriction to invoke the safeguard clauses and to apply the procedures of Article 73.

Furthermore, the desire to use domestic savings solely to meet the requirements of resident issuers — which today appears to be the main reason for maintaining these restrictions in the three member countries referred to above — does not take account of the increased scope for issues a European market would offer. It may be expected that the creation of this market will have the effect, not merely of aggregating the savings already available on each of the existing markets, but also of increasing their total volume.

Two final points to note here are that some degree of balance is necessary between the liberalization commitments undertaken by the various Member States, and that lack of progress in the abolition of exchange-control restrictions would inevitably block progress in other respects towards the achievement of free movement of capital.

18. In practice, the possibility might be considered of proceeding by stages, with at first a limit on the authorization of foreign issues and then gradually raising the limit.

The limit could be related to objective data, such as the volume of gross domestic saving of the country under consideration over a given period.

This is the solution envisaged in the third directive pursuant to Article 67, the draft of which is now under discussion.

B) ELIMINATION OF LEGISLATIVE AND ADMINISTRATIVE RESTRICTIONS

19. Special legislative and administrative restrictions on foreign issues still survive in certain Member States. If, as seems to be the case, the reason for maintaining them is the same as that for maintaining exchange-control restrictions, the arguments advanced above also hold good here. The abolition of these restrictions too is provided for in the draft third directive.

In this way, the discriminatory character of certain provisions would be removed. For example, although in Belgium foreign issues are no longer affected by exchange-control restrictions, they are still subject to authorization by the Minister of Finance. In France, apart from a few special cases, foreign issues are prohibited by a law dating back many years. Moreover, again with certain exceptions, canvassing on behalf of foreign securities is prohibited, and this puts their placement at a considerable disadvantage compared with French securities.

It has been shown in Chapters 4 and 5 that the establishment of a "queue" for issues is often used to determine market-access priorities and as an instrument for regulating long-term trends of interest rates.

It was stressed in those chapters that certain disadvantages in the present method of establishing national issue queues could be avoided if they were to be based on clear-cut, predetermined criteria reflecting purely technical considerations. The aim of the queue would then become simply the prevention of temporary disturbances of market balance, by spreading issues over a period. On these lines, the

establishment of a queue would not be inconsistent with integration prospects, provided the issues of foreign borrowers were treated in a non-discriminatory manner and account was taken of the trend on markets in other member countries. It is a fact, however, that the more closely knit markets become, the greater will be the importance assumed by these considerations, and in consequence the less it will be possible for the supervisory authorities on each of the markets concerned to establish queues separately.

20. The Group accordingly suggests that representatives of the authorities or bodies responsible for establishing the queue in each of the member countries should co-operate in establishing common criteria which could in the future be used as a basis for their decisions, and that systematic co-ordination between these bodies should subsequently be established, so as to harmonize the queues as fully as possible. Consideration could, for example, be given to the idea of lending "institutional support" to such co-ordination arrangements by instructing a competent body, within which representatives of the market supervisory authorities would meet regularly, to monitor trends on the various Community markets, and also on the international market (discussed below), and publish reports on the opportunities for floating foreign issues and on methods of maintaining the equilibrium of the various markets while exploiting their potentialities to the full.

C. PROBLEMS RELATING TO ISSUE COSTS AND PROCEDURES

21. Even if the various restrictions hampering free access to all the EEC bond markets were lifted, issuers would make use of the new facilities available to them only on two conditions — first, that the cost of recourse to a foreign market was advantageous, and secondly, that there were genuine opportunities for reaching investors in other member countries by means of attractive terms of issue.

The rest of this chapter is therefore devoted to the following topics:

- a) Issuing costs;
- b) The problem of competition with resident issuers;
- c) The problem of placing loans with institutional investors;
- d) The problems set by the technical characteristics of the securities issued.

A) ISSUING COSTS

22. As interest rate differentials between the various markets tend to narrow, so the flotation costs incurred increasingly influence the choice of market for an issue. It is by no means certain that, in present conditions, costs on the various Community markets can be considered competitive with those ruling on the leading international capital markets, or even on the Euro-bond market, which is exposed to keen competition from American and British institutions.

In the Member States, it is the credit institutions, and not specialized intermediaries like investment bankers and issuing houses, which are mainly responsible for the

placing of loans. Despite the advantages of a very dense network of offices and close contacts with customers, issue costs appear generally to be rather high, although the margin between the yield to the holder and the cost to the borrower differs appreciably from country to country. By way of comparison, the highest commissions charged are in France, the lowest in the Netherlands; it is not possible to quote figures, since the variations between different issues in one and the same country falsify any comparison.

Two significant factors may nevertheless be noted. First, the practice of canvassing has a considerable incidence on costs, particularly in France. Secondly, in other countries, the extreme weakness of competition between the issuing syndicates and the lack of flexibility in the allocation of quotas among them may raise the cost and impair the quality of the placing. As a consequence of this lack of flexibility, issuing commissions may not provide an accurate reflection of the costs incurred by the syndicate and may not be commensurate with the actual difficulties with which the institutions have to contend and which vary according to the standing of the borrower, the characteristics of the issue and the market situation. This combination of defects is mainly due to the fact that "wholesale" placing with institutional investors is insufficiently developed and that in consequence the market is still, as it were, largely a "retail market". Progress can only come from the gradual development — which is in fact already appreciable — of direct placing of substantial blocks of bonds. On the other hand, selection on a competitive basis of the syndicate to be entrusted with the placing of a given issue may help to stimulate competition where large-scale loans are concerned, as is frequently the case in the United States.

The fact remains that the opening up of the EEC markets cannot be properly effective until competitive costs and placing facilities enable Community financial institutions to entice customers away from the Euro-bond market.

B) THE PROBLEM OF COMPETITION WITH RESIDENT ISSUERS

23. Competing with the issues of resident borrowers involves foreign issuers in special problems when the former have the opportunity to make "tap" issues. These issues assume very considerable importance in Germany as regards communal and mortgage bonds and in France as regards Treasury bills (*Bons du Trésor*). In the other member countries the same technique is used for the financing of local government capital expenditure and residential construction, and also for the refinancing of ordinary credit institutions (short-term deposit certificates). Over the period 1960-65, tap issues averaged about 65% of the total net domestic issues of fixed-interest securities in Germany and 42% of the total in France and Belgium, as against only 23% in Italy and 16% in the Netherlands (see Table 21).

As these issues escape the "discipline" of the queue — in the countries where there is one — the institutions issuing them have an advantage over resident or non-resident borrowers, who under this system may find their issues postponed or even prohibited altogether when the market is over-extended. The special terms on which these securities are frequently offered help to make them first choice for investment portfolios, thus leaving that much less room on the market for other loans.

A solution to this problem might be found in standardization of the "tap" issue conditions in the Member States and co-ordination of the policies of the market authorities. This would prevent tap issues stultifying the effects of the queue system.

C) THE PROBLEM OF PLACING WITH INSTITUTIONAL INVESTORS

24. The inadequate scope for institutional investment in bonds of other member countries has already been analysed at length. There is nevertheless reason to emphasize one special aspect of the problem, namely the principle habitually followed by these organizations causing them to limit their investments in a given currency more or less strictly to the resources they hold in this currency. Since the greater part of their resources is in local currency, this principle clearly militates against their subscribing to loans issued by a foreign borrower on his own market and consequently expressed in a foreign currency.

The device of parallel loans, consisting of various *tranches*, each expressed in a different currency, aims not only at spreading a large loan over several markets, but also at supplying institutional investors in the various countries with bonds expressed in their own currencies. This device has, however, a number of drawbacks, including in particular the very great technical complexity due to the fact that it really entails several simultaneous loans rather than a single loan. Nor are the many administrative formalities involved and the need to adopt a standardized form — even if the yields offered by the various *tranches* differ — calculated to encourage the use of this procedure.

A more convenient variant of this device enables institutional investors to be offered employment for their funds free of exchange risks, without necessitating the issue of a series of foreign loans. Foreign subscribers to a loan placed on the domestic market, but also designed to attract savings from other member countries, are simply given the option of having bonds to which they subscribe expressed in their own currencies. This device has the very considerable advantage that it does not entail any arbitrary fixing of *tranches*, but allows the subscribers to determine the volume of each in accordance with what the appropriate market can absorb. The technique has already been used for an issue by an Italian government-controlled holding company. As interest rates are gradually aligned, its use is likely to become more common.

D) FEATURES OF SECURITIES ISSUED

25. The securities offered in the member countries do not always have identical features. While in some countries it is permissible practice to issue index-linked bonds, participating debentures and "premium bonds", these are not usual in others, and in some are actually illegal. The special attraction exerted by some of them can at times distort the competitive conditions on the issues market.

The practice of index-linking, which was fairly common in the past, has been more or less rigorously circumscribed in all the Member States. Thus in some countries, index-linked securities are found on the market but new issues are not authorized;

in others, the only prohibition has been on gearing to a reference index unrelated to the activity of the issuer. In the latter case, therefore, it is permissible to issue participating debentures giving the holder an interest in the borrower's business results. The participation may take the form of a revaluation of principal or of raising the annual interest payment in proportion to the increase in the borrower's turnover or profits.

Convertible bonds will be examined in Chapter 10 (equity markets), since they raise special problems, particularly in connection with the deferred capital increase that they may represent. Yet, throughout the period preceding conversion they are in effect a form of bond linked to the price of the share.

Finally, "premium bonds"⁽¹⁾. These are normally the special preserve of issuers in the public sector and they vary considerably in importance from country to country.

The problems of competition mentioned above make it desirable that the Member States should so far as possible standardize their attitude to these different kinds of bond in order that issuers receive similar technical facilities on the various markets. Failing such alignment, the diversity of situations might result in an abnormal expansion of issues offering the indexing terms so popular with the public, with the risk that these issues, made by borrowers in the countries with the most liberal system, would exploit this special advantage to drain off savings from other member countries.

CONCLUSIONS

26. The differences in size or structure between the fixed-interest-securities markets in the Member States cannot in themselves warrant limitation of access for foreign borrowers. Nor, as they lessen, can appreciable divergences in yield levels on the various markets be adduced as justification for the maintenance of restrictions. At the very most, there will be a transitional problem which could be overcome by opening up the market in stages and by making certain technical adjustments. The Group accordingly recommends:

- 1) Elimination of the remaining exchange-control restrictions, if necessary limiting authorization of the issues placed by other member countries to maxima fixed in accordance with objective criteria and due to be gradually raised;
- 2) Elimination of certain legislative or administrative provisions discriminating against issues placed by other member countries;
- 3) Introduction of arrangements for systematic co-ordination between the market authorities in order to monitor trends in availability of funds on the markets and thus prevent even temporary overloading of any of them. This co-ordination should be based on criteria determined by common agreement and should be carried out by a body in which all these authorities are represented;

⁽¹⁾ Unlike UK premium bonds, continental premium bonds always bear interest as well.

- 4) Re-appraisal of the existing techniques for placing issues, with a view to furthering those which have proved the most efficient and least costly;
- 5) Agreement on a common attitude to devices such as tap issues, issues of index-linked bonds or participating debentures, "premium bonds", etc., which may favour certain issuers and also produce not inconsiderable distortions of capital movements between Member States.

III. The Euro-bond issue market

27. Conventional foreign issues in local currency have, as has been shown in Chapter 3, already attained an appreciable volume in the Community countries, since their gross value for the years 1961 to 1965 may be estimated at approximately \$550 million. This figure, however, is seen to be low when compared with the value of foreign issues during the same period in the United Kingdom (\$296 million), Switzerland (\$704 million) and above all the United States (\$1 480 million). They accounted in fact for less than 1.5% of the net domestic issues of medium- and long-term fixed-interest securities in the whole of the Community, which totalled more than \$38 000⁽¹⁾ in the period 1961-65. These comparisons suggest that foreign issues in local currency are still at an embryonic stage of development and that a genuine European fixed-interest-securities market is still a long way off.

However, since 1957 — and at an increasing pace since 1963 — an international bond market, the "Euro-bond market", has been building up. The issues placed on this market totalled \$1 770 million in the period 1961-65 and hence far exceed the amount of local-currency foreign flotations in Europe.

The interest aroused by this experiment calls for a searching examination of the characteristics of the market in question, the reasons underlying its development and the problems it is currently facing.

A. PRINCIPAL FEATURES OF THE EURO-BOND ISSUE MARKET AND REASONS FOR ITS DEVELOPMENT

28. The Euro-bond market may be defined by reference to its principal features: the bonds (whether conventional or convertible) are expressed in foreign currencies which play a major role in international financial transactions (dollar, Deutsche Mark) or in European units of account, or embody special clauses, such as an exchange option; they are issued by syndicates consisting of banks in the various

⁽¹⁾ Table 20 (domestic issues) and Table 15 (foreign issues) are not strictly comparable: in the case of foreign issues, only gross figures are available, whereas for domestic issues the figure net of redemptions is shown. If net figures were available in each case, the percentage would be even smaller.

member countries co-operating with others in the main financial centres outside the Community; they are purchased by an international public extending well beyond the confines of the country of issue and sometimes exclusively foreign. In contrast with the international markets of Zurich, New York and London as operated before 1957, the Euro-bond market, physically located in Luxembourg, London, Frankfurt or New York, differs in many cases from the "domestic" markets alongside which it functions in respect of the currency of issue, the yields offered (¹) and the placing techniques employed. Furthermore, Euro-bonds display common features, irrespective of the place of issue or quotation, which no longer has a great deal of significance, the actual sources of the funds being largely the same.

Due mainly to the initiative of foreign financial institutions and stimulated by the benefits which these securities afford both borrowers and subscribers, the development of Euro-bond issues has also been given a boost by fortuitous circumstances associated with tax or exchange-control measures adopted by certain States in implementation of their monetary or external payments policies.

A) DEVELOPMENT OF EURO-BOND ISSUES AND THEIR ADVANTAGES FOR PARTICIPANTS

29. For the borrowers, an outstanding advantage of Euro-bond issues has been to provide them with funds to supplement those from conventional issues or, where no conventional issue has been possible, to provide them with alternative sources of finance. This is to be regarded as an outcome of the public-sector dominance of the domestic markets and the comparatively niggardly treatment of private-sector and foreign recourse in consequence.

In many cases, too, Euro-bonds offer borrowers the advantage of a lower cost than flotations on the domestic markets of the EEC member countries; either the yield can be reduced by reason of the other benefits accorded to the investor, or the placing cost may be lower on account of the competition between international issuing syndicates.

The lower cost may also be due to the fact that the borrower agrees to accept an exchange risk. This is the case with industrial and commercial companies which, because of the nature of their investments and the diversity of their currency earnings, can safely assume an exchange risk that is in any case low in relation to the risks incurred in their industrial and commercial operations. It is also the case with the financial institutions not required to guard against the exchange risk, either because they pass it on to their own debtors or because the risk is assumed by the Government. And, finally, it is the case with the public authorities.

It must be pointed out, however, that private issuers in the Community have not availed themselves to any great extent of the facilities offered by this market, which have been used mainly by international institutions, next by Scandinavian, Portuguese and Japanese borrowers, and of late especially by subsidiaries of

(¹) The rates applied in the case of conventional foreign issues were generally higher than those obtainable on domestic issues, but their variations always corresponded with those of the latter. This is no longer necessarily the case with Euro-bond issues.

American companies. In the case of this last group, however, the capital obtained on the Euro-bond market has always cost more than on the US market; it has mainly been the desire to co-operate in the "programme of voluntary restraint" introduced by the American authorities that has been responsible for the scale of their borrowings on this market; even so, the cost of the funds thus obtained has been less than they would have incurred for issues in local currency on the Community markets.

30. For the investors, the chief attraction of Euro-bonds appears to lie in the fact that they offer a yield free of any tax deduction.

As is known, Euro-bond issues are located in countries in which no deduction of tax at source is applied to non-residents at the present time. But in addition, most of these issues, and in particular those of subsidiaries of American companies, incorporate a clause to the effect that the interest is payable without deduction of any tax, present or future⁽¹⁾, which may be imposed in the issuer's country on interest paid to a non-resident. In the event of such a tax being introduced, the issuers usually undertake to increase the interest so that, after deduction of tax, the holders continue to receive the stipulated net amount. No doubt one of the advantages most appreciated by the public is that the collection of interest on these loans, unlike that of interest on other foreign securities, entails none of the bothersome formalities usually required in order to obtain a refund of tax deducted at source abroad or to offset the deduction against tax due in the country of residence. The investor is thus assured of not having to suffer double taxation. As, moreover, such securities may be held anonymously, there are opportunities for tax evasion by the holders. This is something of which the various governments are naturally aware. It would, however, be going too far to consider it the decisive factor in the development of Euro-bonds.

The various combinations applied have moreover offered investors ample choice between various currencies⁽²⁾ and have enabled them to spread their portfolios both geographically and from the risk point of view. Another incentive to purchase such securities may therefore consist in the investors' desire to protect themselves against the possibility of devaluation of their own currency. It cannot be ruled out, however, that the difficulty some investors may have in assessing the exact scope of the monetary clauses may sometimes have led them to an unduly broad interpretation of the extent of the advantages offered. In point of fact, the investor is protected against possible changes in the parity of certain currencies, but not against erosion of the currency due to rising prices.

B) DEVELOPMENT OF EURO-BOND ISSUES, AND GOVERNMENT POLICIES

31. Although the place of issue is only of minor importance, given the international character of the issuing syndicates and the purchasing public, the physical location of the Euro-bond market in certain countries gives the financial centres of

(¹) This is not the case with Japanese loans, interest on which is subject to deduction at source in Japan itself.

(²) In Chapter 13 (exchange risks) the ways in which the exchange risk is split between holders and issuers of international bonds are examined in detail.

these countries a number of advantages. The market does in fact bring local financial intermediaries a good deal of additional business, thereby helping in particular to improve the operating conditions and profitability of their "issues" departments.

This is particularly the case in the Luxembourg centre, as it once was in the Swiss centres.

As regards London and New York, where the reputation of the existing financial institutions was a decisive factor in the location of the international market, Euro-bond issues have provided an opportunity to continue issue activity for foreign account which would otherwise have been radically reduced. Considerations of prestige and the "invisible" earnings from this activity have been enough by themselves to win official favour in the countries where these markets are established.

Another reason for the official blessing is that the Euro-bond market cannot exert an adverse influence on the country's balance of payments because of arrangements which in practice discourage residents from participating on the market: supply and demand, as already noted, come mainly from non-resident issuers and investors. In the United States, since the introduction of the interest equalization tax, and in the United Kingdom, on account of a high dollar premium, resident investors have no inducement to buy Euro-bonds. The appreciable influence of the American authorities on the development of Euro-bond issues is also attributable to the programme of voluntary restraint, more particularly its encouragement of United States enterprises to find more of their finance requirements abroad, which since 1965, as mentioned above, has induced American subsidiaries to rely more on Euro-bond issues.

In Germany, since the introduction of the 25% withholding tax (*Kuponsteuer*) on the interest on their holdings of German bonds, non-residents have inclined more towards the Deutsche Mark flotations of foreign borrowers which are not subject to this deduction. Consequently, their investments no longer contribute to swell imports of capital, in a manner considered undesirable on account of the already large balance-of-payments surplus. On the other hand, German enterprises have for their part been induced to borrow on the Euro-bond market thanks to the more attractive conditions it offered than the domestic market.

In Luxembourg, there are no regulations preventing Luxembourg investors from subscribing to Euro-bonds. But in practice the problem does not arise, for the Luxembourg investing public is traditionally very conservative with regard to foreign issues. There are also restrictions on the extent to which the leading institutional investors, and in particular the insurance companies and the State Savings Bank, may invest in foreign securities.

32. The attitude of the other Member States has sometimes been more cautious especially so in the countries which, desiring to maintain firm control over their capital markets, have found how difficult it is to follow an autonomous policy when the Euro-bond issue market and the domestic market are already so tightly enmeshed.

But, in the first place, it would be difficult for these States to preclude their enterprises from placing Euro-bond issues, which are a profitable source of finance: to do so would risk putting them at a disadvantage compared with foreign competitors who do make use of the market. Furthermore, these resources supplement domestic funds; if potential demand for capital on the bond market of a Member State exceeds the available supply, the diversion of some of the demand to foreign markets or to the Euro-bond market improves the situation on the internal market by giving greater scope for other issuers to draw on it.

Secondly, investors resident in the Member States are as a rule free to participate in the Euro-bond market, since the securities are quoted on the Luxembourg stock exchange immediately after issue and the total liberalization in force for quoted securities thus becomes applicable to purchases on the Euro-bond market. However, certain restrictions are imposed — formally or informally — on Member State banks participating in issuing syndicates, particularly as regards the extent to which they may advertise such issues. The aim is obviously to prevent Euro-bond issues from encroaching too deeply on the domestic market.

B. THE EURO-BOND MARKET: CURRENT PROBLEMS

A) RECENT TRENDS AND MARKET BALANCE

33. During 1965, American companies, among others, stepped up their recourse to the Euro-bond market. Combined with the general upward movement of interest rates, this at times caused log-jams reflected in difficulties in the placing of issues and, at the beginning of 1966, the withdrawal of some issues previously announced. If too many issues were again made on the market, these difficulties might become even more acute since the relatively limited public for them has already acquired a sizeable portfolio. A saturation problem might thus arise, at least for a period, to point the need for timing of international issues.

There can be no certainty that the financial institutions participating in the issuing syndicates will invariably be able to gauge the market's absorptive capacity accurately and avoid overloading it. An error here could have unfavourable repercussions on price movements on the secondary markets, which would ultimately have the most regrettable consequences as regards the future of such issues.

The idea of establishing a queue for Euro-bond issues has occasionally been mooted, but it is hard to see what sort of authority could be assigned the task in question. However, it would be quite in order for the representatives of market authorities, at the periodic meetings advocated above, to extend their agenda to a study of the trend of the international market and make general recommendations concerning recourse to it, so as to assist in regulating the timing of Euro-bond issues.

B) LONG-TERM BALANCE OF THE EURO-BOND MARKET

34. It is obviously very difficult to gauge the absorptive capacity of the Euro-bond market; its limits, which were beginning to become apparent, have been extended by the vogue for convertible bond issues.

The pronounced success scored by the latter on the international market enabled a number of concerns, and in particular subsidiaries of American companies, to borrow for a time at relatively low rates of interest. None the less, these rates, too, have risen, and the prices of several convertible bond loans are now well below par. As this price movement is also associated with the market behaviour of the shares of the issuing company, however, it should not be concluded that the fall is evidence of saturation of the European market with convertible bonds. In general, the diversification of the securities offered — as shown, for instance, in the recent appearance of relatively short-term loans — and the higher yields may attract new classes of European investor to this market — and also, for that matter, new purchasers from non-Community countries. The supply of capital available for investment on this market may therefore expand further.

At the same time, the increasing cost of capital raised on the Euro-bond market is nullifying one of its principal attractions for certain borrowers. It is also doubtful whether American enterprises will continue to make the considerable financial sacrifices involved in borrowing at rates well above those ruling in their own country. It is possible that they will prefer to finance their foreign subsidiaries by means of issues of shares — by holding companies combining all their European interests — which would appreciably lighten the pressure on the international bond market.

35. While these are the prospects for the development of supply and demand on the Euro-bond market, it must be noted that its future will also depend on an improvement in the markets on which securities currently in circulation are negotiated. One of the main sources of anxiety concerning this market stems from the use various financial institutions participating in the issuing syndicates may have made of short-term funds raised on the Euro-dollar market. The recourse itself would give no reason for concern provided it was only a question of purely temporary utilization to facilitate the orderly placing of an issue. However, it is frequently claimed that, through this expedient, an appreciable proportion of the securities in circulation is in fact being financed on a permanent basis by short-term borrowing. If this is so, the vulnerability of this form of financing might in certain circumstances give rise to sudden pressure on the secondary market and thus to a slump in prices.

36. This source of weakness in the Euro-bond market is not unconnected with the failure of institutional investors to move onto it in strength: the latter have been able to contribute only a meagre amount of funds, at least during the early part of the market's existence, and the quality of placings has consequently often suffered. A more favourable trend appears to be developing of late — witness the growing volume of dealings and the increase in arbitrage.

Without this latest trend, it might have been feared that the combination of these shortcomings of the secondary Euro-bond markets would in the long run hamper the placing of new loans. It might also be useful to encourage a more active market in these securities by quoting them on a number of stock exchanges, more particularly in the borrower's country.

CONCLUSIONS

37. Whereas the interpenetration of the markets of the various member countries has been relatively slow, the Euro-bond issue market has developed more rapidly and has been fulfilling certain functions which would properly belong to a European market in fixed-interest securities. There are, however, a number of defects in its functioning that need attention.

The following observations and recommendations may be made:

- 1) The Euro-bond issue market has enabled borrowers in the Community to find supplementary resources relatively cheaply; it is unlikely that the same volume of capital could readily have been obtained on the Member States' markets.
- 2) Euro-bond issues have led to co-operation between the financial institutions of Community and non-Community countries, and this has enabled the former to develop certain methods of issuing and placing securities which have proved effective on markets outside the Community. At the same time, the usefulness of competition between issuing syndicates and its beneficial effects on the cost of loan capital have been demonstrated.
- 3) It has also been seen — when Euro-bonds have been issued — that an international market can adapt itself perfectly to a multiplicity of financial centres and does not require the concentration of all operations in a single focal point.
- 4) Various procedures for overcoming the obstacle inherent in the exchange risk have been tried out on the Euro-bond market, which has also helped to popularize the use of devices such as the convertible bond, the kind of bond likely to attract wider sections of the public to the market.
- 5) It has not been possible to avoid overloading the market at certain periods, and this — with interest rates generally rising — has seriously disrupted the operation of the market.
- 6) Moreover, the secondary Euro-bond market has in the past shown signs of instability, due to:
 - i) The financing of an appreciable proportion of the securities in circulation by short-term borrowing on the Euro-dollar market;
 - ii) The relatively small-scale participation of institutional investors, who have been able to "absorb" foreign-currency bonds only within narrow limits;
 - iii) The lack of "transparency" of the secondary market and the low level of arbitrage business. In this connection there may well be a case for allowing Euro-bond issues to be quoted on a number of financial markets, more particularly in the country of the borrower.

CHAPTER 10

STRUCTURE OF EQUITY MARKETS

Introduction

1. Equity markets are facing similar problems in the various Community countries.

The annual volume of equity issues in these countries is far from negligible: the average figure for 1960-65 was \$2 500 million, compared with a little more than \$1 000 million in the United States (Table 22). However, even on this impressive scale share issues have not sufficed to restore the financial structure of European enterprises thrown out of balance by the shortage of own capital. This fact and its consequences, discussed in Chapter 2 (sec. 17), are clearly reflected in Tables 10 and 11 on sources of external finance and the financial structure of enterprises.

Another point is that the trend of issues has been very irregular, with appreciable fluctuations from year to year prompted by varying conditions on the stock exchanges. The risk capital market is not, then, as reliable a source of funds as business firms would wish; this is due in part to defects in the machinery of the secondary markets, to be discussed in the next chapter, but also to structural problems affecting both the supply of and the demand for capital on equity markets.

Although the Group concentrates its analysis on problems connected with the development of a European capital market, it has had to touch on some of the problems of the various member countries' markets: more than in any other sector of the capital market, the integration of equity markets is heavily dependent on an improvement in the working of each of the national markets.

This chapter is therefore divided into two parts:

- i) The first deals with ways and means of improving the supply of capital on the markets by an increased contribution from institutional investors and by an adjustment of tax legislation;
- ii) The second discusses how the terms and techniques of issues of industrial securities can best be adapted to the preferences of European savers.

I. Supply of capital on equity markets

A. THE SHORTAGE OF PRIVATE CAPITAL AND THE POSSIBLE CONTRIBUTION OF INSTITUTIONAL INVESTORS

2. Traditionally, the share market has been considered largely the preserve of private investors regularly seeking investment outlets on stock exchanges. Under present circumstances this is no longer valid. The reasons for this change — mainly

the redistribution of incomes and the public's growing interest in other, sometimes speculative forms of investment — have often been discussed. The problems encountered today arise because not all countries have as yet created the conditions necessary to ensure that the traditional clientele of the share market is succeeded by new classes of saver and by institutional investors.

The inadequate supply of capital from private investors, especially those in the middle-income brackets, is also explained by the fact that the financial institutions they usually deal with (savings and other banks) are not always capable of — or perhaps have no interest in — turning their customers' attention towards equities. Such use of their customers' savings would in fact compete with other forms of investment more remunerative to the bank, as for instance deposits, which can be reinvested profitably, or fixed-interest securities, which normally earn the intermediary a higher commission. Another factor is that in continental Europe stockbrokers and other dealers are not organized in such a way as to facilitate contacts with the public at large. As for investment consultants, they are still far removed from the developed stage they have attained on the capital markets of some non-member countries.

European countries are thus at present suffering from a manifest dearth of financial intermediaries with sufficiently wide contacts with the public to allow them to provide advice and assistance in share investments.

This situation alone could not account for the anaemia which afflicts the equity markets of most member countries, if institutional investors, for their part, were contributing handsomely to the supply of capital on these markets. It is precisely here, however, that a fundamental structural weakness of most of the European equity markets lies: institutional investors are still not contributing enough capital. It is a very different story in Britain and the United States, where these institutions dominate the field.

In the Netherlands, institutional investors purchased on average over the years from 1960 to 1965 more than 75% of newly issued equities, but in the other countries the fragmentary data available suggest that their contribution seldom accounts for more than 20%.

There is no doubt that the institutional investors are best suited to manage the savings of a large section of the public with no practical experience of direct and judicious investment in equities. Hence, if the share market is to receive any of the savings of large segments of the population which now keep away from it, the activities of certain intermediary institutions which collect savings and invest them on the basis of sound market analysis need to be stimulated.

Intermediaries of this kind are even more important for investments abroad, since knowledge of foreign stock-exchange techniques and of the quality of foreign securities is possessed by few private individuals. The institutional investors therefore have a key role to play in the interpenetration of European markets.

Unfortunately, mainly as a result of regulations controlling their activities, the institutions of this type in EEC countries are too often restricted both in their efforts to attract fresh funds and in the investment of these funds in shares,

particularly foreign shares. Thus, there is a danger that these institutions, so far from promoting market integration, may in certain cases act as a barrier between their customers and the markets of the other member countries and consequently help to isolate the markets.

There are three groups of institution with differing sets of problems:

- i) Investment companies (open-end and closed-end);
- ii) Insurance and provident institutions;
- iii) The savings-bank networks.

A) INVESTMENT COMPANIES ⁽¹⁾

3. At the present time, the legal status and rules of operation of investment companies differ substantially from one Community country to another. The German, Belgian, Luxembourg and Dutch open-end investment funds have much in common, but there are substantial differences between this type of institution (similar to the American mutual fund and the British unit trust) and the French *société d'investissement à capital variable* (SICAV), introduced at the end of 1963. The closed-end investment companies are still of great importance in France and the Netherlands, as they are in Great Britain. In the Netherlands, moreover, the most widely used formula is a special one, combining the status of a closed-end company with the practical operations of an open-end fund. Thus one or other of the arrangements has thrived, depending on the country, and in certain countries, like the Netherlands and France, both types of institution may even co-exist. In Italy, on the other hand, pending the establishment of legal arrangements for open-end funds, there is at present only one investment company, and it is of the closed-end type.

In 1964, the assets of investment companies, expressed as a percentage of market value ⁽²⁾, were about 5.5% in France, 3.7% in Germany and 2.3% in Belgium ⁽³⁾. The Netherlands is the EEC country with the highest percentage: 8.2. In the United States, Great Britain and Japan, the percentages are appreciably higher than in the EEC countries. This suggests that these companies still have growth prospects in most Community countries, although the resources attracted by them are already considerable.

Through the international movements of capital they involve, the operations of investment companies have already forged strong links between the capital markets of the Community and with those of non-member countries. These links are of

⁽¹⁾ Except where qualified as "open-end" or "closed-end", the term "investment companies", as used in this report, is to be understood as denoting both categories.

⁽²⁾ As this ratio also takes account of the companies' investment abroad, it is used here solely as a pointer to the growth of the investment companies and not as an indication of their contribution to domestic capital markets. (See Table 24: Assets of investment companies 1960-64).

⁽³⁾ For Belgium, it should be borne in mind that some of the funds managed by Belgian banks are incorporated in Luxembourg.

two kinds, stemming on the one hand from the companies' investments in foreign securities and on the other from the distribution of their shares or certificates among foreign savers.

Foreign investments account for a particularly high percentage of the net assets of these organizations in the countries where the range of domestic securities is too narrow to allow of a satisfactory spread of the portfolio. This is the case in all the Benelux countries: in 1964 foreign investments accounted for 57 to 60% of the total in the Netherlands and Belgium, and the percentage was still higher in Luxembourg. On the other hand, it is only about 30% in France and as little as 16% in Germany⁽¹⁾. These are, of course, averages calculated on the basis of the assets of all the open-end and closed-end companies; some of these specialize in foreign securities, others confine their investments to domestic securities. Although the figures for France and Germany are relatively low, it should be noted that the investments of these companies abroad account for a high proportion of overall gross investment of residents in foreign securities, viz. about a quarter in Germany and a half in France in 1962, the only year for which comparative figures are available.

Extension of the activities of these organizations raises various types of problem: harmonization of investment rules, removal of obstacles to the sale of their shares or certificates, alignment of their rules on management, information for the public and supervision, and lastly taxation problems.

4. Although their legal status differs appreciably from country to country, investment companies in Germany, Belgium, Luxembourg and the Netherlands have comparable opportunities for purchasing domestic or foreign securities, since the regulations with which they must conform entail no practical restrictions in respect of the origin of the securities which they may acquire. In France, on the other hand, the rule requiring the SICAVs to hold 30% of their portfolios in bonds denominated in francs does in practice tend to limit investment in foreign securities. In Italy, if the provisions authorizing the constitution of open-end investment funds are adopted in the form proposed in the bill on joint-stock companies, they will be even more restrictive than those applied in France, for the proposal is to authorize investments in securities listed abroad, but not on an Italian stock exchange, only up to a limit of 10% of the assets of the funds. Although it is planned to allow unrestricted purchase by these institutions of foreign securities quoted on Italian stock exchanges, this proviso seems to have no practical value at the moment since no foreign securities are currently listed on Italian stock exchanges.

The sale of investment companies' certificates or shares in member countries other than those in which the companies are registered is also hampered by a variety of obstacles.

⁽¹⁾ The ratio quoted for the Netherlands refers to the ten main Dutch open-end funds for which statistics are available. The figure of 30% given for France is for 1963 and probably exaggerates the position, since it concerns only the fifteen main closed-end funds and does not take account of *France-Obligations*, the inclusion of which would lower the percentage. The investments in foreign securities by "SICAVs" set up since then have, in most cases, not exceeded 30% of their assets. The figure of 16% for Germany refers to investments in foreign shares in 1962, the last year for which a breakdown of the investments of German funds of this type was published by the Bundesbank.

These include exchange-control restrictions and administrative barriers connected, for example, with canvassing for business. The protection of the saver's interests invoked to justify these restrictions, however, need not entirely preclude their abolition, if certain measures of harmonization in connection with disclosure and supervision are adopted. This will be discussed more fully below.

A case in point today arises in connection with the above-mentioned obligation imposed for SICAVs to hold 30% of their assets in bonds. The authorities rule this to be incompatible with unrestricted introduction into France of certificates of foreign open-end funds, which are not subject to the same obligation. To the extent that the French authorities maintain this position, it is desirable that the obligation should gradually be relaxed in order to eliminate the obstacle it presents to free circulation of open-end fund certificates throughout the Community.

In other cases, the difficulties are of a more practical nature, arising because the scope of expansion of open-end funds is largely determined by the sales network placed at their disposal by financial establishments. The fact that a number of European open-end funds have been set up by international banking consortia has facilitated diffusion of their units in all the Community countries and in some non-member countries. On the other hand, the close link in certain countries between the funds and the financial institutions managing them may have inhibited the distribution in these countries of certificates of foreign funds. Stock-exchange dealing in certificates of open-end funds should therefore be considered a welcome development, for it may help to free the funds of this dependence on sales networks. There is already much business done in these certificates on the Amsterdam, Brussels and Luxembourg stock exchanges.

5. Expansion of the activities of investment companies throughout the Community would be encouraged by alignment of the rules governing their management, information for the public and supervision.

It has been noted that, in the countries where there are both funds distributing income only and funds distributing capital gains on sales of securities as well, the latter have had more success with the public; in the "profits" distributed, the public does not always seem to distinguish very clearly between the portfolio income and capital gain elements in the distribution. Since in certain countries (Belgium and France) the distribution of these capital gains is at present forbidden, it is likely that harmonization of the regulations on distributions by these funds will be required eventually. In any case, it is essential that the public should always have at its disposal the information enabling it to make this distinction clearly.

The obligations of investment companies concerning information to be supplied to the public also vary widely in extent from one member country to another. Improvements here would help to increase the public's confidence in this type of investment and hence the sales of certificates and shares. With a view to facilitating comparison, there is also a case for harmonizing the presentation of the information already available in most of the member countries, particularly information on changes in assets of the funds, analysis of their portfolios, management charges, and sale and repurchase prices of certificates.

6. Lastly, harmonization of the supervisory arrangements to which investment companies are subject in the various countries is also required. At present, these controls differ very widely within the EEC, deriving in some case from legislative provisions and in others from administrative or purely professional regulations. Fundamental criteria for the protection of savings should be agreed and established, though alignment on the strictest rules is not desirable. Regulation of the commissions charged by the managers of open-end funds is a particularly delicate point and should be approached with due regard for the problem of appropriately rewarding efforts made in promoting this form of investment.

These harmonization measures would remove all need for the restrictions now imposed in certain countries on the distribution of the certificates of foreign open-end investment funds. At present these restrictions are held to be justified by the need to protect the interests of savers.

7. Tax arrangements for investment companies are a vital factor in their development.

A detailed examination of the relevant arrangements in the various member countries will be made in Chapter 14, which deals with tax problems. It will suffice to note here that "transparency" is a basic requirement in this field, both at domestic and at international level.

On the domestic plane, the aim should be that investment income transmitted through these companies should enjoy the same fiscal treatment as if it had been directly paid to the individual investor. Once tax transparency on these lines was assured within each member country, partial harmonization of the fiscal treatment of institutions engaged in the collective management of savings in the Community would be an accomplished fact. However, complete harmonization would also require alignment of the systems of taxing operations in securities.

At international level, the main problems arise in connection with the application of bilateral double-taxation agreements to income received and distributed by investment companies, in particular when the country in which the income arises, the country in which the company operates and the country in which the owner of the shares or certificates resides are different. The principles governing the taxation of such income vary from one country to another. It may even happen that a tax department takes as criterion the real origin of the income for domestic companies, but only the apparent origin, that of the country where the company is domiciled, when the company is a foreign one. The differences in withholding-tax arrangements lie at the heart of most of the difficulties encountered. Double or even triple taxation may result from the complexity of the situations arising and from divergences in the interpretation of the agreements.

Complete neutrality would be obtained if the real origin of the companies' income and the residence of the beneficiaries of distributed income were taken as criteria, and the nationality of the companies were ignored, since all they do is transfer income. But, as will be shown in Chapter 14, there would be serious technical difficulties in the application of this principle, and the Group feels that an adequate

solution to the problem can only be found in the framework of a multilateral double taxation agreement, containing specific provisions for institutions collectively administering savings.

B) INSURANCE AND PROVIDENT INSTITUTIONS

8. As in the preceding chapter, the study of these institutions must concentrate on life-assurance companies. This is justified by the importance an increased contribution of capital on their part would have for the equity market, and by the strict regulation to which these investments are often subject today. Obviously, some of the principles laid down in the following sections could equally be applied to insurance and provident institutions other than life-assurance companies (notably to pension funds).

Broadly, it may be said that, while the contribution of life-assurance companies to the fixed-interest-securities markets is appreciable in all the member countries, their purchases of equities are more modest, either because of the restrictions on this kind of investment or because of the management's cautious approach to it. This applies especially to the investment of technical reserves: for the employment of their own resources, most companies pursue a more flexible policy with regard to investment in equities.

In Germany, for example, investment in shares must not exceed 10% of the increase in technical reserves, and it is allowed only for exchange-listed shares, or shares in which there are regulated unofficial dealings, that are fully paid up and whose yield is at least equal to the capitalization rate applied by the companies (the "technical interest rate").

In France, the scope for investment in equities, still limited by the requirement to place at least 50% of technical reserves in "first-category securities", has indirectly been widened by a reform introduced in 1966 and extending the range of first-category investments to include, on special terms and conditions and within specified limits, industrial debentures, mortgage loans and the shares of real-estate investment companies all of which were previously in competition with equities for the insurance companies' investible funds.

In Belgium, investment in shares is permitted, up to 15% of actuarial reserves, provided they are shares in Belgian companies meeting certain special conditions.

In Italy, investment in equities was subject to special authorization by the supervisory authorities until 1965. At present, insurance companies are allowed to purchase the shares of Italian companies that have been listed for at least five years. These investments, which compete with investment in industrial debentures, must not exceed 15% of the company's actuarial reserves and must allow an adequate spread of risk.

The two extreme cases are Luxembourg, where the insurance companies are not allowed to invest in equities at all, and the Netherlands, where they are subject to no restrictions, though they do make a point of complying with principles recommended by a supervisory authority, the *Verzekeringskamer*.

9. The criteria laid down in the often very restrictive arrangements governing life-assurance companies' investment in equities are open to criticism from several points of view and are now being gradually revised, as examples given above show. It now seems hardly correct to claim that the saver's interests can best be protected in all circumstances by investment in fixed-interest securities, sound though they are. At present there are signs of a move towards more flexible rules for the administration of insurance company reserves.

The risks that share investment necessarily entails should not be an insuperable barrier to liberalization of the regulations concerned. By wide diversification of share portfolios, effected directly by the insurance company or indirectly through the purchase of certificates of open-end investment funds, it is possible for the risks of fluctuation of the value of these portfolios to be contained within acceptable limits.

Moreover, giving life-assurance companies more generous powers for investment in shares, would probably enable them to attract new kinds of customer and would thus help to support this form of contractual saving, from which savers seem to be turning away in certain countries. They could offer policies geared to the trend of equities, as they already do in the Netherlands, for example, where companies investing their reserves in investment companies' shares or certificates can in this way offer policies in which the assured sum is linked by an index to the trend of the securities managed by the investment companies. Similar policies can be taken out in France too. Many different ways could be devised of gearing policies more or less directly to the equity investments of an insurance company; and they would probably attract new customers who are not interested in the present formulas, based largely on fixed-interest investments.

The Group therefore considers it desirable, both for the development of contractual saving and for the widening of equity markets, that life-assurance companies should be authorized to make use, alongside the present contract arrangements, of new and more flexible devices. It feels, however, that these new arrangements, and especially the types of investment permitted for premiums collected in this way, should be clearly determined in advance and made clear to policyholders so that they have full knowledge of the special conditions involved.

10. If the investment banks of life-assurance companies were broadened in this way, an important contribution would be made to integration of European share markets.

At the present time, the restrictive regulations applied by member countries to investment in shares (see sec. 8) generally include additional limitations on investment in foreign shares.

In Germany, all share investment is subject to special authorization, though there is greater flexibility for domestic shares fulfilling certain criteria. In France, foreign shares can be purchased by insurance companies only if they are quoted on a French stock exchange; apart from this, there are no restrictions other than those applicable to investment in French shares too. In Belgium, investments in foreign securities — shares and bonds — are subject to a ceiling set at 20% of technical reserves; this limitation is of course associated with the one already mentioned

concerning investments in shares in general. To be eligible the foreign shares must in addition figure on a list submitted by the insurance company and given ministerial approval. In Italy, investments in foreign shares are still subject to special authorization, but this is practically automatic when foreign risks are to be covered. The situation in the Netherlands — where life-assurance companies are completely free to invest technical reserves in shares — and in Luxembourg — where they are prohibited from doing so — calls for no further comment.

Two arguments have often been put forward to justify the relatively unfavourable treatment of investment in foreign shares compared with domestic shares. First, it is argued that it is more difficult for insurance companies to assess the quality of foreign shares; and secondly, such investments are held to involve an exchange risk, unless the company is in fact seeking to cover commitments expressed in the same currency. These two arguments are hard to accept. In the first place, the leading foreign securities are almost certainly sounder than some domestic securities the purchase of which is authorized without any check on quality; nor is there anything to prevent insurance companies from investing abroad through specialized institutions, like the open-end investment funds, which have a thorough knowledge of the various markets. Moreover, once risk investments are allowed at all it is hard to see why insurance companies should be forbidden to take exchange risks at a time when they are running quantitatively bigger risks of fluctuation in the value of the equities they hold. This does in fact seem to have been acknowledged in the reform made in 1966 in France: commitments accepted in a specific currency must still be covered by securities denominated in the same currency, but foreign securities quoted in francs on a French stock exchange are now recognized as eligible cover for commitments in francs.

The Group therefore feels that the present differences of treatment between investments in domestic shares and in other member countries' shares should be relaxed so as to allow insurance companies to make their contribution to the integration of equity markets in the Community. Two practical measures could be taken straightaway without upsetting established principles:

- i) Parity of treatment could be introduced for investments in domestic shares and in the certificates of open-end investment funds whose portfolios include foreign securities;
- ii) The distinction between domestic securities and other member countries' securities could be discontinued, where the latter are quoted on a stock exchange in the country in which the insurance company is registered.

C) THE SAVINGS-BANK NETWORKS

11. It may be asked whether a capital market contribution from the savings-bank system in the form of share investments is not a practical possibility. Savings banks transform their resources into longer-term investments in the form of claims and bonds, and at present most of them are bound by severe restrictions on their capacity to hold equities.

In practice, as will be explained in Chapter 12, only the central giro institutions in Germany and the *Caisse des Dépôts et Consignations* in France (in the exercise of

certain of its activities) enjoy relatively liberal powers to purchase shares. There are differences of degree in the limitations imposed on the savings banks in the various countries, but the exceptions to the general ban on investing in shares are few. Among these may be mentioned the power of the Dutch savings banks to make such investments up to a limit of 50% of their own resources, and a few exceptions in favour of the savings banks in Italy, subordinated to the same rules as the commercial banks, of which more later. These already restrictive regulations are even more so for investments in foreign shares.

The restrictions are defended by arguments referring to the need to protect the saver and for special caution in the employment of funds withdrawable at short notice by depositors. But it is undeniable that, in addition to the objective of protecting the saver against the risk of loss or immobilization, these regulations often also serve to canalize the resources of the institutions towards the financing of housing or infrastructural investments which are considered to deserve priority. A revision of these priorities, giving greater importance to the financing of "productive" investment, might lead to some relaxation of the regulations concerning the savings banks and enable them to make a significant contribution to the equity markets. This liberalization process — as indicated in Chapter 12 (secs. 24-30) — could well be more rapid for the central institutions and the savings banks with centralized structure than for the local savings banks.

12. In the immediate future, the savings banks could probably make a major contribution to the development of equity markets in a way other than by direct investment. In view of the growing resources available to them, they should perhaps also aim at helping to interest the small savers who are their customers in more "elaborate" forms of investment than they normally accept, notably investment in equities. In Germany there is an investment fund managed by the savings banks which has enabled certain resources to be directed through these banks onto the securities market. In France, a SICAV sponsored by the *Caisse des Dépôts et Consignations* has just been set up (1966). Its certificates are distributed through the savings banks.

Another way in which the savings banks can stimulate security investment by their customers is by offering their services as managers of portfolios and as intermediaries for securities transactions — as in Germany, Italy and the Netherlands.

B. THE ROLE OF THE BANKS

13. The operations which banks may carry out on the equity markets are subject to laws and regulations based, in some respects, on radically divergent principles in the various Member States. In Germany, the Netherlands and Luxembourg, banks are entitled to hold shares on their own account, both as participations and as portfolio investments; but in other respects controls over these transactions show distinct differences of emphasis in the three countries. In France, a distinction — more important in its legal implications than its practical consequences — is drawn between two types of bank: one, the *banque d'affaires*, is mainly concerned with acquiring participations and carrying out related transactions, whereas the other, the deposit bank, is not allowed to hold shares, save for as long as is strictly

necessary from the technical point of view for the placing of new issues with its customers, or where it is holding or administering a portfolio for a third party, or in respect of the investment of its own capital and the taking of participations in other financial establishments. Rules similar to those applied to the deposit banks in France also occur in Italian and Belgian legislation incorporating the banking reforms of the thirties and defining the limits of the operations of these institutions.

The problems raised by these differences of regulation, and more especially the problem of their possible incidence on competition within a European capital market, will be examined in Chapter 12. Of interest here are the advantages and disadvantages of the two systems for the functioning of the equity markets.

14. The arguments advanced fairly frequently nowadays in favour of less specialization of banks mainly turn on the contribution deposit banks could make to the supply of risk capital, the widening of the often excessively narrow securities markets that might be expected as a result, and finally the need to prepare the banks for international competition. It should be added here that the activities of the banks on the equity markets would contribute appreciably to the integration of these markets at European level, since the banks could acquire the necessary knowledge of business and stock-exchange machinery in the partner countries more easily than other investors.

15. However that may be, the risk of loss through falling prices and the risk of immobilization of capital inherent in share investment would prevent the banks from devoting a large proportion of their resources to this type of investment, given the nature of their commitments to customers. Subject to observance of adequate rules of banking security and control by the supervisory authorities, however, it should be practical to relax the regulations sufficiently to allow banks to increase their contribution. But the problems which would then arise — and which are already discernible in the countries where these institutions have considerable freedom to invest on equity markets — must also be taken into consideration.

16. These problems spring mainly from the conflicts of interest a bank may face in exercising its various functions — distributing credit, taking controlling interests in enterprises, running a share portfolio, participating in issue syndicates, managing open-end investment funds and, finally, acting as adviser to its customers or as manager of investment portfolios.

Conflicts of interest could arise between the bank and its business customers, and also between the bank and the owners of the portfolios it manages or advises on. Problems also arise — and will be examined in Chapter 11 (sec. 46) — in connection with the activity of banks as stock-exchange operators, when they may at the same time hold shares.

It would almost certainly be going too far to assume that such conflicts of interest are inevitable when more than one of these functions are performed together, for the independence of investment management departments of banks and associated institutions could be ensured by strict rules concerning management, information for the public and supervision.

The fact that in some of the more developed markets institutions specialize in one or other of the activities mentioned above does not necessarily mean that specialization would be the arrangement best suited to current conditions on continental European markets, which are manifestly too narrow. The situation might be quite different in an integrated European market of the future.

In short, the possibility of conflicts of interest should be carefully weighed and set against the contribution which fuller participation of the banks on the market could make. Some degree of harmonization of the rules governing the operations of banks on equity markets in the various member countries seems inevitable; but only a detailed study of all the advantages and disadvantages noted in the past can allow its character and limits to be foreseen.

C. TAX INCENTIVES TO INVESTMENT IN SHARES

A) MEASURES TO LIGHTEN TAXATION OF DIVIDENDS

17. Considerations of yield have probably contributed to some extent to depressing the supply of capital for investment in shares. Certain Member States have therefore taken steps to make this type of investment more attractive.

Throughout the period from 1960 to 1964, even when share prices had fallen appreciably, average share yields remained low in most of the EEC countries. Often they were lower than those on American or British securities, to say nothing of yields on fixed-interest securities, which are of course in a completely different category. The fact that investors tend to be more interested in the prospect of capital gains than in the dividends paid by European companies has something to do with this; none the less, low yields have probably discouraged potential investors in search of regular income.

The tendency for investors to look for capital gains rather than income has often been strengthened by taxation systems bearing more heavily on distributed income than on capital gains.

Some Member States, aware of these forces, have therefore sought to lighten the overall tax burden on the distribution of profits and thus to increase the return on the shareholder's investment. Two systems have been introduced: in Germany, a lower rate is charged on distributed dividends than on undistributed profits (double-rate system), which means a tax abatement in the hands of the company; in Belgium and France, a fiscal claim (tax credit) proportionate to the dividend received is granted, representing a tax relief in the hands of the shareholder.

Despite technical differences, the ultimate objective was the same in both cases, i.e. to lighten the double taxation effect deriving from the fact that, whereas profits put to reserve were subject only to corporation tax, distributed income was caught by that tax and also by personal income tax in the hands of the shareholder. Another aim, in these countries, was to lessen the differences of fiscal treatment of share income and income from bonds.

18. There is some doubt as to the effectiveness of these measures, for their results do not seem to have come up to expectations. Their effect seems to depend largely on how prices react to the measures at the time of their adoption or subsequently. If prices reflect the increase in income which will accrue to the shareholder, the tax advantage is capitalized solely to the benefit of existing shareholders, new shareholders being faced with the same yield prospects. Only when the stock exchange does not react does an increase in yield become possible. But even this assumes that companies do not adjust their distribution policies in a way that diverts part of the tax advantages granted by the authorities to satisfaction of the companies' own finance requirements. In such cases, which are in fact the most common, the complex machinery chosen to ease the tax burden has results that are not very different from those which would have been obtained from a straightforward reduction of the rate of corporation tax.

Broadly speaking, the double-rate system and the tax-credit system do not differ much in their impact on the domestic market, but this is far from being the case in respect of their effects on the scope for international integration of equity markets.

B) DIVIDEND TAX RELIEF AND ITS RELATION TO TREATMENT OF FOREIGN SHAREHOLDERS

19. The main difference between the two systems described above lies in their treatment of foreign shareholders.

The double-rate system now operating in Germany benefits all distributed dividends, wherever the shareholder resides. But the tax-credit system, at least as now applied, benefits only the residents of the country in which it is adopted and bears solely on dividends accruing to these residents on shares in domestic companies.

Viewed from the efficiency aspect alone, the fact of reserving the tax reliefs for the benefit of resident shareholders has the effect of limiting the flow of capital onto the equity market, which the measures are in fact designed to stimulate: foreign shareholders not only gain no benefit from the tax-credit system, but may actually suffer if the companies — as seems to have often been the case in France — reduce dividend distributions because the shareholders are also receiving the tax credit. For non-residents, the measure is hence liable to weaken the return on these shares and turn them away from the market. It is, moreover, unlikely that the inducement to resident shareholders to sell foreign securities and switch into domestic securities with higher yields due to this tax concession can suffice to offset the injurious effect mentioned above.

20. The effect both types of measure can have in isolating markets is more serious in the case of the tax credit, since it discourages foreign shareholders and at the same time offers substantial inducements to resident investors to prefer domestic to foreign shares. The double-rate system also lessens communication between markets, but here the effect is limited to the encouragement it affords to investors to prefer investment in domestic securities.

21. Although there are times when tax measures may enable company dividends to be increased, the best way of making share investment more attractive is to improve the general conditions governing the profitability of firms. Moreover, if a tax benefit granted to shareholders is to be appreciated, it must be understood, and from this angle the simplest measures are probably the most effective: in the past, measures to increase the return on equities have sometimes been much too indirect.

To prevent the measures adopted tending to divide rather than unite equity markets, action should be taken — pending harmonization of the various tax-relief systems — to organize without delay an arrangement under which the two systems, the tax-credit and the double-rate system, may coexist. For example, shareholders in domestic companies who are resident in another Community country could be allowed a refund equivalent to the tax credit enjoyed by residents.

CONCLUSIONS

22. Action to expand the supply of capital on equity markets must principally focus on raising the contribution of institutional investors.

1) The Group therefore recommends:

a) With regard to investment companies:

- i) That not only the few surviving limitations on purchases of foreign shares should be abolished, but also restrictions hampering the distribution of shares or certificates issued by these companies among savers in other member countries;
- ii) That rules concerning management, information for the public and supervision of these companies should be aligned, with the special aim of eliminating any doubt as to the nature of the income distributed and of the conditions under which the shares or certificates can be bought and sold;
- iii) The achievement of complete tax transparency, both at domestic and at international level, in order to prevent income passing through these companies from being penalized.

b) With regard to insurance and provident institutions, particularly life-assurance companies:

- i) That the authorities should reconsider the rules which — for reasons associated with protection of the interests of savers — have so far hampered broader action by these institutions on equity markets;
- ii) That the life-assurance companies should be authorized to offer policies linked with equity investments or investments in open-end investment funds, alongside existing types of contract based mainly on investments at fixed interest;
- iii) That, as an immediate measure, the distinction between investment in domestic securities and investment in foreign securities listed on a stock exchange of the country in which the institution in question is registered should no longer be made.

c) With regard to the savings-bank networks:

- i) That, as recommended in Chapter 9, local savings banks be allowed to use a small percentage of their resources to make investments in other member countries similar to those permitted on the domestic market. Investment in shares would thus also benefit from the relaxation. The central institutions and savings banks with centralized structures could already be allowed greater latitude;
 - ii) That the savings banks be allowed to invest part of their own funds in domestic or other member countries' shares, along the lines followed in the Netherlands;
 - iii) That savings banks throughout the Community be authorized to set up open-end investment funds and handle share investments on behalf of their customers — as they do already in some member countries.
- 2) The activities that can be carried on by banks on the equity market are subject in the various member countries to laws and regulations often based on radically divergent principles. The Group is fully aware of the contribution that the banks can make to the broadening of capital markets and the supplying of private enterprise with risk capital, particularly in the context of a future European market. However, the possibility that bank action in this field might lead to conflicts of interest has to be considered. It is therefore not possible without detailed study to draw conclusions on the advisability of extending — or reducing — the rights of banks to take participations and hold share portfolios.
- 3) The low yield on equities may have turned potential investors away from Community markets: the tax incentives adopted in three of the member countries in order to give shareholders a better yield may therefore increase the flow of funds to the markets. However, the rule reserving the tax relief to resident holders of domestic shares is a factor tending to keep the markets apart and ultimately to reduce the efficacy of the measures taken. The Group therefore hopes that these drawbacks will be eliminated by allowing share-holders resident in other member countries advantages equivalent to the tax credit enjoyed by residents.

II. Issues of equities

23. The problems besetting the equity markets of the member countries arise not only from the shortage of capital for risk investment. The supply of securities by enterprises does not always seem to be adapted with sufficient flexibility to the pattern of savers' demand either.

In spite of the relative inadequacy of their own resources, Community enterprises have not consistently endeavoured to place new issues of shares on the market to the extent required to re-establish a sound financial structure (Chapter 2, II and Table 11).

The absence from stock-exchange lists of the securities of companies which, in view of their size, would surely have 'gone public' in other countries deprives the European markets of a certain means of capturing the public's interest. The

reasons for this situation are complex and only the chief among them can be briefly indicated here.

Firms where control is in the hands of a family group are often unwilling to have their securities quoted on the stock exchange and 'go public' because the majority shareholders do not care to run the risk of losing control and managements wish to ensure stable operation.

A completely different question is that of the reluctance of companies already listed to increase their capital when unfavourable market conditions would entail undervaluation of new shares offered to the public and therefore "dilution" of the holdings of existing shareholders — a situation arising frequently in recent years.

Another reason why companies seeking finance prefer loan capital to share issue is that borrowing may well appear the cheaper alternative because of the way taxes are framed and past experience of the tendency for money gradually to depreciate. Lastly, it is doubtful, given the competition which must be maintained with other sometimes fiscally aided, types of investment, whether the techniques used in the member countries for the placing of securities are adapted to present circumstances, which call for growing efforts to attract the savings of the public onto the market. The Group suggests four different ways of dealing with these problems:

- i) The use of preference shares, shares with limited voting rights, and shares with plural voting rights;
- ii) The issue of convertible debentures;
- iii) The adjustment of issue controls and of taxation of distributed profits;
- iv) The improvement of the networks for distributing new issues.

A. PREFERENCE SHARES AND SHARES WITH PLURAL VOTING RIGHTS

24. The reluctance of managements to increase their capital for fear of losing control and being unable to ensure continuity of management might be partly overcome by widening the range of securities to include, apart from ordinary shares, preference shares with limited voting rights and shares carrying more than one vote. Resort to the capital market by the issue of such securities would enable large concerns of a family character to have their stocks dealt in on the market. This could be a welcome development provided a fair relationship is maintained between the rights and obligations of the various categories of shareholder and more especially provided the limitation of voting rights is compensated by offering holders of these shares genuine advantages of a financial nature.

25. Preference shares, enjoying priority in the distribution of profits and in the event of the company's liquidation, but conferring no or only limited voting rights, are known in most member and non-member countries, although the rules applying to them vary fairly widely. Preference shares are, of course, intended to suit the needs of managing groups referred to above. But they may also be of interest to shareholders whose influence on the management and development of the company

is in any case negligible and who may attach greater value to the stability of income associated with this type of share than to the right to vote. Shareholders of this category include institutional investors whose participation in a given company is in any event limited to a small percentage of the company's capital.

In the context of the development of a European capital market, certain problems might arise because the official attitude to shares of this type is not the same in all the Member States. Thus, development of their use was recommended by the Lorain Committee in France, and more recently, in an Italian draft for the reform of joint-stock-company legislation, which specifically provides for a category of "savings share" enjoying precisely defined privileges, whereas in Belgium the supervisory authorities are apparently hostile to any limitation of shareholders' voting rights.

These attitudes should be reconciled so as to preclude disparities in the opportunities available to Community firms to draw on the savings of the public on attractive terms. A common basis might be found by defining the privileges which future issues of this type of share should be awarded to compensate for the loss of voting rights — a loss that might perhaps be confined solely to decisions concerning the day-to-day administration of the firm.

26. The question of the granting of plural voting rights is more arguable. Here too the result is to introduce a distinction between two categories of shareholder, without the difference of rights necessarily being accompanied by compensatory advantages.

Without going into the many facets of this problem, it may be suggested here that shares conferring more than one voting right may also facilitate resort to the risk capital market by certain companies, as the groups already in control would not feel their position threatened. However, to avoid abuse, the utilization of plural voting rights should be strictly limited. If the Member States were to incline towards recognition of this kind of share — and the legislation of some of them is at present still distinctly hostile — the model might well be the rules currently in force in France, where the voting right is dependent on the length of time a given share is held in one portfolio. The plural voting right is thus seen not as an arbitrary privilege but as a reward for the investor's "loyalty" to a company.

B. CONVERTIBLE DEBENTURES⁽¹⁾

27. The convertible bond or debenture gives the holder the right to convert into a specified number of shares after a fixed period of time; this right is exercisable within a given time-limit and on terms and conditions specified at the time of issue.

The issue of convertible debentures has the advantage over a straightforward share issue of enabling a company to raise funds even when stock-exchange prices are

(1) It has not been thought necessary to discuss here the possible variants of the convertible debenture (debentures with detachable warrants, exchangeable debentures, etc.). These all present much the same problems as regards suitability for a European capital market.

relatively low, to deduct from taxable income the interest paid until the time of conversion and to defer an increase in capital until a time when it will no longer depress prices. In particular, it allows a company, by means of the conversion terms, to fix the issue premium on the shares at a higher level than would normally be possible with an ordinary capital increase. Compared with the traditional type of bond, the convertible variety has the advantage that it usually enables the company to pay a lower rate of interest.

The formula is attractive to the type of investor who desires a satisfactory return on capital and at the same time a stake in the success of the firm, for it allows the holder, during the time between issue of the debenture and expiry of the conversion right, to benefit from any appreciation of the shares that may occur and to protect himself against the possibility of depreciation, since in the latter event the convertible debenture for practical purposes becomes an ordinary bond whose price is related solely to its yield. Such an investment therefore involves limited risks and seems likely to attract investors most when there is uncertainty as to the movement of share prices; for similar reasons, the convertible debenture is also a useful instrument for interesting savers in foreign markets of which they might otherwise fight shy for lack of knowledge of the shares available.

Another important point to stress in the context of market integration is that, as the rules on institutional investment abroad are generally more restrictive for shares than for bonds and as convertible debentures come into the latter category, they can be placed with foreign institutional investors more easily than shares.

Consequently, both among individuals and institutions, there is a wider market for these securities than for shares. This fact is supported by the success of recent convertible debenture issues in the Member States and the issues of American companies on the Euro-bond market.

The Group considers that increased use of this formula, currently still hampered in certain countries by legal obstacles (time-limit of conversion right, no possibility of distinguishing between "authorized capital" and "issued capital"), would favour both the widening and the integration of European markets. As in the case of preference shares and shares with plural voting rights, harmonization of legal regulations on this type of security and of official attitudes to it is needed, in order to prevent its use becoming particularly widespread in some Member States and thus leading to unequal competitive conditions and distortions of capital movements within the Community.

C. SUPERVISION OF ISSUES AND TAXATION OF DISTRIBUTED PROFITS

28. Although issues of shares, like those of bonds are subject in most cases to control or prior authorization, unlike the latter they do not encounter real restrictions. It will suffice to note here that, in Belgium and Luxembourg, prior authorization is required for all equity issues, in France for issues exceeding FF 1 million, in Italy for operations in excess of Lit. 500 million, in the Netherlands for those exceeding Fl. 10 million and in Germany for issues of convertible debentures and shares with plural voting rights. The fact that these ceilings and

the authorities responsible for applying them differ from country to country does not seem likely to create obstacles to the integration of markets within the Community.

The problem should, however, be considered from another, no less important point of view. It has often been argued that, by granting interest subsidies, making finance available at favourable rates and placing various forms of loan capital at the disposal of enterprises, the authorities in some countries had encouraged them to run up excessive debts. It is therefore appropriate to inquire whether the same public authorities could not use the often very strong hold they have over the financing of enterprises through loan capital to work for an improvement of their financial structure. As is already practised now and again, particularly in Italy, the authorities could stipulate as a condition of their agreement to a loan that the enterprise increase its capital sufficiently to maintain a balanced financial structure, which otherwise might be distorted by excessive borrowing.

29. Equity issues could be effectively stimulated by taxation measures; at present the taxation of issues of equity stocks, and of dividend distributions on new shares, increases the cost of recourse to the market to a point where it deters some enterprises from increasing their capital.

The problem of indirect taxes will be dealt with in Chapter 14 (sec. 46); that of direct taxes on distributed profits has already been discussed in secs. 17-21 above, where certain reservations were expressed in respect of the advantages accorded to shareholders in the form of tax reliefs for distributed profits. None the less, such advantages are likely to facilitate indirectly the issue of new shares, since the dividend charge to the company is reduced by these tax reliefs.

Certain more direct and probably more effective measures of encouragement to issues of new shares could, however, also be considered.

30. It is known that, when companies raise capital by share issues, the offer of a net yield often costs them twice as much as it would to resort to credit or issue bonds. Accordingly, they should be allowed, for a given period, to deduct dividends paid on new shares from their profit liable to corporation tax; these dividends would then be treated on the same footing as interest paid to bondholders. Measures of this kind were introduced for a limited number of years in France in 1957, and remained in force until the end of 1965. The Group considers that similar temporary measures could be adopted in other member countries, where they might make a useful contribution to restoring the balance between the various methods of raising funds employed by companies, which for tax reasons too frequently opt for loan capital.

31. It has also been suggested that the practice of distributing bonus shares instead of — or, even better, as a supplement to — dividends in cash provides an acceptable compromise between the need for companies to increase their own capital and the desire of shareholders to be remunerated in a tangible and easily realizable form. This practice is widespread among Dutch and American companies in particular. Some of them declare "stock dividends" regularly, others intermittently.

This method has indisputable advantages, particularly in present circumstances, when profit margins are narrow and it is difficult to place new issues of shares. However, differences in the fiscal treatment of stock dividends raise certain problems. They are sometimes treated as ordinary dividend distributions, and sometimes as actual capital increases not subject to income tax in the hands of the beneficiary. This sometimes results in double taxation at international level, but there would seem to be no major obstacle to solving this problem by harmonization measures.

D. THE DISTRIBUTIVE NETWORKS FOR NEW ISSUES⁽¹⁾ AND THE SUPPLYING OF MEDIUM-SIZED FIRMS WITH RISK CAPITAL

32. It is not impossible that the difficulties and cost of placing new issues of shares with the public may have contributed in some cases to limiting the frequency and scale of such operations; the techniques for distributing new issues are indeed less well developed on EEC markets than on those of certain non-member countries, where institutions specializing in the underwriting and placing of securities offer companies a wide range of services adapted to the most diverse situations. The underwriting of capital increases is a technique that is relatively little used in continental Europe, perhaps because of the narrowness of European markets and their poor capacity for absorbing large quantities of stock without generating excessive price fluctuations. In such circumstances an underwriting operation entails a relatively high risk, which financial institutions may hesitate to take, particularly if their articles forbid them to incorporate the unplaced securities temporarily in their own portfolios for subsequent sale on the market. Hence, whatever legal basis the Member States choose to give their all-purpose or specialized banks, it is desirable that the regulations on their security investments should allow them sufficient flexibility to act in the placing of share issues.

The existence of intermediaries specializing in the underwriting of new issues of shares and in the redistribution of securities presupposes a large volume of issues and above all a substantial contribution from institutional investors. These conditions are fulfilled in practically none of the Member States' markets, considered in isolation, and consequently issuing still has a subordinate place in the activities of credit institutions. International bank consortia are now being set up to play on the European market the role played by merchant banks and investment banks on the British and American markets. Here is further evidence that many of the operating defects and institutional deficiencies on the European markets can only be removed by progressive integration.

33. The problem of supplying risk capital to medium-sized enterprises is in some ways similar to the above, though a solution will have to be sought along rather different lines. The difficulty is not, as in the last case, one of placing large new issues on the market without disturbing it and at the lowest possible cost. It is rather one of supplying enterprises not yet able to turn directly to the market

⁽¹⁾ The aspects of this problem concerning distribution through stock-exchange machinery are dealt with in Chapter 11 (secs. 44 and 48).

with the risk capital needed to balance their financial structure and expand their business, until such time as they are able to make a more direct approach to the market. This need is particularly obvious in those countries where the business traditionally handled by *banques d'affaires* has, for one reason or another, failed to develop normally.

In their attempt to solve this long-standing problem, it is only quite recently that Community countries have done much to create the institutional background. In some cases the task has been put in the hands of specially formed institutions under public ownership, while in others private banks have taken action on their own initiative.

It has also been suggested that a "European development company" might help to solve the problem, especially those aspects more directly concerned with European integration, by acquiring participations, stimulating growth and reorganization, and unloading its participations on the market as soon as possible, thus ensuring that its funds are deployed to maximum effect.

Experience gained in this field is of too recent date for the Group to be able to express an opinion on the contribution that such ideas might make to the balanced development of the European capital market.

CONCLUSIONS

34. Enterprises issuing securities do not always seem to have selected the type of security and placing technique best adapted to the pattern of savers' demand. Several factors explain the preference given to borrowing rather than capital increases, and possible remedies are therefore to be found in different fields.

- 1) The widening of the range of securities offered, by greater recourse to preference shares with limited voting rights and, under certain conditions, to shares carrying more than one vote, would enable the diffidence of managements anxious to retain control to be overcome. Use of these types of security requires, however, the strict maintenance of equilibrium between the changes introduced in voting rights and the benefits or restrictions involved for the shareholder. Harmonization at Community level would also be desirable.
- 2) Convertible debentures enable firms to resort to the market on better terms than by issuing ordinary shares, especially when market prices are depressed. They also give holders the chance to benefit from appreciation of the shares while at the same time protecting them against the possibility of depreciation and assuring them a satisfactory yield. They are the ideal instrument for a first approach to foreign markets and are also a means of attracting institutional investors, for whom investment in foreign shares is forbidden.
- 3) In the interests of protecting savings and by reference to objective criteria the authorities should see to it that business concerns do not incur excessive loan commitments when their financial structure calls for an increase in own capital.

- 4) If, for a given period, firms were allowed to deduct dividends on newly issued shares from profits liable to corporation tax, these dividends would then enjoy comparable treatment with the interest paid on bonds, and recourse to risk capital would entail fewer disadvantages than at present. The distribution of bonus shares (stock divided) in addition to dividends in cash would constitute an acceptable compromise between the need for companies to increase their own capital and the desire of shareholders to be remunerated in a tangible and easily realizable form. The tax arrangements concerning these distributions should, however, be harmonized so as to avoid any double taxation.
- 5) An improvement in the channels through which new issues are distributed could play an important role in reducing the difficulties and cost attendant on such operations. However, intermediaries could specialize only if the market were large enough and they could rely on a substantial contribution from institutional investors. These conditions could be more easily attained in the framework of an integrated capital market.

CHAPTER 11

OPERATION OF A EUROPEAN SECURITIES MARKET: INFORMATION FOR THE PUBLIC, DEALING IN AND MOVEMENT OF SECURITIES

Introduction

1. The two preceding chapters dealt with certain structural problems of national security markets, and a number of arrangements were suggested which would remove the major obstacles to market integration. Measures of this kind are necessary, but by themselves not sufficient to ensure the development of a genuinely European market. To this end two sets of additional conditions need to be fulfilled.

First, the horizon of transactors on each existing national market needs to be widened and they must have at their disposal sufficient and reasonably homogeneous information on securities dealt in on other markets.

Secondly, movement and dealing conditions for all European securities need to be such that investors can interest themselves in the securities of other Member States as readily as in their own country's, without such transactions being penalized by higher costs. These two sets of problems are discussed below under Heads I and II, respectively.

I. Information

A. THE ROLE OF INFORMATION IN THE DEVELOPMENT OF SECURITIES MARKETS

2. In all Member States an essential factor in the expansion of the capital market is that the public be given better information on securities and familiarized with the machinery of the stock exchange. Looked at from the point of view of the development of a European capital market, these problems assume a new aspect and added urgency.

A) IMPROVEMENT OF INFORMATION AND DEVELOPMENT OF NATIONAL MARKETS

3. In most cases, the problem of making information on securities available to the public has been approached in Member States from the angle of protecting savers. But publicity is important also for an expansion of capital supply on the security market, and this aspect seems to have been neglected.

In the first place, for lack of sufficient information on the operations and prospects of companies some investors are inclined to tread warily on equity markets. By contrast, it is the wide range of information available — among other things — that explains why the leading international securities are so popular with investors.

Another consequence of deficient information is that the public tends to attach more importance to political or tax aspects than to the basic facts showing a company's development and its prospects; this explains the often speculative bent of European stock markets and the public's lack of selectivity as between different securities.

4. These defects are apt to discourage many classes of potential investor from placing their money in equities. Another point is that changes in the distribution of national income to the benefit of wage-earners have diminished the savings capacity of social groups used to equity investment and increased that of groups with little experience of the stock exchange.

It is true that, thanks mainly to the efforts of financial institutions, there has been some growth of publicity in recent years for the various forms of investment; but it is a striking fact that most of this publicity has been directed towards savings deposits and time deposits, life-assurance policies, building-society savings schemes and the purchase of fixed-interest securities, while publicity for equity investment is relatively undeveloped and, in some countries at least, appears to be hampered by legislative or administrative regulations even stricter than those actually required for protecting the saver. Publicity in favour of certain institutions no doubt does attract funds to the equity market; nevertheless, there remains scope for educational publicity campaigns which, free from certain excesses of canvassing, could help to broaden the range of equity investors, who in the Member States still account for a distinctly smaller proportion of the population than they do, for example, in the United States and in Great Britain.

5. Lack of information by which the comparative merits of different types of investment can be assessed, especially from the point of view of their yield and soundness, induces savers to stick to the simplest forms, like sight deposits and savings deposits, because they are not in a position to assess the advantages of other forms of investment, such as securities.

All this means that the economic and financial objectives of fostering the supply of entrepreneurial capital, combined with the need to protect the savings of the public, together create a strong case — despite differences between the two requirements — for the provision of fuller information for the public. Several official studies on the problem of financing investment do indeed suggest that fuller information for the public is of paramount importance for an improvement in the supply of risk capital. Examples are the report of the Lorain Committee (May 1963) appointed by the French Government to investigate the problem of investment finance, and the report of the government commission in Belgium (De Voghel Commission, March 1962) which was set up to study the problem of financing economic growth.

B) FULLER INFORMATION AND MARKET INTEGRATION

6. When it comes to security investments on foreign markets the above-mentioned problems are multiplied. There is, at the outset, the by no means negligible difficulty of assessing another country's political, economic and financial

situation and prospects, the structural aspects and short-term outlook of particular industries, and finally the likely trend on a stock market operated by techniques and reacting to forces unfamiliar to the investor.

As regards foreign shares, the investor has the additional problem of interpreting the facts and figures published by companies. Comparison is difficult, first of all because the material varies in quality as between countries, and secondly because of differences in laws and in fiscal and administrative regulations and practices. As things are at present, these difficulties cannot be overcome completely.

As regards foreign bonds, the main deterrent to the non-professional investor lies in the diversity of the terms and conditions on which the securities are issued and, as will be seen presently, in the difficulty of comparing real bond yields as between different countries. The lack of information is surely one of the reasons why investment in foreign bonds has not progressed more significantly in spite of the appreciable yield differentials which in some circumstances develop between one market and another.

Though institutional investors, of course, have more knowledge of foreign markets, their investment potential is often restricted by regulations intended to protect savers. It would doubtless become easier to relax these regulations if there were fewer gaps in information about the provisions and practices ruling on different markets.

7. One way of giving both individuals and institutional investors fuller information might be for banks, stockbrokers and investment consultants to work on the basic information available and then present it to investors in a clear and easily accessible form. Some moves in this direction have already been made; certain groups of financial institution have set up joint research units to guide their own and their associated investment houses' investment policy, and have placed the information so collected at the disposal of their clients. Similarly, financial analysis companies have been formed, precisely for the purpose of circulating to their subscribers comparative information on securities in various countries. But in spite of these praiseworthy initiatives, the quality of published information unfortunately still suffers only too often from the inadequacy of the basic data disclosed by companies.

Contrary to the practices of other countries, and more especially of the United States, information available on most companies in Member States is still embryonic; but strangely enough, the regular publication of material normally withheld from European shareholders has been readily undertaken by certain companies when they wanted to raise funds on the American or British capital markets. On the other hand, the fact that information on US companies has been made widely available in Europe by brokers and investment consultants has had the result that the public can often get to know more about American companies than about those of its own country, and this in turn has induced domestic companies to display somewhat less reticence in publishing facts about their own affairs.

In conclusion, the first prerequisite for any satisfactory development of information is recognition of the need for it by the issuers of securities, supported to this end by action on the part of the authorities responsible for capital markets. The Group has tried to define in more detail the nature and limits of what can be done in this matter.

C) THE TASKS AND THEIR LIMITS

8. In view of other studies now in progress under the auspices of the EEC Commission, and more especially the work on the harmonization of company law in Member States [Article 54(3 g) of the Treaty of Rome], the following analysis will not cover:

- i) Rules on the drawing-up of balance sheets and profit-and-loss accounts, auditing and reports of directors or managers and auditors;
- ii) Rules governing the issue of securities, definition of the rights attaching thereto, dealings in such securities, etc. Apart from publicity in connection with the rendering of annual accounts, the problem of information for savers and investors, as here discussed, embraces two distinct features that arise, however, only where a call is being made on public saving:
 - i) Information for subscribers on the occasion of a public offering of securities;
 - ii) In addition to the annual publication of accounts, a continuous flow of information for shareholders and the public at large, providing accurate facts and figures on company operations.

Though the laws of more than one member country prescribe special disclosure rules in the case of public issues, France seems at present to be alone in legislating, at least as far as the bigger companies⁽¹⁾ are concerned, for a continuous flow of information for shareholders and others.

Yet, though information is clearly of particular value when an appeal is made for the public's savings and, even more so, when shares are offered for public subscription and listed on the stock exchange, it is no less necessary in other circumstances; a steady flow of intelligence to shareholders and the public, not limited to the publication of annual accounts, seems indispensable if investors and their advisers are to be enabled to take fully informed investment decisions.

The Group is, of course, aware that the development of such permanent and more detailed information may raise certain problems for companies in relation to shareholders, employees, competitors and the tax authorities, given current European practices in this respect. It will therefore be necessary to proceed with some caution, and it will no doubt be indispensable to harmonize legal requirements so that all European firms are placed on an equal footing. However, experience in the United States testifies to the fact that fuller publicity requirements have done no harm to companies but have in fact redounded to their benefit as regards both sources of finance and relations with the public in general.

Although the practice of providing a continuous flow of information has been spreading in recent years, it is doubtful whether it will do so sufficiently unless it is made compulsory. This suggests, and the French example confirms, that the law will have to step in if current customs and usages are to be radically altered.

⁽¹⁾ Ordinance No. 59-247, of 4 February 1959, on the capital market, supplemented by decree No. 65 999, of 29 November 1965, on information for shareholders and the public.

Given the fears of business firms that more exhaustive disclosure of their affairs would weaken their competitive position unless their rivals were obliged to be equally forthcoming, the pertinent requirements need to be equivalent in all the countries of the Community and there must be no discrimination on grounds of nationality.

As regards the content of information regularly published, the following principles may be suggested.

- a) The Board of Directors should periodically, that is at quarterly or six-monthly intervals, publish a statement indicating at least sales and gross profits, together with the figures for the corresponding period of the preceding year;
- b) Any new factor which might have a major bearing on the firm's situation or profit expectations (for instance investment programmes, important agreements or contracts) should be brought to the public's notice almost at once;
- c) When the annual accounts are published, the report of the Board of Directors should restate or bring up to date some of the information on the company published when the shares were first issued.

If current discussions within the Community lead to the establishment of a new type of European incorporated company, this should provide an opportunity for progress in the matter of company disclosures.

9. In the present report, however, the Group has been unable to define in detail any rules on information to be supplied regularly, which also entail some harmonization of the rules concerning annual accounts.⁽¹⁾

The Group examined only the rules which should govern information for investors in cases of public issues or of admission to stock-exchange listing.

Since it is on these occasions that information needs to be most comprehensive, part of these rules might serve as a basis for the later definition of rules on continuing publicity.

The Group presents in an annex its detailed proposals for a model prospectus for public issues or admission to stock-exchange listing. This model prospectus should be regarded as a coherent set of suggestions illustrating the principles of an information policy to be discussed below. Other solutions would no doubt be feasible and acceptable to the extent that they provided investors with equivalent information.

D) PROBLEMS IN CONNECTION WITH THE ESTABLISHMENT OF COMMON RULES

10. The preparation of proposals on the provision of information for investors entails harmonization of existing or planned legislation in the Member States, and many obstacles have to be overcome.

⁽¹⁾ For fuller information the reader is referred to the Report of the Permanent Commission on Standardization (Project 1966/3), approved at the 1966 Noordwijk Congress of the European Federation of Financial Analysts Societies.

Planned legislation in the member countries is by no means following a uniform trend. In some countries of the Community, the relevant legal provisions are now under revision; in others, it is not yet known how recently adopted regulations are going to be applied. Thus the new French bill for the reform of company law makes the Government responsible for laying down by decree the rules of information to the public and disclosure to shareholders; the Belgian bill for reform of the law on limited companies proposes abandonment of the "statutory disclosure" system (*notice légale*) and bringing the whole field of public security issues under the separate legislation of Royal Decree No. 185, of 9 July 1935. In Luxembourg, a new system of information control and capital market supervision on the Belgian model was recently introduced, but it is not as yet clear how the administration will apply it.

The scope of legal provisions on information for investors varies considerably from one country to another. In some cases, they apply only to company issues — or indeed issues of certain types of company, such as limited companies — involving an appeal to public savings; they may also apply to issues made in the country by foreign companies. In other cases these legal provisions are applicable regardless of the status and nationality of the issuer, subject to certain specified exceptions. In Belgium, for instance, information controls under the Royal Decree mentioned above apply not only to the issues of Belgian and foreign companies, but also to those of foreign governments and international institutions.

Several entirely different approaches to the information problem find expression in the law of the various Member States. Some countries have no special publicity requirements at all in the case of public issues. In other countries, the particulars to be furnished by companies in the case of a public issue are laid down by law in uniform manner and are hence necessarily defined in formal terms. In Belgium and Luxembourg publicity obligations of this formal type are in some respects supplemented by the control exercised by an administrative body; and this arrangement, backed by the constant build-up of case law on the subject, is producing a system in which the nature and quantity of information made available depends closely on the status of the issuing company or institution. The borrower must, in each case, publish whatever is "necessary for the correct appraisal of the nature of the business and of the rights attaching to the securities".

Finally, practices not resting on the law itself, but enforced by banking houses acting as intermediaries in security issues, are extremely important in setting the publicity pattern with which issuers must conform.

B. THE CONTENT OF AN INFORMATION POLICY

A) BASIC PRINCIPLES

11. In view of the legislative and conceptual differences between the EEC countries with respect to information for subscribers to new issues, it would seem impracticable to work out uniform legislation in this matter. A more promising approach would be to formulate rules the scope and content of which would be

bindingly accepted as a minimum by Member States, leaving each country free, within the limits discussed below, to broaden the field of application and to enforce additional regulations and formalities in the case of issues offered wholly or conjointly on its territory.

Legislation governing the provision of information for subscribers is essentially public protection law (*législation de police*), which is traditionally a matter of territorial rather than national jurisdiction. It follows that the law applicable is that of the country in which the security issue takes place, and not the law of the country to which the issuing institution or company is subject. Whatever merits adoption of the nationality principle might have for the freedom of capital movements, it would in practice lead in each Member State to discrimination, sometimes to a foreign issuer's advantage, sometimes against him. In any event, the territoriality principle will need to be applied to issues by institutions and companies from non-Community countries and above all from countries where the provision of information for subscribers is subject to no special rules.

However, the territoriality principle in no way precludes a country's legislature from applying one set of publicity principles for domestic issues and another for foreign issues, provided such differentiation does not discriminate against residents of another EEC country.

For the rest, the principle of non-discrimination laid down by the Treaty of Rome, together with the requirement that a company must accord equal treatment to all its shareholders, means that any company or institution raising funds on foreign capital markets where information is subject to less severe rules than at home must provide the same information for foreign as for domestic subscribers.

B) THE SCOPE OF COMMON RULES ON DISCLOSURE OF INFORMATION

12. Clear lines need to be drawn to delimit the scope of any information rules to be worked out at Community level in the light of these principles.

As regards the nature of the securities offered, only resort to the capital market by issues of securities is considered, viz.:

- i) Negotiable, transferable and redeemable securities, whether they be registered, to order or to bearer;
- ii) Securities forming part of a collective issue and conferring rights corresponding to their proportion in the collective total.

Thus, the raising of funds by credit entry in account or passbook, or by other means not having the above "collective" characteristic, is excluded.

The securities concerned must represent:

- i) Either members' title to shares in firms or companies under private or public law, shares in a limited company to be understood as including also securities indirectly representative of such shares or entitling the holder to subscribe, e.g. subscription rights and warrants, or

ii) Creditors' claims on such firms or companies, or on public authorities or international institutions.

At Community level, the scope of the disclosure rules might possibly be limited to issues of shares in joint-stock companies and to issues of bonded loans by such companies and by public authorities, enterprises or agencies [Articles 54(3 g) and 58, second paragraph, of the Treaty of Rome]. For other security issues the publicity requirements would then be the sole prerogative of the national legislature.

However, the information rules need not necessarily apply to issues made or guaranteed within the country by central government or local authorities.

13. The rules would apply only when an appeal is made for the public's savings. Subscribers to a private placing may be presumed to be in a position to obtain the necessary information from the borrower and to be able to appraise it correctly.

The concept of public appeal for savings is an empirical one which needs objective definition. The term "public issue" in a market may be taken to denote that the securities created or to be created are, by the efforts of the issuing institution or company or a third party, distributed among the public of the country concerned, or that, by virtue of their admission to official or unofficial quotation in that country, they are liable to be so distributed.

For criteria by which to define a call on the savings of the public, those adopted in the new French company law might serve as a starting point, viz.:

- i) The employment of banks, financial enterprises or stockbrokers with a view to placing the securities;
- ii) The use of any method of publicity to the same end;
- iii) Inclusion in the official list of a stock exchange, from the date of listing.

This last criterion seems to be worded too restrictively, given that in some countries periodical lists or unofficial lists include unquoted securities traded on a large scale. Further research on these markets would be required prior to a decision on this point.

As regards the form or legal designation of the issuing operation, the term public issue should be understood to include display for sale, offer for sale, public sale, offering for public subscription, public exchange and public offer of exchange, and stock-exchange listing.

C) THE CONTENT OF COMMON RULES ON DISCLOSURE OF INFORMATION

14. It is implicit in the objective of the publicity requirement that it should bear on the main features of the situation of the institution or company whose securities are to be issued, and on the rights attaching to these securities. These essential elements, which determine the value of the securities for which subscriptions are invited, are necessarily of an individual character and cannot be accurately defined

by general rules. Moreover, subscription to securities, in the nature of things, largely hinges on the issuing company's growth prospects and the likely trend of its profitability. Neither the future outlook nor the policies which condition it can generally be discerned clearly in the accounts relating to past years.

This necessarily individual character of company information is particularly in evidence where it is a question of an issue of securities directly or indirectly representing title to shares, the value of which depends closely upon the company's situation and profitability. In these circumstances there seems little point in any disclosure arrangement which goes no further than to require the obligatory publication of certain particulars, such as balance sheets, extracts from articles, bonded debt outstanding and composition of management and supervisory boards. While such a system would no doubt be better than none at all, it would be a bad one in so far as it might lead to incomplete and therefore misleading information, while allowing the issuing company to claim it had properly complied with the legal formalities. It is this shortcoming of the "statutory disclosure" system which led to its replacement by administrative information controls in Belgium and Luxembourg.

There is therefore one general principle the information rules should provide for, and that is that the issue prospectus must correctly describe the rights attaching to the securities offered and must give a full, frank and unambiguous picture of the issuing company's or institution's situation.

This general principle transposes to the field of calls on public saving the requirement — embodied in statute law in several Member States and in doctrine or case law in others — that the balance sheet, profit-and-loss account and directors' report to the general meeting of shareholders must give a full, frank and unambiguous picture of the company's assets and profit-earning capacity.

In spite of its, for practical purposes, somewhat imprecise legal language, this general principle does need to be explicitly stated as an essential element of the publicity requirement, because it provides the basis for assessing:

- i) The responsibility of the signatories of the prospectus in the event of its being incomplete or inaccurate or of its misleading subscribers (criminal responsibility, liability for damages under civil law, possibility of subscribers claiming annulment of the subscription);
- ii) The actions of all the parties to an issue operation — banks, firm takers, underwriters and sub-underwriters — or of the bodies exercising a legal function in the protection of savings (stock-exchange authorities, government agencies).

15. In addition to this general principle, there will need to be a list of the particulars which, whatever the type of issue, must in all cases be furnished to potential investors.

This list will necessarily differ according to categories of issue. It should include the following considerations:

- i) The nature of the securities concerned: information on the issuing company's situation needs to be more exhaustive in the case of securities representing either title to shares or entitlement to subscribe thereto (e.g. warrants, subscription rights

or convertible debentures) than in the case of securities representing creditors' claims. On the other hand, there are certain types of information on rights attaching to securities that are specifically required for bond issues (redemption table, advance repayment, index clauses, currency-option clauses, etc.);

- ii) The status and nature of the issuer: information to be furnished will necessarily not be the same for a loan issued by a business company as for a loan issued by a public authority;
- iii) The nationality of the borrower may need to be indicated, in so far as it may have a bearing on the rights attaching to the securities and on the fiscal treatment of interest or dividends accruing and sales proceeds.

C. INSTITUTIONAL ASPECTS OF INFORMATION CONTROL

A) EXTERNAL CONTROLS

16. The problem of information for investors cannot be dissociated from the question of external control of information furnished on the occasion of a security issue.

An initial external control should be exercised by the banks participating in the sale of an issue and staking their reputation on the quality of the securities concerned and the terms on which they are placed.

That the banks can have far-reaching influence in this matter is borne out by the comprehensive information provided, mainly at their instance, on the occasion of most of the recent issues of Euro-bonds.

However, the effectiveness of bank action depends largely upon the participating bank's reputation and upon usage in different countries. It depends, further, upon the capacity in which the banks act and the extent to which their own credit is committed. This degree of commitment differs according to whether the bank acts merely as an intermediary, assumes responsibility for the financial servicing of the issue, or purchases it outright or underwrites it. However, this control by the banks may prove insufficient where their interests diverge from those of subscribers.

17. Another type of control is exercised in most Member States by the stock-exchange supervisory authorities in all cases where an application is made for admission of securities to quotation.

The action of these supervisory authorities, which is not confined to the supply of information, varies as between different countries, both *de jure* and *de facto*, and is strongly influenced by prevailing usage.

The efficiency of this control is limited by the fact that it becomes operative only on the occasion of an application for stock-exchange quotation. The procedure may be effective enough in the case of security sales through the stock exchange, but it generally becomes applicable only after a sale by public issue. It is thus more

in the nature of *a posteriori* control of the information furnished. The refusal of stock-exchange quotation on these grounds is generally an inadequate and awkward sanction, for it hurts the holders of the securities more than the issuing company or institution.

Nevertheless, this does not prevent scrutiny by the stock-exchange supervisory authorities from having appreciable influence, in so far as borrowers proceeding to a public issue will be led to adhere to the principles laid down by these authorities for admission to quotation.

18. A third type of information control is prior control. Such a system exists at present in Belgium and Luxembourg, where prior control is exercised by an independent administrative agency in some ways akin to the US Securities and Exchange Commission.

19. The principle of external information control prior to any public issue must be sharply distinguished from the question of the nature and quality of the institution or agency responsible for such control.

There can be no doubt that external information control prior to any public issue is in general the right way to ensure that subscribers are fully informed and supplied with data best adapted to the specific characteristics of each issue and the situation of the issuing company or institution. This method, furthermore, makes room for the disclosure requirements to take account of questions of business ethics not always spelled out in law, as well as protection of the interests and rights of shareholders and creditors. Experience in countries where such prior control exists goes to show that its effectiveness is widely recognized even by the institutions controlled.

B) POSSIBLE METHODS OF CONTROL ON A EUROPEAN CAPITAL MARKET

20. If it is considered desirable to establish or organize external information control in the setting of a European capital market, the next question to examine is how and by whom this control might be exercised.

A first solution that comes to mind is the establishment of an agency at Community level, to be competent for issues floated within the territory of the Community and to be endowed with powers similar to those of the Securities and Exchange Commission in the United States, the Banking Commission in Belgium or the Bank Control Commissariat in Luxembourg. But this solution does not appear practicable as soon as would be necessary. Although the setting of a larger market would make such a solution appear more logical, the establishment of such agencies in the countries which still lack them could also be envisaged: this might indeed be the most appropriate way of "moralizing" the stock exchange — a topical problem in several countries — and at the same time of making investment in securities a sounder proposition than it all too often is at the present time.

21. Another method, also at Community level, might be to set up a Co-ordinating Committee composed of representatives of the supervisory agencies already mentioned or, pending the establishment of these agencies, representatives drawn

from the professions concerned, from banking circles, the authorities responsible for admission to stock-exchange quotation, and from such national governmental authorities as have a supervisory function in respect of information.

This Co-ordinating Committee would by definition have no official status and therefore no statutory powers. It would limit itself to formulating opinions regarding the adequacy of information furnished to the public. Possible sanctions would be of two kinds: first, the Committee could communicate an adverse opinion to the firm concerned and to the competent national authorities, and secondly it could advise to the bank or issuing house heading the issuing consortium not to collaborate in an issue where the conditions were found to be misleading for subscribers. At a later stage the Committee might be empowered to publish any adverse opinion ignored, and authorized to make public the fact that a proposed issue had not been submitted to the Committee for an opinion. But this would involve conferring an official character upon the Committee and attributing to it quasi-judicial powers.

However informal and unofficial such a system might be, a necessary precondition for its introduction is that the professional circles concerned support it and that the competent national authorities have a real desire to collaborate. It also requires that the bankers handling the issue or the national authority responsible for the scrutiny of the records be released by the issuer from the requirement of professional secrecy vis-à-vis this Committee.

If all these conditions were fulfilled, the Committee could, as and when operations were submitted to it for its opinion, gradually work out information rules, taking full account of past experience on the major capital markets of non-member countries; it could also base its opinions on compliance with a jointly defined model prospectus, such as is annexed to this report. Initially, the Committee could concentrate on international operations.

This system, resting entirely on voluntary support, would certainly contribute to the improvement of information and to the development of a European capital market. But it depends upon this support being forthcoming, and also upon the smooth functioning of a committee with, if it were to work efficiently, would definitely need some modicum of administrative organization and services.

22. A third approach might be to issue a directive under the Rome Treaty, envisaging harmonization of information for subscribers and the establishment of similar systems of prior information control by each Member State. The next step would be to get the various institutions to co-ordinate the application of the regulations in force in Member States with respect to information in the case of "domestic" issues, and to define a common attitude to "international" issues.

Such a directive would need to specify and rule on the operations to be subject to control, the methods of control and the powers of the responsible authority. On the other hand, the choice of the institution or agency to be responsible for information control in each Member State can safely be left to each country's own legislation. Under this proposal the relevant powers could be vested either with the stock-exchange authorities, with appropriate modification of their sphere of competence, or with an administrative body.

To be meaningful, such prior control must be more than a mere check on legality showing whether the minimum publicity requirements specified in the directive have been fulfilled. The chief purpose of the work of these authorities should in fact be to ascertain that the prospectus provides an accurate and frank picture of the issuing company's or institution's situation as well as a full description of the rights attaching to the securities. On the other hand, the control will only be effective if the sanctions imposed for non-compliance are clearly stated. In this field, too, co-ordination among the authorities could be most valuable.

23. It is also important to ensure that the information needed for an investor's enlightenment is available to him at the moment when he is called upon to make his investment. In this connection a distinction has to be made between public sales and subscriptions on the one hand, and admission to official quotation and introduction on the stock exchange on the other.

Under the law of most Member States, the public sale or subscription of company shares and debentures is already subject to the requirement that the subscription or sale must be recorded in an application form made out in duplicate, one copy to be retained by the subscriber.

There is a case for confirming this rule at Community level by prescribing that the application form must be part of the prospectus itself and that the complete document must be placed at the disposal of the subscriber.

It might perhaps be expedient to prescribe also that brokers in the official and unofficial markets (*courtiers, agents de change, banquiers*, etc.) should be authorized to subscribe as agents or proxies only if they were in possession of an application form signed by the client, and to sell to a client such securities as they may have subscribed or acquired on the occasion of an issue only against the client's signature on an application form. An exception might be allowed on orders received from other brokers.

Non-compliance with these provisions could probably attract only civil sanctions; for instance, a broker would have no grounds for action at law against a client who declined to honour a commitment resulting from a subscription at variance with the prescribed procedures.

It should also be laid down that announcements concerning the issue — whatever their form — must indicate where and how the prospectus may be obtained.

In the cases of admission to stock-exchange quotation or of issues through stock-exchange channels, provision should be made for the public to be informed adequately according to unambiguous rules, especially through press advertising; here again the announcement should indicate where and how the complete document (the prospectus) may be obtained.

CONCLUSIONS

24. The problem of proper provision of information for the public is in the forefront among those which take on a new aspect and added urgency in the light of the development of a European capital market. The difficulty of getting genuine

participation from savers even in the relatively homogeneous context of the present national markets is multiplied in the setting of the developing European market.

- 1) An information policy should involve:
 - a) Campaigns to familiarize the public with security investment and stock-exchange machinery;
 - b) A permanent flow of information on the operations of companies, in addition to the annual publication of their accounts;
 - c) Especially comprehensive information whenever an appeal is made for the public's savings — that is, on the occasion of a security issue or the introduction of securities on a stock exchange.
- 2) The Group gave particular attention to this last problem with a view to the formulation of disclosure rules the scope and content of which would be acceptable to Member States as a common base. This common base might consist of a model prospectus — such as that which is annexed to this report — adapted to the specific circumstances of different categories of securities and issuers.
- 3) External controls appear necessary in order to enforce observation of certain minimum requirements concerning the scope and quality of information. Such controls are in fact exercised in all Member States by banks and stock-exchange authorities, and in some of them by an independent administrative agency endowed with quasi-judicial powers.

In the setting of a European market, the Group feels that external control procedures should be extended and harmonized; so far as "International operations" are concerned, the control could be exercised by a Co-ordinating Committee manned by representatives of the professions concerned and of the existing supervisory authorities. It would work on the basis of voluntary support.

A harmonization directive aiming at alignment, in substance and form, of the Member States' practices in this respect would give a better structural base to the co-operation and allow it to be widened in scope.

There is also a case for considering the establishment at Community level of an agency similar to the Belgian Banking Commission or the US Securities and Exchange Commission.

II. Operation of the stock exchanges and movement of securities

25. Improving the structure of supply of and demand for securities and broadening the investing public's horizon would not be enough to satisfy all the conditions for the development of a capital market integrated at European level, unless it was accompanied by action to adapt security dealing techniques on official and unofficial markets and to create the conditions for securities to circulate as freely throughout the Community as within a domestic market.

Dealings in securities listed on foreign bourses by residents of Member States are no longer hindered by exchange controls, but they may be handicapped by cost differentials and by technical problems.

In more general terms it may be said that, while the security markets of the EEC countries have a broad range of facilities and long experience to offer, they nevertheless show working defects which everybody agrees are mainly due to their narrowness and division into separate compartments.

The Group has therefore first tried to isolate and summarize the various factors responsible for this state of affairs.

It then examines ways of amplifying the list of officially quoted securities — especially by introducing more foreign securities — and increasing stock-exchange turnover.

Lastly, it considers a number of special problems in connection with international security dealings and movements.

A. THE NARROWNESS OF EUROPEAN SECURITY MARKETS

26. The principal problem affecting the working of security markets in most Member States is the difficulty of buying or selling a large amount of any one security without causing considerable price fluctuations. Although the seriousness of the problem is plain enough, especially on the equity market, it is much more difficult to measure it statistically and to compare its extent on different markets.

The volume of business transacted is often regarded as the most meaningful indicator. The number of securities listed, which is a measure of the range of securities available for stock-exchange investment, is not without significance from the point of view of expanding arbitrage operations. The market value of outstanding securities, finally, may be taken as a measure of the volume of savings invested in listed securities.

A) QUANTITATIVE INDICATORS

27. The statistics available in the different Member States on stock-exchange transactions cover either the bulk or only a fraction of all security dealings, depending on whether there is a "bourse monopoly", as in France and Belgium, or a large part of the business is done outside the exchange within and between financial enterprises. Furthermore, in Germany and the Netherlands bargains are recorded in terms of nominal instead of market value, and in all the countries only transactions on the official market are reflected in the statistics, whereas a great deal of business in unlisted stocks is done on special markets and even outside the exchange altogether; no full information is available on these transactions.

28. Subject to these reservations, the volume of annual transactions in listed variable-yield securities in the EEC countries as a whole may be estimated at \$9 000 million on average during the years 1960 to 1965; this figure is calculated from official statistics in Belgium, France and Italy, and extrapolations from the German and Dutch statistics of the nominal value of bargains. Over the same period, the value of share transactions averaged about \$65 000 million a year in the United States, and in 1965 — the only year for which figures are available — the total was close to \$10 000 million on the London Stock Exchange alone. Even if, for the reasons mentioned, the EEC figures understate the volume of business in listed shares, the comparison clearly brings out its relatively modest size.

29. The number of shares listed is also relatively low in certain EEC countries. At the end of 1965, domestic shares⁽¹⁾ numbered 590 in Amsterdam, 496 in Brussels, 618 in Düsseldorf, 187 in Milan and 971 in Paris, compared with 3 630 in London and 1 601 at the New York Stock Exchange.

30. Finally, the market value of outstanding variable-yield securities listed in Member States during the period 1960-65 was roughly \$64 000 million (end-of-year average), made up, in round figures, of \$22 000 million in Germany, \$20 000 million in France, \$9 000 million in the Netherlands, \$8 500 million in Italy and \$4 500 million in Belgium. Available statistics for the United Kingdom and the United States show corresponding values of about \$120 000 million and \$410 000 million, respectively, for the same period. However, the disproportion is somewhat overstated as the last two figures are for domestic and foreign shares, whereas those given for the EEC refer to domestic shares only.

Even such hazardous comparisons as have here been made for shares are impossible on any kind of satisfactory basis for the bond markets. For reasons explained in Chapter 9, very few company debentures are listed in Belgium, Germany and Italy.

B) PROBLEMS CONNECTED WITH THE NARROWNESS OF MARKETS

31. No detailed analysis can be undertaken here of what keeps equity markets so narrow. The main reasons are:

- i) That savers are often reluctant to invest in securities;
- ii) That only a small proportion of a company's shares are actually accessible to the public: the rest is either in the hands of a family group which refuses to put them on the market or else "frozen" in the portfolios of finance companies;
- iii) That institutional investors do not enter the market on a large enough scale;
- iv) That a large volume of business is transacted outside the exchange.

In short, the factors discussed in the preceding chapter in connection with the structure of equity markets operate here too.

(1) The foreign shares listed are examined in sub-section B and in Table 26.

The consequences of this narrowness are serious. It partly explains the reluctance of institutional and other big investors to acquire European stocks for fear of not being able, later, to adjust the composition of their portfolios without provoking adverse price movements. This lack of "liquidity" and the consequent possibility of fluctuations in certain stocks is also liable to discourage individual investors, who are most likely to need to realize their investments at short notice.

The fact that the range of quoted shares is so restricted certainly does nothing to increase the volume of transactions in any of them; on the contrary, it weakens the market by depriving it of the support of investors who wish to diversify their holdings and have no choice other than to turn to the markets of non-member countries. This argument applies to institutional investors in particular.

There is thus a vicious circle, from which the only escape is through:

- a) Giving certain institutional investors increased scope for dealing on the equity market;
- b) Attracting back to the stock exchanges business that is now transacted outside it (this can be done by altering the regulations concerning intermediaries);
- c) Establishing links between the various stock exchanges, by way of international transactions and introduction of foreign shares to official quotations.

32. The markets in fixed-interest securities have different problems. The range of available securities is narrow only in the case of company debentures, while the volume of transactions in public-sector bonds is relatively large.

The fundamental problem here is no doubt that of the relationship between the flotation of new issues and their subsequent behaviour on the secondary market. A steady flow of debenture issues is possible only in countries where this secondary market works satisfactorily; otherwise, there will be sharp spurts of new issues from time to time when the situation is temporarily propitious, but no orderly continuity of issues such as is necessary and attainable in an efficient market. Even more than in the case of the equity market, where the risk of price fluctuations is accepted, investors will fight increasingly shy of fixed-interest securities if they are virtually unable to realize sizeable bondholdings without causing price movements quite unrelated either to the market trend or to the credit standing of the issuer. Even for institutional investors direct lending or other forms of investment become more attractive than bonds, since the lower yield of these is not compensated by any real liquidity. Where there are large yield gaps between comparable bonds and these differences are not automatically evened out by arbitrage operations, the market is clearly not working satisfactorily.

This situation is largely due to the fact that in several Member States the bond market is still essentially a "retail" rather than a "wholesale" market and that placing with a firm holder cannot always be arranged. When financial institutions forming part of an issuing syndicate sell parcels of a loan stock below the issue price because not all of it could be placed, the secondary market trend is bound to be affected. Sometimes the issuing syndicate agrees to a price support clause making the underwriter's commission refundable if the securities reappear on the market within a certain time limit; but this does not seem to be enough to solve the problem.

In Germany, the central bank has at times intervened with appropriate action to steady the prices of public bonds. Somewhat different in character are the price-support operations undertaken in Italy by semi-public institutions at the instance of the monetary authorities. In Belgium, the *Fonds des Rentes* intervenes on the market for government bonds to smooth out fluctuations without trying to stabilize prices, but its powers are rather limited. In France, finally, the *Caisse des Dépôts et Consignations* takes action to regulate quotations in all sections of the bond market, partly with the help of associates like the investment company *France-Obligations* and the National Social Security Fund.

As urged in Chapter 4 (sec. 25), efforts should be made to harmonize the methods by which the Member States try to influence the short-term trend of interest rates on the markets. If the method chosen were that of entrusting a particular agency with the task of direct market intervention, the Group feels that the implementation of its measures would have to be closely concerted.

Official price-steadying intervention does a great deal to give the secondary market a firm tone, but — partly because it is sporadic and partly because its range is limited — there is no prospect of its having the same effects as active arbitrage dealing specialized intermediaries and investors familiar with the potentialities of the domestic market and foreign markets.

Once more, one is led to the conclusion that two things are needed for the good functioning of the secondary markets, namely:

- a) Active participation of professional investors able to deal in a broad range of securities;
- b) Growing interconnection between markets, such as is already evident in the alignment of bond yields in the various Member States but could be further enhanced by the introduction of foreign fixed-interest securities into stock-exchange lists in each Member State.

B. PROBLEMS CONNECTED WITH STOCK-EXCHANGE QUOTATION

33. What has been said earlier on the inadequacy of information for investors, on the difficulties of placing securities and on the division of markets into separate compartments makes it clear that it is necessary:

- i) To lengthen official stock-exchange lists in member countries, especially by introducing foreign securities;
- ii) To foster also dealings in foreign securities outside the official market (on unofficial markets, by supplementary public sales, etc.);
- iii) To simplify and harmonize price quotation techniques.

A) LENGTHENING OFFICIAL STOCK-EXCHANGE LISTS

34. Listing of foreign securities on the stock exchanges of Member States is at present one of the principal means which could quickly bring about some measure of market interpenetration.

However, in some member countries listing of foreign securities is hampered by stricter requirements and formalities than apply to the introduction of domestic securities. To justify this unequal treatment, it is argued that introduction on the stock exchange is in practice tantamount to the placing of an issue in the country by the foreign institution or company and that the conditions required for the protection of savers when new issues are floated still vary considerably from one country to another; hence, controls need to be stricter when foreign securities are to be introduced.

Admittedly, protection of the interests of savers when foreign securities are introduced on a stock exchange does raise special problems, but they could be solved by harmonizing the conditions required for admission to quotation, especially as regards publicity requirements. In point of fact, the argument that savers must be protected often masks a desire to reserve the market's resources for domestic enterprises.

Such an attitude fails to consider all aspects of the problem, for it ignores the invigorationg effect the widening of quotations and volume of business by the introduction of foreign securities may have on the market. A second point is that admission to stock-exchange quotation is not necessarily synonymous with placing a new issue, for it is not always accompanied by a block sale of foreign securities previously held by non-residents. It may be no more than recognition of a *de facto* situation, namely that residents already have an appreciable holding of a given foreign security; in that event quotation of the security is justified in order to make dealings easier and less costly for holders and to give local intermediaries the benefit of additional business which otherwise would be transacted on a foreign market.

35. It should be stressed that introduction of a larger number of securities from other Member States to stock-exchange dealing would lower the cost of transactions in these securities, which is now distinctly higher than for comparable dealings in domestic securities.

A transaction on a foreign bourse in fact involves not only bank charges and brokerage in the operator's own country, but also the expenses of correspondents abroad, an exchange commission which is fairly high in relation to stock-exchange charges and, finally, indirect taxes which may mean double taxation. And to these higher costs of the transaction itself must be added the heavier charges — for collection of coupons, safe custody, etc. attracted by foreign securities, compared with domestic, during the whole period of the investment.

36. An appreciable number of foreign securities are already listed in all the Community countries except Italy, and more especially in Amsterdam, Paris and Brussels.

Indeed, the number of foreign equities listed on the stock exchanges of these five Member States is larger than on the New York Stock Exchange (Table 26). It may be of interest to note that the proportion of foreign shares in the total of domestic and foreign equities listed is approximately 33% on the Amsterdam stock exchange, 20% in Brussels, 18% in Paris, and 4% in Frankfurt and Düsseldorf, as against 42% in Zurich, 9% in London and 1.5% in New York.

But among these foreign equities, those of EEC origin still occupy a relatively minor place. Of 292 foreign shares quoted in Amsterdam, 195 are American and no more than 30 from EEC countries, and only 40 and 44, respectively, are EEC shares out of a total of 213 foreign shares dealt in Paris and 118 in Brussels.

Although EEC bourses have been introducing more shares from other member countries in the course of the last few years, the Group considers that this trend should be accelerated in the future in order to promote the creation of a genuine European market in equities.

Hence the obstacles to the quotation of shares of other member countries should be removed without delay, especially in Italy and Germany.

37. As regards fixed-interest securities, the number of foreign loans listed in each Member State is strikingly small and often includes only those actually issued in the country where they are listed. The admission of loan stocks issued in other member countries to stock-exchange dealing might create interest in foreign bonds, even if the market were initially narrow. Issuers whose bonds were dealt in on the stock exchange of another member country might find it easier to place subsequent issues in that country.

38. All in all, the introduction of foreign securities to quotation on the stock exchanges of member countries should be encouraged, if need be by a reform of admission procedures. The following steps might be considered to this end:

- i) Elimination of all discriminatory measures of administrative origin, as has been provided for in the proposed third directive for the implementation of Article 67;
- ii) Harmonization of the publicity requirements and procedural rules applied by bourse authorities. The International Federation of Stock Exchanges has already put forward proposals for co-operation by bourse authorities, for example through "quotation certificates" which would make it unnecessary for an issuer to go several times through formalities he had already complied with; these proposals could do much to speed up and simplify the admission of foreign securities.

B) DEVELOPMENT OF DEALINGS IN FOREIGN SECURITIES OUTSIDE THE OFFICIAL MARKETS

39. Securities not listed on the "official market" may, in EEC countries, be traded either on special markets within the stock exchange, on the basis of simplified procedures, or outside the exchange.

On the unofficial market (*marché hors cote*) in France, for instance, the securities of 718 issuers were quoted at the end of 1965, of which 117 were foreign, including those of the franc area. In Belgium, "supplementary public sales" (*ventes publiques supplémentaires*) are organized periodically at the Brussels and Antwerp stock exchanges (at least once a month for all securities not officially listed and more often for certain specially authorized securities), thus enabling securities that do not satisfy the Listing Committee's conditions for official

admission to be traded on the bourse none the less. In Luxembourg, monthly public sales take place on the same system. In Germany, there is alongside the official market (*amtlicher Markt*) a system of "regulated free trading" (*geregelter Freiverkehr*) for bourse dealings in securities which have qualified for admission by simplified and less costly procedures. In addition, outside the exchange, telephone dealings in unlisted securities (*Telefonhandel in unnotierten Werten*) are organized by the banks for shares of companies which have applied for admission to neither of the two markets (*amtlicher Markt* and *geregelter Freiverkehr*) described above; many foreign securities are traded in this way.

In the Netherlands, there is an unofficial telephone market, on which brokers deal in unlisted securities; but it is relatively small, and foreign securities need a special permit from the Nederlandsche Bank to be traded on it. In Italy, finally, the Milan bourse has a "restricted market" (*mercato ristretto*), where the stocks of about 160 companies not officially listed can be traded once a week.

40. The Group considers that these markets fulfil a very useful function in acclimatizing securities until they are ready for admission to the official market, and this applies more especially to foreign securities. It would like to see more of the securities of other Member States admitted to these parallel markets. Simplified admission procedures are particularly appropriate when the securities concerned have already satisfied listing requirements on their own domestic market. One might even go so far as to allow any security officially listed in any Member State to be automatically eligible for unofficial trading in other Member States without further formalities.

C) HARMONIZING AND SIMPLIFYING PRICE QUOTATION TECHNIQUES

41. Different systems of price quotation are employed at present in Member States. Shares are quoted in some countries in terms of percentage of nominal value, in others in terms of money units, and in some countries both systems exist side by side. Fixed-interest security quotations take account of accrued interest in certain countries and ignore it in others.

The form in which the prices of officially listed securities are published varies considerably from one country to another, even in the case of dealings for cash, to say nothing of those for forward settlement and in options, in countries where these are possible. Prices marked on unofficial markets are often published separately, and the way they are presented varies even more widely.

There can be no doubt that even an investor familiar with the machinery of his own domestic market often finds it difficult to read and interpret foreign quotations. This situation is hardly a propitious one for security arbitrage, since, given the varying characteristics of securities and quotation systems, actual yields can be worked out only by calculations which few investors are in a position to undertake. Simplification and some harmonization in the presentation of price lists would be very helpful in this respect.

C. PROBLEMS CONNECTED WITH MOVEMENT AND NEGOTIATION OF SECURITIES

42. Differences in stock-exchange technique do not normally set insoluble problems for the carrying-out of international transactions, which can perfectly well take place in spite of some degree of variety in the way stock exchanges are organized⁽¹⁾.

Nevertheless, there may well be a case for equipping the various markets with equivalent technical facilities in order to give them equal opportunities for development and to improve market linkages by certain reforms.

A simple but helpful suggestion might be to lengthen and synchronize the hours of business on stock exchanges and thus facilitate arbitrage operations.

A more radical reform would be to introduce a market in dealings for forward settlement in centres where they do not exist as yet. A project of this kind is at present under discussion in Germany. The high cost of a credit system for stock-exchange transactions, such as exists in the United States, suggests that generally speaking the organization of a forward market would, in European conditions, probably be the best arrangement for sustaining and increasing the volume of business.

The Group feels that the movement and negotiation of securities among the Member States might be improved by:

- i) The establishment of a European clearing for security transactions;
- ii) Fiscal measures to encourage circulation of securities;
- iii) Harmonization of the rules applied to stock-exchange intermediaries and to the transactions of certain categories of operator;
- iv) The development of block trading techniques.

A) ESTABLISHMENT OF A EUROPEAN SECURITY CLEARING

43. It has already been noted that the physical handling of securities occasions a number of difficulties, including in particular the problem of accidental loss of bearer securities. In this connection the Group wishes to draw attention to an agreement, now under study, designed to provide, among other things, for securities on which a stop has been placed to be widely publicized throughout the Community.

However, the crucial problem is that of the cost and complexity of dealings; this is largely solved in France and Germany by the existence of security clearing associations of bankers and brokers. The establishment of such institutions in other Member States might help later to set up a European security clearing

⁽¹⁾ For a detailed account of how the stock exchanges work in the member countries, see *Les bourses européennes* (second edition) published in 1965 by the "Groupement européen d'études financières", formed by financial institutions of several countries.

system on the pattern, for instance, of the French SICOVAM (*Société Interprofessionnelle pour la Compensation des Valeurs Mobilières*). Voluntary participation of the national giros, or even direct participation of financial intermediaries in member and non-member countries, in this European clearing system would enable it to accept bearer securities, open current security accounts for members and act as nominee for foreign registered securities, thus facilitating the handling of international transactions and reducing commissions and brokerage, which at present are well above those charged for operations of a domestic nature.

The International Federation of Stock Exchanges has already devoted much attention to the study of all these problems and to the possibility of harmonizing the physical presentation of securities. Its important work in this direction should now be followed up by concrete action on the part of government and bourse authorities in Member States to implement the technical progress achieved. What is chiefly needed is amendment of the legal provisions applied in certain member countries, such as Italy, Belgium and Luxembourg, requiring securities to be "individualized". Such provisions impede the establishment of security clearing systems, since stocks deposited with a central giro necessarily lose the individuality conferred upon them by an identification number or registration in the owner's name.

B) FISCAL MEASURES TO ENCOURAGE SECURITY TRANSACTIONS

44. The circulation of securities could be encouraged by measures in the field of direct taxation.

Tax considerations are at times the root cause of the rigidity in the portfolios of certain companies, whose managers might otherwise wish to realize some of their investments or alter the composition of their holdings. This is the case, for instance, where heavy direct taxes are levied on capital gains realized on the sale of securities — gains that are sometimes paper profits only if allowance is made for the general rise in prices after an investment is first shown in the balance sheet at cost and if subsequent balance sheets have not been adjusted.

Appropriate fiscal treatment of these capital gains would help to "thaw" the portfolios of these companies, and the securities concerned could thus be brought back into circulation. For instance, certain tax reliefs granted to companies "on condition of reinvestment" in respect of sales of other types of asset might be allowed also on security investments. In particular, provisions are needed to facilitate the dissolution of companies which no longer do any business but are reluctant for fiscal reasons to liquidate their portfolios.

Another difficulty stems from the fact that in most member countries the tax privilege conceded to parent companies in respect of income transferred to them by their subsidiaries is conditional upon the parent company having a high minimum holding in these subsidiaries; as a result, certain parent companies have to hold far more of their subsidiaries' equity than they would otherwise wish to do. This rule may have the effect of inhibiting direct recourse of subsidiaries to public saving. Some way should be found to alter these fiscal regulations.

Moreover, where there are provisions allowing tax privileges or bonuses to individuals to encourage them to hold securities, for instance under investment plans, the Group feels that these provisions should apply, without discrimination, to the securities of all member countries.

45. Alleviation and harmonization of indirect taxes affecting the introduction of securities to dealing and transactions on the stock exchanges would also be a factor of considerable expansionary force.

As regards stamp duty on the issue and introduction of securities, the directive concerning the harmonization of taxes on capital contributions, now under consideration by the EEC Council, should, once it is adopted, create comparable conditions on the various markets. The content and implications of this directive are discussed in Chapter 14 (fiscal problems), as are the associated problems of taxes on stock-exchange transactions; the proposal is that these taxes, too, should be abolished or harmonized.

C) HARMONIZATION OF RULES GOVERNING INTERMEDIARY ACTIVITIES ON STOCK EXCHANGES AND TRANSACTIONS BY CERTAIN CATEGORIES OF OPERATOR

46. Whereas in France and Belgium security transactions are a stock-exchange monopoly, in other member countries they may be effected by settlement among the customers of financial establishments, which if necessary themselves run stock on behalf of customers. In addition, certain credit institutions are authorized to deal on the stock exchange in Germany, the Netherlands and Luxembourg, while in Italy they are mere observers on the market.

A system of bourse monopoly is the best guarantee of genuine price quotations and therefore deserves support, provided it involves no disadvantages for certain types of transaction such as block trading of shares (to be discussed below).

From the point of view of credit institutions, the problem may be considered from three different aspects:

- a) The right to act on the stock exchange as an intermediary;
- b) The right to hold securities on own account;
- c) The right to effect transactions outside the exchange, by matching customers' purchase and sale orders with stock held for their own account.

The combination of these three functions is obviously apt to be detrimental to the good functioning of the market, because of the conflicts of interest that may result, and is therefore best avoided. It will be recalled that for this very reason a plan now under discussion in Germany proposes the banning of the making-up of bargains outside the exchange, except for transactions between credit institutions. On the other hand, there is no reason why credit institutions should not act as intermediaries in stock-exchange business; nor should they be prevented from fulfilling their functions in block trading, which indeed they can facilitate thanks to their close contacts with customers.

47. The same general principles should be borne in mind in drawing up rules governing the operations of company directors and executives in securities of their own company.

The objective is to make sure that all persons carrying out a stock-exchange operation are on an equal footing and to prevent those who, by virtue of their office in a company, have access to information which might influence the market from using their knowledge to secure a personal advantage denied to other investors.

This problem has been solved in the United States by very far-reaching disclosure requirements with respect to transactions by executives and directors, and also by the policing functions of the Securities and Exchange Commission. In the United Kingdom, a similar arrangement has just been adopted, though the disclosure obligations are less stringent.

In EEC countries there are at present no regulations of this kind, even though misgivings on this point have been expressed, especially in France.

There are obvious difficulties in establishing rules for so complex a matter, and no precise suggestions can be put forward at this stage. The most that can be done is to outline the underlying principles:

- i) As regards the scope of the rules, they should bear on every sale or purchase of shares or other partnership rights in a company or its subsidiaries, made directly or indirectly by an executive or director of the company concerned;
- ii) As regards the restrictions to be placed upon the executives' or directors' freedom of action, these should essentially aim at preventing them from using information acquired by virtue of their office to trade in the company's securities to their own advantage, before such information has become public knowledge;
- iii) As regards methods of application, a system of absolute prohibition of such transactions would hardly be realistic: a better arrangement would be that of empowering stock-exchange authorities or some administrative agency to undertake investigations whenever price fluctuations occur that suggest company managers or directors may have put through deals at variance with these principles.

D) BLOCK SALES AND PURCHASES OF SHARES

48. When a whole block of shares is offered to the public or a bid is made for buying in all or part of a company's shares, this is one of the ways by which, on the most developed capital markets, large-scale transactions can be put through in conditions which are fair to all parties concerned and entail a minimum of disturbance to the market. The possibility of such transactions being carried out would prevent the persistent underpricing of certain shares and, where foreign shares were introduced in any given country, would enable them to be placed with a wide range of investors.

The various techniques normally employed in London and New York — specialist purchase, exchange distribution, special offering, secondary offering or tender —

are by no means unknown on the markets of Member States. Nevertheless, their institutional structure may not always lend itself to this type of operation, notably because of the absence of the appropriate intermediaries.

Secondly, where there is a bourse monopoly, these operations must be reconciled with it, but no major difficulties seem likely on this score; takeover bids and secondary offerings are in fact subject to special rules in France, and also in Belgium.

Third and last, there is the problem of checking the genuineness of the offer to buy or sell, in order to prevent fraudulent manoeuvres serving no other purpose than to create price movements on the stock exchange.

As in the case mentioned in sec. 47, no detailed recommendations can be made here. The Group can only stress the value of creating conditions under which block trading in shares can take place on a comparable basis in all the Member States. Without such harmonization it might obviously happen that these transactions would concentrate on the markets with the most liberal system and so circumvent the unduly restrictive rules of others.

CONCLUSIONS

49. 1) The stock markets of EEC countries have a common working problem, which is the narrowness of the market evident in the difficulty of dealing in any one security without causing undue price movements. This state of affairs can be remedied only by:

- a) Giving institutional investors increased opportunities to enter the market;
 - b) Attracting back to the bourse business now conducted outside it;
 - c) Establishing closer communication between markets both by introducing foreign securities, thereby enriching stock-exchange lists, and by international arbitrage.
- 2) The admission of securities of other member countries to dealing on the various domestic markets would make negotiation of these securities easier and less costly. To this end the Group recommends:
- a) Any discriminatory provisions which may make the admission of foreign securities to quotation more difficult or more expensive should be removed, and disclosure requirements and the procedures for admission to quotation should be harmonized.
 - b) Steps should be taken to facilitate the introduction of a larger number of foreign securities to dealing on markets which have simplified admission procedures (the French *marché hors cote*, supplementary public sales as in Belgium and Luxembourg, the German *Freiverkehr*, the Milan "restricted market"). Their admission to these markets should be allowed without formality if they are already listed in their country of origin;

c) Price quotation techniques and the presentation of price lists should be simplified and harmonized, in order to promote better knowledge of foreign markets and stimulate arbitrage.

3) Certain technical improvements might be introduced to facilitate the movement and negotiation of securities. The following may be mentioned:

a) The establishment of a European security clearing;

b) The adoption of fiscal measures designed to bring back into circulation shares now immobilized in company portfolios and also to reduce the cost of transactions;

c) Harmonization of the rules applied to stock-exchange intermediaries, and more particularly restriction of offset operations effected by credit institutions outside the exchange, as well as an effort to find a solution to the problems raised by the transactions of managers and directors in their own companies' securities;

d) An adjustment of current provisions with a view to enabling blocks of shares to be negotiated in comparable conditions of freedom and safety in all Member States.

ANNEX TO CHAPTER 11

Model prospectus for public security issues of admission to stock exchange listing ⁽¹⁾ ⁽²⁾

0. Every prospectus shall name the persons who assume responsibility for it, or for parts thereof, and shall state in what capacity these persons act.

1. ISSUE BY PUBLIC OFFER OF SHARES OR DEBENTURES OF COMPANIES FOR SALE OR SUBSCRIPTION ⁽³⁾ (FIRST OFFERING)

1.1 *Debentures:* The prospectus shall indicate

1.1.1. As regards the securities to be issued and the rights attaching thereto

1.1.1.1 i) The nominal amount of the loan;
ii) The number and characteristics of the securities representing the loan;
iii) The resolution of the body which took the decision to make the loan issue;

1.1.1.2 i) The date from which interest runs;
ii) The rate and due-dates of interest;
iii) The redemption yield, calculated according to the different redemption alternatives;
iv) The calculation base and terms of attribution of other benefits, if any;

1.1.1.3 The fiscal provisions applying to the securities issued, especially whether interest is payable net of withholding tax or not;

1.1.1.4 i) The life of the loan; where applicable, dates for premature calling;
ii) The redemption table and methods of redemption (by drawings, repurchase on the stock exchange, etc.);
iii) Any power to effect advance repayments and the manner of imputing these in the redemption table;

⁽¹⁾ For the content and significance of the prospectus, see Chapter 11.

⁽²⁾ Without prejudice to existing national legislation in this field, exemption from the obligation to publish a prospectus might be permitted or less detailed particulars required when the value of the securities to be issued or admitted to stock exchange listing does not exceed (100 000) units of account.

⁽³⁾ For a definition of the concept of company, see Article 58, para. 2 of the Treaty of Rome.

- 1.1.1.5 Any guarantees attaching to the loan (description of tangible security, indication and extent of any guarantees granted by public authorities or other companies — see also 9);
- 1.1.1.6 Special rights of debenture holders, including in particular a commitment, if any, to extend to the debentures of this loan any guarantees or benefits attaching to a subsequent loan issue, or a commitment not to furnish a subsequent loan with special guarantees without applying them also to the debentures of the present loan;
- 1.1.1.7 The establishments handling the capital and interest service of the loan;
- 1.1.1.8 The decision whether to apply for stock exchange listing of the debentures of the loan or not; if so, the stock exchanges to which admission will be sought.

1.1.2 As regards the issue procedure

- 1.1.2.1 Subscription rights, if any (if applicable, quotation or other procedure for negotiation of the rights);
- 1.1.2.2
 - i) The purchase or subscription price;
 - ii) Arrangements for payment of the purchase or subscription price;
 - iii) The period during which lists are open;
 - iv) The amount and composition of the issuing expenses (as a whole and per debenture) and how they are to be charged;
 - v) Arrangements and time-limits for issue of the certificates;
- 1.1.2.3 If the issue is taken firm or underwritten, the name of the firm buyer or underwriter, the composition of the underwriting group and the terms of the firm purchase or underwriting;
- 1.1.2.4 The establishments authorized to accept subscriptions.

1.1.3 As regards the company whose securities are being offered

- 1.1.3.1 The company's name, date of incorporation, duration, registered office, capital and the number of shares, the amount of capital not paid up, and reference to the published articles and memorandum of association and any amendments thereto;
- 1.1.3.2 Description of the company's objects and activities;

- 1.1.3.3 i) Comparative accounts for the last three financial years (including contingency accounts and profit appropriation accounts) or, if the company is less than three years old, its accounts since incorporation;
- ii) A recent statement of position if the last balance sheet is more than nine months old;
- iii) The proposed employment of the proceeds of the issue;
- 1.1.3.4 Other loan stocks issued by the company and any guarantees attaching thereto;
- 1.1.3.5 Composition of the company's boards;
- 1.1.3.6 Certification by the company's auditing board (if any) that the particulars contained in the prospectus are — at least in substance — accurate

1.1.4 As regards debentures of foreign companies

The prospectus shall indicate in addition

- i) *Under 1.1.1.1:* The legislative provisions applicable to the debentures issued and the courts competent in the event of disputes;
- ii) *Under 1.1.1.3:* Withholding taxes, if any, levied on interest received by non-resident individuals in the country of origin or the country of issue;
- iii) *Under 1.1.1.7:* Foreign exchange transfer permits, if any, obtained by the issuing company to enable it to pay interest and repay principal abroad.

1.1.5 As regards debentures expressed in foreign currency

The prospectus shall indicate in addition

- Under 1.1.1.2:* Foreign exchange permits, if any, obtained for the payment of interest and repayment of principal.

1.1.6 As regards debentures expressed in units of account

The prospectus shall indicate in addition

- Under 1.1.1.2:* The contractual status of the unit of account stipulated.

1.2 Shares

1.2.1 Shares issued on the occasion of a capital increase for cash

The prospectus shall indicate:

1.2.1.1 As regards the securities to be issued and the rights attaching thereto

1.2.1.1.1 The resolution of the body which took the decision to issue the securities;

1.2.1.1.2 The amount of the capital increase, the number and characteristics of the securities representing this increase;

1.2.1.1.3 i) The rights attaching to the new securities (voting rights, profit share, etc.);

ii) The date from which they rank for dividend;

1.2.1.1.4 The decision whether or not to apply for stock exchange listing of all or part of the securities floated by public issue; if applicable, the stock exchanges to which admission is being sought;

1.2.1.1.5 The establishments acting as financial agents to the company.

1.2.1.2 As regards the issue procedure

1.2.1.2.1 i) Subscription rights, if any (quotation of the rights);
ii) The treatment of subscription rights not exercised;

1.2.1.2.2 i) The purchase or subscription price;
ii) Arrangements for payment of the purchase or subscription price;
iii) Arrangements for subsequent payments for securities not fully paid;
iv) The period during which lists are open;
v) The number of securities being issued;
vi) The amount and composition of the issue costs;
vii) Arrangements and time-limits for issue of the certificates;

1.2.1.2.3 If the issue is taken firm or underwritten, the name of the firm buyer or underwriter, the composition of the underwriting group and the terms of the firm purchase or underwriting;

1.2.1.2.4 The establishments authorized to accept subscriptions.

1.2.1.3 As regards the company whose securities are being offered

- 1.2.1.3.1 i) The company's name, date of incorporation, duration, registered office, capital (where necessary, authorized and issued), the number of shares, the number of securities not representing capital, the rights attaching to the securities of various categories, in particular voting rights and rights to a share in the profits and the liquidation surplus, the amount of capital not paid up, and reference to the published articles and memorandum of association and any amendments thereto;
- ii) The history of the capital and the securities representing it as well as of the securities not representing capital;
- 1.2.1.3.2 Description of the company's objects and activities;
- 1.2.1.3.3 i) Comparative accounts for the last three financial years (including contingency accounts and profit appropriation accounts) or, if the company is less than three years old, its accounts since incorporation;
- ii) Possibly a recent statement of position if the last balance sheet is more than nine months old;
- 1.2.1.3.4 i) Methods used for valuation of fixed assets, stocks, claims, the security portfolio and other current assets; depreciation rates applied to fixed assets;
- ii) Any changes in valuation methods or depreciation rates during the last three years and the incidence thereof;
- 1.2.1.3.5 i) Composition of the security portfolio (other than government or government-guaranteed loan stock) and changes therein during the last three years; for each item, an indication of what proportion the holding represents in the total securities of the same category issued by the company whose securities are held, if this proportion is (5) per cent or more;
- ii) The balance sheet and the profit and loss account of subsidiary companies⁽¹⁾ together with a description of their activities and, if necessary, prospects, except if a statement of position in respect of these subsidiaries is incorporated in a consolidated balance sheet published in the issue prospectus;
- iii) The consolidated balance sheet of the company and its subsidiaries together with a statement on the principles and methods of consolidation, if such integrated accounts appear warranted and desirable;

⁽¹⁾ For the concepts of subsidiary company and "dominant" company, cf. the studies on harmonization of safeguards to protect the interests of members and third parties [Article 54 (3 g) of the Treaty of Rome].

- 1.2.1.3.6 i) Industrial and commercial agreements, licensing contracts, etc., having a major bearing on the company's business; description of these agreements and contracts;
- ii) Output and sales figures (⁽¹⁾);
- iii) The investment programme and how it is financed;
- iv) The proposed employment of the proceeds of the issue;
- 1.2.1.3.7 Income tax paid or provided for by the company during the last three financial years;
- 1.2.1.3.8 i) Composition of the company's boards;
- ii) The overall amount of remuneration paid under whatever heading, charged to general expenses or the profit appropriation account, to the members of the board of directors during the last proceeding or the current financial year;
- 1.2.1.3.9 Any other disclosure required by domestic legislation in connection with the annual accounts or legal information obligations;
- 1.2.1.3.10 Certification by the company's auditing board (if any) that the particulars contained in the prospectus are — at least in substance — accurate.

1.2.2 *Shares issued for cash on the occasion of a company's establishment*

The issue prospectus shall contain the particulars required under 1.2.1., except for those relating to the history of the capital and the company's past.

1.2.3 *Issue by public offer of a foreign company's shares for sale or subscription*

The issue prospectus shall contain the particulars required under 1.2.1 and shall indicate in addition

- i) *Under 1.2.1.1.2:* The legislative provisions applicable to the securities issued and the courts competent in the event of disputes;
- ii) *Under 1.2.1.1.3:* Withholding taxes levied on dividends paid to non-resident individuals in the country of origin, and foreign exchange transfer permits, if any, obtained by the issuing company to enable it to pay dividends abroad.

(¹) Not applicable to financial establishments (banks, savings banks, finance companies, etc.).

2. ADMISSION TO STOCK EXCHANGE LISTING

- 2.1 *Admission to stock exchange listing of securities floated during the year preceding the listing by public issue, in connection with which a prospectus complying with the requirements under 1 has been published.*

In this case disclosure of information may be limited to a supplement to the original prospectus, bringing this up to date.

- 2.2 *Admission to stock exchange listing of shares created subsequent to capitalization of reserves or profits, or of debentures allotted by way of interest or dividend*

No prospectus required.

- 2.3 *Admission to stock exchange listing of securities representing the capital increase of a company whose stock is listed, subsequent to this company's take-over of another company whose stock was listed in the same country, or of the securities of a company formed by the merger of companies whose stock was listed*

The admission prospectus shall indicate in particular:

- i) The reports presented to the two companies' general meetings of shareholders to justify the merger proposal;
- ii) Justification of the basis of the merger;
- iii) The last balance sheet and profit and loss account of each of the merged companies;
- iv) An initial statement of position subsequent to the merger;
- v) A statement on future outlook and especially on the prospective yield of the securities.

2.4 *Other cases of admission to stock exchange listing*

The admission prospectus shall contain the particulars required under 1. and 2.3

3. PUBLIC OFFER FOR SALE OF A COMPANY'S SECURITIES BY AN ISSUER BEING A THIRD PARTY WITH RESPECT TO THE COMPANY WHOSE SECURITIES ARE OFFERED AND NOT ACTING IN THE CAPACITY OF FIRM BUYER (SECONDARY OFFERING)

The issue prospectus shall contain the particulars required under 1., provided the issuer has access to them. If this is not so, it shall be explicitly stated that the prospectus has been prepared only on the basis of information available to the issuer.

The prospectus shall, in addition, state why the public offer for sale is made.

The prospectus shall, finally, contain the following particulars on the issuer making the public offer for sale, if the issuer is a company:

- i) Full name and identity of the issuing company (cf. 1.2.1.3.1);
- ii) Its latest balance sheet, profit and loss account and profit appropriation account;
- iii) The composition of its security portfolio.

4. ISSUE OF (BEARER) CERTIFICATES REPRESENTING (REGISTERED) SHARES; ISSUE OF STOCK BY "ADMINISTRATIEKANTOREN" (TRUSTEE OFFICES)

The issue prospectus shall indicate:

4.1 As regards the issuer of the certificates or stock

- i) Full name and identity of the issuing company (cf. 1.2.1.3.1);
- ii) Description of the issuer's or issuing office's objects and activities;
- iii) Comparative accounts for the last three financial years, including contingency accounts and profit appropriation accounts;
- iv) Composition of boards;
- v) The composition and amount or rate of commission and expenses in connection with the issue of the certificates or stock, with coupon payment and with the creation of additional certificates or stock, as well as with the exchange of the certificates for the original shares.

4.2 As regards the certificates themselves

- i) Their legal status in detail, especially with reference to the exercise of voting rights and the possibility of converting the certificates into the original shares they represent;
- ii) Their stock exchange quotation, if any.

4.3 As regards the company whose shares are represented by the certificates

The particulars required under 1.2.

5. ISSUE OF DEBENTURES CONVERTIBLE INTO SHARES

5.1 The prospectus prepared on the occasion of the issue of these convertible debentures shall, in addition to the particulars required under 1.1.1, 1.1.2 and 1.2.1.3, indicate:

- i) The conversion dates, terms and arrangements;
- ii) Guarantees designed to safeguard the rights of the holders of the convertible debentures;

- iii) A list of outstanding convertible loan issues together with their terms;
 - iv) The stock exchange quotation, if any, of the securities into which the debentures are convertible.
- 5.2 The prospectus prepared on the occasion of a conversion offer for these debentures shall consist of the issue prospectus brought up to date. However, if the conversion offer is made less than a year after the issue, the prospectus for it may consist simply of a supplement bringing the original prospectus up to date. If the conversion period extends over several years, the particulars of the prospectus shall be brought up to date annually.
6. ISSUE OF DEBENTURES WITH STOCK-PURCHASE WARRANTS
- The same principles shall apply as in the case of convertible debenture issues as under 5., except that the prospectus shall, in addition, contain the following particulars:
- i) A detailed description of the characteristics of the warrants and the rights attaching thereto;
 - ii) The guarantees designed to safeguard the rights of warrant holders.
7. ISSUE OF DEBENTURES EXCHANGEABLE AGAINST SHARES
- The same principles shall apply as in the case of an issue of debentures convertible into shares or partnership stock.
8. SUBSCRIPTION WARRANTS
- 8.1 Free allotment of subscription warrants:
No prospectus need be prepared in this case.
- 8.2 Issue of subscription warrants by public offer for sale or their admission to stock exchange listing:
The prospectus prepared on the occasion of the issue or listing shall contain the particulars required under 1.2, and in addition:
 - i) A detailed description of the characteristics of the subscription warrants and the rights attaching thereto;
 - ii) The guarantees designed to safeguard the rights of subscription warrant holders.
- 8.3 At the opening of the subscription lists for the shares to which the subscription warrants give a right, a prospectus shall be prepared and contain the particulars required under 1.2.

9. ISSUE OF A COMPANY'S SHARES OR DEBENTURES GUARANTEED BY ANOTHER COMPANY

In addition to the particulars required under 1. as regards the securities to be issued, the issue terms and arrangements and the company whose securities are being issued, the issue prospectus shall indicate, as regards the guaranteeing company, the particulars required under 1.1.3 or 1.2.1.3, according to whether the securities are debentures or shares.

10. ISSUE OF DEBENTURES BY COMPANIES FORMING A GROUP FOR THIS PURPOSE

10.1 Joint issue by a group having legal personality:

The issue prospectus shall be so prepared as to state clearly the guarantees offered by the companies forming part of the group and the terms of their relationship with it.

10.2 Joint issue by a group having no distinct legal personality:

The prospectus shall indicate:

- i) The particulars required under 1. as regards the securities to be issued, the issue terms and arrangements and each of the companies on behalf of which the group is acting;
- ii) A description of the group contract;
- iii) The holders' rights of recourse against each of the companies in the group.

11. PUBLIC OFFER OF EXCHANGE OF SHARES

The prospectus prepared on this occasion shall, as regards the company making the public offer, contain the particulars required under 1.2. In addition, it shall indicate:

- i) The purpose of the operation;
- ii) The particulars required under 1.2.1.3 as regards the company to whose securities the exchange offer applies, provided that the company making the public offer has access to this information;
- iii) Reasons for the exchange ratio chosen.

12. TAKE-OVER BIDS (FOR CASH)

The prospectus shall indicate:

- i) Full name and identity of the company making the public offer (cf. 1.2.1.3.1);
- ii) The statement of the offer;

- iii) The terms, arrangements and time-limit of the offer;
- iv) The purpose of the operation;
- v) The justification of the price offered;
- vi) The particulars required under 1.2.1.3. as regards the company for whose shares or stock a bid is made, provided the company making the public offer has access to this information. Where this is not so, it shall be explicitly stated that the prospectus has been prepared only on the basis of information available to the company making the offer;
- vii) The establishments authorized to handle the transaction.

13. DEBENTURE ISSUES BY DOMESTIC, FOREIGN OR INTERNATIONAL AUTHORITIES

The prospectus shall furnish the particulars required under 1.1.1 and 1.1.2.

14. PUBLIC ISSUE OR ADMISSION TO STOCK EXCHANGE LISTING OF SHARES AND CERTIFICATES OF OPEN-END INVESTMENT FUNDS

14.1 *Open-end investment funds with undivided ownership of underlying securities*

The prospectus shall indicate:

14.1.1 As regards the fund

- 14.1.1.1 The fund's name, legal status, date of establishment and the period for which it has been set up; the registered office of the managers; the legislation under which the fund has been set up and conducts its business. Unless the trust deed and the regulations governing the conduct of the fund are reproduced in full in the prospectus, an indication of what information has been made public and an indication of the address or the publication where the texts can be consulted by anyone who may wish to do so;
- 14.1.1.2 Under whose authority and by what procedures the trust deed or the regulations governing the management of the fund may be altered;
- 14.1.1.3 The general objectives of the fund (e.g. whether universal, or specializing in particular securities, etc.);
- 14.1.1.4 The rules adopted regarding the placing, acquisition and sale of securities by the fund;
- 14.1.1.5 The fund's investment policy; on a fund's foundation, the prospectus shall instead indicate the proposed investment policy;

- 14.1.1.6 Name and identity of:
- i) The institution or institutions responsible for the holding and custody of the fund's securities and for the implementation of management decisions;
 - ii) The agency or agencies responsible for financial servicing on behalf of the fund (acceptance of applications to join or discontinue membership; payment of income, etc.);
 - iii) The obligations assumed by these institutions and agencies and the guarantees, if any, attaching to these obligations;
- 14.1.1.7 The intervals at which a statement of assets and an income and expense account are prepared, together with auditing arrangements and publication arrangements for these accounts and the auditors' report;
- 14.1.1.8
- i) The appropriation of the balance on income and expense account (distribution, reinvestment);
 - ii) The authorization, if any, to distribute capital gains, and, if appropriate, the methods of determining distributable gains and of distributing them (in cash or certificates);
- 14.1.1.9 The latest statement of assets:
- i) An itemized list of the fund's holdings, indicating for each holding its proportion in the fund's total assets;
 - ii) The various valuation methods applied, by categories;
 - iii) An indication of the proportion of the fund's holding of any security in the total of securities of the same category issued by the same company or institution, if this proportion exceeds 1 per cent;
 - iv) The number of certificates outstanding;
 - v) The inventory value per certificate;
- 14.1.1.10 The latest income and expense account;
- 14.1.1.11 If applicable, the amount of distributable and distributed capital gains;
- 14.1.1.12 The last five years' figures (or the figures since the establishment of the fund if it is less than five years old), for
- i) The net assets of the fund;
 - ii) The inventory value per certificate;
 - iii) The balance on income and expense account;
 - iv) Distributed or capitalized income;
 - v) Capital gains distributable and distributed in cash or securities;
 - vi) Any changes introduced in valuation methods and the incidence of these changes on the accounts;
- 14.1.1.13 Securities acquired and sold during the last twelve months.

14.1.2 As regards subscription and repayment of certificates and the rights attaching to certificates

- 14.1.2.1** The method of determining the inventory value of certificates;
- 14.1.2.2** The method of determining the subscription price and repayment price and the composition, by categories of expenses and charges, of the difference between the inventory value of the certificate and its subscription and repayment price;
- 14.1.2.3** The dates, days or periods when subscriptions or applications for repayment are accepted; a full list of the conditions on which applications for repayment may, in accordance with the memorandum or articles of association, be refused, or repayment may be made in instalments or deferred;
- 14.1.2.4** Voting rights, if any, attaching to the certificates;
- 14.1.2.5** If the certificates are listed on the stock exchange, the criteria and terms of possible stock exchange issue or repurchase of certificates on behalf of the fund;
- 14.1.2.6** If the fund offers certificates under a systematic saving or investment plan, a list of the subscriber's rights and obligations, and explicit mention of any clauses barring an interruption in the subscriber's payments or an immediate repayment of the certificates he already holds, and of any indemnities which may be payable;
- 14.1.2.7** If this systematic subscription plan is associated with a life assurance contract, the respective rights and obligations of the insured person and the insurer, the name of the insuring institution, the mortality tables and the capitalization rates on which the insurance premium is calculated;
- 14.1.2.8** The amount and method of calculation of commissions, charges and expenses payable to the management, the custodian or a third party in respect of the management of the fund and the distribution of income and capital gains, as well as the method of charging these commissions, and costs (whether to capital or to income);
- 14.1.2.9** The establishments acting as financial agents to the fund;
- 14.1.2.10** Withholding taxes levied in the country of origin on distributions of income and capital gains.

14.1.3 As regards the fund's management company

- 14.1.3.1** The company's name, date of incorporation, nationality, registered office and objects; reference to the published memorandum and articles of association and any amendments thereto;

- 14.1.3.2 The amount of the company's capital and the securities which represent it;
- 14.1.3.3 The amount of capital not paid up; identification of the owners of not fully paid-up shares and indication of their call liability;
- 14.1.3.4 The company's activities;
- 14.1.3.5 The composition of the company's boards and of its investment committee, if any;
- 14.1.3.6 The company's latest balance sheet and profit and loss account.

14.2 Open-end investment funds constituted in company form

The prospectus shall indicate:

14.2.1 As regards the company

- 14.2.1.1 The company's name, date of incorporation, duration, nationality, registered office and objects, and references to the published memorandum and articles of association and amendments thereto;
- 14.2.1.2 As applicable in specific cases:
 - i) The amount of authorized and issued capital;
 - ii) Powers and procedures for changing authorized capital;
 - iii) The amount of fixed capital and the powers and procedures for changing it;
- 14.2.1.3 The latest balance sheet, profit and loss account and profit appropriation account;
- 14.2.1.4 The particulars required under 14.1.1.3 to 14.1.1.9, 14.1.1.11 and 14.1.1.13;
- 14.2.1.5 For the last three years (or since the establishment of the company if it is less than three years old):
 - i) The balance sheets and profit and loss accounts;
 - ii) The number of securities in circulation;
 - iii) Income distributed, allocated to reserves or capitalized;
 - iv) Capital gains distributable and distributed in cash or securities;
 - v) Any changes introduced in valuation methods and the incidence of these changes on the accounts;
- 14.2.1.6 The particulars required under 1.2.1.3.7 to 1.2.1.3.9.

14.2.2 As regards the issue of new shares, repurchase of shares and the rights attaching thereto

- 14.2.2.1 Powers and procedures for issuing new shares;**
- 14.2.2.2 If new participation certificates are issued through the stock exchange, the criteria and conditions applied to the issue of new certificates in the light of the inventory value per share;**
- 14.2.2.3 If new certificates are issued otherwise than through the stock exchange, the method of determining the issue price and the composition, by categories of expenses and charges, of the difference between the inventory value per share and the issue price;**
- 14.2.2.4 The dates, days or periods when subscriptions are accepted;**
- 14.2.2.5 Preemptive subscription rights, if any;**
- 14.2.2.6 The rights attaching to the shares; when there are several categories of shares or securities, the rights attaching to each category;**
- 14.2.2.7 The particulars required under 14.1.2.6, 14.1.2.7, 14.1.2.9, and 14.1.2.10;**
- 14.2.2.8 The holders' right, if any, to apply for repayment of their shares; limitations and conditions to which this right may be subject;**
- 14.2.2.9 The company's right, if any, to buy its own shares on the stock exchange or otherwise;**
- 14.2.2.10 In the event of the company's repurchase of its own shares, the method of determining the price for purchases otherwise than on the stock exchange, and the criteria and conditions applied to repurchase on the stock exchange, in the light of the inventory value per share;**
- 14.2.2.11 The company's right, if any, to hold in its portfolio such if its own securities as it may have acquired; conditions and limits to which this holding may be subject; the exercise of the rights attaching to the company's own shares in its portfolio.**

PART FIVE

REMOVAL OF OBSTACLES PREVENTING EQUAL ACCESS TO THE EUROPEAN CAPITAL MARKET

Many of the obstacles to international financial operations affect more than one sector of the capital market. In confining the analysis solely to individual sectors there is a danger that the wood may not be seen for the trees. That is why the Group has thought it fitting to devote the three chapters of this Part, to a systematic examination of specific problems bearing on the market as a whole.

To lessen the inequalities of access to the European capital market, the financial institutions need, above all, to be given a role in the European market comparable with the one they play on the domestic markets, in competitive conditions which are not affected by excessive divergences between operation rules and control systems.

The exchange risk which may be involved in international financial operations will not completely disappear until a monetary union is established in the Community. Meanwhile it continues to set problems, the nature and gravity of which may differ according to the type of borrower and lender. In its search for possible ways of eliminating the exchange risk, the Group looked for solutions that might make a positive contribution to the development of international financial transactions without, in so doing, introducing new elements likely to disturb the domestic capital markets.

The differences between the fiscal systems applicable to loan, investment and issue operations, and the frequent cases of international double taxation due to these differences, are perhaps the commonest cause of distortion in the movement of capital. After making a comparative study of the incidence of taxation on the international financial operations of most importance to the development of a European capital market, the Group has attempted to identify the measures needed to give practical effect to the principle of neutrality of fiscal systems and prevent these systems influencing the international movement of capital.

CHAPTER 12

DISPARITIES IN THE WORKING AND SUPERVISION OF FINANCIAL INSTITUTIONS

Introduction

1. Integration of the European capital markets entails the active participation of financial organizations in capital movements between the different Community countries. In each of the domestic markets the operations of financial intermediaries play a predominant role; and this is how it should be in an integrated European market.

It is, therefore, not enough for individuals to be free to carry out all the operations necessitating capital movements from one country to another. If a broad and efficient European market is to be formed, the financial organizations must be able to play in it the same role as in each of the domestic markets, both in the collecting and distribution of funds.

2. There are many obstacles preventing financial intermediaries from participating in the creation of a European capital market. Those arising from exchange control, fiscal laws and the exchange risk are dealt with in other chapters, since they also concern capital movements effected by individuals. Financial institutions, for their part, find their active contribution to the creation of a European market impeded by other restrictions as well, deriving from the operating rules and controls imposed on them by law or by administrative regulations.

3. The object of this chapter is to describe the main characteristics of these rules and controls and to examine to what degree they are liable to distort competition between institutions and, thereby, slow down the creation of a European capital market.

This part of the report, preceded by a few remarks to clarify the nature of the problem and of the solutions proposed, deals in turn with the regulations applied to:

- i) Banks;
- ii) Institutions specializing in medium- and long-term credit;
- iii) Savings banks and their central organizations;
- iv) Life assurance companies.

I. Required adjustments: principles and methods

A. ORIGIN AND NATURE OF THE LIMITATIONS IMPOSED ON FINANCIAL INSTITUTIONS

4. In most member countries the present arrangements concerning the working and supervision of banks date from measures taken to palliate the effects of the great economic crisis of the inter-war period. The regulations have been progressively refined as the role of the state in economic life has grown.

5. Money-creating institutions like deposit banks must comply with certain rules and controls dictated by official economic policy; these are imposed either for reasons of monetary policy (limitation of money creation and control of credit expansion by the central bank, external equilibrium and exchange stability, and stability of domestic prices), or in order to protect depositors (proper management of banks from the angle of security and liquidity), or again in order to achieve certain policy objectives in the broad sense (e.g. separation of the lending and participations business of all-purpose banks, in order to avoid excessive risks being taken and prevent financial groups from acquiring excessive influence over the economy; measures preventing bank concentration; nationalization of the big deposit banks). Rules aiming at the automatic supply of the Treasury's cash requirements may be regarded as stemming from the same considerations.

6. Non-money-creating financial intermediaries (savings banks, insurance companies and specialized institutions) are governed by rules which are designed more specifically to protect savings and which consequently seem to derive from social rather than economic considerations, although nowadays behind this justification there often lies the desire of the authorities to direct a substantial part of the resources at the disposal of these institutions to the financing of priority objectives.

This is particularly true of the public-sector financial organizations set up in order to meet specific social needs (e.g. to encourage the small saver and protect him against all risks, to facilitate home-ownership, to finance small firms, etc.). Save where these organizations have gone beyond their original objectives, their lending business is necessarily restricted and this limits the scope for fitting them into a European market except as regards their refinance requirements.

In other cases, the rules are also often tinged by considerations of economic policy. These institutions may, for example, be required to specialize in order to prevent their acquiring an influence in the monetary field that might undermine central bank policy; another aim can be to associate these important fund-raising bodies with the financing of objectives laid down as part of investment policy.

B. THE GENERAL APPROACH TO THE PROBLEMS DISCUSSED IN THIS CHAPTER

7. Even if the distortions arising from taxation and exchange control were eliminated, competition among similar institutions in the various EEC countries would remain unequal because of disparities in the rules under which they operate. This inequality, of course, does not necessarily mean that the idea of competition has to be discarded altogether and that a European capital market cannot be brought into being. It is in fact conceivable for the competition to be between different types of institution in the various sectors. Finance for building and construction could, for instance, be the province of savings banks in one country, of commercial banks in another, and of a specialized public institution in a third. The markets could be integrated on condition that there was competition between institutions belonging to different countries, even if these institutions were not of the same nature.

8. There are, nevertheless, numerous practical difficulties in the way of this approach. In each of the EEC countries there is a growing tendency for each type of financial intermediary to enlarge its range of activity, both in the collection and in the employment of funds. This trend seems to be a fundamental one and is accepted by the national authorities. It arises from the inner forces making for the development of institutions anxious to cater for the needs of an industrial and commercial world undergoing radical changes. This development could hardly be arrested on the international plane when it is so powerful in the domestic markets. As the capital markets become wider and freer, each institution will try to develop its competitive capacity in all the fields already covered by similar institutions in the other Community countries. Consequently, there will be an inevitable tendency, both under political pressure and under pressure from the internal development of the firms, towards some harmonization of the operating rules and control systems for each class of financial intermediary.

9. The Group feels that such harmonization should be embarked upon systematically rather than be left to develop as and when local pressures make themselves felt. While the Group does not recommend complete harmonization of operating rules throughout the Community, it does consider that the elimination of fundamental divergences is an essential condition for the integration of European capital markets.

II. Banks

10. The main operating rules imposed on banks and liable to affect international competition concern the way they obtain and employ funds. In this section these rules are first of all classified according to the purposes they serve, and the extent to which they can be maintained in an integrated market and the conditions under which this can be done are then discussed⁽¹⁾.

A. RULES CONCERNING THE COLLECTION OF FUNDS

11. There are no important divergences concerning the range of the operations that the banks may use to raise funds; in practice, however, certain operations may be considerably limited by the advantages attaching to similar operations of other institutions (state guarantees, more favourable fiscal arrangements).

12. However, a problem does arise in the matter of interest rates. Except in the Netherlands, and in Germany in the case of very large sums, the interest rates which banks may pay on deposits are laid down by the authorities or in inter-bank agreements, which are also generally supervised by the authorities. The reasons underlying the control of deposit rates are many and vary according to the rate in question.

⁽¹⁾ Table 29 shows how the different national rules in Community countries have led to very different utilization of bank resources.

Imposed or agreed rates are generally the maximum legal rates, but they are also normally the actual rates applied. The limits they set to the extent to which the banks may bid against each other for deposits arose originally from the desire to prevent competition liable to endanger the security of deposits. A second reason was to allow the banks to lend at reasonable rates.

The aim of some restrictions may also be to curtail the operations of the banks on markets where the State wishes to give priority to the raising of funds by the authorities or by other financial institutions whose investments further certain objectives of economic or social policy; this type of motivation underlies the limits imposed on the interest rates at which the banks may issue bonds or deposit receipts (*bons de caisse*) and remunerate savings deposits. Rules concerning the interest on savings deposits are often combined with others specifying ceilings beyond which the interest paid is lower than the basic rates.

Lastly, certain rules on deposit rates — like those forbidding the remuneration of the current accounts or short-term deposits of non-residents and those linking deposit rates to Bank rate — are applied for monetary policy reasons.

As and when the obstacles to international transactions disappear, the obligation to apply lower interest rates than those offered by competing institutions abroad may prevent the banks from undertaking certain operations, especially those which involve relatively large sums and which normally cost the banks least to handle. Where maximum rates have been fixed in order to facilitate the collection of funds by other institutions or by the public authorities, the effect of foreign competition would likewise be felt and this would limit the value of maintaining interest rates below those obtaining in other countries.

B. RULES CONCERNING EMPLOYMENT OF FUNDS

13. The employment of funds, like the collection of funds, may be subjected to laws or regulations fixing interest rates. In Italy there are minimum rates for loans granted by banks. This type of rule is intended mainly to prevent cutthroat competition, which might undermine the security of the banking system. The position of Italian banks in international competition is affected only if the minimum rates are higher than those offered for the same operations by foreign competitors.

In Germany and Luxembourg, on the other hand, there are maximum rates, and in Belgium the possibility of introducing maximum rates is expressly provided for. The main object of these ceilings is to prevent the operations financed by such loans from costing too much. Normally the maximum rates apply only when demand is heavy. Their existence then forces the banks to "ration" their loans.

14. But the employment of bank funds is limited not so much by the rules governing interest rates as by those directly specifying the minimum and maximum quotas for certain types of asset.

15. Certain stipulated ratios with which the banks must comply — varying in number from country to country — also vary greatly in impact in the several countries, though their objectives are much the same:

- i) Minimum reserve ratio "freezing" a proportion of funds collected (with or without interest);
- ii) Special system of minimum reserves (*coefficient de trésorerie*) establishing a minimum relation between liquid or immediately mobilizable assets and liabilities;
- iii) Cover ratio requiring banks to hold a certain quantity of Government stock or paper;
- iv) Transformation coefficient establishing a maximum relation between fixed investments and participations on the one hand and the bank's own capital and long-, medium- and short-term resources on the other;
- v) Solvency ratio establishing a maximum relation between the amount of liabilities towards third parties, whether included in the balance sheet or not, and the bank's own capital;
- vi) "Spread of risks" ratio limiting the loans a bank may grant to one firm;
- vii) Limitation of the participations held by banks to a specified percentage of the capital of non-financial institutions (or an outright ban on such participations).

16. Other rules may have indirect effects on the composition of assets. They are those that lay down which categories of securities can be rediscounted or mobilized at the central bank and, where applicable, the limits within which rediscounting is authorized (ceilings). Similar effects may result from *règles d'encadrement*, that is rules which limit the expansion of certain types of credit.

17. Cases of unequal competition arise not only in connection with medium- and long-term credit which, as has been seen in Chapter 7, remains subject to limitations in certain countries, but also, in particular, with regard to the holding of industrial and commercial shares and debentures.

In France, Italy and Belgium a major distinction is made between deposit banks and *banques d'affaires* (similar to investment banks) and this can cause certain handicaps, particularly in the fields of risk capital for industry, transactions in securities, and even the efficient participation of banks as intermediaries in the issue of securities.

In Belgium, a recent bill proposes considerable changes as a result of which the distinction between deposit banks and *banques d'affaires* would be applied less rigidly. It is proposed that deposit banks should be allowed to hold bonds, with no time-limit, and should be able to hold shares for a year from the time of issue, or possibly longer with the authorization of the *Commission Bancaire*. The explanatory memorandum accompanying the bill brings out clearly the Government's intention to encourage the banks to play a more active role as intermediaries in the security market.

In France deposit banks may not use more than 75% of their own resources for participations of firm subscriptions to shares or *parts* issued by enterprises. They may not hold more than 10% of the capital of enterprises other than enterprises,

real estate companies or services enterprises necessary to the bank's operation. On the other hand, the *banques d'affaires* were recently authorized to accept deposits of all kinds from the public and have no limit, within that set by the total of their own capital, on the amount of these securities they may hold. They may even hold more than the sum of their own resources when these reach a specified standard of stability. It must not be forgotten, however, that in the collecting of deposits the *banques d'affaires* are at a disadvantage vis-à-vis the big banks, which have a wide network of branches and sub-branches.

In Italy the banks' legal status does not forbid them to hold bonds or shares listed on an Italian bourse, but the latter they may hold only "so far as necessitated by their relations with their customers".

In the Netherlands the commercial banks are completely free to invest in shares or bonds as long, of course, as the rules regarding solvency and liquidity are respected. Banks may not, however, take participations in credit institutions, except with the approval of the central bank. On the occasion of recent mergers the central bank arranged with the banks concerned that its prior authorization should be the rule for any direct or indirect participation exceeding 5% of the capital of an enterprise.

Germany and Luxembourg are the countries where the banks have the greatest freedom to hold shares and bonds.

CONCLUSIONS

18. 1) The need to achieve a certain balance between the rules on the management of a bank's liabilities and those dealing with the assets it may hold makes harmonization even more necessary. If the diversity of the present pattern is maintained, competition problems will be created between the banks of different countries, in the same way as such problems — sometimes acute — have arisen between different institutions in the same country.
- 2) The Group recommends, therefore, that a study should be made of the progressive harmonization of the operating rules and control systems applicable to banks conducting business in the EEC. Harmonization should be concentrated on:
 - i) The establishment of common rules on interest rates, notably in connection with the collecting of deposits;
 - ii) The gradual alignment of laws prescribing rules for balancing the composition of the banks' liabilities and assets;
 - iii) The alignment of rules concerning the right of banks to hold industrial and commercial securities in their portfolios.
- 3) Lastly, the Group recalls that some of its recommendations, in particular those relating to the unification of policy on deposit interest rates, can be put into practice only if monetary policies are effectively harmonized, as has been stated in Chapter 4. Harmonization would remove the handicap of unequal competition caused directly or indirectly by divergences in the employment of the instruments of monetary policy.

III. Institutions specializing in medium- and long-term credit

19. Institutions with a special status and having a particular role in the medium- and long-term financing of industrial capital expenditure, housing, local authorities' capital expenditure, or of particular sectors of the economy, exist in all the Member States (see Table 30). However, they differ in their modes of operation and in the advantages or restrictions relating to their activities. The problems concerning the role that these institutions might play in a European capital market have already been dealt with in Chapters 7 and 8, particularly in relation to credit for industry, housing and local authorities' capital expenditure; this leaves for consideration the problems affecting competition that may arise from the advantages and restrictions referred to.

20. Unlike banks, savings banks and similar bodies, the specialized financial institutions do not normally accept deposits from the public but are financed rather by the issue of bonded loans and by private loans from other financial bodies or the public authorities.

Where these institutions do not receive direct financial aid from the State, the cost of their methods of procuring finance could sometimes put them at a disadvantage when their lending and investment operations bring them into competition with bodies enjoying wide facilities for transforming short-term into long-term resources. On the other hand the fact that they specialize is of some advantage in types of operation where administration presents special problems: mortgage loans, loans to consumers, leasing business, etc.: it is not unusual to find financial bodies whose memoranda or articles of association do not preclude such operations preferring to leave them to subsidiaries and sometimes even, when the size of the market so demands, to subsidiaries which are common to several of these bodies but competitive so far as other operations are concerned.

21. Besides the institutions which specialize solely for economic reasons, there are others which do so mainly for the political purpose of promoting or controlling certain classes of operation more strictly. Generally some institutions in the private sector are allowed to finance such operations, but the public institutions have the advantage of being able to obtain finance more easily and on better terms: State guarantees for loans they float, the right to attract savings by offering fiscal privileges or higher interest rates than those officially fixed for the other financial bodies, exemption from taxes, direct State subsidies.

22. The problem is not so much whether the present special characteristics of these bodies would make it difficult for them to be fitted into a system of international competition, but rather whether their position — which is often a privileged one — does not prevent other institutions from conducting the same line of business. This probably does not arise so much with institutions specializing for purely technical reasons, as with those serving the purpose of instruments of economic policy.

It is not for the Group to pronounce on the wisdom of pursuing particular economic policy objectives. Events have shown, however, that bodies originally set up for a specific purpose that justified privileges sometimes tend to extend their activities

into new fields while preserving their privileges, which are then no longer justified and consequently give rise to distortions of competition.

If institutions enjoying privileges on the domestic market preserved their advantages, directly or indirectly, in new functions they might be given in a European market, such distortions of competition could have repercussions on that market.

CONCLUSIONS

23. 1) Recommendations on the activity of specialized credit institutions should be made case by case and country by country, paying due heed to the particular economic and social function of the specialized institutions and after weighing the advantages to be expected from any measure from the angle of European integration against the disadvantages the same measure might have for the internal working of the markets.

2) In general terms, it must, however, be repeated that the advantages enjoyed by these institutions are justified in so far as they offset specific burdens or obligations imposed upon them. These advantages should therefore be extended to all institutions subject to the same restrictions and obligations, and care should be taken that the balance once established is not subsequently disturbed.

IV. Savings banks and their central organizations

24. Originally savings banks were not commercial credit institutions, but institutions with social aims to which certain privileges were granted and whose activities, furthermore, were subject to certain restrictions. Today this initial stage is now over in all the member countries, though the field of activity of the savings banks has developed differently from country to country. In Germany, Italy and Luxembourg especially, savings banks have scope for action very similar to that of commercial banks and similar credit institutions.

In all the Member States they are of particular importance. The network of points of contact with the public for the ordinary savings banks is, in some countries, wider than that of all the other credit institutions put together. This is true even if the branches of the post office savings banks are not counted. The volume of the funds handled by the savings banks is particularly large in Germany, Luxembourg and Italy (Table 28).

A. THE SAVINGS BANK SYSTEMS IN THE MEMBER STATES

25. The organization of savings banks and their central organizations varies widely from one country to another. In France the funds collected by the network of savings banks are all managed by a central organization, the *Caisse des Dépôts et Consignations*. In Luxembourg there is only one central savings bank.

In the Netherlands, the central organization's function is virtually confined to assisting the savings banks in the employment of liquid funds, while medium- and long-term investments are handled direct by the savings banks themselves.

In Germany and Italy there is a balanced division of labour between the local savings banks and their central organizations. The local savings banks are not obliged to transfer to the central organization more than a relatively small part of their funds; they may also use the central organization's services when they do not find suitable investment openings in their regional fields of activity. One of the main functions of the central organizations is therefore to ensure regional equilibrium between the collection of savings and investment opportunities. The consequence is that in Germany and Italy the central organizations are tending to acquire growing importance in the field of loans and other medium- and long-term investments.

In Belgium there is one large public organization, the *Caisse Générale d'Epargne et de Retraite*, which for the most part uses the post office branches, and a number of private savings banks, which are credit institutions having the right to accept savings deposits and which are subject, in respect of these operations, to special legislation. The savings deposits held at these institutions equal about half the deposits at the *Caisse Générale d'Epargne et de Retraite*.

In Germany, France, Italy and the Netherlands there are post office savings banks, but only in the last two countries do they operate on a scale comparable with that of the ordinary savings banks.

B. PROBLEMS RAISED BY DIFFERENCES IN OPERATING SYSTEMS

26. This section is split up under three headings:

- a) Collection of savings;
- b) Investment abroad;
- c) Financial services offered to customers.

A) COLLECTION OF SAVINGS

27. In certain member countries the regulations on savings deposits and interest rates give the savings banks some advantages over other credit institutions. Mention must also be made of the rules on minimum reserves and of the fiscal advantages accruing to income from savings deposits.

Except in frontier areas, the collection of saving deposits is unlikely to engender serious problems of competition among the savings banks in the various member countries. Some measure of competition between them in respect of refinance resources other than deposits (e.g. bonds issued by some savings banks and central

organizations) is inevitable. The indirect effects of competition between savings banks and other credit institutions in the same country might also influence the development of a European capital market.

B) INVESTMENT ABROAD

28. At present savings banks and their central organizations have few opportunities of participating in international financial operations.

In Germany and France the local savings banks are not allowed to invest abroad. In Belgium private savings banks have the right to make certain investments abroad without authorization from the supervisory body, but it is in fact a long time since they have done so. In Italy the local savings banks are allowed to purchase bonds issued by international organizations of which Italy is a member. In the Netherlands local savings banks are allowed to invest in foreign bonds or shares (the latter only when they are quoted on the Amsterdam Exchange) to the limit of their own capital.

Among the central organizations or centralized savings banks only the *Caisse Générale d'Epargne et de Retraite* (Belgium) may not invest savings-deposit funds abroad. In Italy the rule referred to for local savings banks also applies to their central organization. In France, the *Caisse des Dépôts et Consignations* and in Luxembourg the *Caisse d'Epargne de l'Etat* may invest in foreign securities. In France, a list of authorized security investments is established by the Minister of Finance and Economic Affairs. In Luxembourg the *Caisse d'Epargne de l'Etat* has on several occasions bought Belgian government stock with ministerial authorization. In Germany the *Girozentralen* may effect all transactions abroad freely.

C) FINANCIAL SERVICES OFFERED TO CUSTOMERS

29. In Germany, Italy and Luxembourg the range of financial services offered by the savings banks or their central organizations is wider than in the other member countries. In particular, the savings banks may act as intermediaries in the purchase of securities and accept current accounts. In the Netherlands the savings banks act as intermediaries in security transactions but they do not accept current accounts.

So far in France and Belgium these financial services hardly exist at all. In Belgium, however, the *Caisse Générale d'Epargne et de Retraite* is preparing the ground by extending its own network of branches. In France it is already possible to subscribe to public issues at the savings banks (though they cannot be negotiated through these outlets thereafter). The *Caisse des Dépôts et Consignations* is to launch a *Société d'Investissements à Capital Variable* (SICAV), whose certificates will be sold by the savings banks.

The ability to provide such financial services may confer an important competitive advantage. For example, institutions which can open current accounts into which wages are regularly paid will probably have the benefit of a regular flow of funds from these accounts to savings deposits or other investments in the same institution.

Savings banks which act as intermediaries for the purchase and sale of securities may reach sections of the population which otherwise would not invest in securities. They may also participate in the management of open-end investment funds and join issuing syndicates for national or international loans.

CONCLUSIONS

30. In all the Member States the networks of savings banks have become an important reservoir of capital. The Group would therefore like to see the following changes made in the regulations concerning savings banks in order to enable them to play their full part in a European market:

- 1) As has already been suggested for the lending and deposit-collecting activities of other financial institutions and operators, the fiscal and other advantages granted to savings banks in respect of the collection of funds should offset — no more and no less — such restrictions or limitations as may be imposed on these institutions.
- 2) In accordance with the conclusions already presented in Chapter 8, sec. 18, it is suggested that the central organizations and centralized savings banks should progressively be allowed wider freedom to effect operations abroad and in addition that the local savings banks should be allowed to employ abroad a small percentage of their deposits — for example 1% as a first step — for the same types of investment as are open to them on the domestic market.
- 3) There is a case for allowing the savings banks to purchase any foreign security listed on a bourse in the country in which the bank is established. This would be in addition to the present arrangement under which they are generally free to purchase bonds issued or guaranteed by international financial institutions of which the State in question is a member.
- 4) In view of their extensive network, savings banks are in a position to contribute effectively to the distribution of securities, especially the certificates of open-end investment funds. Therefore the right of savings banks to serve their customers in this field — already granted in some of the countries — should be recognized in the others as well. These institutions would thus be enabled to contribute to the integration of the securities markets at European level.
- 5) Particular attention should be given to the question of establishing facilities for transfers between the various savings bank systems. A service could be organized in agreement with the savings banks of the various member countries. For instance, as is now the practice for French residents travelling in France, the holders of savings bank accounts could be authorized to withdraw, when travelling abroad, a sum up to a specified maximum from any savings bank in the Community. This service might in fact involve quite small sums but would be of great psychological value.

V. Life assurance companies

31. The operating rules discussed here concern life assurance companies, exclusive of other insurance firms. The reason is that life assurance, unlike other forms of insurance, is based mainly on capitalization and therefore gives rise to a considerable accumulation of financial assets. France is the only member country in which assurance of death risk policies concluded for a limited number of years are still fairly widespread. These are essentially risk-insurance contracts involving only low capitalization.

32. The volume of life assurance is particularly large in the Netherlands: In the last few years the growth of the reserves of these companies has accounted for over 7% of gross domestic capital formation (Table 27). Although the percentage is smaller in the other member countries — in Italy and in France between 1% and 2% only — these data show the importance of the role which may be played by life-assurance companies in a European capital market.

Headings A and B below are devoted to the questions of investment abroad and of the direct conclusion — without use of subsidiaries or branches — of contracts with non-residents.

A. INVESTMENT ABROAD

33. The legal restrictions on investment abroad by life assurance companies have already been referred to on several occasions in this report. In Luxembourg such investments are in fact prohibited. In Italy they are permitted within the limits of contracts denominated in foreign currencies. In Germany the control bodies must grant what is known as *Deckungsstockfähigkeit*⁽¹⁾ for investments in foreign shares (this, however, also applies in respect of the purchase of securities of German industrial enterprises). In France there are no specific restrictions on investments in foreign securities quoted on a French bourse. In Belgium life assurance companies may invest a maximum of 10% of their technical reserves in bonds denominated in Belgian francs issued by international organizations of which Belgium is a member; purchases of other foreign securities may not exceed 20% of reserves and are limited to securities approved by ministerial decision. The Netherlands is the only member country where the freedom of domestic life assurance companies to invest abroad is virtually unrestricted; there are still restrictions, however, on the subsidiaries and branches of foreign life assurance companies.

34. Because of their knowledge of other markets, including those in their country of origin, the subsidiaries and branches of foreign life assurance companies are particularly well placed to invest abroad. Consequently, it is also very important that all obstacles to the establishment of subsidiaries or branches of life assurance

⁽¹⁾ Which makes the securities acceptable as cover for liabilities to policy-holders.

companies in the other member countries should be abolished. There are practically no obstacles preventing the establishment of subsidiaries, but there are still certain difficulties where branches are concerned (discriminatory guarantee requirements, discretionary granting of authorization to conduct business, and in certain countries the need to establish a distinct legal personality etc.). A directive to remove these obstacles is being prepared by the Commission.

CONCLUSIONS

35. In view of the volume of funds administered by the life assurance companies, gradual removal of limitations on investment would promote further integration of the capital markets.

- 1) Life assurance companies should therefore have the right to effect in other member countries, up to a certain percentage of their reserves, any investment permitted in their own country. Initially, this percentage might be 1%, but should be increased as the companies' experience develops.
- 2) Life assurance companies should be able to buy freely any foreign securities quoted on a stock exchange in the country in which they are established.
- 3) They should be allowed to acquire investments guaranteed by the government of another Member State or a Community body in the same way as those guaranteed by a legal entity under public law in the same country.
- 4) The subsidiaries or branches of life assurance companies in other member countries should have the right to transfer all or part of their technical reserves to the parent company. This possibility could be limited, for an initial period, to a given percentage of those reserves, but the percentage should be increased progressively.

B. WRITING OF LIFE ASSURANCE CONTRACTS WITH NON-RESIDENTS

36. One way of promoting the integration of European capital markets is by giving life assurance companies the right to collect funds in the other member countries, that is by permitting them, as is not the case at present, to advertise and canvass directly by means of a network of representatives, in a country in which they are not established, and to write life assurance contracts directly with that country's residents without going through a branch or subsidiary.

37. This would lead to certain problems in connection with:

- i) The fiscal obstacles in the form of indirect taxes which companies must pay on life assurance premiums collected. These taxes amount to 4.8% in France, 2% in Luxembourg, 1.2% in Belgium, and between 1 and 2% in Italy according to the kind of contract. They do not exist in Germany or the Netherlands. In the

course of preparatory work for the Fifth Plan, a proposal has been made to abolish this tax in France.

ii) Fiscal advantages in connection with income tax and other direct taxes, in particular concessions connected with the life-assurance premiums paid by the insured. The conditions on which these advantages are given are complex and vary from one country to another. The most important fiscal advantages, which allow deduction of life-assurance premiums from taxable income, are determined by the taxation rates applicable to marginal income. The "savings premium" may, in most of the member countries, amount, according to the insured person's income, to between 20% and 50% of life-assurance premiums.

Briefly, these advantages are much the same in four member countries: Germany, Italy, Belgium and Luxembourg. In these countries, provided the contract is for a certain minimum period, concessions are granted for all the usual forms of life assurance. In the Netherlands they are given only for life annuities and on condition that the insurance is payable only at retirement age (generally 65). In France concessions were abolished in 1958, but the *Commission de l'Economie Générale et du Financement* proposed, when the Fifth Plan was being prepared, that new concessions should be introduced.

iii) Control of life assurance companies by the authorities. Here there are two opposing principles. In all the Member States, with the exception of the Netherlands, the principle is that the State is duty bound to see that the reserves of all life-assurance companies are made up in more or less the same way and consist mainly of fixed-interest investments, such as government stock, real estate and first mortgages. In the Netherlands, life assurance companies are practically free to invest their reserves as they like. The supervisory institutions may normally intervene only if the company is managed in such a way that there is a risk of the savers' money being lost.

iv) Separation of branches. In three member countries — Germany, France and the Netherlands — life assurance may be provided only by companies specializing in this type of insurance, while in the other countries the same company may handle other types of insurance business as well as life assurance.

Separation of branches may mean extra costs for the insured (because of the duplication of administrative, legal and taxation departments, advertising and external services, computer equipment, and so on). Companies which can undertake several branches of insurance at the same time will therefore normally have a competitive advantage. On the other hand, the main argument in favour of separation of branches is that holders of an assurance policy must be protected against the possibility of losses arising in other branches, such as fire, where the risks of catastrophe are far greater than in life assurance.

v). Administrative obstacles. In France, Italy and the Netherlands there is a ban on the direct conclusion of life assurance contracts with foreign companies. In Belgium this ban is limited to contracts made with a foreign company which possesses a branch or a subsidiary in Belgium.

CONCLUSIONS

38. 1) In order to facilitate the extension of the activities of life assurance companies to the underwriting of direct contracts with non-residents, the Group suggests that:

- i) Advertising and canvassing by life assurance companies residing in other member countries should be permitted;
 - ii) Administrative obstacles still preventing the writing of direct contracts beyond frontiers should be removed.
- 2) The Group is aware that if these recommendations were put into practice they would cause certain problems of competition between life assurance companies in various member countries. Consequently it recommends that:
- i) Indirect taxes which companies have to pay on life assurance premiums should be abolished in those Member States where they are still levied;
 - ii) Life assurance contracts concluded with companies in other member countries should enjoy the same fiscal advantages as contracts with domestic companies. At present this is not always so and consequently foreign companies find themselves practically barred from certain markets.
 - iii) The problem of the separation of branches requires solution: the advantages of the two types of organization could be combined by allowing the joint provision of various forms of insurance in principle but granting persons taking out life assurance-policies the status of preferential creditors.
 - iv) The current principles underlying supervision of investments should be harmonized: the long-term aim should be to permit a fair degree of freedom as to the form of investment, coupled with very strict requirements as to the information that must be given to the public. In all the member countries, furthermore, life assurance companies should be free to offer policies based on differing investment formulas (for example, contracts based mainly on investments in equities). In this way the companies would be in a better position than at present to satisfy the requirements of savers and could interest a wider public in insurance as a form of saving.

CHAPTER 13

THE EXCHANGE RISK — AN OBSTACLE TO TRANSACTIONS

1. Although it will gradually lessen as a European capital market develops, the exchange risk will not disappear completely until formal monetary union has been achieved. The fact that the Group discusses exchange-risk problems in this report should not therefore be interpreted as the expression of a doubt as to whether monetary union within the EEC will be achieved.

i) Head I deals with the exchange-risk problems which the various classes of lender and borrower have to face.

ii) Head II presents certain proposals designed to limit the risks deriving from the fluctuation of exchange rates around official parities.

iii) Head III discusses techniques which can be used to spread the exchange risk between debtors and creditors: currency options, use of a "third" currency, adoption of a unit of account, etc.

I. Problems arising from the assumption of an exchange risk

A. BORROWERS' PROBLEMS

2. For transactions concluded with non-residents, most borrowers encounter practically no legislative or statutory impediments to the contracting of debts in foreign currency. The main obstacle is a practical one: it arises from comparison of the cost of credit in the borrower's own country with the estimated cost of an external loan, after taking into account the risks of loss (or prospects of gain) due to changes of parity or exchange-rate fluctuations.

The fact that in recent years the foreign-exchange indebtedness of borrowers resident in the Community has increased seems to confirm that exaggerated fears with regard to the exchange risk have gradually been allayed. Once a firm begins to extend its operational sphere to several markets and therefore has a foreign-exchange income from exports or from participations in foreign firms, it is more willing to assume an exchange risk; this situation is tending to become general as economic integration advances.

B. LENDERS' PROBLEMS

3. Within the EEC, individuals and investment companies are to all intents and purposes completely free to take an exchange risk. They also show less reluctance than most to run this risk in their investment policies.

The situation is different for savings banks and insurance companies, which are hampered, as has been shown in the preceding chapter, by major restrictions on their investment abroad. As a general rule, these institutions invest in a foreign currency only when they need to cover exchange risks incurred because they have accepted deposits or written insurance policies expressed in the currency in question. In the Netherlands, however, it appears that the investments of these institutions expressed in foreign currencies exceed their foreign-exchange commitments. In France, foreign stocks and shares quoted on a French stock exchange may serve to cover the franc commitments of life-assurance companies.

It is also noteworthy that, in Belgium, France and Italy, life assurance companies have shown less reluctance to invest in the foreign-currency stocks issued by domestic borrowers, which suggests that the status of the borrower or the close links between him and the institutional investors may sometimes push the exchange-risk problem into the background.

The problem has a different dimension for the banks. Their medium-term transactions in foreign currencies are limited because they feel obliged to seek a covering operation that they can normally find only for short-term transactions. With a few exceptions, the banks undertake to finance medium- and long-term transactions in a specific currency only if they have the necessary funds in the same currency at their disposal.

4. The particular problems connected with the operations of institutions specializing in credit for industry, housing and local authorities' capital expenditure have already been mentioned in Chapters 7 and 8. As these institutions work to narrow interest rate margins, they are unable to take exchange risks, except perhaps within the limits of credits granted from their own resources. In most of the Member States, the specialized credit institutions are thus required to match their foreign-currency claims with their foreign-currency commitments in respect of bonds issued for refinancing purposes.

There have been exceptions to this rule, however, notably in Italy, where the *Cassa per il Mezzogiorno*, for example has been able to obtain credit abroad in foreign exchange and later distribute the funds obtained among domestic borrowers in lire, thus assuming the exchange risk itself.

CONCLUSIONS

5. 1) In general, the exchange-risk obstacles seem likely to decline rapidly in importance, at least in relations between the member countries of the EEC. With the progressive dismantling of the various impediments to intra-Community trade, in particular customs barriers, economic integration is tending to standardize the price structure within the Community. The decisions connected with the common agricultural policy signify a decisive step in this direction. Because common agricultural prices have been fixed and are expressed in units of account, any modification of exchange-rate relationships between the member countries would have such a heavy impact on the Community's farming sector that it now seems

a very unlikely eventuality. Indeed, the likelihood seems all the more remote as the chain reaction — on consumer prices and, subsequently, wages — would make it much more problematic than in the past whether the results usually sought by devaluation or revaluation of a currency would in fact be achieved. These are, then, the beginnings of "real monetary integration", reflected at formal level in the 1964 decision that the Member States will consult beforehand if any one of them is contemplating adjusting the parity of its currency. This commitment could well be the first step towards the establishment of absolute solidarity between the six currencies.

2) In certain cases, firms or financial institutions may be reluctant to run exchange risks because the gains they may make from differences in interest rates between the domestic market and foreign markets are spread over several years in the profit-and-loss accounts, whereas any corresponding capital losses would have to be written off in a single year. One way of overcoming this reluctance would be to allow firms to set aside reserves against exchange losses, deductible, within specified limits, from taxable income.

3) With regard to investments in bonds denominated in foreign currencies or including special currency clauses, the Group considers that the exchange-risk obstacle could be reduced by the promotion of open-end investment funds specializing in this type of investment. These funds have the advantage of being better placed than individuals to assess the risk attendant on an investment in a given currency or containing a specific currency clause; they can spread risks over several currencies; finally, by issuing certificates expressed in a single currency, they save holders the trouble of having to convert the various foreign currencies into their own themselves.

4) The restrictions on institutional investors with regard to investments containing an exchange-risk element are often defended by the argument that savings must be protected. However, in certain member countries, particularly the Netherlands, institutional investors have been authorized to make investment of this kind within specified limits, and no harm has resulted. The Group considers that, in view of developments since these investment rules were fixed, the regulations now applied in the other member countries are based on unduly restrictive criteria. These seem even harder to justify when it is remembered that, in certain countries, these investors are regarded as sufficiently careful in their administration of the assets protecting their customers to be allowed to make certain kinds of investment (for example, in shares) involving risks at least as substantial as exchange risks.

The Group is therefore of the opinion that institutional investors should normally be allowed to make, within certain limits, investments involving exchange risks. As a first step, they might be authorized to purchase any security — including those denominated in foreign currencies — quoted on domestic stock exchanges.

5) In particular, the Group endorses the principles on which the Dutch regulations concerning the foreign investments of savings banks are based: within the limits of their capital and reserves, these banks should enjoy complete freedom to invest. The Group also recalls its recommendation in Chapter 8 on the operations of the central institutions of saving banks: given their importance and the role they play

on the capital market, the restrictions on their investments in other member countries should be removed — including those on transactions which may entail exchange risks.

6) With regard to the specialized credit institutions, the strict requirements imposed by most of the Member States for matching the bonds in circulation with the credits financed by them generally suffice to ensure the protection of creditors; it is therefore safe to recommend giving these institutions greater latitude for credit operations within the scope of their own capital.

7) Moreover, it might be thought expedient for these financial institutions to be given support from the authorities in respect of the exchange risk, as already happens in Italy. These support measures would, however, have to be consistent with the principles set out in Chapters 5 and 6 to govern action by the authorities on the capital markets and would in particular have to avoid conferring an exclusive privilege on certain public or semi-public institutions.

8) Hitherto the European Investment Bank and the ECSC High Authority have, as a matter of principle, balanced their assets and liabilities denominated in the various currencies. While recognizing that this attitude — based on a desire for financial orthodoxy during their early years — is a sound one, the Group considers that the diminished importance of the exchange risk in operations in Community currencies and the progress made in the process of economic integration would now allow the EIB and the High Authority to incur exchange risks in those currencies if the need to do so became apparent.

II. The reduction of risks connected with fluctuations in exchange rates around parity

A. THE PROBLEM OF THE "FREE MARKETS"

6. The exchange risk is generally taken to mean the risk of a change in the parities of the various currencies. But, in addition to this risk, investors or borrowers may suffer losses through exchange-rate fluctuations around the official parities.

For capital transactions on the "free market", these fluctuations may, in Belgium-Luxembourg and the Netherlands, exceed the 3% which is the theoretical maximum spread for current operations between any two Community currencies.

The margins between "free" exchange rates and official exchange rates have in recent years been relatively narrow. This is largely due to the repeated intervention of the monetary authorities on the "free" markets. The main reason for their intervening is that too wide a gap between the "free" rates and the official rates could prove an incentive to unauthorized operations and to speculation on the official market. Under the first directive for the implementation of Article 67 of the Treaty, intervention becomes compulsory when the free rates show "appreciable and lasting" divergences from the official rates.

It is therefore questionable whether the maintenance of "free" exchange rates is, in present circumstances, still worth while. The Group feels that unification of the foreign-exchange markets is now feasible and would bring with it major benefits. In the first place, it would mean greater security for borrowers and lenders at present operating on the "free markets". Another no less important advantage would lie in the discontinuance of a number of administrative controls over financial transactions, originally adopted solely to determine which of several foreign-exchange markets a transaction would pass through.

B. THE PROBLEM OF EXCHANGE-RATE FLUCTUATIONS BETWEEN EEC CURRENCIES

7. In the longer term, there is one measure which would go even further and which in the Group's view would have particularly important advantages. This is the measure proposed in 1964 by Professor Pfleiderer, Chairman of the Landeszentralbank of Baden-Württemberg, under which all possibility of fluctuation between the exchange rates of the various currencies of member countries would be completely eliminated.⁽¹⁾ In addition to disposing, of all exchange risks in intra-Community financial operations, the measure would also have the advantage of easing payments transactions within the Community and reducing their cost. The measure presupposes extensive co-ordination of Member States' intervention arrangements on the currency markets, and at the same time it would necessitate fuller co-operation in monetary policy. It would thus represent a major step towards the establishment of a monetary union within the EEC.

III. Techniques for spreading exchange risks between borrowers and lenders

8. The "currency clause", i.e. the terms governing the distribution of exchange risks between debtor and creditor, is of great importance in connection with the issuing of international loans or the granting of international credit. Other things being equal, an international loan will not enjoy the same success if the debtor chooses his own currency (and consequently burdens his creditors with the whole of the exchange risk) as if he adopts a currency frequently used by the main investors or if he offers a currency option.

The choice of the currency clause is thus of major importance not only for debtor and creditor but also for the development of a European capital market. Currency clauses devised to meet the wishes of lenders on a number of separate markets not only serve to promote capital-market integration at the issue stage, but also help to strengthen the links between the secondary markets on which loan issues are subsequently dealt in.

⁽¹⁾ Pfleiderer O., Währungsordnung und europäische Integration, Kieler Vorträge, N.F., Heft 32 (Kiel, 1964), p. 19.

For these reasons the Group has undertaken an analysis of the currency clauses most often applied to international borrowing and lending. It has considered:

- i) The various forms of currency option,
- ii) Use of the currency of the market of issue,
- iii) Use of a "unit of account",
- iv) Use of a currency other than that of the market of issue.

A. LOANS WITH A CURRENCY OPTION

9. Recently, there have been relatively few examples of a "true" currency option, i.e. one covering a whole range of currencies, the parities adopted being those in force on the date of issue.⁽¹⁾ The commonest technique so far is that of loans denominated in sterling, the capital and interest service on which can at any time be requested by the creditor in DM or sterling, at a fixed parity.⁽²⁾

For creditors the currency option is normally the most advantageous of the various types of clause, particularly if it covers several leading currencies. If the creditor's currency is included, the currency option involves no risk at all for him but only the possibility of gain.

For the debtor, on the other hand, the currency option entails a particularly large risk, and no prospect of gain at all if his own currency is included in the option. In practice, however, this disadvantage may be offset if, by accepting this clause, he is able to obtain a more favourable interest rate and easier access to the markets where the currencies specified in the option are used.

The risk incurred by the debtor diminishes in proportion as the likelihood of unilateral changes in the parities of the currencies specified in the option becomes more remote. The stronger this tendency grows in the Community, therefore, the less of a burden a currency option covering the six currencies will become to the debtor. As this clause also protects creditors in all the EEC capital markets from all risks, it could prove advantageous for the integration of the European capital markets if it were used in financial operations of interest to the Community as a whole.

⁽¹⁾ These include: Petrofina, 5 1/2% to 7 1/2%, 1957 (\$25 million), payable in dollars, Belgian francs, guilders or Swiss francs; Republic of Austria, 5 1/2%, 1958 (\$25 million), payable in dollars, sterling, DM or Austrian schillings.

⁽²⁾ These include: City of Turin, 6 1/2%, 1964 (£5 million); Enso-Gutzeit, 6 1/2%, 1965 (£4 million); Lamco, 5 3/4%, 1965 (£4 million); Mobil Oil Holdings, 5 3/4%, 1965 (£10 million); US Rubber, 6%, 1965 (£5 million).

B. USE OF THE CURRENCY OF THE MARKET OF ISSUE (CREDITOR'S CURRENCY)

10. From the angle of the integration of the European capital markets, use of the creditor's currency has two aspects: in the first place it protects the creditor from any exchange risk (this has the great merit of removing the main obstacle facing institutional investors) and in the second place — unlike the currency option — it confines the debtor's risk to a single currency.

For these two reasons the currency clause most frequently adopted in the past specified the currency of the market in which the issue was made. The loans were thus "traditional" foreign loans, i.e. operations in respect of which the majority of the purchasers were resident in the country of issue.

The Group feels that a variant of the "parallel loans" studied in Chapter 9 may be of value — the technique used, for example, in 1964 in an international loan issued by the *Istituto per la Ricostruzione Industriale* (IRI), under which the purchasers could choose at the time of issue between securities denominated in dollars and securities denominated in DM, the same terms attaching to each. One appreciable advantage of this arrangement is that it leaves it to the subscribers to determine how the sections of the loan are to be allocated among the various currencies, and this improves the quality of the placing.

A particular form of this technique — relatively easy to operate — should be made available: it should be open to investors resident in one Community country, desiring to subscribe to loans issued in another Member State, to have their securities denominated in their own currencies.

C. THE UNIT OF ACCOUNT

11. The unit of account is a valuable technique for issuers wishing to appeal simultaneously to a large number of markets, since subscribers are attracted by the special stability of this device. The value of the unit of account most frequently used is related to gold. This value remains constant unless there is a change in the gold parity of all the reference currencies — i.e. the seventeen currencies of the member countries of the former European Payments Union (EPU) — to which the unit of account is linked and at least two thirds of the reference currencies are then adjusted in the same direction. Where these two conditions are fulfilled, the unit of account is revalued or devalued by the same percentage as that reference currency, among the two-thirds that move in the same direction, which changes least in relation to its previous parity.

However, the stability of the unit of account does not mean that the creditor escapes the exchange risk altogether; for he suffers an exchange loss if his own currency is revalued against the unit of account. On the other hand, the unit of account protects him against unilateral devaluation of the debtor's currency, or of a third currency; should his own currency be devalued, he would practically always gain from the adjustment.

For the debtor, the unit of account has the principal advantage of operating in his favour should his own currency be revalued against the unit of account. Conversely, he suffers a loss should his currency be devalued in relation to the unit.

The unit of account is thus a compromise between the interests of debtors and those of creditors, though it benefits creditors if devaluations are more frequent than revaluations. The increased stability for creditors is generally offset by interest rates favouring the debtors.

For as long as the parity of his own currency is not changed, the creditor whose local currency is among the reference currencies runs no risk and may therefore regard a claim in units of account as a claim in his local currency. This is a better arrangement for institutional investors than an investment in a foreign currency or an investment with a currency option not including the investor's local currency.

12. The choice of "reference currencies" is of great importance for the definition and use of the unit of account. The unit of account hitherto used for international loans is based on the seventeen currencies of the former EPU, and hence includes the currencies of certain countries whose capital markets are relatively narrow. With a view to the integration of the capital markets of the EEC, there may be a case for using a unit of account based on the six Common Market currencies.

The progressive integration of the EEC will appreciably reduce the risks of unilateral revaluation or devaluation of a Community currency. For a Community creditor, the "EPU unit of account" has the disadvantage, compared with an "EEC unit of account", that he would suffer an exchange loss if all the Member States were to revalue their currencies to the same extent and a single one of the eleven other EPU currencies was not revalued or was revalued to a lesser extent. Conversely, an EEC debtor would suffer an exchange loss if all the EEC countries devalued to the same extent and just one of the other EPU currencies was not devalued or was devalued to a lesser extent.

For these reasons, and because the adoption of an EEC unit of account is a logical move in the Common Market's process of economic integration, the Group finds that the use of an "EEC unit of account" could offer certain advantages for financial transactions based on a future integrated market. Whatever unit-of-account formula is adopted for implementation of the common agricultural policy will very probably become the basis for this "EEC unit of account".

D. USE OF A CURRENCY OTHER THAN THAT OF THE MARKET OF ISSUE

13. When international loans are issued in a currency other than that of the market of issue, subscribers risk a loss if the currency used is devalued in relation to their own. The issuer, for his part, takes the risk of revaluation unless the currency concerned is his own. This situation is relatively disadvantageous for creditors, and as a rule they agree to use a third currency or the issuer's currency only if it is a hard currency and one frequently used in international financial operations. In fact, so far only three currencies have been used in international loans — mainly the dollar, and to a lesser extent the DM and the Swiss franc.

One objection to the use of a currency other than that of the market of issue stems from the fear that its adoption may be interpreted as indicating a lack of confidence in the local currency; this argument would seem, however, to be valid only where the last-named is already in difficulties.

Another objection arises from the possible reluctance of certain categories of purchaser to subscribe to loans on the market of issue in these conditions. However, this factor is usually more than offset by the appeal of the issue currency chosen to residents of the country whose currency it is, or even to other subscribers where it is a case of a hard currency extensively used in international financial operations. This is why it is so regrettable that measures like the American interest equalization tax and the German *Kuponsteuer*, devised to meet quite different requirements, both have the end-effect of segregating the domestic and foreign markets in the same currency, thereby reducing the numbers of investors likely to engage in arbitrage. This separation of a currency's internal and external market has been highlighted in recent years by the loan issues placed abroad in dollars by American companies and in DM by German companies.

Against these arguments it may, however, be contended that the use of loans denominated in a third currency helps to get savers used to issues in currencies other than their own and may thus make a useful contribution to the integration of the European capital markets.

CONCLUSION

14. The currency clauses considered in this chapter may give rise to differences of opinion. It has been said that these clauses tend to make savers to some extent mistrustful of investment in their own currency. Another criticism often made questions the degree of real protection which currency clauses can give subscribers in times of monetary upheaval.

The Group took the view that its study of the various types of clause for the purposes of this report should concentrate on their possible contribution to the development of a European capital market. From this angle it became clear that the various experiments tried out to date have helped towards diversification of investments by enabling issue terms to be flexibly adapted to the investing public's preferences. They have at the same time helped to increase the international fluidity of capital. In future, however, the disappearance of the exchange risk should make it unnecessary to resort to such devices.

CHAPTER 14

TAX OBSTACLES

1. This chapter is intended to give a general view of the fiscal adjustments most likely to promote the development and smooth functioning within the Community of a capital market of truly European dimensions. A brief survey of the principles which have guided the Group is followed by an account of the tax obstacles existing at present and suggestions as to how the main ones could be eliminated.

I. Objectives

2. The main object of adapting the tax systems is to attain a degree of fiscal neutrality that will allow capital movements to take place within the Community in conditions similar to those on a domestic market. To achieve this general aim, three broad requirements must be met. The first two relate to the smooth working of the various sectors of the market, and the third concerns the balance between these sectors.
3. First, the tax system should have no influence on choice of the place for the investment or transaction. This requirement is a direct corollary of the size of market envisaged, no longer limited to the national scale.
4. Secondly, the tax system should not influence the saver's choice between making his investment direct or using the services of an intermediary acting as a collector of savings. This requirement is at present only very imperfectly satisfied in several Member States, even for domestic financial operations. Such a situation may be no more than a minor obstacle to the smooth working of a market, provided the holders of capital available for investment on it are sufficiently well informed of the opportunities and mechanisms of the market. However, the Group feels that there must be access to specialized intermediaries if the capital markets are to attract broader classes of saver, especially for foreign investments: hence the importance of this neutrality requirement.
5. Finally, when the capital markets are integrated, the fiscal system of each country must give equivalent incentives for the relative development of the various types of investment and methods of financing. Meanwhile, everything possible should be done to taper down the disparities existing in this respect between the tax systems of the Member States.

As was explained in the previous chapters, the Group does not advocate identical fiscal treatment of the various types of investment. It accepts that differences of taxation may be used to encourage a specific type of investment, with a view to securing the right balance of investment within the economy as a whole (e.g.,

application of a system favouring long-term investment if it is thought advisable to combat excessive liquidity of savings, or one favouring risk investments, if the supply of risk capital appears inadequate).

However, the Group finds it desirable that the Member States, as a general rule, should ultimately apply the same incentives to promote the same types of investment and methods of financing. This is not an immediate requirement. The initial situations in the various States are very different, and the existence of different tax incentives in the national systems does not, in the present circumstances, appear to be incompatible with the efficient working of a European capital market.

6. Where such differences in fiscal incentives are of a permanent character, they affect the functioning of the market no more seriously than do the differences of scale, from country to country, in the investment preferences shown by savers and businessmen. The market is more likely to be disturbed by changes in incentives within a Member State, which may upset the pattern of capital supply and demand by suddenly introducing new forces on the market.

However, it seems that the Member States will put an end to unilateral adjustment of these incentives only when they are collectively agreed to do so — which, in practice, presupposes their adopting a uniform attitude on the matter. Until then, they will always be free, as they are now, to invoke economic, structural or social considerations to justify changes.

II. Present obstacles

7. The reasons why the requirements set out above cannot be met at the present time fall into three broad categories:

- i) Double taxation;
- ii) Preferential treatment of investments made in the country of tax domicile or, conversely, imposition of taxes peculiar to some member countries only;
- iii) Different treatment, from country to country, of investment income paid to non-residents or persons preserving fiscal anonymity by not filing tax returns.

These obstacles are described in general terms below, in order to give an overall view of the tax problems besetting capital markets. Ways of solving the main problems are suggested in the following parts of this chapter.

A. DOUBLE TAXATION

A) INTERNATIONAL DOUBLE TAXATION

8. Apart from the incidence of the different rates of income and corporation tax in the Member States, the difference between the gross yield (before tax) and the net yield (after tax) of a given type of investment may be larger or smaller according

to the country of investment (source of income), when this is not the country of tax domicile of the beneficiary and tax is charged in both countries on the beneficiary's income. Where investments are made with an eye to yield, the double taxation effect tends to establish a preference for investment in the country in which the investor is domiciled for tax purposes.

Double taxation occurs with both direct and indirect taxes. The rates of indirect tax are generally lower than those of direct tax, but as in many cases they are applicable to capital and not to income, their effect on yield may be far from negligible.

International double taxation would be avoided between States which agreed, for the various equivalent types of tax, on a uniform rule providing for taxation in only one of the two countries, the alternatives being: ⁽¹⁾

- a) Country of domicile (head office) of the beneficiary, or country of source, for taxes on income and profits;
- b) Country of domicile (or head office) or country of location (of capital assets), for taxes on wealth;
- c) Country of destination (consumption) or country of origin (production), for indirect taxes.

If the Member States agreed to adopt uniform tax principles, there would be nothing much to choose between these alternatives so far as the smooth functioning of the capital market is concerned. The choice would have to be made in the light of other arguments, such as considerations of fiscal technique or budgetary factors.

The adoption of uniform principles for taxing income in one country only would be an ideal way of avoiding double taxation of investment in a country not that of the investor's residence. However, the Group considers — again, solely from the point of view of the capital market objectives — that this solution is not the only one. It may be sufficient simply to neutralize the effects of double taxation in the hands of the investor, the taxes charged in the other country being refundable or wholly allowable against tax due in the country of domicile.

B) DOUBLE TAXATION OF INVESTMENTS MADE THROUGH A FINANCIAL INTERMEDIARY

9. The yield of an investment may differ according to whether it is made direct or through a financial intermediary (quite apart from the cost of the intermediary's services), if the taxes charged on investments made through direct channels are augmented by others where the transaction is handled by an intermediary, and the latter taxes are neither refundable nor allowable in the hands of the investor.

⁽¹⁾ According to the classification adopted by a Fiscal and Financial Committee attached to the EEC Commission. *Rapport du CCF*, 1962, p. 76.

In most Community States there are arrangements under which investments of the second type can entirely (or very largely) escape any additional tax within the country; but, as these arrangements as often as not spring from purely national considerations, they do not usually avoid the disadvantage of international double taxation when the investment is in a country other than that of the investor's residence and, even more so, when the investor's tax residence is not in the same country as his intermediary's.

C) INTERNATIONAL CONVENTIONS FOR AVOIDANCE OF DOUBLE TAXATION

10. Even between Community countries double taxation can often occur, either through the absence of agreements (e.g. between Italy and Luxembourg, Luxembourg and the Netherlands), or because the existing conventions do not cover investment incomes (Belgium and the Netherlands), or because some of them, being very old, are no longer appropriate to present-day tax systems.

Moreover, current bilateral agreements are based on principles which vary and sometimes even conflict; and the methods employed in them to avoid double taxation are consequently very different. Furthermore, some of the implementing procedures are so complicated that they are apt to discourage investors from placing their money abroad.

The ideal way of eliminating the remaining cases of double taxation between Member States would undoubtedly be by conclusion of a multilateral convention among them. This course is in fact now under consideration, with the OECD model used as the basis.

However, as the work in progress in this field may take some time to produce results, it might be wise in the interim to look for an at least temporary solution of the double taxation problem within the bilateral framework, i.e. by adding to and improving the current agreements, the object being to iron out excessive divergences in current principles and techniques. Heads III, IV and V of this chapter are mainly concerned with the practical arrangements which might be made under multilateral or bilateral conventions.

Unilateral measures can also remove the hardships of double taxation for the residents of a given State. Indeed, without any formal agreement, some countries already permit tax withheld abroad to be allowed, at least in part, for tax purposes at home.

B. TAX PRIVILEGES OR CHARGES APPLIED SOLELY TO INVESTMENTS IN CERTAIN COUNTRIES

A) TAX PRIVILEGES CONFINED TO INVESTMENTS MADE IN THE COUNTRY OF RESIDENCE

11. There is no incentive to make an investment in one country rather than another so long as the privilege applies equally to whoever makes it, whatever his country of tax domicile may be: in this case, the advantage accrues to the user of

the capital. Nor does the advantage affect the choice of country of investment if it is granted by a State to persons who have their tax domicile there without stipulations regarding the country of investment. On the other hand, fiscal advantages granted on condition that the investment is made in the country of residence are, by definition, in direct conflict with the desired neutrality of fiscal systems.

B) HIGHER TAXATION OF INVESTMENTS OR METHODS OF FINANCING IN CERTAIN COUNTRIES

Where a tax exists only in one country, or where a rate of tax is higher in one country than in the others, the result may be to render certain types of financing more expensive in the country in question than in other countries or increase the cost of certain types of financial transaction. This is often the case with indirect taxes on the raising and movement of capital. As regards direct taxes, it is especially the case with some schedular taxes. Certain differences in systems of corporation tax might have the same effect, but this question lies outside the province of the present study.

C. COUNTRY-TO-COUNTRY DIFFERENCES IN THE TAX TREATMENT OF INVESTMENT INCOME ACCRUING TO NON-RESIDENTS OR PERSONS NOT MAKING A TAX RETURN

12. When dividend or interest is paid in the country of source to a non-resident not protected by a convention, the tax authorities of the beneficiary's country of domicile are normally not at present informed. As many countries apply the principle of limited fiscal obligations to non-residents by imposing a fixed-rate withholding tax, the non-resident beneficiary can often avoid graduated taxation by collecting his income in the source country and not declaring it in his country of domicile, with the result that he is taxed only in the source country at the standard rate applied by that country to non-residents not protected by an international convention.

Some countries even allow residents to avoid graduated personal taxation on some types of investment income by collecting a withholding tax which exempts this income from all other taxation. Others, whilst not legally accepting the principle of a withholding tax giving full discharge, use a deduction which may in practice have the same effect, since the tax authorities are not informed of the identity of the beneficiary. Lastly, some countries levy no withholding tax on interest payments and do not require the authorities to be informed of the identity of the beneficiary.

These opportunities for avoiding the graduation factor in personal taxes on some types of investment income are of obvious interest to persons taxed at a higher marginal rate in their country of domicile than the withholding tax rate. They may

also be attractive to persons taxed at a lower marginal rate where the income accruing abroad, if declared, would not wholly escape double taxation, in the absence of a satisfactory convention.

The cost of capital to the borrower, and thereby the relative development of the various forms of finance, may be affected, in some market situations, by the different fiscal treatment applied by the various countries to investment income accruing to non-residents not protected by a convention or — where this is allowed — to persons remaining fiscally anonymous. Fuller harmonization of taxation and control systems within the Community is needed to avoid these consequences, which can only impede the development and smooth functioning of the European market. The Group considers harmonization especially urgent for fixed-interest investments; for, where an investor chooses to invest in equities, the immediate yield does not determine his choice as directly as it does in the case of fixed-interest investments.

13. Tables B and E of the Annex show the marginal rate of personal income tax at and beyond which it is to the investor's advantage to avoid the graduation factor in personal income tax by paying the withholding tax discharging him from further tax liability, or by collecting the investment income in a country which does not require his identity to be disclosed and communicated to the tax authorities in his country of residence. The figures given take into account the incidence of international double taxation conventions, the arrangements made by certain countries to allow taxes paid abroad even in the absence of a convention, and "tax credits" granted by some other countries. These tables show under what conditions avoidance of progressive personal tax may be profitable; they do not indicate whether there is an incentive to make an investment in one country rather than in another.

III. Adjustment of direct taxation of investments by individuals

14. The development of a genuine international market for investments made direct by individuals is chiefly hampered by two of the types of obstacle mentioned:

- a) Double taxation of incomes;
- b) Grant of tax advantages only to investments made in the country of residence.

The Group has paid particular attention to investments in shares and bonds, since these are the main types of transaction performed by individuals in respect of which tax considerations may decide the choice of the country of investment.

In addition, it has confined its study to problems raised by income taxes. At this stage it did not seem feasible to study in detail capital gains, wealth and inheritance taxes. These taxes may present problems similar to those arising from income taxes, and capable of solution on the same general principles.

A. INVESTMENTS IN SHARES BY AN INDIVIDUAL

A) DOUBLE TAXATION OF INCOME

15. Payment of a dividend to an individual resident in a country different from that in which the company concerned is incorporated may attract tax at two levels when the dividend is paid in the company's country, viz. withholding tax in that country, and personal income tax in the shareholder's country of tax domicile. When the dividend is collected by the shareholder in his country of domicile, a withholding tax may be collected by the paying agency. This withholding tax is an advance payment of personal income tax and, in principle, allowable in full, any excess being repaid. Technically, there are several possible ways of avoiding the double taxation cases described above.

16. The Member States could agree to tax the income in one country only: either in the country in which the company has its registered office, by the imposition of an irrecoverable withholding tax (and waiver of income tax liability in the country of domicile), or in the country of domicile only.

The first of these alternative solutions would seem acceptable only as an option to the shareholder; a different procedure would also be necessary, for the sake of shareholders whose top rate of income tax is lower than that of the withholding tax charged abroad, in order to avoid their being penalized and ceasing to invest in foreign countries.

On the other hand, from the special angle of this study, the Group sees no objection to taxation solely in the shareholder's own country. Technically, this could be arranged either by not charging the foreign shareholder withholding tax, or by refunding it. If the withholding tax were not charged, the shareholder would be spared the necessity of having to collect his income in two parts; but it could open the door to tax evasion unless the revenue departments of the various States agreed to notify the shareholder's identity to the tax authorities in his country of domicile. In the system as at present applied between certain countries, the refund of withholding tax is made on submission by the shareholder of proof that he has declared the income in question to the tax authorities in his own country.

17. Rather than agree on taxation in one country only, States wishing to avoid double taxation might prefer to share the tax receipts by charging a withholding tax in the source country and systematically allowing it for tax in the country of domicile, with provision for a refund if the beneficiary's tax liability is less than the amount withheld or if he is not liable to tax.

This is a refined version of arrangements already widely used to avoid double taxation, in which the aim is to tax investment income in the country of domicile while safeguarding the financial interests of the source State, or, in other words, to share the yield from taxation of such income between the two States. The result of this sharing depends on the rate of withholding tax applied and the rate to which the beneficiary of the income is ultimately liable in his State of domicile. In order to balance the sharing process, the current conventions embodying this solution often provide that the rate of withholding tax applied in relations between

the signatory countries shall be lower than that normally applied to non-residents who cannot (or do not wish to) invoke the benefit of a convention. (This reduced rate may be arrived at either by reimbursement of part of the withholding tax charged at the ordinary rate, or by charging a reduced rate from the outset.)

18. The way in which the States choose to share tax receipts among themselves has scarcely any effect on the functioning of the capital markets. On the other hand, it is necessary for any tax withheld, and not refundable, in the company's country to be allowable in full in the shareholder's country, and even repaid if it exceeds the income tax due in the latter.

At present, this condition is not fully met. Certain countries do not permit tax withheld abroad to be set against the internal tax liability; others do so only to a partial extent. Many countries treat tax withheld abroad as allowable for internal tax purposes only at the rate of national tax due on the income slice into which the foreign dividend falls, thus penalizing the foreign investments of persons paying a rate of tax lower than that of the foreign withholding tax. Other countries allow tax withheld abroad within a limit not determined by the rate of national income tax the shareholder pays, but by the rate of withholding tax which they themselves apply to non-resident shareholders in their own national companies (see Table A of Annex).

19. Apart from possible administrative complications, the Group would see no objection to the Member States agreeing to maintain a withholding tax in the source country, for application to foreign shareholders, provided this tax was wholly allowable for the purposes of the shareholder's tax liability in his country of domicile and any excess was refundable. This solution would embody the principle, not as yet recognized, of possible reimbursement of the withholding tax by the State of domicile and might thus lead to compensatory payments being made between States where they declined to refund taxes they had not in fact levied. To the shareholder, the withholding tax would then always be simply an advance payment of tax, and hence would hardly influence his choice of country of investment whatever the rate of the tax. It would be preferable if the rate were the same in all countries, and identical with that of the withholding taxes levied on shareholders resident in the company's own country; by facilitating comparisons of yield, this would help to make the neutrality of tax systems more effective as regards selection of the place of investment.

B) TAX PRIVILEGES GRANTED ON INVESTMENTS MADE IN THE COUNTRY OF RESIDENCE ONLY

20. For some time past a very special problem has been set by the employment, in certain countries, of fiscal techniques which may hamper international capital movements.

On dividends of companies registered in her territory Belgium grants residents a "tax credit" which is in effect a reimbursement of part of the tax paid on profits by the companies.

In France there is a "tax credit" which appears to be the same for the dividends of domestic and foreign companies, but which in fact represents a partial refund

to the shareholder of tax on company profits only in the case of dividends of domestic companies; for those of foreign companies, the tax credit is no more than the refund of a special withholding tax imposed in France or the company's country (where there is a convention between France and the latter). A French shareholder returning a dividend of (FF) 100 may set (FF) 50 against his tax liability, or obtain full or partial refund of this sum if he has no further liability. If the company is French, the dividend of (FF) 100 suffers no withholding tax at source, and the (FF) 50 allowed for tax is therefore the refund of a tax paid by the company before distribution of dividends. On a foreign company dividend of (FF) 100, a withholding tax of 33.3% is applied and it is only this tax which can be claimed. Accordingly, the shareholder's real income is in this case only (FF) 100, whereas it is (FF) 150 for a French company distributing the same dividend. Thus, the system has radically different effects according to whether the dividend is paid by a French or by a foreign company.

21. In so far as the majority of its shareholders are entitled to claim the tax credit, the introduction of such a system gives a company a number of possibilities of using the reduction of "economic double taxation" (the combined impact of corporation tax and personal income tax) to facilitate the supply of outside finance in the form of risk capital. These possibilities range from maintenance of the shareholder's income, including his fiscal claim, (by cutting the dividend by the extent of the tax credit and increasing self-financing to a corresponding degree)⁽¹⁾ to maintenance of the dividend (entailing an increase in the shareholder's net income).

22. The introduction of the tax credit may have several different effects on shareholders. It tends to lead to a capital gain via the market's capitalization of the increased yield prospects it holds out for shareholders resident in the company's country. It also tends to make the shares of domestic companies a more profitable investment for residents than for non-residents, and also more profitable for residents to invest in than the shares of foreign companies. These effects bring the tax credit system, in its present form, in direct conflict with the first of the principles advocated, i.e. that taxation should not influence the choice of place of investment.

23. Apart from the doubts as to how effective a tax incentive as complex as this can be in influencing shareholders, the main reason why the tax credit system in its present form is open to criticism is because it discriminates between income from "national" shares and income from foreign shares, and between residents and non-residents.

The segmentation effect on the markets could be avoided through the granting of the same tax credit on the dividends of foreign companies. A solution better suited to the requirements for smooth operation of the market would be to give non-residents a refund of corporation tax equivalent to the tax credit. The second solution would, moreover, link up with a system pursuing the same aims as the

⁽¹⁾ This is not just a theoretical assumption. There are many examples of this course having been chosen since the French law came into force.

tax credit while avoiding the discriminatory effects entailed by the latter, i.e. with the system, now applied in Germany, whereby tax is charged at a reduced rate on the distributed portion of company profits.

24. If the principle of reduction of tax on the distributed portion of company profits were generally adopted, it would be desirable that the Member States should also adopt a uniform reduced rate. As regards incentives to the relative development of the various types of investment and methods of financing, uniformity of tax systems within the different countries is in point of fact the best guarantee of smooth working of the capital market.

B. INVESTMENT IN BONDS BY INDIVIDUALS

25. Differences in the fiscal treatment of income tend to partition bond markets much more than share markets. In an investment in shares, consideration of the prospects of capital gain may take precedence over the dividend yields; in a bond investment, yield is always a primary consideration.

The technical reasons for the partitioning of the bond market by tax systems resemble those described for the equities markets.

26. Among persons declaring their bond income for tax, a difference in yield may arise according to whether they reside in the country of issue or not, if a withholding tax is levied at source in the country of issue and is neither refunded nor wholly allowed for tax in the country of domicile of the bondholder.

Certain countries give an international flavour to all loans issued in their territory by not withholding any tax at source. Other States, without formally adopting this principle, nevertheless refrain from levying withholding tax on certain loans of public authorities or establishments under their jurisdiction. However, these differences in treatment according to category of loan seem to be in process of disappearing, except in Italy, where there is a special system. On interest from Italian bonds a tax is levied which has no equivalent abroad, the so-called tax on income from movable wealth (*imposta sui redditi di ricchezza mobile*), category A, at a rate of about 32%. This is a schedular tax (theoretically borne by the creditor, but withheld and paid by the debtor) and cannot in any circumstance be set against the creditor's total income tax liability. The effect is to make the debenture loan in Italy a type of financing which is relatively more expensive for private enterprises. In respect of income from bonds just as much as from shares, the smooth working of a European capital market depends on holders in other member countries being able to obtain reimbursement of tax withheld at source or to have it allowed for tax due in their country of domicile. The possible procedures for shares have been detailed. It is not necessary to go further into them here, as the main problem for the bond market is a different one.

27. Considerable differences still persist from country to country — even from loan to loan — in the fiscal treatment of interest paid to non-residents not protected by a convention or to persons not making a tax return. These differences in tax

arrangements tend to engender differences in the cost of financing by debenture loan. In so far as the markets are integrated, the net yield which must be offered to lenders tends to be the same in every country. Hence, if interest on certain loans is subject to a withholding tax, the borrower may have to bear it himself — by offering a higher gross interest — to the extent that the lender regards the tax withheld as an irrecoverable charge rather than as prepayment of a tax he would have paid anyway (i.e. to the extent that the lender cannot charge the withholding tax to his income tax liability, or does not declare the income in his country of domicile). The cost of financing by issue of a loan the interest on which attracts withholding tax can therefore never be lower than the cost if there were no withholding tax but may be higher by the amount of the withholding tax when there is only a limited supply of capital from lenders who declare the interest they receive and can charge the withholding tax to their tax liability or have it reimbursed.

28. In so far as differences in the fiscal treatment of debenture loans give rise to different costs of this type of finance in the several countries, they also tend to cause differences in the relative cost of the various methods of financing. As was explained at the beginning of the chapter, differences of this kind are all the more of an obstacle to the smooth working of a European capital market because their extent may constantly change.

29. A more uniform treatment of debenture-loan creditors is needed in the Community countries. The abolition of withholding tax, or application of the same rate of withholding tax in all the countries, are possible ways of reaching this objective.

If a uniform rate were applied, it would have to be relatively low, for it is clear that the bond market is a more developed one in the countries where bond income is not subject to the tax, either *de jure* or *de facto*.

Moreover, whereas on their dividend distributions companies cannot avoid paying withholding tax levied by the country in which the companies are incorporated (except by moving their registered office) companies wishing to float a debenture loan may avoid the withholding tax by issuing the loan abroad, in a country in which no such tax is levied.

30. The tax system applied to bonds raises yet another series of problems. For, like other securities, bonds in some cases rank for fiscal advantages granted to residents only.

For instance, in Belgium the State grants what amounts to a "tax credit" by giving the creditor an income tax allowance in respect of withholding tax at the normal rate on certain public loans which are partly exempt from it by virtue of a privilege accorded at a time when a tax system, since changed, was in force. The practical incidence of these tax credits is small to the extent that bondholders prefer to remain anonymous.

Germany, which originally did not levy withholding tax on interest from certain categories of loan, even when the interest was paid to creditors not making an income tax return, later introduced a withholding tax of 25% applicable only to

non-resident bondholders. This is in effect tantamount to discrimination between non-residents and residents among creditors not declaring their income from these bonds to the tax authorities. The introduction of this withholding tax led to heavy sales by foreign bondholders wishing to preserve their anonymity or unable to get the withholding tax refunded or allowed, in the absence of a tax convention between their country and Germany or of internal legislation permitting tax levied abroad to be set against the tax liability at home.

31. With regard to transitional problems, modification of the tax system applied to a loan may change its yield for certain categories of holder and affect the market price of the bonds. Hence, the Group considers that it would be better not to introduce in a single operation a common fiscal rule for all the differently taxed bonds now in circulation, but to phase the transitions by applying a common rule only to new issues, unless the new system is more favourable, in which case existing loans could be accorded the same treatment. For it would seem essential to the smooth functioning of the market that nothing should happen to shake the confidence of investors that tax arrangements applying at the time of issue will remain at least as favourable for them until maturity.

IV. Adjustment of direct taxation of investments of financial institutions

32. From the point of view of the development and smooth functioning of a European capital market, the tax system applied to the investment income of financial institutions raises two kinds of problem.

First, the tax systems must not be allowed to influence the choice of the countries in which these legal entities place their investments.

Secondly, individuals who do not wish to make their investments direct must be able to entrust this task to financial institutions without fiscal disadvantage.

A. INVESTMENTS BY INSTITUTIONAL INVESTORS

33. Where financial institutions invest in the capacity of institutional investors rather than as mere intermediaries, an adequate way of preventing tax arrangements from inducing them to invest in one country rather than another is to ensure that taxes withheld in the source country and not reimbursed by it can be wholly allowed for tax purposes in the countries in which the financial institutions are taxed (with reimbursement of any excess) and that no particular advantages are attached to investing in this country only.

The problem of allowing or refunding tax withheld abroad is fundamentally the same for institutional investors (insurance companies and pension funds) as for individuals and calls for broadly similar solutions. Again, as regards financial

institutions granting credit direct to foreign countries, the solutions applied up till now in several Member States are much the same as those described in section 26 in connection with investment in securities. The system applicable to interest on direct credits may in fact entail double taxation when the debtor is domiciled in France, Belgium and Italy, as these countries impose withholding tax on interest on these credits in the same way as on bond interest. The Netherlands, on the other hand, levies no withholding tax on interest, and in Germany and Luxembourg, there is no withholding tax on interest other than from bonds.

34. However, a particular feature of the taxation of corporate incomes in certain member countries raises a further difficulty. Withholding tax charged in the country of residence on income received by an individual can, as a very general rule, not only be allowed against tax due, but can also be refunded where the tax paid exceeds the liability. In some countries, the same rule is applied to corporate income, but in others provision is only made for allowing the tax, not for its reimbursement. Hence, in certain conditions, the tax paid might be irrecoverable. It is practically impossible to assess what influence this irrecoverable tax may exert at present on the choice of investment by institutional investors, for it cannot be isolated from other differences of tax system equally likely to affect the investment pattern, as for instance the various possibilities for offsetting tax withheld at source abroad.

B. INVESTMENTS BY INVESTMENT COMPANIES

35. For the purposes of the development of an efficient European capital market another requirement arises in respect of investments made by financial intermediaries who may pass the income on direct to individuals or to other institutions. Certain arrangements are necessary to ensure "fiscal transparency", i.e. arrangements under which investment income passed on in this way reaches the beneficiaries as though they had made the investment direct, in such a way as to avoid penalizing, from the tax point of view, persons who prefer to have their savings administered by expert intermediaries. Any such arrangement must preclude the imposition of additional tax on the investment income in the hands of the intermediary and must also permit the ultimate beneficiary to set against other income tax liability any retention at source which has not already been refunded or allowed to the intermediary.

Administration of savings by intermediaries may take a large number of forms. At the extreme end of the range, there are institutions which can hardly be considered pure intermediaries because their object is to acquire participations giving them a virtual controlling interest in the concerns. It would appear desirable to deal with them too, because the problem of "fiscal transparency" arises there as well. However, it is not part of the Group's task to examine here the question of relations between parent companies and subsidiaries, despite the similarity of the taxation problems they present; in this case it is a question of taxation of working capital — not investment capital, the only kind considered for the purposes of this report.

36. In Community countries, investment income passed on through joint-stock companies of the ordinary type is usually taxed twice because it suffers corporation tax in addition to the tax withheld at source. The only exception to this rule is dividend income received by Belgian companies. There, corporation tax is charged on only 15% (10% as from 1967) of the net dividend, reduced to 5% in the case of industrial companies. The incidence of corporation tax at the level of the intermediary is therefore in this case small. No other direct taxes are imposed on dividends of Belgian origin. When the dividend is redistributed the company is exempted from the withholding tax, and the shareholder can charge the amount withheld on the initial distribution to his tax liability. The system applicable to dividends of foreign companies redistributed by a Belgian company is similar, though less favourable, for it is generally not possible either to have foreign withholding tax allowed or to claim its refund. However, the non-allowance of foreign withholding tax tends to be offset, for Belgian individuals who are shareholders of the investment company and who declare the dividends they receive from it, by the operation of the "tax credit", which also applies to redistribution of foreign dividends by the Belgian company. Furthermore, except where other arrangements have been made under international conventions, the normal rate of withholding tax on dividends of foreign origin on their entry into Belgium has been reduced to 10% for income received or collected from 1 January 1965 by Belgian joint stock companies and other corporate bodies treated on the same footing.

In respect of investment in equities, the effect of these rules is that Belgian investment companies can offer their shareholders an income similar to that which they would obtain by making the same investments direct. In the case of bonds, on the other hand, only direct investment is attractive, since "fiscal transparency" has not been achieved.

37. In Luxembourg, there is a special arrangement for financial companies with the status of holding companies. A holding company is defined as any Luxembourg company whose sole object is to acquire participations, in any form, in other Luxembourg or foreign enterprises, and to administer and exploit such participations, without performing any industrial activity of its own or having a commercial establishment open to the public.

Holding companies are exempt from the direct taxes normally levied on other companies and are subject only to certain special taxes involving a relatively low charge. They are also exempt from withholding tax on the dividends they distribute. However, the dividends they receive from Luxembourg companies are liable to withholding tax which cannot be refunded or allowed against other tax. In addition, investment income of foreign origin received by the holding companies does not qualify for concessions under double taxation conventions, since the latter never apply to holding companies.

The holding companies' undistributed profits escape virtually all tax. This is the system's greatest attraction, as it makes the establishment of a subsidiary with the status of a Luxembourg holding company often a more profitable method of managing certain types of asset than direct management, for companies wishing to reinvest profits on these assets. For individuals, shares in Luxembourg holding companies produce practically the same net income as direct investments made under cover of fiscal anonymity.

38. The Netherlands has established a special tax system for the closed-end investment company (*Beleggingsmaatschappij*), whose sole purpose is to acquire, hold, administer and dispose of equities. If the shares of the company are quoted on the Amsterdam or Rotterdam stock exchanges, dividends received by it are not included in the taxable profit provided they come from companies subject to a tax similar to Dutch corporation tax (a proviso which excludes, in particular, Luxembourg holding companies). Closed-end investment companies whose shares are not quoted enjoy the same exemption, provided they distribute to their shareholders at least 60% of the dividends and profits accruing in the course of the financial year.

The dividends distributed by these investment companies attract withholding tax at the ordinary rate of 25%. However, in the case of redistribution of dividends received from Dutch companies this does not constitute a new charge, for the company can claim the tax initially withheld.

Redistribution of dividends received from abroad involves double taxation, except where the dividends originate in countries which have a convention with the Netherlands providing for the withholding tax to be refunded, or allowed for tax purposes, to the Dutch shareholder.

The result of these rules is that Dutch investment companies give their Dutch shareholders an income comparable to that which they would obtain by investing direct in the same shares and declaring the income received thereon. Dutch investment companies can offer "fiscal transparency" under the same conditions for their foreign shareholders resident in a country which has concluded with the Netherlands a convention providing for the reimbursement or allowance of Dutch withholding tax. On the other hand these companies can offer no such fiscal neutrality for bond investments, the tax system applied to them having been designed expressly for investment in shares.

39. The tax arrangements for French investment companies are more generous than those for Dutch companies inasmuch as the exemption from corporation tax applies also to bond income. The exemption may, however, be subject to certain conditions of redistribution, as is the case with the open-end investment companies SICAV (*Sociétés d'investissement à capital variable*).

The dividends of French investment companies are exempt from withholding tax; furthermore, French shareholders can set against their tax liability the tax withheld on dividends paid to the investment company and, where appropriate, secure a tax credit on the same terms as though they had made identical investments direct. This system has the disadvantage for foreign shareholders that they cannot, under existing conventions, claim tax relief or refunds in respect of deductions at source from investment income received by the company.

40. In Italy, there is only one investment company, of the closed-end variety. The dividends it receives are no longer liable to tax on income from movable wealth (*imposta sui redditi di ricchezza mobile*). They are normally subject to corporation tax, however, escaping it only if the dividend received has suffered withholding tax at the 30% rate treated as full discharge of tax obligations, instead

of the normal 5%. The investment company enjoys a reduction of 25% of corporation tax. This privilege is granted to all finance companies if not less than 60% of their assets is invested in participations in joint-stock companies (the reduction is 40% if the State holds shares in the finance company). Capital gains on the sale of securities, and profits, distributed or undistributed, attract the proportional tax on income from movable wealth. Profits distributed by this company to individuals are subject, in the beneficiary's hands, to the additional progressive tax at the appropriate rate. Furthermore, the normal system of withholding tax at source is also applicable to the income distributed by the investment company.

The double taxation which results in practice from this system is certainly the basic reason why investment companies have not developed in Italy.

41. The securities portfolio of the investment companies liable to tax in accordance with the systems described above is in law the companies' own property. In the open-end investment funds existing in Germany, Belgium, the Netherlands and Luxembourg, the securities do not belong to the legal entity managing them, but are the collective property of the unitholders, who are bound to the managing company by a contract of a special type.

As the investment income is at no time the property of the managers, it cannot be taxed as profit in their hands. For the same reason, the distribution of investment income does not attract withholding tax at the level of the fund. National and foreign withholding taxes charged on income received by the fund are, for holders of certificates resident in the country in which the fund is incorporated, refundable or allowable for tax as though the investments had been made direct by the certificate-holders, provided a statement of the fund's investments is produced.

On the same condition, individuals participating in a Belgian open-end investment fund and resident in Belgium can claim the "tax credit" allowed on the dividends of Belgian companies, in proportion to the share of such dividends in the fund's income.

Tax withheld at source on the dividends of German companies is refunded to German open-end investment funds. This is a privilege not found in any other EEC country, and tends to make these funds particularly profitable for persons making a tax return.

Thus, the open-end investment fund may provide a solution which, from the tax point of view, is at least as profitable as making their investments direct for persons resident in the country in which the fund has been set up, whether its investments are in that country or abroad.

For persons not resident in the country in which the fund has been set up, the solution it offers, at any rate in respect of investments in the fund's own country, is fiscally the equivalent of investing direct when these persons do not declare the income received from it in their country of domicile. It tends to be a fiscally less profitable solution when they declare this income, since the existing conventions

do not enable tax withheld on income distributed by foreign investment funds to be set against the ultimate beneficiary's tax liability: only the tax authorities of the countries in which the funds have been set up allow these withholding taxes to be taken into account, on the basis of investment statements submitted by the funds.

42. This brief survey of the possibilities afforded by investment through financial intermediaries thus shows that "fiscal transparency" is by no means achieved in all cases on the international plane.

For savers declaring their investment income, it is only in France, Germany, Belgium and Luxembourg that this equality of fiscal treatment exists alike for share and bond investments and for internal and external investment — but it applies only to residents. In the Netherlands, "transparency" exists only for investment in equities, but agreements for avoidance of double taxation enable some non-residents to benefit as well.

43. If investments through intermediaries are to play their proper part in the development of the European capital market, it is essential that the obstacles to "fiscal transparency", in those countries where the present arrangements apply to certain investment categories only, should be removed for the other categories as well. It is also necessary for the income of investment companies — open-end and closed-end — to be accorded the same fiscal treatment wherever the beneficiary resides in the Community.

44. At the moment, it is hardly possible to suggest the technical methods of achieving these aims.

The solution of the problems will depend on the principles adopted by the Member States regarding the taxation of income from capital invested abroad, and in particular on their choice between taxation in one country only and sharing of tax receipts between source country and domicile country. Moreover, no completely satisfactory arrangement can be made for investments in non-member countries as long as the Member States' conventions with them are based on differing principles.

These difficulties are not likely to be adequately settled without a multilateral double taxation convention which explicitly caters for the special case of investment companies.

V. Adjustment of indirect taxes on the raising and transfer of capital

45. As regards indirect taxes, the Group paid particular attention to the two categories which at present have the most immediate effect on the working of capital markets:

i) Indirect taxes on capital raised or borrowed; this category comprises, in particular, tax on acquisition of corporate rights and stamp duty on loan capital taken up by

domestic borrowers and on the introduction of foreign securities to stock-exchange dealing;

ii) Indirect taxes on the movement of securities; this category includes taxes on stock-exchange transactions and other comparable taxes.

46. Duty on the acquisition of corporate rights is usually levied when a company (or other legal person treated on the same footing) is formed or its life extended, and when any changes are made in its capital or corporate structure. This duty generally takes the form of a registration tax, except in Germany where it is a special tax (*Gesellschaftsteuer*), and is always paid by the company receiving the capital. Stamp duty is levied when securities are issued in the country of issue, or when foreign securities are brought into circulation in a country. The two occasions for the charge may overlap in the case of securities circulating abroad.

In collaboration with the appropriate departments in the Member States, the Commission has worked out a draft directive, — now before the Council — concerning the two types of indirect tax on the raising of capital. The object of this directive is elimination of the causes of double taxation and, where any of these taxes is maintained, adoption of a uniform rate in all the six countries, with a view to avoiding differences among them in the cost of various methods of financing.

The simplest solution for all these problems would have been abolition of both stamp duty and duty on the acquisition of corporate rights. The Commission's departments suggested this, but it was found that it would be difficult to obtain the assent of all the Member States. The draft directive before the Council provides for the abolition of stamp duty and the prohibition of any tax which might replace it, and uniform adoption of a tax on the acquisition of corporate rights reduced to 1%, and reduced still further, to 0.5%, in the case of mergers, with conditions of collection harmonized so as to preclude double taxation. (The system amounts, in principle, to taxation solely in the country in which the company is incorporated.)

The Group considers that, short of the abolition of these two types of tax, the arrangement proposed in the draft directive will come closest to achieving the desired objectives.

47. The taxes on stock-exchange transactions concern purchases and sales for cash and for forward settlement and contango operations. No taxes of this type are levied in Luxembourg. The pattern of rates in the other Member States differs quite considerably from country to country. Furthermore, Germany and the Netherlands tax not only transactions in their own countries but also, under certain conditions, transactions carried out abroad for account of their residents; this may result in double taxation.

The rates of tax on stock-exchange transactions are relatively low, but not negligible. The international differences can therefore lead to one country being preferred for a transaction to another. Moreover, these taxes, by discouraging arbitrage between securities of similar type, are a factor making it less easy to discern what are the true current costs of the various methods of obtaining capital on the market. This has prompted the Group to suggest the abolition of taxes on stock-

exchange transactions rather than the adoption in all six countries of uniform rates and conditions of collection designed to avoid double taxation. However, failing agreement on abolition, the adoption of uniform rates would be preferable to maintenance of the *status quo*, for it would ensure the neutrality of the tax with regard to choice of the place for transactions.

48. Stamp duties on bills of exchange, where these are drawn to finance international transactions, may also give rise to double taxation. This might be eliminated by measures similar to those suggested above.

Conclusions

49. If an integrated capital market is to be developed and operated smoothly inside the Community, the tax systems must not prevent the creation in that market of conditions similar to those of a domestic market. Tax neutrality means that taxes affect neither the choice of the place of investment or transaction nor the saver's choice between making the investment direct or using the services of a financial intermediary. It also means there should be no tax-induced differences among member countries in the relative development of the various types of investment and methods of financing.

If these requirements are to be fulfilled some improvements in the tax systems of member countries would seem called for.

1) The double taxation still arising on income from security investments in a country other than that of the beneficiary's domicile should be eliminated. If the requirements of a European capital market are alone considered, this could be accomplished either by taxing the income in one country only, or by dividing the revenue between the two by imposing a withholding tax in the source State and systematically allowing it for tax purposes in the beneficiary's State of domicile.

Similarly, double taxation by way of indirect taxes on the raising and movement of capital must be eliminated. The necessary measures are now being discussed and a draft directive, drawn up by the Commission in association with official departments of the Member States, has been submitted to the Council.

2) The tax disadvantages still attaching to investment effected in other member countries through the intermediary of financial institutions should be got out of the way. Arrangements made will depend on what principles the Member States adopt for taxing income from capital invested in securities abroad. Because of the complex legal relations between the various parties to such investments, it is probable that "fiscal transparency" can only be satisfactorily achieved under a multilateral double taxation convention which explicitly caters for the special case of investment companies.

3) There should no longer be any fiscal advantages reserved exclusively for investment in particular countries. This requires amendment of the "tax credit" systems under which part of corporation tax is at present refunded to residents only and

only on the dividends of domestic companies. The arrangement best suited to the smooth working of a European capital market would be to extend the concession by granting a refund to non-resident investors.

4) At present there are many disparities between member countries in their fiscal treatment of dividend and interest paid to non-residents or to persons not making a tax return. Here taxation and supervision systems should be harmonized. This is especially important for the bond market, since considerations of yield are of prime importance in determining the choice of an investment in fixed-yield securities. The harmonization might take the form of total abolition of withholding tax on bond interest or application of a uniform rate of tax throughout the Community.

ANNEX TO CHAPTER 14

Taxation of distributed profits of joint stock companies and of interest on bonds accruing to individuals

I. Taxation of company profits distributed to shareholders who are individuals ⁽¹⁾

GERMANY

A) DIRECT TAXES BORNE BY COMPANIES

- (1) A profits tax, the yield on which goes to the Bund (Federal government) and the Länder, at a rate of 15% on distributed profits (51% on undistributed profits). The tax on distributed profits is not treated as a deductible expense, but as undistributed profit. The real tax charge on distributed profit is therefore 23.44%.
- (2) A communal tax, the rate of which varies from Land to Land and may attain 5%, but levied on a broader basis than profit in the true sense. (No account is taken here of communal taxes on the net worth of the company and on payrolls, which are considered indirect charges.)
- (3) A tax on wealth (*Vermögensteuer*), at a maximum rate of 1%, of a tax base calculated by rather complex procedures.

The combined incidence of (2) and (3) corresponds, on average, to about 15% of the gross profit.

B) TAX BORNE BY SHAREHOLDERS, CHARGED AT THE TIME OF A DIVIDEND DISTRIBUTION

- (1) Dividends of German companies
 - i) Paid to a German shareholder: tax withheld at source at a rate of 25% of the gross dividend.
 - ii) Paid to a foreign shareholder: same rule. The rate is reduced, by agreement, to 15% for French, Dutch, Luxembourg, Swiss and British shareholders.
- (2) Dividends of foreign companies: no withholding tax in Germany.

⁽¹⁾ I. Companies and shareholders domiciled in Germany, Belgium, France, Italy, the Netherlands, Luxembourg, Switzerland, the UK and the USA.

II. Stamp duties and taxes on stock-exchange transactions are not taken into account.

III. When the shareholder is a corporate entity the tax arrangements are often very different, especially in the case of companies owning large participations.

C) ALLOWANCE OF TAX WITHHELD AT SOURCE

- (1) Dividends of German companies: the German shareholder may charge tax withheld at source to personal tax liability.
- (2) Dividends of foreign companies: the German shareholder may charge tax withheld at source abroad to personal income tax due in Germany, up to an amount not exceeding the German tax due on the portion of his income represented by the foreign income in question. (The allowance procedure may differ slightly according to the foreign country concerned.)

B E L G I U M

A) DIRECT TAX BORNE BY COMPANIES

A 30% tax on profits. 35% on any part of the profit exceeding Bfrs. 5 million. The additional 5% is refunded in the event of subsequent distribution.

B) TAX BORNE BY SHAREHOLDERS, CHARGED AT THE TIME OF A DIVIDEND DISTRIBUTION

- (1) Dividends of Belgian companies
 - i) Paid to a Belgian shareholder: tax is withheld at source at a rate of 20% of the gross dividend (as from 1967).
 - ii) Paid to a foreign shareholder: the same withholding tax is levied, as a tax on non-residents.
- (2) Dividends of foreign companies: withholding tax is charged at 20% of the net dividend at the frontier.

C) ALLOWANCE OF TAX WITHHELD AT SOURCE, AND TAX CREDIT

- (1) Dividends of Belgian companies: the Belgian shareholder may charge tax withheld at source to personal tax liability. He also has a right to a tax credit equal to half the profits tax paid by the companies (on the proportion of their gross profits distributed as dividend).
- (2) Dividends of foreign companies: the Belgian shareholder may claim for tax withheld at source in Belgium to his liability. For dividends which have attracted withholding tax abroad, he has a right to tax allowance for 15% of the net dividend at the frontier, representing the flat rate of allowance for taxes paid abroad.

F R A N C E

A) DIRECT TAX BORNE BY COMPANIES

A tax on profits at the rate of 50%.

B) TAX BORNE BY SHAREHOLDERS, CHARGED AT THE TIME OF A DIVIDEND DISTRIBUTION

- (1) Dividends of French companies
 - i) Paid to a French shareholder: no withholding tax.

ii) Paid to a foreign shareholder: tax withheld at source at the rate of 25% of the gross dividend. This is reduced, by agreement, to 18% for Belgian shareholders, 15% for German and American shareholders, and to nil for Dutch and Swiss shareholders.

(2) Dividends of foreign companies: when these dividends are paid in France, tax is withheld by the banks effecting the payment at a basic rate of 33.3% of the net dividend at the frontier. This rate is reduced when tax has been charged abroad on the dividend so that the sum of taxes levied in the two countries equals 33.3% of the gross dividend; when the foreign tax (e.g. UK tax) exceeds 33.3%, no tax is withheld in France.

C) ALLOWANCE OF TAX WITHHELD AT SOURCE, AND TAX CREDIT

(1) Dividends of French companies: the French shareholder has a right to a tax credit equal to half the profits tax paid by the companies (on the distributed proportion of their gross profits).

(2) Dividends of foreign companies: the French shareholder may charge 50% of the net dividend to tax liability, which corresponds to the rate of French withholding tax.

ITALY

A) DIRECT TAX BORNE BY COMPANIES

(1) A tax on income from movable wealth accompanied by various additional charges, bringing the total tax incidence to about 35% of gross profits.

(2) A tax on companies at a rate of 0.75% of the taxable capital and 15% of the proportion of income exceeding 6% of that capital. Since 1961, a surcharge of 10% has been added. The average incidence of this tax on gross profit is about 15%.

B) TAX BORNE BY SHAREHOLDERS, CHARGED AT THE TIME OF A DIVIDEND DISTRIBUTION

(1) Dividends of Italian companies

i) Paid to an Italian shareholder: tax withheld at source at a rate of 5%. This is raised to 30% for shareholders whose identity is not revealed, and the withholding tax then counts as irrecoverable. In the tables, only the 5% rate has been taken into account.

ii) Paid to a foreign shareholder: tax withheld at source at a rate of 30%. This is reduced by agreement to 15% for US shareholders.

(2) Dividends of foreign companies: withholding tax of 5% on the net dividend at the frontier (30% for shareholders whose identity is not revealed).

C) ALLOWANCE OF TAX WITHHELD AT SOURCE

- (1) Dividends of Italian companies: the Italian shareholder may charge the 5% withheld at source to his tax liability.
- (2) Dividends of foreign companies: the Italian shareholder is entitled to allowance for the Italian withholding tax of 5%; and for taxes paid on dividends in the USA and UK, up to an amount not exceeding 8% of the gross dividend.

THE NETHERLANDS

A) DIRECT TAXES BORNE BY COMPANIES

A tax on company profits at a graduated rate, representing a charge of about 47% of gross profits for large companies.

B) TAX BORNE BY SHAREHOLDERS, CHARGED AT THE TIME OF A DIVIDEND DISTRIBUTION

- (1) Dividends of Dutch companies
 - i) Paid to a Dutch shareholder: 25% withheld at source.
 - ii) Paid to a foreign shareholder: same general rule. The rate of the withholding tax is reduced, by agreement, to 15% for German shareholders, 10% for Swiss shareholders and nil for French, Italian, British and American shareholders.
- (2) Dividends of foreign companies: no withholding tax.

C) ALLOWANCE OF TAX WITHHELD AT SOURCE, AND TAX CREDIT

- (1) Dividends of Dutch companies: the Dutch shareholder can charge tax withheld at source to personal tax liability.

N.B.: For 1966, it is planned to grant the Dutch shareholder a tax credit of 10% of the gross dividend in addition to the allowance of tax withheld at source (25%).

- (2) Dividends of foreign companies: no allowance in the Netherlands for foreign taxes on dividends (instead, the Netherlands is endeavouring to conclude agreements for the reduction or abolition of withholding taxes levied abroad on dividends payable to Dutch shareholders).

LUXEMBOURG

A) DIRECT TAXES BORNE BY COMPANIES

- (1) A communal tax on operating profit and on capital, at a rate of 4% on profits and 2% on capital, together producing an average incidence of about 11% on profits.

(2) A graduated State tax on company profits, amounting to 40% for large companies. This rate is applied to the profit after deduction of communal tax.

(3) A State tax on wealth at a rate of 5%, amounting to an average charge of about 5% on profits.

B) TAX BORNE BY SHAREHOLDERS, CHARGED AT THE TIME OF A DIVIDEND DISTRIBUTION

(1) Dividends of Luxembourg companies

i) Paid to a Luxembourg shareholder: tax withheld at source at a rate of 15% of the gross dividend.

ii) Paid to a foreign shareholder: same rule.

(2) Dividends of foreign companies: no Luxembourg withholding tax.

C) ALLOWANCE OF TAX WITHHELD AT SOURCE

(1) Dividends of Luxembourg companies: the Luxembourg shareholder may charge the 15% tax withheld at source to personal tax liability.

(2) Dividends of foreign companies: the Luxembourg shareholder has the right, by special arrangement, to allowance for tax withheld at source in the US and Germany (at the reduced rate of 15%); and for French withholding tax up to a limit of 15% of the gross dividend (rate of withholding tax in Luxembourg).

S W I T Z E R L A N D

A) DIRECT TAXES BORNE BY COMPANIES

(1) A federal tax on profits at a progressive rate, averaging 8%.

(2) Various cantonal and municipal taxes, with an incidence on profits ranging from 15% to nearly 40%.

B) TAX BORNE BY SHAREHOLDERS, CHARGED AT THE TIME OF A DIVIDEND DISTRIBUTION

(1) Dividends of Swiss companies

i) Paid to a Swiss shareholder: an "anticipatory federal tax" of 27% and a "stamp duty on coupons" of 3%, making 30% in all.

N.B.: It is planned to combine these two taxes in a single anticipatory federal tax of 30%.

ii) Paid to a foreign shareholder: same general rule. By agreement, the rate of withholding tax is reduced to 15% for German and American shareholders, 5% for French shareholders, and 3% for Dutch shareholders, and varies from 3% to 27% (according to the income declared) for British shareholders.

(2) Dividends of foreign companies: in general, no withholding tax is levied in Switzerland. However, a "supplementary US withholding tax" of 15% is levied on income from American shares.

C) ALLOWANCE OF TAX WITHHELD AT SOURCE

(1) Dividends of Swiss companies: the Swiss shareholder may set the anticipatory federal tax against his cantonal taxes.

(2) Dividends of foreign companies: the Swiss shareholder is entitled to allowance for the "supplementary US withholding tax" and, under certain conditions, for tax withheld at source in Germany.

UNITED KINGDOM

A) DIRECT TAXES BORNE BY COMPANIES

A direct tax on gross profit, at a rate of 40% (corporation tax).

B) TAX BORNE BY SHAREHOLDERS, CHARGED AT THE TIME OF A DIVIDEND DISTRIBUTION

(1) Dividends of British companies

i) Paid to a British shareholder: personal income tax on the gross dividend is withheld at source at the standard rate of 8s. 3d. (41.25%).

ii) Paid to a foreign shareholder: same rule. By agreement, a withholding tax of only 3s. (15%) is charged on dividends payable to US shareholders.

(2) Dividends of foreign companies: no tax withheld at source in the United Kingdom.

C) ALLOWANCE OF TAX WITHHELD AT SOURCE

(1) Dividends of British companies: the British shareholder may charge tax withheld at source to personal tax liability.

(2) Dividends of foreign companies: the British shareholder is entitled to allowance for tax withheld at source abroad to an amount not exceeding the British tax due on the portion of his income represented by the foreign income.

UNITED STATES OF AMERICA

A) DIRECT TAX BORNE BY COMPANIES

A graduated tax in two steps on company profits (the first being called "normal tax" and the second "surtax"), the total impact of which on big companies is about 48% of gross profit.

B) TAX BORNE BY SHAREHOLDERS, CHARGED AT THE TIME OF A DIVIDEND DISTRIBUTION

(1) Dividends of US companies

- i) Paid to a US shareholder: no withholding tax.
- ii) Paid to a foreign shareholder: in principle, tax is withheld at source at a rate of 30% of the gross dividend. This is reduced, by agreement, to 15% for German, Belgian, French, Swiss, Dutch, Luxembourg, Italian and British shareholders.

(2) Dividends of foreign companies: no withholding tax.

C) ALLOWANCE OF TAX WITHHELD AT SOURCE

(1) Dividends of US companies: no withholding tax.

(2) Dividends of foreign companies: the US shareholder may, under certain conditions, charge tax on dividends paid abroad to personal tax liability, up to an amount not exceeding the US tax due on the portion of his income represented by the foreign income.

II. Taxation of bond interest accruing to individuals ⁽¹⁾

GERMANY

A) TAX BORNE BY CREDITORS ON PAYMENT OF INTEREST

(1) Interest on German bonds

- i) Paid to a German creditor: no withholding tax.

(1) I. Bonds issued and interest received in Germany, Belgium, France, Italy, the Netherlands, Luxembourg, Switzerland, the UK and the USA.

II. Stamp duties and taxes on stock-exchange transactions are not taken into account.

III. Many bond issues (mainly in connection with government loans) are accompanied by privileges sometimes extended to all holders, sometimes only to foreigners or nationals of the country concerned (or even certain categories only among these). This restricts the practical significance of some of the rules summarized below.

- ii) Paid to a foreign creditor: 25% withheld at source.

By agreement, this tax is not charged to French, Dutch, Luxembourg, Swiss, British and US creditors.

- (2) Interest on foreign bonds: no withholding tax.

B) ALLOWANCE OF TAX WITHHELD AT SOURCE

- (1) Interest on German bonds: no withholding tax.

(2) Interest on foreign bonds: the German creditor may charge tax withheld at source abroad to tax liability, up to an amount not exceeding the German tax due on the portion of his income represented by the foreign income.

B E L G I U M

A) TAX BORNE BY CREDITORS ON PAYMENT OF INTEREST

- (1) Interest on Belgian bonds

i) Paid to a Belgian creditor: tax is withheld at source at a rate of 20% of gross interest (as from 1967).

ii) Paid to a foreign creditor: the same withholding tax is levied, as a tax on non-residents.

(2) Interest on foreign bonds: withholding tax is charged at a rate of 20% on net interest receipt at frontier.

B) ALLOWANCE OF TAX WITHHELD AT SOURCE

(1) Interest on Belgian bonds: the Belgian creditor may charge tax withheld at source to personal tax liability.⁽¹⁾

(2) Interest on foreign bonds: the Belgian creditor may charge tax withheld in Belgium to personal tax liability. In the case of interest which has suffered withholding tax abroad, he is entitled to allowance of 15% of the net interest at frontier, representing a flat rate of allowance for taxes paid abroad.

⁽¹⁾ For certain Belgian Government stocks which are exempt at the time of issue from all withholding tax, the actual rate of the withholding tax is reduced to 5%. The rate of 20% may nevertheless be claimed for.

F R A N C E

A) TAX BORNE BY CREDITORS ON PAYMENT OF INTEREST

(1) Interest on French bonds

i) Paid to a French creditor: they have a choice between two systems:

1. 12% or 10% withholding tax (according to whether the bonds concerned were issued before 1 January 1965 or subsequently). Interest is subject to personal income tax; this arrangement is the only one allowed in respect of indexed bonds;

2. 25% withholding tax, in full discharge of income tax liability.

ii) Paid to a foreign creditor: 25% withholding tax. However, withholding tax is maintained at the rate of 12% or 10% for creditors of countries which have double taxation conventions with France. By agreement, no tax is withheld on interest payable to German, Dutch and Swiss creditors.

(2) Interest on foreign bonds: 33.3% withholding tax on net interest at frontier. This rate is reduced when tax is withheld abroad so that the total taxes levied in the two countries equal 33.3% of the gross interest; when the rate of the tax abroad exceeds 33.3%, no tax is withheld in France.

B) ALLOWANCE OF TAX WITHHELD AT SOURCE

(1) Interest on French bonds: the French creditor may charge the tax of 12% or 10% withheld at source (real or "fictitious" withholding tax) to personal tax liability. When the flat rate of 25% is charged, the question of allowance for tax obviously does not arise, as it represents full discharge of income tax liability.

(2) Interest on foreign bonds: the recipient may charge 50% of net interest to personal tax liability. By this system, the additional withholding tax levied in France is always allowable, but foreign withholding tax may only be allowed in full if its rate does not exceed 33.3%.

I T A L Y

A) TAX BORNE BY CREDITORS ON PAYMENT OF INTEREST

(1) Interest on Italian bonds: the tax on movable wealth, category A (about 32%) is, generally speaking, paid by the debtor; the creditor does not even know the amount. As it is a schedular tax, it cannot be allowed against the creditor's personal taxes either in Italy or in the countries which have double taxation conventions with Italy. In addition, it should be noted that the tax on movable wealth, category A, is only levied at the full rate on interest from debentures issued by companies in the private sector (not including semi-public enterprises).

(2) Interest on foreign bonds: no withholding tax in Italy.

B) ALLOWANCE OF TAX WITHHELD AT SOURCE

(1) Interest on Italian bonds: see above.

(2) Interest on foreign bonds: there is no Italian withholding tax. By agreement, the Italian creditor can charge tax paid on interest in the USA and the UK, to liability for Italian tax, up to an amount not exceeding 8% of the gross interest.⁽¹⁾

T H E N E T H E R L A N D S

A) TAX BORNE BY CREDITORS ON PAYMENT OF INTEREST

No tax is withheld at source on payment of interest on bonds.

B) ALLOWANCE OF TAX WITHHELD AT SOURCE

Withholding tax charged abroad on bond interest is not taken into account.⁽²⁾

L U X E M B O U R G

A) TAX BORNE BY CREDITORS ON PAYMENT OF INTEREST

(1) Interest on Luxembourg bonds

i) Paid to a Luxembourg creditor: 5% withholding tax.

ii) Paid to a foreign creditor: same rule. By agreement, the rate of the withholding tax is reduced to nil for German creditors.

(2) Interest on foreign bonds: no Luxembourg withholding tax.

B) ALLOWANCE OF TAX WITHHELD AT SOURCE

(1) Interest on Luxembourg bonds: the Luxembourg creditor is entitled to a tax credit equal to the tax withheld at source.

(2) Interest on foreign bonds: the Luxembourg creditor has the right to charge French withholding tax on interest on French bonds to personal tax liability, up to 5% of the income.

⁽¹⁾ An Italian creditor with an income in the Netherlands which is large enough to render him liable to personal income tax in that country is exempted from personal income tax in Italy on that income, which, however, is taken into consideration in determining the rate of tax applicable to his income in Italy.

⁽²⁾ A Dutch creditor with an Italian income so large that he has to pay personal income tax on it in Italy is exempted from paying income tax on it in the Netherlands. This Italian income is, however, taken into account in determining the rate of tax applicable to his income in the Netherlands.

S W I T Z E R L A N D

A) TAX BORNE BY CREDITORS ON PAYMENT OF INTEREST

(1) Interest on Swiss bonds

i) Paid to a Swiss creditor: an "anticipatory tax" is withheld at source at the rate of 27% plus a stamp duty of 3%.

ii) Paid to a foreign creditor: same general rule, the rate of withholding tax being reduced, by agreement, to 10% for Dutch creditors, 5% for French and American creditors, and 3% for German creditors, and varying from 3% to 27% (according to the income declared) for British creditors.

(2) Interest on foreign bonds: no tax withheld in Switzerland, in principle. However, a "supplementary US withholding tax" of 25% is charged on interest from US bonds.

B) ALLOWANCE OF TAX WITHHELD AT SOURCE

(1) Interest on Swiss bonds: the Swiss creditor may charge the anticipatory federal tax withheld at source to his cantonal taxes.

(2) Interest on foreign bonds: the Swiss creditor may charge the "supplementary US withholding tax" to tax liability.

U N I T E D K I N G D O M

A) TAX BORNE BY CREDITORS ON PAYMENT OF INTEREST

(1) Interest on British bonds

i) Paid to a British creditor: personal income tax is withheld at source at the standard rate when the interest is paid (8s.3d. [41.25%] in 1965/66).

ii) Paid to a foreign creditor: same general rule. By agreement, no withholding tax is charged to German, Dutch, Swiss and American creditors.

(2) Interest on foreign bonds: no tax withheld at source in the United Kingdom.

B) ALLOWANCE OF TAX WITHHELD AT SOURCE

(1) Interest on British bonds: the British creditor may charge tax withheld at source to income tax liability.

(2) Interest on foreign bonds: the British creditor is allowed tax withheld at source abroad up to an amount not exceeding the UK tax due for that portion of his income represented by the foreign income concerned.

UNITED STATES

A) TAX BORNE BY CREDITORS ON PAYMENT OF INTEREST

(1) Interest on US bonds

- i) Paid to a US creditor: no withholding tax.
- ii) Paid to a foreign creditor: normally tax is withheld at source at a rate of 30%. This rate is reduced to 15% for Belgian and French creditors, 5% for Swiss creditors, and nil for German, Dutch, Luxembourg and British creditors.

(2) Interest on foreign bonds: no tax withheld at source in the USA.

B) ALLOWANCE OF TAX WITHHELD AT SOURCE

(1) Interest on American bonds: (no withholding tax).

(2) Interest on foreign bonds: the American creditor may, under certain conditions, charge income withheld at source abroad to tax liability, up to an amount not exceeding the American tax due for that portion of his income accounted for by the foreign income concerned.

III. Tables showing, by countries of origin and destination, the effect of taxation on the distributed profits of joint stock companies and on interest from bonds

A. SCOPE OF THE TABLES

The purpose of the tables is to show the extent of the distortions which tax systems may cause in the working of the international capital market.

They are theoretical to the extent that they have been constructed from a relatively compact digest of the national tax laws and international conventions. Certain provisions of the tax laws or conventions considered in drawing up the tables may not in fact be applied, no implementing regulations having been adopted. Again, in practice the national tax authorities may give some provisions a slightly different interpretation from that assumed here.

B. EXPLANATION OF THE TABLES

Table A: Income procured for the shareholder (individual) by distribution of a dividend of 100

Except in the case of a dividend collected in a "tax haven", the income here is a gross income, on which personal income tax is still due (progressive tax in the countries dealt with here).

This income is calculated:

- a) By deducting, where applicable, from the dividend distributed, the taxes borne by the shareholder and withheld at source
 - i) In the country of the company,
 - ii) In the country of the shareholder, which gives the net dividend actually received in cash by the shareholder;
- b) Then by adding back, where applicable, to this net dividend:
 - i) The portion of taxes withheld at source which can be set against personal income tax,
 - ii) The tax credit granted by certain states, enabling resident shareholders to recover part of the profits tax paid by companies.

The effect of international double taxation conventions has been taken into account.

Where applicable, it is assumed that the shareholder was in the most favourable position to claim allowances for taxes withheld at source abroad. Many States take into consideration taxes withheld abroad only up to an amount not exceeding the national tax due on the portion of income accounted for by the foreign income concerned. Full allowance for tax paid therefore presupposes a total income which is sufficient for the rate of national income tax to exceed that of foreign withholding tax. The tables have been based on this assumption.

Dividends received in a "tax haven" may be considered net.

The commonest haven is that to be found in certain countries which levy neither withholding taxes at source nor personal income tax on the foreign income of persons (as often as not, holders of an "external bank account") who are not normally resident in those countries, and sometimes provided they do not spend the income in question there. Dividends collected in a "tax haven" have been subjected in the country of domicile of the company to withholding tax at the highest rate, and the tax concerned is irrecoverable, since no convention for avoidance of double taxation can operate unless new taxes are introduced in the country in which the dividend is received. In many cases, the rate of tax withheld at source is lower than the marginal rate of personal income tax which the shareholder would have had to pay upon declaring this income in his own country.

Table B: Marginal rates of personal income tax beyond which the "tax haven" secures a higher immediate yield for the shareholder

This table shows the marginal rate of income tax beyond which it would, in terms of immediate yield, pay the shareholder to collect his dividends in a "tax haven" country.

This rate is calculated from the data of Table A, by relating the net income received in the tax haven to the gross income which the shareholder would have received in his own country.

Table C: Income procured for the shareholder (individual) by a gross profit of 100, wholly distributed

This table shows the maximum remuneration which can be offered to the shareholders of the various countries by a company making a profit of 100 before payment of taxes to which it is directly liable (gross remuneration as a general rule, net for shareholders collecting their dividends in the tax haven).

This remuneration has been calculated by first deducting from the gross profit the taxes directly payable by the company, which gives the gross dividend. To this last, it is sufficient to apply the coefficients listed in Table A.

Table D: Income procured for the creditor (individual) by gross interest from bonds of 100

and

Table E: Marginal rate of personal income tax beyond which the "tax haven" would secure a higher immediate yield for the bondholder

These tables are on the same pattern as Tables A and B.

They describe the general arrangement. There are numerous exceptions to this: many government loans and loans issued by local authorities and semi-public enterprises carry with them tax privileges extended sometimes to all bondholders alike, sometimes only to foreigners or to nationals of the country concerned (and sometimes even to certain categories only of these).

The privilege most often granted to foreign creditors is abolition of withholding tax in the debtor's country. Since tax withheld at source in the creditor's country is always an advance payment chargeable to personal tax, the gross income obtained for the foreign bondholder in this case is 100% of the gross dividend.

For some loans of certain countries, even interest collected in a tax haven is exempted from withholding tax at source in the debtor's country. The creditor (individual) then has an advantage in having the interest on these loans paid out in a tax haven, if the same privileges of exemption from withholding tax and of anonymity are not given him in his own country.

C. COMPARABILITY OF DATA

UNITED KINGDOM

In the United Kingdom, exchange controls limit the supply of foreign currency available for investment in foreign shares and in foreign bonds with more than five years to run to maturity. The currency for these transactions is negotiated at a premium which has at times exceeded 25%.

This means a lower rate of return for the British holder. No account has been taken of this in the tables.

UNITED STATES

In the USA, a tax of 15% (interest equalization tax) is levied on the introduction of foreign shares. The result is that the price of these shares in the United States may be 15% above the price abroad when the American market is a net buyer, but may be the same if it is a net seller. This can mean a loss for the American shareholder.

Interest equalization tax is also levied on the introduction of foreign bonds of more than 3 years' term. The rate varies according to the term, from 2.75% for bonds maturing at between 3 and 3 1/2 years to 15% for bonds maturing at 28 1/2 years or more.

The incidence of the interest equalization tax has not been taken into account in the tables.

TABLE A

Income obtained by the shareholder (individual) from distribution of a dividend of 100

Company's country	Shareholder's country						
	Germany	Belgium	France	Italy	Nether-lands	Luxem-bourg	Switzer-land
Germany	100	86.25	100	75.00	85.00	100.00	100
Belgium	100	121.44	100	80.00	80.00	80.00	100
France	100	94.30	150	75.00	100.00	90.00	100.00
Italy	100	80.50	100	100.00	70.00	70.00	100
Netherlands	100	86.25	100	100.00	100.00	75.00	90.00
Luxembourg	100	97.75	100	85.00	85.00	100.00	85.00
Switzerland	100	80.50	100	70.00	97.00	70.00	97
United Kingdom	100	67.56	88.13	66.75	58.75	58.75	100
United States	100	97.75	100	93.00	85.00	100.00	85.00

(^a) Data not fully comparable : see III C.

TABLE B

Marginal rate of personal income tax beyond which the "tax haven" offers the shareholder a higher immediate return

(*Rates in %*)

Company's country	Shareholder's country								
	Germany	Belgium	France	Italy	Nether-lands	Luxem-bourg	Switzer-land	United Kingdom	United States
Germany	25	13	25	1	12	25	25	25	25
Belgium	20	34	20	1	1	1	1	20	20
France	25	20	50	1	25	17	25	25	25
Italy	30	13	30	30	1	1	1	30	30
Netherlands	25	13	25	25	25	1	17	25	25
Luxembourg	15	13	15	1	1	15	1	15	15
Switzerland	30	13	30	1	28	1	28	28	30
United Kingdom	42	13	34	13	1	1	1	42	42
United States	30	29	30	25	18	30	18	30	30

TABLE C

Income obtained by the shareholder (individual) from a gross profit of 100, wholly distributed

Company's country	Shareholder's country									
	Germany	Belgium	France	Italy	Nether-lands	Luxem-bourg	Switzer-land	United Kingdom	United States	"Tax haven"
Germany	62	54	62	47	53	62	62	62	62	47
Belgium	70	85	70	56	56	56	56	70	70	56
France	50	47	75	38	50	45	50	50	50	38
Italy	50	40	50	50	35	35	35	50	50	35
Netherlands	53	46	53	53	53	40	48	53	53	40
Luxembourg	49	48	49	42	42	49	42	49	49	42
Switzerland	52	42	52	36	50	36	50	50	52	36
United Kingdom	60	41	53	41	35	35	35	60	60	35
United States	50	49	50	47	43	50	43	50	50	35

TABLE D

Income obtained by the creditor (individual) from gross interest from bonds of 100

Debtor's country	Creditor's country									
	Germany	Belgium	France	Italy	Nether-lands	Luxem- bourg	Switzer- land	United Kingdom (¹)	United States (¹)	"Tax," haven,
Germany	100	86.25	100.00	75.00	100.00	100.00	100.00	100	100	75.00
Belgium	100	100.00	100.00	80.00	80.00	80.00	80.00	100	100	80.00
France	100	100.00	100.00	90.00	100.00	95.00	100.00	100	100	75.00
Italy	100	100.00	100.00	100.00	100.00	100.00	100.00	100	100	100.00
Netherlands	100	100.00	100.00	100.00	100.00	100.00	100.00	100	100	100.00
Luxembourg	100	100.00	100.00	95.00	95.00	100.00	95.00	100	100	95.00
Switzerland	100	80.50	100.00	70.00	90.00	70.00	97.00	100	100	70.00
United Kingdom	100	67.56	88.13	66.75	100.00	58.75	100.00	100	100	58.75
United States	100	97.75	100.00	78.00	100.00	100.00	95.00	100	100	70.00

(¹) Data not fully comparable : see III C.

TABLE E

Marginal rates of personal income tax beyond which the "tax haven" offers the bondholder a higher immediate return

(in %)

Debtor's country	Creditor's country						United States
	Germany	Belgium	France	Italy	Nether-lands	Luxem-bourg	
Germany	25	13	25	1	25	25	25
Belgium	20	20	20	1	1	1	20
France	25	25	25	17	25	21	25
Italy	1	1	1	1	1	1	1
Netherlands	1	1	1	1	1	1	1
Luxembourg	5	5	5	1	1	5	5
Switzerland	30	13	30	1	23	1	28
United Kingdom	42	13	34	13	42	1	42
United States	30	29	30	11	30	27	30

STATISTICAL [ANNEX

LIST OF TABLES (1)

1. Gross domestic capital formation and its financing
2. Savings as a percentage of gross national product (GNP) and of gross domestic capital formation (GCF)
3. Gross public-sector saving as a proportion of public-sector investment
4. Self-financing of enterprises: gross rates
5. Size of the capital markets combined
6. Supply of funds by sections of the capital market
7. Net domestic issues of medium- and long-term securities
8. Medium- and long-term loans to business and private customers
9. Net domestic issues of medium- and long-term fixed-interest securities for the financing of the public sector in the EEC countries
10. Borrowing by enterprises
11. Financial structure of enterprises
12. Net financial investment of non-financial sectors
13. Movements of long-term private capital by country
14. Movements of long-term private capital by type
15. Public issues of foreign bonds
16. Public issues of foreign bonds, classified by market of issue and residence of issuer
17. Gross fixed capital formation in the housing sector

(1) The statistics supplied by the member countries are not homogeneous and in some cases the data are either inadequate or non-existent; since in addition it has not been possible to eliminate differences between the definitions adopted in the various countries, the figures that have been brought together are far from fully comparable.

The sources used for the Community countries are given under each table. For the United Kingdom and the United States, the Group was authorized to use certain figures obtained by the OECD Committee for Invisible Transactions for a study on capital markets now in preparation. These figures are provisional and subject to amendment.

18. Analysis of net purchases of fixed-interest securities
19. Apparent and real yields of fixed-interest securities
20. Net domestic issues of medium- and long-term fixed-interest securities
21. Tap issues of medium-and long-term fixed-interest securities
22. Issues of variable-yield securities
23. Market value of variable-yield securities
24. Assets of investment companies (open-end and closed-end)
25. Gross issues of convertible bonds
26. Number of foreign variable-yield securities quoted on nine international exchanges
27. Investments of life assurance companies
28. Investments of savings banks and their central institutions
29. Bank lending and security investments
30. Lending and security investments of specialized institutions

Abbreviations and signs used :

--	= Zero, or less than half the final digit shown
.	= Not available
m.	= Million
u.a.	= Unit of account
GNP	= Gross national product
GCF	= Gross domestic capital formation
EEC	= European Economic Community
SOEC	= Statistical Office of the European Communities
ECSC	= European Coal and Steel Community
OECD	= Organization for Economic Co-operation and Development
CIT	= OECD Committee for Invisible Transactions
EIB	= European Investment Bank
IBRD	= International Bank for Reconstruction and Development

TABLE 1

Gross domestic capital formation and its financing (1)

	Germany						France						Italy						Netherlands					
	1962	1963	1964	Average 1962-65	1962	1963	1964	Average 1962-65	1962	1963	1964	Average 1962-65	1962	1963	1964	Average 1962-65	1962	1963	1964	Average 1962-65	1962	1963	1964	Average 1962-65
Public Sector																								
Gross fixed capital formation	3.54	4.11	4.79	5.07	4.38	1.78	2.09	2.39	2.74	2.25	1.21	1.34	1.46	1.44	1.36	0.60	0.69	0.86	0.93					
Gross savings	7.14	6.85	7.95	6.90	7.21	2.14	2.84	3.90	4.27	3.29	1.74	1.70	1.89	0.48	1.45	0.67	0.59	0.78	0.80					
Financial surplus (+) or deficit (-) of the sector before capital transfers	+ 3.60	+ 2.74	+ 3.16	+ 1.83	+ 2.83	+ 0.36	+ 0.75	+ 1.51	+ 1.53	+ 1.04	+ 0.53	+ 0.36	+ 0.43	- 0.96	+ 0.09	+ 0.07	- 0.10	- 0.08	- 0.13					
Companies and households																								
Gross capital formation (by companies)	19.88	20.24	22.50	26.16	22.19	13.53	14.93	17.62	17.73	15.95	9.24	10.65	10.41	9.75	10.01	2.82	2.87	3.86	3.96					
Gross saving by companies	9.16	10.10	11.37	12.30	10.73	8.12	8.67	9.59	10.00	9.09	9.01	9.57	10.63	12.99	10.55	1.80	1.88	2.17	2.25					
Gross saving by individuals	7.07	7.62	9.40	10.57	8.66	4.64	4.88	5.41	6.07	5.25						1.09	1.19	1.68	1.87					
Financial surplus (+) or deficit (-) of the sector	- 3.65	- 2.52	- 1.73	- 3.29	- 3.00	- 0.77	- 1.38	- 2.62	- 1.66	- 1.61	- 0.23	- 1.08	+ 0.22	+ 3.24	+ 0.54	+ 0.07	+ 0.20	- 0.01	+ 2.16					
All sectors																								
Gross domestic capital formation (of which : housing)	23.42	24.35	28.46	31.23	26.57	15.31	17.02	20.01	20.47	18.20	10.45	11.99	11.87	11.19	11.37	3.42	3.56	4.72	4.89					
Gross national saving	23.37	24.57	28.72	29.77	26.60	14.90	16.39	18.90	20.34	17.63	10.75	11.27	12.52	13.47	12.00	3.56	3.66	4.63	6.92	(0.92)				
Financial surplus (+) or deficit (-) for all sectors of the economy	- 0.05	+ 0.22	+ 0.26	- 1.46	- 0.17	- 0.41	- 0.63	- 1.11	- 0.13	- 0.57	+ 0.30	- 0.72	+ 0.65	+ 2.28	+ 0.14	+ 0.10	- 0.09	+ 2.03						

Source: SOEC, National Accounts 1955-65. For UK and USA: OECD, CIT.

(1) Public enterprises are included under "Companies" everywhere except in USA, where they are included under "Public Sector".

(2) Provisional figures.

TABLE I

Gross domestic capital formation and its financing

(in '000 million)

Continued from 339/340a

	Belgium				UK				USA						
Average 1962-65	1962	1963	1964	1965 (*)	1962	1963	1964	1965 (*)	1962	1963	1964	1965 (*)	Average 1962-65		
0.77	0.29	0.35	0.46	0.43	0.38	1.64	1.75	2.14	2.23	1.94	14.71	15.49	16.46	18.01	16.17
0.71	0.12	0.07	0.35	0.22	0.19	1.95	0.88	1.82	2.91	1.89	14.31	18.70	15.86	23.49	18.09
-0.06	-0.17	-0.28	-0.11	-0.21	-0.19	+ 0.31	-0.87	-0.32	+ 0.68	-0.05	-0.40	+ 3.21	-0.60	+ 5.48	+ 1.92
3.38	2.34	2.40	2.90	3.05	2.67	11.86	12.59	15.90	16.39	14.18	85.49	88.91	94.71	108.83	94.49
2.52	1.45	1.58	1.77	1.88	1.67	8.50	10.19	10.83	10.98	10.12	66.27	69.08	75.36	82.61	73.33
1.46	1.14	1.01	1.27	1.53	1.24	3.27	3.56	4.29	4.44	3.89	21.60	20.50	26.30	26.51	23.73
+ 0.60	+ 0.25	-0.13	+ 0.24	+ 0.05	+ 0.24	-0.09	+ 1.16	-0.78	-0.97	-0.17	+ 2.38	+ 0.67	+ 6.95	+ 0.29	+ 2.57
4.15	2.63	2.75	3.36	3.48	3.05	13.50	14.34	18.04	18.62	16.12	100.20	104.40	111.17	126.84	110.66
(0.69)	(0.59)	(0.56)	(0.90)	(0.96)	(0.75)	(2.50)	(2.65)	(3.40)	(3.60)	(3.04)	(26.85)	(28.22)	(28.84)	(28.80)	(28.18)
4.69	2.71	2.66	3.39	3.63	3.10	13.72	14.63	16.94	18.33	15.90	102.18	108.28	117.52	132.61	115.15
+ 0.54	+ 0.08	-0.09	+ 0.03	+ 0.15	+ 0.05	+ 0.22	+ 0.29	-1.10	-0.29	-0.22	+ 1.98	+ 3.88	+ 6.35	+ 5.77	+ 4.49

TABLE 2

Saving as a percentage of gross national product (GNP) and of gross domestic capital formation (GCF) (1)
 (Average 1962-65)

	Germany		France		Italy		Netherlands		Belgium		UK		USA	
	% of GNP	% of GCF	% of GNP	% of GCF	% of GNP	% of GCF	% of GNP	% of GCF	% of GNP	% of GCF	% of GNP	% of GCF	% of GNP	% of GCF
<i>Public Sector</i>														
Gross fixed capital formation	4.4	16.3	2.7	12.4	2.7	12.0	4.9	18.6	2.6	12.5	2.2	12.0	2.6	14.7
Gross savings	7.2	26.8	3.9	18.1	2.9	12.8	4.3	16.4	1.1	5.6	2.1	11.7	2.9	16.3
Financial surplus (+) or deficit (-) before capital transfers	+ 2.8	+ 10.5	+ 1.2	+ 5.7	+ 0.2	+ 0.8	- 0.6	- 2.2	- 1.5	- 6.9	- 0.1	- 0.3	+ 0.3	+ 1.6
<i>Companies and households</i>														
Gross capital formation	22.5	83.7	20.8	87.6	20.1	88.0	21.3	81.4	18.2	87.5	15.8	88.0	15.1	85.3
(of which : housing)	(5.7)	(38.1)	(5.8)	(26.4)	(7.1)	(36.6)	(4.3)	(16.8)	(4.6)	(24.2)	(3.4)	(18.9)	(4.5)	(25.4)
Gross saving by companies	10.7	40.0	10.9	49.9	{ 21.2	92.7	12.8	48.8	11.4	54.6	11.3	62.9	11.7	66.1
Gross saving by individuals	8.7	32.3	6.3	28.8	{ 21.2	92.7	9.2	35.1	8.4	40.5	4.3	24.2	3.8	21.4
Financial surplus (+) or deficit (-) of the sector	- 3.1	- 11.4	- 3.6	- 8.9	+ 1.1	+ 4.7	+ 0.7	+ 2.5	+ 1.6	+ 7.6	- 0.2	- 0.9	+ 0.4	+ 2.2
<i>Gross national saving</i>														
Financial surplus (+) or deficit (-) in all sectors of the economy	- 0.3	- 0.9	- 2.4	- 3.2	+ 1.3	+ 5.5	+ 0.1	+ 0.3	+ 0.1	+ 0.7	- 0.3	- 1.2	+ 0.7	+ 3.8

Sources : SOBC, National Accounts 1955-65. For UK and USA : OECD, CIT.

(1) Public enterprises are included under "Companies" everywhere except in USA, where they are included under "Public Sector".

TABLE 3

Gross public-sector saving as a proportion of public-sector investment

(in %)

Country	1960	1961	1962	1963	1964	1965
I. Before capital transfers						
Germany	247.32	245.02	201.62	166.46	165.78	136.09
France	176.61	167.83	120.23	135.69	162.91	155.50
Italy	116.80	143.25	143.62	127.20	129.36	33.05
Netherlands	144.80	144.89	111.46	85.70	78.53	85.21
Belgium	(¹)	17.74	41.10	20.23	74.57	50.46
II. After capital transfers (²)						
Germany	199.18	186.61	137.59	122.11	123.79	87.77
France	113.87	118.10	72.73	84.62	107.87	105.24
Italy	93.12	99.61	101.77	88.49	90.29	(¹)
Netherlands	118.51	101.80	87.85	71.97	66.99	76.04

Source : SOEC, National Accounts 1955-1965.

(¹) Minus figure.(²) Except for Belgium, where capital transfers are not dealt with separately.

TABLE 4
*Self-financing of enterprises: gross rates
 (estimates from various sources)*

(in %)

Country	Average	1960	1961	1962	1963	1964
Germany						
(¹)	78	81	75	80	80	76
(²)	74	76	73	72	75	72
(³)	78	93	73	67	80	.
(⁴)	93					
France						
(¹)	64	72	66	66	63.8	57
(²)	71	82	68	72	67	68
(³)	70	98	63	56	63	.
(⁴)	79					
Italy						
(¹)	46	64	51	40	37	40
(²)	46					
Netherlands						
(¹)	67	74	68	69	66	60
(²)	113					
Belgium						
(¹)	75	75	76	75	73	71
UK						
(¹)	110	.	.	106	116	107
(²)	128	.	122	112	135	140
(³)	88	.	77	83	104	.
USA						
(¹)	99	.	.	98	99	99
(²)	117	106	115	122	124	120

N. B. For Notes and Sources see next page.

Notes and Sources for Table 4

i) *Germany*

- (¹) Monthly Report of the Bundesbank; enterprises excluding housing. The net balance of capital transfers is included in internal financing.
(²) OECD, CIT All enterprises excluding housing; Bundesbank.
(³) CECD, CIT Sample of 2 000 joint stock companies; Statistisches Bundesamt.
(⁴) 26 companies (1959-62); Euros syndicat.

ii) *France*

- (¹) Private enterprises, excluding farms and housing; Comptes de la Nation.
(²) OECD, CIT All non-financial enterprises; Comptes de la Nation.
(³) OECD, CIT 103 companies; sample calculated by the Crédit Lyonnais. Strongly weighted in favour of iron and steel and heavy industry, consequently over-estimating average decline in self-financing.
(⁴) 30 companies (1959-62); Euros syndicat.

iii) *Italy*

- (¹) Sample of 233 industrial companies whose gross fixed investment in 1964 accounted for about half of total gross fixed investment in industry, excluding building and construction and ENEL; Banca d'Italia.
(²) 18 companies (1959-62); Euros syndicat.

iv) *Netherlands*

- (¹) All enterprises - Le Poole Report, Table IX; Central Statistical Bureau.
(²) 9 big companies (1959-62); Euros syndicat.

v) *Belgium*

- (¹) OECD, CIT All private enterprises; Unofficial estimate provided by the Ministry of Finance.

vi) *United Kingdom*

- (¹) Saving and investment of private companies; Financial Statistics.
(²) OECD, CIT All non-financial enterprises; Central Statistical Office.
(³) OECD, CIT Sample of about 2 000 companies; Board of Trade.

vii) *United States*

- (¹) Saving and investment of American companies; Federal Reserve Bulletin.
(²) OECD, CIT All non-financial enterprises except farms; Flow of Funds Survey of Current Business, Nov. 65.

TABLE 5
Size of the capital markets combined (¹)

Country	1960	1961	1962	1963	1964	Average
<i>I. Funds supplied by the capital market (converted into \$ million)</i>						
Germany	10 610	10 597	9 512	11 470	13 210	11 080
France	6 161	6 956	7 785	8 811	8 793	7 701
Italy (²)	.	.	.	6 667	4 855	5 761
Netherlands	1 537	1 547	1 707	1 953	2 204	1 805
Belgium	1 400	1 844	1 400	2 120 (³)	.	1 691
UK	.	.	5 788	7 361	10 556	7 902
USA	34 400	47 200	56 000	63 100	70 000	54 100
<i>II. As a percentage of gross domestic capital formation</i>						
Germany	53.5	48.9	40.6	47.1	46.4	47.1
France	48.8	52.2	50.8	52.1	44.4	49.4
Italy (²)	.	.	.	60.7	45.5	53.2
Netherlands	50.8	46.0	49.9	54.1	46.4	49.3
Belgium	65.1	74.5	56.2	77.4	.	68.2
UK	.	.	43.5	51.5	59.6	52.3
USA	38.4	54.0	55.9	60.4	62.9	54.9

Sources : Funds supplied by the capital market : OECD, CIT. Gross domestic capital formation : SOEC General Statistical Bulletin.

(¹) To avoid double counting, funds collected on the securities market by credit institutions for lending purposes have been deducted.

(²) For Italy no data concerning funds supplied by the market are available : figures for funds collected by the market have therefore been used.

(³) OECD estimate.

TABLE 6

Supply of funds by sections of the capital market (1) (2)

	(in %)						
	Germany (1960-64)	France (1964-65)	Italy (1964-65)	Nether- lands (1960-64)	Bel- gium (1960-64)	UK (1962-64)	USA (1960-64)
Securities market	13.5	17.4	36.0	23.2	39.8	13.4	— 0.3
i) Issues of fixed-interest securities	6.6	7.8	13.0	19.6	25.4	13.4	— 0.3
ii) Issues of shares	7.3	9.5	16.0	3.6	14.4		
iii) Issues of short-term negotiable securities	— 0.4	—	7.0	—	—	—	—
Public sector	10.1	14.0	1.0	2.1	— 0.5	18.6	10.0
Banking system	39.3	27.3	28.0	20.0	27.3	37.9	29.9
Other financial intermediaries	32.4	29.8	35.0	56.6 (3)	33.3	24.3	55.0
Miscellaneous	4.7	11.5	—	— 1.9	—	5.8	6.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source : OECD, CIT. The figures for France were broken down in order to distinguish the funds supplied by the banking system from those supplied by the "Caisse des Dépôts et Consignations", which are shown under "Other financial intermediaries".

(1) Figures not available for Luxembourg.

(2) To "final borrowers" in the public and private sectors, excluding "financial intermediaries".

(3) For the Netherlands this includes direct loans and mortgage loans, which together account for 55.6 % of the total.

TABLE 7

Net domestic issues of medium- and long-term securities
 (Annual average 1960-65)

Country	Equity securities		Fixed-interest securities		All securities	
	In \$ million	As % of total	In \$ million	As % of total	In \$ million	As % of GCF
Germany	653.0	20.9	2 473.6	79.1	3 126.6	12.7
France	803.4	31.5	1 744.3	68.5	2 547.7	15.5
Italy	814.6	29.0	1 992.2	71.0	2 806.8	31.6
Netherlands	67.6	19.5	278.5	80.5	346.1	9.0
Belgium	148.6	21.4	547.0	78.6	695.6	25.2
Luxembourg	65.6	92.1	5.6	7.9	71.2	44.3 ⁽¹⁾
EEC	2 552.8	26.6	7 041.2	73.4	9 594.0	19.7
UK	724.2	39.8	1 092.9 ⁽²⁾	60.2	1 817.1	12.0
USA	1 016.0	3.1	32 368.6	96.9	33 384.6	32.8 ⁽¹⁾

Sources : Gross domestic capital formation, SOEC General Statistical Bulletin. See the sources given for the following tables : (i) Table 22 : issues of equity securities. (ii) Table 21 : net domestic issues of medium- and long-term fixed-interest securities. (iii) For the United Kingdom and the United States, OECD, CIT.

Notes : Except where otherwise indicated, issues of fixed-interest securities include normal long-term fixed-interest securities, mortgage debentures, tap issues of medium-term fixed-interest securities with a life of more than one year in Germany and Belgium, and of two years in the other countries, such as the deposit notes issued by the credit institutions and Treasury bills.

⁽¹⁾ 1960-1964.

⁽²⁾ Mortgage securities and Treasury bills excluded.

TABLE 8
Medium- and long-term loans to business and private customers

(in \$ '000 million)

Country	1962	1963	1964	1965	Average 1962-65
<i>Medium- and long-term loans to business and private customers (¹)</i>					
Germany	6.21	6.21	6.82	7.12	6.59
France	2.79	2.84	3.63	3.41	3.17
Italy	2.29	2.77	2.72	2.25	2.51
Netherlands	1.05	1.06	1.33	1.54	1.25
Belgium	0.40 (²)	0.49 (²)	0.65 (²)	0.58 (²)	0.53
EEC	12.74	13.37	15.15	14.90	14.04
<i>of which:</i>					
<i>Loans granted against deposits and own resources</i>					
Germany	5.02	4.75	5.11	5.70	5.15
France	2.43	2.40	3.04	2.80	2.67
Italy	1.14	1.53	1.58	1.26	1.38
Netherlands	0.98	0.94	1.24	1.38	1.14
Belgium	0.32 (²)	0.40 (²)	0.63 (²)	0.43 (²)	0.45
EEC	9.89	10.02	11.60	11.57	10.77
<i>Loans granted against funds borrowed on securities market</i>					
Germany	1.19	1.46	1.71	1.42	1.45
France	0.36	0.44	0.59	0.61	0.50
Italy	1.15	1.24	1.14	0.99	1.13
Netherlands	0.07	0.12	0.09	0.16	0.11
Belgium	0.08	0.09	0.02	0.15	0.09
EEC	2.85	3.35	3.55	3.33	3.27

Source : European Investment Bank, Annual Report 1966.

(¹) By financial institutions. Direct loans between individuals and advances by shareholders to their companies are not included. In Germany, France, Italy and the Netherlands, loans granted by the public sector are included in the figures.

(²) Including investment credits and fixed-term advances granted by the Belgian banks, assessed arbitrarily at 50 % of the item "advances" in their balance-sheets.

TABLE 9

*Net domestic issues of medium- and long-term fixed-interest securities
for the financing of the public sector in the EEC countries
(Average 1960-65)*

	Germany	France	Italy	Nether- lands	Belgium
<i>In millions of dollars</i>					
1. Central government	329.17 (1)	486.12		69.53	213.00
2. Local authorities	558.12	27.68	{ 216.88 (4)	105.93 (6)	105.66
<i>of which :</i>					
Direct issues	(9.16)	(27.68)	.	.	(3.33)
Issues by specialized credit institutions for the financing of local authorities	(548.96) (2)	(3)	(5)	.	(102.33)
3. Public enterprises	273.86	318.34	498.75	(7)	41.33
Total public sector	1 161.15	832.14	715.63	175.46	359.99
<i>As a percentage of total net domestic issues</i>					
1. Central government	13.3	27.9	{ 11.1	25.0	38.9
2. Local authorities	22.6	1.7		38.0	19.3
<i>of which :</i>					
Direct issues	(0.4)	(1.7)	.	.	(0.6)
Issues by specialized credit institutions for the financing of local authorities	(22.2)	.	.	.	(18.7)
3. Public enterprises	11.1	18.2	24.9	.	7.6
Total public sector	47.0	47.8	36.0	63.0	65.8

N. B. For Notes and Sources see next page.

Notes and Sources for Table 9

Sources: Germany: Monthly Reports of the Deutsche Bundesbank. France: Annual Report of the Conseil National du Crédit. Italy: Annual Reports of the Banca d'Italia. Netherlands: Annual Reports of the Nederlandsche Bank. Belgium: Information and documentation bulletin of the Banque Nationale de Belgique and Annual Reports of the Crédit Communal de Belgique.

Notes

(¹) Including the Länder.

(²) The funds collected in the form of "communal bonds" are mainly used for the financing of the communes, but also for the financing of other investments of the public sector, or even, in Germany, for construction backed by public guarantees. In Germany some of the bonds included in the figure are issued by private mortgage banks.

(³) Only the gross figure is available for communal bonds issued by the Crédit Foncier de France. 1960-65 average: \$37 810 000.

(⁴) Government loans and CCOP loans on Treasury account, except railway loans on Treasury account, which are included under public enterprises.

(⁵) In Italy there are no "communal bonds" closely comparable with the securities issued by the Crédit Foncier in France or the mortgage banks in Germany. But the "ordinary" bonds of the CCOP and the bonds issued by the special branches for the financing of the public works of the "Cassa di Risparmio delle Province Lombarde" and of the "Istituto Fondiario delle Venezie" are roughly comparable with communal bonds; it has not been possible to isolate the sums involved in these issues.

(⁶) Including the issues of the Netherlands Communes Bank, no net figure for issues by the provinces and communes being available.

(⁷) It has not been possible to isolate net issues of semi-public enterprises.

TABLE

Borrowing

(i) Including residential construction

	GERMANY				FRANCE			
	I		II		I		II	
	DM. '000 m.	%	DM. '000 m.	%	FF. '000 m.	%	FF. '000 m.	%
Total financing :								
1960	27.7	100.0	16.8	100.0	25.6	100.0	20.2	100.0
1961	35.6	100.0	23.8	100.0	27.8	100.0	22.3	100.0
1962	35.0	100.0	21.9	100.0	31.1	100.0	25.4	100.0
1963	36.0	100.0	21.8	100.0	34.3	100.0	27.6	100.0
1964	41.7 (*)	100.0	26.3 (*)	100.0				
Average 1960-64	35.3	100.0	22.2	100.0	29.7 (*)	100.0 (*)	23.9 (*)	100.0 (*)
Short-term loans from credit institutions :								
1960	5.6	20.2	5.5	32.7	7.1	27.7	7.0	34.7
1961	7.1	19.9	6.9	29.0	8.4	30.2	8.2	36.8
1962	2.9	8.3	2.6	11.9	9.7	31.2	9.5	37.4
1963	3.6	10.0	3.3	15.1	8.6	25.1	8.0	29.0
1964	5.1 (*)	12.2	5.1 (*)	19.4				
Average 1960-64	4.9	13.9	4.7	21.2	8.5 (*)	28.6 (*)	8.2 (*)	34.5 (*)
Medium- and long-term loans from credit institutions :								
1960	11.3	40.9	4.3	25.6	6.4	25.0	3.0	14.8
1961	15.6	43.8	7.8	32.8	7.7	27.7	4.3	19.3
1962	17.9	51.1	9.0	41.7	9.5	30.5	6.0	23.6
1963	18.5	51.4	8.8	49.1	11.0	32.1	7.3	26.4
1964	19.8 (*)	47.5	8.4 (*)	31.9				
Average 1960-64	16.6	47.0	7.7	34.7	8.7 (*)	28.8 (*)	5.2 (*)	21.0 (*)
Loans from insurance institutions :								
1960	1.7	6.1	1.1	6.5	.	.	.	.
1961	2.6	7.3	1.6	6.7	.	.	.	.
1962	2.6	7.4	1.6	7.3	.	.	.	.
1963	2.7	7.5	1.4	6.4	.	.	.	.
1964	2.8 (*)	6.7	1.5 (*)	5.7	.	.	.	.
Average 1960-64	2.5	7.1	1.4	6.3	.	.	.	.
Issue of fixed-interest securities :								
1960	0.2	0.7	0.2	1.2	2.3	9.0	2.3	11.4
1961	0.9	2.5	0.9	3.8	2.5	9.0	2.5	11.2
1962	2.2	6.3	2.2	10.0	2.8	9.0	2.8	11.0
1963	2.0	5.6	2.0	9.2	2.5	7.3	2.5	9.1
1964	1.7	4.1	1.7 (*)	6.5	.	.	.	.
Average 1960-64	1.4	4.0	1.4	6.3	2.5 (*)	8.6 (*)	2.5 (*)	10.1 (*)
Issue of shares :								
1960	2.8	10.1	2.8	16.7	2.6	10.2	2.6	12.9
1961	3.3	9.3	3.3	13.9	3.4	12.2	3.4	15.2
1962	2.2	6.3	2.1	9.6	4.5	14.5	4.5	17.7
1963	1.3	3.6	1.3	6.0	4.2	12.2	4.2	15.2
1964	2.2	5.3	2.1 (*)	8.0	.	.	.	.
Average 1960-64	2.4	6.8	2.3	10.4	3.7	12.3 (*)	3.7 (*)	15.3 (*)
Direct loans from Central government :								
1960	2.5	9.0	-0.4	-2.4	5.7	22.3	3.8	18.8
1961	4.0	11.2	1.2	5.0	4.2	15.1	2.3	10.3
1962	6.0	17.1	-3.2	14.6	2.7	8.7	0.7	2.8
1963	6.8	18.9	3.9	17.9	6.2	18.1	3.8	13.8
1964	6.0 (*)	14.4	3.4 (*)	12.9	.	.	.	.
Average 1960-64	5.1	14.4	2.3	10.4	4.7 (*)	16.0 (*)	2.7 (*)	11.4 (*)
Borrowing from abroad :								
1960	3.3	13.1	3.3	19.7	1.5	7.8	1.5	7.4
1961	2.1	6.0	2.1	8.8	1.6	5.8	1.6	7.2
1962	1.2	3.5	1.2	5.5	1.9	6.1	1.9	7.5
1963	1.1	3.0	1.1	5.0	1.8	5.2	1.8	6.5
1964	4.1 (*)	9.8	4.1 (*)	15.6	.	.	.	.
Average 1960-64	2.4	6.8	2.4	10.7	1.7 (*)	5.7 (*)	1.7 (*)	7.2 (*)

Sources : J. P. Delacour : "Remarques sur certains aspects du financement des investissements industriels dans les pays de la CEE". Table based on SOEC Statistical Bulletin : for France, Rapport sur les Comptes de la Nation; for Germany, Monthly Reports of the Deutsche Bundesbank; for the Netherlands, Nacionale Rekeningen; for Italy, Reports of the Banca d'Italia. For Column 1, sources brought up to date for Germany, Italy and Belgium and rectified for these countries in respect of issues of fixed-interest securities and shares.

by enterprises

(ii) Excluding residential construction

(¹) Provisional.

⁽²⁾ Average 1960-63.

⁽⁴⁾ Within these figures

(*) Within these figures it has not been possible to distinguish between medium- and long-term loans from credit institutions and the issue of fixed-interest securities. Commissariat général du Plan d'Équipement et de Productivité : Ve Plan 1966-1970. Rapport général de la Commission de l'Economie général et du Financement, Annexes, Tome II.

TABLE 11
Financial structure of enterprises

1963	Ratio of owners' equity to fixed assets	Ratio of long-term capital to fixed assets	Ratio of net working capital to stocks	Ratio of realizable and liquid assets to short-term debts	Ratio of medium- and long-term debt to cash flow	Ratio of medium- and long-term debt to owners' equity
Germany	0.90 ⁽¹⁾	1.27	0.72	0.82	2.44	0.41
France	0.94	1.31	0.68	0.78	2.64	0.39
Italy	0.67 ⁽¹⁾	1.07	0.25	0.64	4.31 ⁽²⁾	0.59
UK ⁽³⁾	1.26	1.49	1.04	1.05		0.18
USA	1.18	1.46	1.24	1.31	1.50	0.24

Sources: See Table 10 : Germany : Wirtschaft und Statistik, statistics on a large number of enterprises. France : SEDES balance-sheet data (219 companies in 10 industries, including iron and steel) Italy : Mediobanca (131 major non-financial companies from various industries). UK : Crédit Lyonnais (sample of 76 major non-financial companies). USA : US Treasury Department statistics (more than 32 000 non-financial companies).

⁽¹⁾ Including pension reserves in Germany (8.2 %) and severance payments in Italy (6 %).

⁽²⁾ The long-term debt/cash flow ratio for Italy has been worked out from a different sample, of 44 companies.

⁽³⁾ 1962.

TABLE 12

Net financial investment of non-financial sectors
(Average annual increase)

Funds	Germany (1960-64)	France (1959-63)	Italy (1963-65)	Netherlands (1960-64)	Belgium (1959-63)	UK (1962-65)	USA (1960-64)
1. <i>Funds invested in securities</i>							
Fixed-interest securities	19.3	15.3	22.0	14.0	31.8	-9.0	10.7
Shares	12.8	8.5	11.0	—	21.1	—	11.8
Shares	6.5	6.8	11.0	—	10.6	—	—1.1
2. <i>Funds entrusted to the banking system</i>							
Notes and coin	32.7	40.5	58.0	23.6	35.2	35.0	31.0
Sight deposits	{ 12.0	{ 31.5	{ 6.0	{ 7.9	{ 19.5	{ 35.0	{ 6.1
Time deposits	1.8	6.4	{ 25.0	{ 7.0	{ 5.0	{ 4.5	{ 24.9
Savings deposits	4.3	—	—	—	—	—	—
Other funds entrusted to the banks (except funds to be invested in securities)	14.6	2.6	4.0	0.1	6.3	—	—
3. <i>Funds entrusted to the public financial sector</i> (except time deposits) ⁽¹⁾ of which Treasury bills	—2.5	17.9	—	—1.3	—	9.0	9.2
	—	5.7	—	—0.8	0.1	—3.0	—
4. <i>Funds entrusted to other financial intermediaries</i> (except funds to be invested in securities)	33.0	26.3	20.0	61.8	32.9	65.0	49.0
Funds entrusted to savings institutions	18.4	20.0	8.0	22.7	15.7	5.0	27.2
Funds entrusted to specialized credit institutions	5.0	3.6	5.0	—	2.7	22.0	1.5
Funds entrusted to pension funds and to insurance companies	9.6	2.7	7.0	39.1	14.4	38.0	20.3
5. <i>Miscellaneous</i>	17.5 ⁽²⁾	—	—	1.8	—	—	—
6. <i>Total</i>	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source : OECD, CIT. The figures for Germany and for France have been broken down in order to distinguish the funds entrusted to savings institutions from those entrusted to the banking system and to specialized credit institutions.

(1) The definition of the public financial sector varies from country to country.

(2) These are mainly funds which the authorities provide — through public financial institutions — for residential construction.

TABLE 13

Movements of long-term private capital by country (1)

Country	1960	1961	1962	1963	1964	1965	(in \$ million)	
							Total	
Germany	R (2)	— 339.86	— 253.75	— 345.50	— 296.00	— 513.00	— 530.50	— 2 278.61
	NR (3)	+ 598.86	+ 461.25	+ 621.25	+ 1 085.25	+ 622.25	+ 974.50	+ 4 363.35
	Balance	+ 259.00	+ 207.50	+ 275.75	+ 789.25	+ 109.25	+ 444.00	+ 2 084.74
(of which EEC)	R	(— 127.37)	(— 17.25)	(— 38.50)	(— 122.25)	(— 230.75)	(— 236.25)	(— 772.37)
	NR	(+ 252.66)	(+ 71.00)	(+ 207.00)	(+ 338.00)	(+ 206.00)	(+ 433.75)	(+ 1 508.41)
	Balance	(+ 125.29)	(+ 53.75)	(+ 168.50)	(+ 215.75)	(— 24.75)	(+ 197.50)	(+ 736.04)
France	R	— 13.70	— 56.90	— 22.90	+ 52.50	— 45.96	— 175.00	— 261.96
	NR	+ 318.50	+ 427.10	+ 465.00	+ 458.20	+ 540.60	+ 239.79	+ 2 449.19
	Balance	+ 304.80	+ 370.20	+ 442.10	+ 510.70	+ 494.64	+ 64.79	+ 2 187.23
(of which EEC)	R	(— 3.90)	(— 44.60)	(— 53.00)	(— 22.76)	(— 64.96)	(— 39.00)	(— 228.22)
	NR	(+ 51.10)	(+ 96.10)	(+ 105.00)	(+ 136.10)	(+ 118.45)	(+ 161.00)	(+ 667.75)
	Balance	(+ 47.20)	(+ 51.50)	(+ 52.00)	(+ 113.34)	(+ 53.49)	(+ 122.00)	(+ 439.53)
Italy	R	.	.	.	— 263.90	— 221.00	— 301.00	— 785.90
	NR	.	.	.	+ 1 214.00	+ 1 063.00	+ 492.00	+ 2 769.00
	Balance (4)	+ 309.80	+ 499.90	+ 541.40	+ 950.10	+ 842.00	+ 191.00	+ 3 334.20
(of which EEC)	R	.	.	.	(— 48.90)	(— 56.00)	(— 137.00)	(— 241.90)
	NR	.	.	.	(+ 82.60)	(+ 292.00)	(+ 80.00)	(+ 454.60)
	Balance	.	.	.	(+ 33.70)	(+ 236.00)	(— 57.00)	(+ 212.70)

Netherlands	R	— 162.37	— 429.01	— 288.94	— 293.96	— 146.00	— 280.00	— 1 600.28
	NR	+ 345.01	+ 320.72	+ 278.36	+ 277.68	+ 287.00	+ 307.00	+ 1 815.77
Balance		+ 182.64	— 171.29	— 10.58	— 16.28	+ 141.00	+ 27.00	+ 215.49
(of which EEC) R		(— 186.84)	(— 206.92)	(— 155.24)	(— 126.24)	(— 67.00)	(— 120.00)	(— 862.24)
NR	(+ 64.47)	(+ 24.59)	(+ 99.44)	(+ 45.58)	(+ 83.00)	(+ 113.00)	(+ 430.08)	
Balance		(— 122.17)	(— 182.33)	(— 55.80)	(— 80.66)	(+ 16.00)	(— 7.00)	(— 432.16)
B.L.E.U.	R	.	.	.	.	.	.	.
	NR	.	.	.	.	.	.	.
Balance		— 80.00	+ 44.00	+ 24.00	+ 12.00	+ 168.00	+ 134.00	+ 302.00
(of which EEC) R		.	.	.	.	.	.	.
NR	.	.	.	.	.	.	.	.
Balance		.	.	.	.	.	.	.
Overall Balance (*)	+ 976.24	+ 960.31	+ 1 272.67	+ 2 245.77	+ 1 754.89	+ 860.79	+ 8 070.67	

Source : Balance-of-payments figures.

(*) Private capital placed for over one year.

(**) R = transactions by residents (export of capital net of liquidations and repayments).

(**) NR = transactions by non-residents (import of capital net of liquidations and repayments).

(*) These figures are artificially swollen by the repatriation, under cover of foreign names, of Italian capital previously exported as banknotes. The Banca d'Italia estimates the figures at \$75 million in 1962 and \$95 million in 1963. No estimate has been given for 1964 or 1965, but as the amount then repatriated in this way was smaller, the adjustment to be made is also smaller.

TABLE 14

Movements of long-term private capital by type

Country	1960	1961	1962	1963	1964	1965	Total
A. Direct investment							
Germany	- 61.77	- 75.00	- 81.25	- 98.25	- 233.00	- 299.00	- 848.27
NR ⁽¹⁾	+ 82.14	+ 108.50	+ 138.00	+ 144.25	+ 324.00	+ 614.00	+ 1 410.89
(of which EEC)	(- 13.81)	(- 13.25)	(- 13.75)	(+ 17.25)	(- 98.00)	(- 123.00)	(- 318.06)
NR	(+ 33.81)	(+ 18.75)	(+ 34.75)	(+ 81.00)	(+ 140.00)	(+ 124.00)	(+ 326.20)
France	- 54.40	- 99.50	- 49.40	- 95.90	- 132.00	- 189.00	- 620.20
NR	+ 117.30	+ 166.30	+ 251.00	+ 211.10	+ 232.00	+ 237.00	+ 1 224.70
(of which EEC)	(- 14.60)	(- 45.70)	(- 1.50)	(- 23.40)	(- 63.00)	(- 28.00)	(- 176.20)
NR	(+ 30.20)	(+ 62.70)	(+ 63.80)	(+ 66.20)	(+ 60.00)	(+ 58.00)	(+ 340.90)
Italy	-	-	-	- 168.30	- 136.00	- 178.00	- 482.30
NR	-	-	-	+ 338.30	+ 535.00	+ 286.00	+ 1 159.30
(of which EEC)	R	-	-	(- 37.10)	(- 25.00)	(- 61.00)	(- 123.10)
NR	-	-	-	(+ 39.00)	(+ 234.00)	(+ 38.00)	(+ 311.00)
Netherlands	- 93.95	- 93.92	- 106.35	- 137.57	- 145.00	- 124.00	- 700.79
NR	+ 26.32	+ 23.76	+ 55.52	+ 70.99	+ 89.00	+ 67.00	+ 332.59
(of which EEC)	R	(- 44.21)	(- 41.99)	(- 61.60)	(- 52.76)	(- 44.00)	(- 116.56)
NR	(+ 6.32)	(+ 23.20)	(+ 30.66)	(+ 10.50)	(+ 17.00)	(+ 15.00)	(+ 102.68)
B. Portfolio investment							
Germany	- 170.24	- 28.25	- 183.25	- 118.75	- 135.00	- 116.00	- 751.49
NR	+ 493.57	+ 368.75	+ 380.50	+ 717.00	+ 46.00	- 9.00	+ 1 996.82
(of which EEC)	R	(- 90.47)	(+ 23.00)	(- 4.75)	(- 44.50)	(- 25.00)	(- 161.72)
NR	(+ 219.76)	(+ 83.50)	(+ 118.50)	(+ 226.25)	(+ 9.00)	(+ 15.00)	(+ 672.01)
France	R	+ 61.20	+ 64.70	+ 1.50	+ 115.60	+ 78.00	+ 59.00
NR	+ 46.00	+ 120.00	+ 123.00	+ 129.80	+ 137.00	+ 115.00	+ 670.00
(of which EEC)	R	(+ 13.80)	(+ 6.70)	(- 45.40)	(+ 15.30)	(+ 3.00)	(+ 13.00)
NR	(+ 11.30)	(+ 21.80)	(+ 28.70)	(+ 32.40)	(+ 32.00)	(+ 54.00)	(+ 180.20)
Italy ⁽²⁾	R	-	-	- 20.40	- 14.00	- 12.00	- 46.40
NR	-	-	-	+ 595.60	+ 3.00	- 27.60	+ 571.60
(of which EEC)	R	-	-	(- 4.80)	(- 3.00)	(- 5.00)	(- 12.80)
NR	-	-	-	(+ 13.90)	(+ 11.00)	(+ 15.00)	(+ 39.90)
Netherlands	R	- 111.84	- 211.33	- 103.31	- 54.70	+ 13.00	- 514.18
NR	+ 282.37	+ 181.77	+ 206.35	+ 142.54	+ 90.00	+ 124.00	+ 1 027.03
(of which EEC)	R	(- 125.26)	(- 62.98)	(- 72.37)	(+ 27.00)	(- 48.00)	(- 412.83)
NR	(+ 55.78)	(+ 2.21)	(+ 59.94)	(+ 21.55)	(+ 52.00)	(+ 65.00)	(+ 256.48)
B.I.E.U. ⁽⁴⁾	R	- 90.00	- 94.00	- 60.00	- 102.00	- 26.00	- 414.00
NR	+ 10.00	+ 30.00	+ 16.00	+ 16.00	+ 2.00	+ 10.00	+ 84.00
(of which EEC)	R	(- 46.00)	(- 62.00)	(- 38.00)	(- 96.00)	(- 22.00)	(- 316.00)
NR	(+ 8.00)	(+ 12.00)	(+ 8.00)	(+ 6.00)	(+ 8.00)	(+ 2.00)	(+ 44.00)

		C. Credits - one year and over (5)			
		-	+	-	+
Germany	R	- 78.33	- 105.75	- 24.75	- 37.50
	NR	+ 45.05	+ 22.75	+ 129.25	+ 243.50
	(of which EEC)	(+ 16.90)	(- 18.00)	(- 5.75)	(- 7.00)
France	R	- 26.66	- 23.50	(+ 57.25)	(+ 97.27)
	NR	- 20.50	- 22.10	- 15.70	- 35.90
	(of which EEC)	+ 155.20	+ 130.80	+ 91.10	+ 117.30
Italy	R	- 3.10	- 5.60	(- 11.20)	(- 22.50)
	NR	(+ 9.60)	(+ 11.60)	(+ 12.50)	(+ 37.50)
Netherlands	R	.	.	.	.
	NR	.	.	.	.
	(of which EEC)	.	.	.	.
	NR	.	.	.	.
	(of which EEC)	R	.	.	.
	NR	- 55.63	- 122.38	- 64.09	- 87.60
	(+ 17.37)	(+ 33.16)	(+ 107.18)	(+ 12.71)	(+ 56.97)
	NR	(+ 2.63)	(- 34.81)	(- 1.10)	(- 26.52)
				(+ 10.22)	(+ 12.15)
Germany	R	- 29.52	- 44.75	- 56.25	- 41.50
	NR	- 21.90	- 38.75	- 26.50	- 19.50
	(of which EEC)	(- 6.19)	(- 9.00)	(- 14.25)	(- 14.50)
France	R	(- 3.57)	(- 7.75)	(- 3.50)	(- 3.25)
	NR	.	.	(+ 43.70)	(+ 68.70)
	(of which EEC)	R	.	.	.
	NR	.	.	(+ 0.10)	(+ 0.10)
Italy	R	.	.	(+ 5.10)	(+ 7.84)
	NR	.	.	.	.
	(of which EEC)	R	.	.	.
	NR	.	.	.	.
Netherlands	R	- 1.05	- 1.38	- 15.19	- 14.09
	NR	+ 3.16	+ 8.01	+ 3.78	+ 7.18
	(of which EEC)	(- 0.26)	(+ 1.10)	(- 4.14)	(- 5.25)
	NR	(- 0.26)	(+ 0.28)	(- 1.38)	(- 1.38)

Source : See Table 13.

(1) R = transactions by residents (export of capital net of liquidations and repayments).

(2) NR = transactions by non-residents (import of capital net of liquidations and repayments).

(3) This heading includes various transactions in respect of investment in real estate.

(4) This heading comprises net purchase of foreign securities by residents and net purchase of B.I.E.U. securities by non-residents.

(5) For France (1964), Italy and the Netherlands (1964 and 1965), this heading includes miscellaneous transactions, no breakdown being at present available which distinguishes credits for one year and over from miscellaneous transactions.

(6) For France this heading, not introduced until 1962, covers funds repatriated anonymously and compensation for nationalization. These operations were previously included under portfolio investments. For Germany this heading includes investment in real estate.

TABLE 15
Public issues of foreign bonds 1961-65
(Gross totals in \$ million)

Issues	1961	1962	1963	1964	1965	1961-65 Total
A. Foreign issues in local currency	199.71	651.36	568.63	588.00	609.41	3 011.11
Germany (1)	24.90	5.00	40.00	35.00	—	104.90
France	—	—	—	30.38	25.32	55.70
Italy (2)	24.00	24.00	24.00	—	24.00	96.00
Netherlands	159.39	52.49	—	15.20	29.00	256.08
Belgium	—	—	—	—	12.00	12.00
Luxembourg	—	6.00	—	—	0.60	6.60
Total EEC	208.29	87.49	64.00	80.58	90.92	531.28
United Kingdom (3)	—	5.60	130.09	123.62	36.82	296.13
Switzerland	242.82	149.77	131.71	93.30	86.67	704.27
Total Europe	451.11	248.86	325.80	297.50	214.41	1 531.68
United States (4)	148.60	402.50	242.83	290.50	395.00	1 479.43
B. Euro-bond issues (5)	5.00	25.00	132.22	650.75	957.52	1 770.49
of which :						
Units of account	5.00	5.00	53.00	10.00	—	73.00
Currency option	—	20.00	—	14.00	64.40	98.40
DM	—	—	—	200.05	415.00	615.05
Swiss Francs	—	—	13.72	—	—	13.72
Dollar subject to IET	—	—	65.50	426.70	478.12	970.32
Total (A + B)	604.71	676.36	700.85	1 238.75	1 566.93	4 781.60

Source : EEC Directorate-General for Economic and Financial Affairs; Directorate for Studies.

(1) Since 1 April 1964, when the establishment of a withholding tax (Kuponsteuer) on income from German bonds held by non-residents was announced, loans in DM issued in Germany by non-residents have been considered Euro-bond issues as a very high percentage of them has been subscribed by non-residents.

(2) For 1965, this does not include the Italian tranche of the ENEL parallel loan, this being treated as a domestic loan.

(3) Including loans floated by Commonwealth countries.

(4) Excluding dollar issues placed (a) outside the USA, (b) inside the USA, but subject to the Interest Equalization Tax, and (c) dollar issues which may not be sold in the USA : the \$400 million loan of the Development Corporation for Israel, which began in 1964, and Canadian loans are also excluded.

(5) This comprises issues placed mainly on markets other than that of the country in whose currency they are denominated, in particular the following :

i) Dollar issues subject to Interest Equalization Tax (IET)

ii) DM issues floated after 1 April 1964 (see Note 1)

iii) Issues with \$/DM and £/DM currency options

iv) Issues in units of account

v) Swiss franc issues floated abroad.

TABLE 16

*Public issues of foreign bonds, classified by market of issue and residence of issuer
(Gross totals 1961-65)*

Country	A. Value of bonds issued by borrowers resident in countries shown		B. Value of bonds issued in countries shown by borrowers resident in						Total	Balance (A - B)	
	EEC markets	Euro-bond market	Total	EEC ⁽¹⁾	Other international organizations ⁽²⁾	UK	USA	Scandinavia	Japan	Other	
Germany			140.62	85.00	1.90				10.00	75.00	3.00
France	24.86	20.00	120.95	55.70	24.00					96.00	104.90
Italy	34.82	30.00	70.09	34.29	204.11	72.00				55.70	55.72
Netherlands		135.00	11.43	67.05	158.70	33.15	5.52		33.85	12.00	69.25
Belgium	46.82	55.62	81.29	168.11	12.00					256.08	108.11
Luxembourg		20.00	13.72	13.72	6.60					12.00	189.03
EIB and ECSC	213.50	157.50	384.72							6.60	156.11
											7.12
											384.72
Total	320.00	418.12	1 103.28	320.00	59.05	5.52			43.85	75.00	531.28
Other international organizations ⁽²⁾											572.00
Euro-bond issues ⁽³⁾											
Switzerland	59.05	122.50	641.76	823.31	418.12	122.50	25.00	297.00	575.87	164.50	1 770.49
UK					310.16	77.76	124.51	37.73	60.04	11.43	823.31
USA	5.52	25.00	297.00	124.51	155.03	8.40			4.06	14.00	-1 770.49
Japan	75.00	164.50	37.73	334.73	55.00	532.60			225.50	239.00	704.27
Scandinavia	43.85	575.87	264.43	503.93	909.32						-1 441.10
Other	27.86	167.50	289.60	975.00	23.00						1 447.33
Total	531.28	1 770.49	2 502.83	4 804.60	1 103.28	823.31	155.03	334.73	909.32	503.93	1 479.43
											503.93
											909.32
											952.00
											0.00

Source : See Table 15.

(1) Including issues by EIB and ECSC.

(2) This heading includes issues by : International Bank for Reconstruction and Development, Inter-American Development Bank, Council of Europe Resettlement Fund, Eurofima.

(3) See Table 15, note (5).

(4) This figure does not correspond to the total of Table 15 because it includes a \$23 million loan floated in March 1965 by the International Bank for Reconstruction and Development on the Canadian market.

TABLE 17

Gross fixed capital formation in the housing sector

Country	1960		1961		1962		1963		1964		1965		Average 1960-65	Average Per inhabitant 1960-65
	in \$ million													
Germany	3 747.62	4 452.50	4 942.50	5 307.50	6 092.50	6 370.00	5 152.10	90						
France	2 831.68	3 125.38	3 457.56	4 134.09	5 424.34	6 218.35	4 198.57	89						
Italy	2 016.00	2 270.40	2 828.80	3 459.20	4 075.20	3 843.20	3 082.13	61						
Netherlands	475.79	510.22	516.57	556.08	773.48	922.65	625.80	53						
Belgium	586.00	646.00	588.00	560.00	898.00	956.00	705.67	76						
Luxembourg	19.92	27.80	29.00	30.72	.	.	26.86	84						
EEC	9 677.01	11 032.30	12 362.43	14 047.59	17 263.52	18 310.20	13 782.17	78						
Germany	22.3	22.1	21.9	22.3	22.3	22.3	21.3	22.0						
France	25.3	24.5	24.3	25.6	29.0	30.7	30.7	27.0						
Italy	27.0	26.6	28.8	30.2	35.4	35.8	35.8	31.1						
Netherlands	17.9	16.9	16.1	16.3	18.2	19.8	19.8	17.7						
Belgium	27.5	27.0	22.4	20.6	27.4	27.6	27.6	25.5						
Luxembourg	18.2	21.9	20.3	17.4	.	.	.	19.3						
EEC	23.8	23.5	23.4	24.2	26.3	26.4	26.4	24.8						

Source : SOEC, National Accounts 1955-65.

TABLE 18
Analysis of net purchases of fixed-interest securities (1)

	\$ m.	Per cent						Average
		1960	1961	1962	1963	1964	1965	
<i>Germany</i>								
Enterprises, households and open-end investment funds	908.09	30.3	26.5	29.8	32.5	45.0	43.7	36.0
Non-residents	178.15	29.7	3.4	7.6	16.8	-0.9	0.8	7.1
Local authorities	70.95	7.9	5.2	1.6	3.7	1.9	0.3	2.9
Social insurance institutions	327.76	20.2	9.6	15.5	10.1	10.7	16.4	13.0
Insurance companies and pension funds	231.51	15.6	7.3	9.4	7.3	8.8	10.4	9.2
Banks and specialized credit institutions	802.00	-3.7	48.0	36.1	29.6	34.5	28.4	31.8
Total	2 518.46	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<i>France</i>								
Enterprises, households	1 069.10	55.5	56.5	56.7	72.8	71.4	72.8	66.4
Non-residents (2)	.	.	.	.	.	.	.	.
Central government and local authorities	6.71	0.6	0.5	—	0.4	0.5	0.5	0.4
Social insurance institutions	98.89	9.2	9.6	8.2	5.7	5.4	1.9	6.0
Banks and specialized credit institutions	1.95	0.1	—	0.4	0.2	0.2	—	0.1
Caisse des dépôts et consignations, savings banks	68.60	-3.4	4.8	9.3	1.7	5.0	6.5	4.3
Investment companies	365.43	38.0	28.6	25.4	9.7	17.5	18.3	22.8
Regional development companies							9.5	
Insurance companies								
Total	1 610.68	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<i>Italy</i>								
Enterprises, households and non-residents	728.93	.	63.5	26.8	31.3	19.8	39.5	35.0
Insurance companies	40.67	.	3.8	3.7	1.9	0.7	1.1	1.9
Social insurance institutions	129.34	.	3.3	7.1	5.8	15.8	0.2	6.2
Cassa Depositi e Prestiti and post office savings banks	238.72	.	1.8	10.3	30.6	19.5	0.1	1.1
Banks and specialized credit institutions	942.69	.	27.6	52.1	30.4	44.2	59.1	55.8
Total	2 080.35	.	100.0	100.0	100.0	100.0	100.0	100.0

TABLE 18 (cont.)

	\$ m.	Per cent						
		Average	1960	1961	1962	1963	1964	1965	Average
<i>Netherlands (3)</i>								
Enterprises, households, banks								
Specialized credit institutions, open-end investment funds, non-residents (4)	148.91	33.0	43.1	63.1	36.4	113.8	.	54.0
Social insurance institutions	17.23	5.8	8.7	10.2	3.3	4.5	.	6.3
Pension funds	39.67	21.1	20.5	6.4	19.7	-3.4	.	14.4
Life assurance	0.36	6.5	1.1	-2.2	2.7	-12.5	.	0.1
Postal giro services	7.89	2.9	3.6	1.4	3.3	2.4	.	2.9
Postal savings banks	10.29	4.0	2.9	9.4	3.3	0.1	.	3.7
General savings banks	37.58	16.9	17.7	17.1	14.5	-0.2	.	13.6
Building societies	0.33	0.2	0.5	—	—	—	.	0.1
Agricultural savings banks	13.55	10.0	1.9	-5.4	16.8	-4.7	.	4.9
Total	275.81	100.0	100.0	100.0	100.0	100.0	.	100.0
<i>Belgium (5)</i>								
Enterprises, households, open-end investment funds, non-residents								
Local authorities	181.20	44.0	50.7	35.2	14.8	86.7	.	45.9
Social insurance institutions	7.20	6.5	0.9	1.8	1.8	-0.6	.	1.8
Fonds des rentes	0.80	0.7	-0.9	-2.2	-1.2	6.1	.	0.3
Savings banks and mortgage companies	5.60	8.6	1.3	3.3	3.6	-8.9	.	1.4
Insurance companies and pension funds	33.20	12.2	5.3	12.3	24.4	-11.1	.	8.4
Banks and specialized credit institutions	85.20	27.3	13.2	11.9	40.8	25.0	.	21.6
Total	81.20	0.7	29.5	37.7	15.8	2.8	.	20.6
	394.40	100.0	100.0	100.0	100.0	100.0	.	100.0

Sources : Germany : Monthly Report of the Deutsche Bundesbank, April 1966. France : Comptes de la Nation. Italy : Annual reports of the Banca d'Italia. Netherlands : Maandstatistiek van het financiewezien, August 1965, and annual reports of the Nederlandsche Bank. Belgium : Bulletin d'information et de documentation of the Banque Nationale de Belgique, May 1966.

(*) Unless shown otherwise, purchases of domestic or foreign ordinary bonds, mortgage bonds and convertible debentures offered for public subscription or placed privately (including, in Germany, France and Luxembourg, purchases of medium-term securities at fixed interest).

(**) The only figure available is that for total purchases of securities in France by non-residents. In the "Comptes de la Nation" this figure was taken to represent purchases of bonds.

(*) Only securities offered for public subscription.

(*) The item "households, enterprises, banks, specialized credit institutions, open-end investment funds and non-residents" has been calculated by deducting the total purchases of institutional investors from total domestic and foreign issues offered for public subscription on the domestic market (only figures published).

(*) Public-sector issues only.

TABLE 19

Apparent and real yields of fixed-interest securities

Country	Yield at current prices				Real yield at constant prices			
	Average 1958		End of 1965		Average 1958		End of 1965	
	Public sector	Private sector	Public sector	Private sector	Public sector	Private sector	Public sector	Private sector
Germany	6.60	6.70	7.70	7.60	2.40	3.82	3.91	4.82
France	7.20	8.25	5.50	6.50	4.05	2.70	3.59	1.24
Italy	6.20	6.70	5.70	6.50	3.70	2.17	2.60	1.73
Netherlands	4.40	4.55	5.95	6.00	3.35	0.92	1.05	2.28
Belgium	6.45	5.30	5.65	5.95	2.00	4.11	3.05	3.37

Source : European Investment Bank.

TABLE

Net domestic issues of medium- and

	\$ million				
	1960	1961	1962	1963	1964
<i>Germany</i>					
Federal Government and Länder	139.96	290.93	158.72	412.45	433.22
Local authorities (4)	232.02	464.20	463.20	639.75	751.50
Financial institutions (3)	617.93	1 029.35	1 204.32	1 466.62	1 735.02
Public enterprises (4)	145.31	190.75	402.27	410.75	334.50
Private enterprises	— 89.62	25.12	147.90	85.80	83.52
Total	1 045.60	2 000.35	2 376.41	3 015.37	3 337.76
<i>France</i>					
Central government	— 226.86	166.09	506.38	1 124.16	698.80
Local authorities (5)	— 14.18	30.38	16.20	30.38	34.43
Financial institutions (6)	287.62	415.22	526.63	631.96	909.46
Public enterprises (7)	190.40	220.78	253.19	350.41	368.64
Private enterprises	328.13	354.47	279.52	267.37	168.12
Total	565.11	1 186.94	1 581.92	2 404.28	2 179.45
<i>Italy</i>					
Central government and local authorities	195.68	— 12.80	— 174.40	— 320.00	112.00
Institutions issuing for account of the Treasury (8)	63.04	228.80	273.60	206.40	254.40
Other financial institutions (9)	720.00	893.28	1 213.44	1 292.00	1 175.20
Public enterprises (10)	41.44	184.00	96.00	440.00	758.40
Private enterprises	307.84	220.80	329.60	150.40	52.80
Total	1 328.00	1 514.08	1 738.24	1 768.80	2 352.80
<i>Netherlands</i>					
Central government	159.60	10.74	46.99	135.25	4.30
Local authorities (11)	178.68	48.62	55.80	110.50	79.28
Mortgage banks	30.26	19.34	36.46	39.78	82.32
Specialized credit institutions (12)	41.58	14.92	83.98	— 4.97	38.12
Private and semi-public institutions {					
Non-profit-making institutions }					
Total	410.12	93.62	223.23	280.56	204.02
<i>Belgium</i>					
Central government	298.00	120.00	270.00	102.00	158.00
Local authorities (13)	84.00	78.00	128.00	62.00	104.00
Independent funds (14)	— 8.00	42.00	38.00	32.00	86.00
Financial institutions (15)	156.00	196.00	170.00	104.00	44.00
Public enterprises (16)	— 14.00	28.00	20.00	34.00	— 10.00
Private enterprises	10.00	16.00	64.00	62.00	60.00
Total	526.00	480.00	690.00	396.00	442.00
<i>Luxembourg</i>					
Total	6.10	— 1.90	13.10	— 1.70	4.10
<i>EEC</i>					
Total	3 880.93	5 273.09	6 622.90	7 863.31	8 520.13

N. B. For Notes and Sources see p. 368.

long-term fixed-interest securities (¹)

		Per cent						
1965	Annual average	1960	1961	1962	1963	1964	1965	Annual average
539.69	329.17	13.4	14.5	6.7	13.7	13.9	17.6	13.3
798.08	558.12	22.2	23.2	19.5	21.2	22.5	26.0	22.6
1 478.15	1 255.23	59.1	51.5	50.7	48.6	52.0	48.2	50.7
159.60	273.86	13.9	9.5	16.9	13.6	10.0	5.2	11.1
90.80	57.25	— 8.6	1.3	6.2	2.9	2.6	3.0	2.3
3 066.32	2 473.63	100.0	100.0	100.0	100.0	100.0	100.0	100.0
648.10	486.12	— 40.1	14.0	32.0	46.7	32.1	25.4	27.9
68.88	27.68	— 2.6	2.5	1.0	1.3	1.6	2.7	1.7
1 148.47	653.23	50.9	35.0	33.3	26.3	41.7	45.1	37.4
526.63	318.34	33.7	18.6	16.0	14.6	16.9	20.7	18.2
155.96	258.93	58.1	29.9	17.7	11.1	7.7	6.1	14.8
2 548.10	1 744.30	100.0	100.0	100.0	100.0	100.0	100.0	100.0
257.60	9.68	14.7	— 0.9	— 10.0	— 18.1	4.8	7.9	+ 0.6
801.60	304.64	4.7	15.1	15.7	11.6	10.8	24.6	15.3
1 153.62	1 074.59	54.2	59.0	69.8	73.0	49.9	35.5	53.9
888.00	401.31	3.1	12.2	5.5	24.9	32.2	27.3	20.1
150.40	201.97	23.3	14.6	19.0	8.6	2.3	4.7	10.1
3 251.22	1 992.19	100.0	100.0	100.0	100.0	100.0	100.0	100.0
60.33	69.53	38.9	11.5	21.0	48.2	2.1	13.1	25.0
162.71	105.93	43.6	51.9	25.0	39.4	38.8	35.4	38.0
54.14	43.72	7.4	20.6	16.3	14.2	40.3	11.8	15.7
182.60	59.37	10.1	16.0	37.7	— 1.8	18.8	39.7	21.3
459.78	278.55	100.0	100.0	100.0	100.0	100.0	100.0	100.0
330.00	213.00	56.6	25.0	39.1	25.8	35.7	44.1	38.9
178.00	105.66	16.0	16.2	18.6	15.6	23.5	23.8	19.3
14.00	34.00	— 1.5	8.7	5.5	8.1	19.5	1.9	6.2
172.80	140.47	29.6	40.8	24.6	26.3	10.0	23.1	25.7
— 14.00	7.33	— 2.7	5.8	2.9	8.6	— 2.3	— 1.9	1.4
67.32	46.55	2.0	3.5	9.3	15.6	13.6	9.0	8.5
748.12	547.01	100.0	100.0	100.0	100.0	100.0	100.0	100.0
14.00	5.62	.	.	.	.	.	.	.
10 087.54	7 041.30	.	.	.	.	.	.	.

Notes and Sources for Table 20

Sources : Germany : Monthly reports of the Deutsche Bundesbank. France : Rapports annuels du Conseil National du Crédit. Italy : Annual reports and Bulletin of the Banca d'Italia. Netherlands : Annual reports of the Nederlandsche Bank. Belgium : Bulletin d'information et de documentation of the Banque Nationale de Belgique. Rapports annuels de la Commission Bancaire. Bulletin Statistique of the Institut National de la Statistique. Luxembourg : SOEC.

(¹) Only public issues by residents of member countries on their home market, including bonds issued on tap, mortgage bonds, medium-term securities (medium-term notes and certificates (bons de caisse) and Treasury bonds) with a currency of one year and over in Germany and Belgium, 18 months in Italy, and two years in the other countries.

(²) Includes direct issues by local authorities and issues of communal bonds, part of which is used to finance building.

(³) Medium-term notes and certificates and mortgage bonds.

(⁴) Federal Post Office and Federal Railways.

(⁵) Not including the communal bonds of the Crédit Foncier de France, no net figure for which is available. Gross issues averaged \$ 37.81 m. a year in the period from 1960 to 1965.

(⁶) Crédit National, Crédit Foncier and Caisse Nationale de Crédit Agricole.

(⁷) Poste et Télécommunications, Société Nationale des Chemins de Fer Français, Electricité et Gaz de France, Charbonnages de France, Caisse Nationale des Autoroutes.

(⁸) Issues of the Consorzio di Credito per le Opere Pubbliche (CCOP) to finance railways, the Green Plan (for agricultural development), ANAS (Azienda Autonoma delle Strade Statali, or highway service), etc.

(⁹) Public boards, "people's banks", ordinary credit banks and first-category pawnbrokers.

(¹⁰) IRI (Istituto per la Ricostruzione Industriale), ENEL (Ente per l'Energia Elettrica) and ENI (Ente Nazionale Idrocarburi).

(¹¹) Provinces, communes and the Bank voor Nederlandsche Gemeenten.

(¹²) The only available breakdown is for gross issues. The 1960-65 annual average is (in \$ million) :

Specialized credit institutions	8.14
Private and semi-public enterprises	55.37
Non-profit-making institutions	7.28
Miscellaneous	3.86
Total	74.65

(¹³) Provinces, communes and Crédit communal de Belgique.

(¹⁴) Road fund.

(¹⁵) Société Nationale de Crédit à l'Industrie, Caisse Nationale de Crédit Professionnel, Institut National de Crédit Agricole, Office Central de Crédit Hypothécaire, miscellaneous building societies, private mortgage companies, banks and savings banks.

(¹⁶) Société Nationale des Chemins de Fer Belges, Société Nationale des Chemins de Fer Vicinaux, Société Nationale de Distribution des Eaux, SABENA, RTT and various inter-communal companies.

TABLE 21

Tap issues of medium- and long-term fixed-interest securities

	\$m.	Percentage of total net domestic issues						
		Aver-age 1960-65	1960	1961	1962	1963	1964	Aver-age 1960-65
<i>Germany</i>								
Mortgage bonds (Pfandbriefe)	889.83	50.7	41.3	38.3	30.8	33.1	33.4	36.0
Communal bonds	548.96	21.5	23.3	18.6	21.5	22.0	25.1	22.2
Medium-term notes and certificates	164.30	12.9	3.5	4.5	2.8	11.6	6.5	6.6
Total	1 603.09	85.1	68.1	61.4	55.1	66.7	65.0	64.8
<i>France</i>								
Three- or five-year Treasury bonds	485.45	—	26.8	43.0	29.9	26.9	24.6	27.8
Five-year certificates of the Caisse Nationale de Crédit Agricole	254.87	20.2	11.3	12.4	10.4	15.7	19.4	14.7
Total	740.32	20.2	38.1	55.4	39.5	42.6	44.0	42.5
<i>Italy</i>								
Mortgage bonds (Car-telle fondiarie)	386.64	16.4	24.3	25.9	27.6	16.3	12.7	19.4
Medium-term deposit certificates issued by banks and public credit institutions	67.71	4.6	4.7	3.7	2.9	1.6	3.7	3.4
Total	454.35	21.0	29.0	29.6	30.5	17.9	16.4	22.8
<i>Netherlands</i>								
Mortgage bonds (Pandbrieven)	43.71	7.4	20.7	16.3	14.2	40.3	11.8	15.7
Five-year Treasury bonds	— 0.06	0.6	— 67.0	32.3	— 11.4	— 24.4	15.1	—
Total	43.65	8.0	— 46.3	48.6	2.8	15.9	26.9	15.7
<i>Belgium</i>								
Mortgage bonds	20.10	3.4	4.6	4.9	2.0	3.6	3.3	3.8
Medium-term certifi-cates of the Crédit Communal	89.00	19.0	19.6	17.2	13.2	19.9	11.0	16.2
Other medium-term deposit certificates	120.71	21.3	26.2	33.3	25.2	12.7	13.4	22.1
Total	229.81	43.7	50.4	55.4	40.4	36.2	27.7	42.1

Source : See Table 20.

TABLE 22
Issues of variable-yield securities (1)

Country	(in \$ million)						
	1960	1961	1962	1963	1964	1965	Average 1960-65
Germany	664.9	823.9	549.0	329.7	560.8	989.7	653.0
France	480.0	656.3	808.2	844.6	1 014.8	1 016.8	803.4
Italy	793.6	823.4	1 144.8	636.0	887.7	601.8	814.6
Netherlands	49.1	39.8	128.7	22.7	61.1	52.2	67.6
Belgium	125.3	120.3	165.0	130.9	221.3	128.7	148.6
Luxembourg	15.9	32.4	55.0	85.0	88.2	117.0	65.6
Total	2 128.8	2 496.1	2 850.7	2 048.9	2 833.9	2 906.2	2 552.8

Sources: Germany: Monthly reports of the Deutsche Bundesbank. France: Rapport annuel du Conseil National du Crédit. Italy: Annual reports of the Banca d'Italia. Netherlands: Annual reports of the Nederlandsche Bank. Belgium: Bulletin d'information et documentation of the Banque Nationale de Belgique. Luxembourg: General Statistical Bulletin of the Statistical Office of the European Communities.

(1) Sums actually paid up. Issues of convertible debentures are shown in a separate table and are not included in these figures.

TABLE 23

Market value of variable-yield securities (1)

(in \$ '000 million)

Country	1960	1961	1962	1963	1964	1965	Average
Germany	24.6	24.2	18.6	20.9	22.2	19.5	21.7
France	17.5	21.8	23.0	20.8	20.0	18.7	20.3
Italy	6.5	10.5	7.2	10.0	7.4	9.3	8.4
Netherlands	7.9	8.4	8.0	9.0	9.9	9.4	8.8
Belgium	.	.	4.2	4.7	4.9	4.2	4.5
EEC (2)	56.5	64.9	61.0	65.4	54.4	61.1	63.7
UK (3)	142.8	140.0	154.0	168.0	210.0	218.4	172.2
USA	307.0	387.8	345.8	411.3	474.3	537.5	410.6

Sources: Germany: Wirtschaft und Statistik. France: Rapports annuels du Conseil National du Crédit. Italy: Banca Nazionale del Lavoro. Netherlands: Maandstatistiek van het Financiewezen. Belgium: Commission de la Bourse de Bruxelles. United Kingdom: Statistics relating to Securities quoted on the London Stock Exchange (for the year ending 31 March 1966). United States: Survey of Current Business.

(1) The market value figures have been established, with due regard to the number of securities listed, on the basis of the first price quoted (cash dealings) at the last stock exchange session of the year. For the EEC countries they embrace only the securities of the country concerned, but for the United Kingdom and the United States the figures take in all securities listed on the stock exchanges. The figures cover securities listed on the following stock exchanges: in Germany, all stock exchanges except Berlin, in France, the Paris stock exchange, in Italy, all stock exchanges, in the Netherlands, the Amsterdam stock exchange, in Belgium, the Brussels stock exchange, and in the United States the New York Stock Exchange.

(2) Not including Luxembourg, no figures being available.

(3) For the United Kingdom, the only figures available are those on the aggregate market value of all fixed-interest and variable-yield securities. In March 1966 the market value of the variable-yield securities was about 72% of the total.

TABLE 24

Assets of investment companies (open-end and closed-end)

(in \$ million)

Country	1960	1961	1962	1963	1964
Germany	786.1	777.3	655.3	730.4	825.1
France	642.8	777.0	735.7	1 058.6	1 095.3
Netherlands ⁽¹⁾	427.7	524.0	529.5	679.2	813.8
Belgium	98.0	113.6	103.2	112.3	113.9
Luxembourg ⁽²⁾	65.3	95.0	100.5	131.1	121.9

Sources : Germany : Monthly reports of the Deutsche Bundesbank. France : Annuaire de l'association des sociétés françaises d'investissement for 1960, 1961, 1962. For 1963 and 1964 information supplied directly by this association. Netherlands : Maandstatistiek van het Financiewesen. Net assets have been calculated from the balance sheets by subtracting from total assets the three "debit" items (debenture loans, sundry creditors, dividends to be paid) and also capital not paid up. Belgium : Rapports annuels de la Commission Bancaire. Luxembourg : 1960-1962 : Études financières, Kredietbank, December 1964. The figures for 1963 and 1964; Banque Internationale, Luxembourg.

(¹) The figures refer to the 10 main Dutch funds.

(²) The figures for 1960 to 1962 concern 6 funds, those for 1963 and 1964 refer to 11 funds.

TABLE 25

Gross issues of convertible bonds (¹)

(in \$ million)

Country	1960	1961	1962	1963	1964	1965
Germany (²)	—	—	—	—	106.88	67.50
France	30.38	18.22	26.33	4.05	22.28	81.02
Italy	—	—	—	80.00	136.00	24.00
Netherlands	19.47	14.09	26.80	6.30	21.55	42.54
Belgium (²)	0.12	1.44	—	—	28.26	16.31
Total (³)	49.97	33.75	53.13	90.35	314.97	231.37

Sources : Germany : Das Börsenbild 1966, Deutsche Bank. France : Rapport annuel du Conseil National du Crédit, 1965. Italy : Annual report of the Banca d'Italia, 1964. Netherlands : Annual reports of the Nederlandsche Bank. Belgium : Figures supplied directly by the Commission Bancaire.

(¹) The total of net issues cannot be calculated since in most of the member countries there are no statistics relating to bonds converted into shares or to the value of bonds not so converted that have been redeemed.

(²) Excluding issues placed privately.

(³) Excluding Luxembourg, no figures being available.

TABLE 26

Number of foreign variable-yield securities quoted on nine international exchanges on 31 December 1964

Exchange (1)	European Economic Community						Country of issue						Other countries		
	Germany	Belgium	France	Italy	Luxembourg	Netherlands	EEC total	UK	USA	South Africa	Canada	Switzerland	Misc.	Total other countries	
Amsterdam	15	6	4	3	2	—	30	11	195	3	24	2	27	262	
Brussels	4	—	15	4	6	15	44	16	23	11	10	—	14	74	
Frankfurt	—	1	6	6	—	4	17	1	4	1	—	—	4	10	
Luxembourg	1	10	—	—	—	4	15	—	4	—	1	—	7	12	
Paris	9	14	—	6	2	9	40	18	32	33	13	3	74 (2)	173 (2)	
London	5	1	3	2	1	7	19	—	19	177	57	1	95	349	
Montreal	—	—	2	—	—	—	2	12	3	—	—	—	—	15	
New York (NYSE)	—	—	—	1	—	4	5	3	—	2	13	—	3	21	
Zurich	14	2	3	1	2	3	25	4	28	5	3	—	5	45	

Source : *L'année boursière*, yearbook of the Compagnie française des agents de change.

(1) No foreign securities are quoted on Italian stock exchanges.
(2) Including 32 franc-area securities.

TABLE 27

Investments of life assurance companies

Investments	Germany	France	Italy	Netherlands	Belgium	UK	USA
<i>I. Breakdown of assets at the end of 1964</i>							
A. Total assets, \$million	6 394	2 792	1 351	3 518	1 292	22 212	149 470
B. As % of total:							
Shares	4.5	14.9	—	3.0	6.0	22.5	5.3
Fixed-interest securities	21.8 (1)	64.0	27.0	6.0	48.2	43.1	25.5
Mortgage loans	24.8	3.3	3.0	27.3	28.3	17.3	36.9
Loans on policies	1.7	0.9	2.9	0.8	3.2		4.8
Other claims and loans	35.0	7.8	14.0	53.2	1.7	{ 6.7	20.0
Balances with banks and elsewhere	—	—	4.0	1.1	3.7 (2)		4.5
Participations	0.7	—	6.3	—	—	—	—
Real estate	11.5	9.1	42.8	8.5	8.9	10.4	3.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<i>II. Average annual increase in assets of EEC life assurance companies in relation to certain economic aggregates (3)</i>							
A. Total in \$ per head of population	12.3	4.7	2.5	21.6	10.7	.	.
B. As % of gross domestic capital formation	2.9	1.4	1.2	7.4	3.7	.	.

Sources: European Insurance Committee; SOEC General Statistical Bulletin. Germany: Monthly Reports of the Deutsche Bundesbank. France: Statistiques et Etudes Financières: Rapport du Ministère de l'Economie et des Finances sur l'activité des sociétés d'assurances et de capitalisation. Italy: Report of the Banca d'Italia. Netherlands: Maandstatistiek van het financiewezen. Belgium: Bulletin d'information et de documentation of the Banque Nationale de Belgique.

(1) Including claims on Equalization Fund.

(2) Foreign securities.

(3) Average for 1960-1965 for Germany, 1960-1964 for France, 1960-1964 for Italy, 1960-1963 for Netherlands, 1960-1964 for Belgium.

TABLE
Investments of savings banks

Investments	Germany		France		Italy		Netherlands (*)	
	1959	1964	1959	1964	1959	1964	1959	1964
\$ mil								
Liquid assets (*)	2 027.64	3 510.72	118.19	152.19	1 090.35	1 269.86	22.34	48.92
Treasury bills	24.76	0.15	901.15	1 915.23	2.40	214.84	41.79	50.39
Bills	388.02 (*)	640.97 (*)	—	—	482.64	874.40	—	—
Securities	1 418.48	3 135.15	840.31	1 683.11	916.12	2 325.56	615.16	917.13
Short- and medium-term loans (*)	1 368.76	2 756.67	50.43	421.81	602.85	1 508.17	7.84	20.22
Loans to local authorities	936.50	2 077.10	3 123.84	6 434.33	407.34	920.33	396.45	586.40
Mortgage loans	2 809.26	6 845.90	9.15 (*)	18.88 (*)	268.43	738.31	120.74	295.19
Other long-term loans	639.19	1 461.10	484.04	518.41	11.37	31.27	187.79	545.19
Other assets	1 949.55 (*)	2 752.57 (*)	25.32	139.70	508.60	1 063.79	29.63	71.02
Total assets	11 562.16	23 180.33	5 552.43	11 284.23	4 335.10	8 946.53	1 421.74	2 534.46
As % of								
Liquid assets (*)	17.6	15.1	2.1	1.3	25.2	14.2	1.6	1.9
Treasury bills	0.2	—	16.2	17.0	0.1	2.4	2.9	2.0
Bills	3.4	2.7	—	—	11.1	9.8	—	—
Securities	12.2	13.5	15.1	14.9	22.2	26.0	43.3	36.2
Short- and medium-term loans (*)	11.8	11.9	0.9	3.7	13.9	16.9	0.5	0.8
Loans to local authorities	8.1	9.0	56.3	57.0	9.4	10.3	27.9	23.2
Mortgage loans	24.3	29.5	0.2	0.3	6.2	8.3	8.5	11.6
Other long-term loans	5.5	6.5	8.7	4.6	0.2	0.2	13.2	21.5
Other assets	16.9	11.8	0.5	1.2	11.7	11.9	2.1	2.8
Total assets	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source : World Thrift : special issue for the congress of March/April 1966 arranged by the International Savings Banks Institute.

(*) Local, post office, State or central savings banks.

(1) Cash in hand, postal cheque account and bank balances (including compulsory minimum reserves).

(2) To enterprises and individuals.

(3) Including cheques and bills for collection, interest coupons and dividend warrants due.

(4) Including transmitted credits : 1959, \$685.43 million; 1964, \$138.32 million.

and their central institutions ()*

Belgium		Luxembourg		EEC		UK (*)		USA	
1959	1964	1959	1964	1959	1964	1959	1964	1959	1964
<i>lion</i>									
6.35	37.14	8.44	33.34	3 273.31	5 052.74	46.20	70.28	829.1	1 003.7
86.00	—	—	1 056.10	2 263.61	—	—	—	—	—
—	73.25	33.15	39.01	903.81	1 627.63	—	—	—	—
754.13	843.39	44.43	44.17	4 633.63	8 948.51	2 740.36 (10)	3 791.76 (10)	12 433.8 (11)	11 280.9 (11)
137.45	69.95	10.83	13.83	2 178.16	4 790.65	—	—	361.2 (11)	739.9 (11)
35.91 (?)	31.29 (?)	24.87	68.49	4 924.91	10 117.94	734.16	1 464.96	—	—
695.52	1 043.40	61.74	89.78	3 964.84	9 031.46	—	—	24 783.1	40 328.5
26.58	296.61 (*)	—	—	1 348.97	2 852.58	—	—	—	—
24.00	141.66	3.70	2.86	2 540.80	4 171.00	35.84	66.08	553.8	885.9
1 765.94	2 619.69	187.16	291.48	24 824.53	48 856.72	3 556.56	5 393.08	38 961.1	54 237.8
<i>assets</i>									
0.4	1.4	4.5	11.4	13.2	10.4	1.3	1.3	2.1	1.9
4.9	3.2	—	—	4.2	4.6	—	—	—	—
—	2.8	17.7	13.4	3.6	3.3	—	—	—	—
42.7	32.2	23.7	15.2	18.7	18.3	77.0	70.3	31.0	20.8
7.8	2.7	5.8	4.7	8.8	9.8	—	—	0.9	1.4
1.9	1.2	13.3	23.5	19.8	20.8	20.6	27.2	—	—
39.4	39.8	33.0	30.8	16.0	18.5	—	—	63.6	74.4
1.5	11.3	—	—	5.4	5.8	—	—	—	—
1.4	5.4	2.0	1.0	10.3	8.5	1.1	1.2	1.4	1.5
100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

(*) Only the Alsace-Lorraine savings banks.

(**) The figures refer to savings banks included in the register of credit institutions and to six communal savings banks. Not included are savings institutions closely connected with commercial banks.

(?) Including provincial and communal bonds not included under "Securities".

(*) Of which industrial loans, \$220 million.

(**) 20 November 1959 and 20 November 1964.

(10) Of which deposited with the National Debt Commissioners : 1959, \$2 418.64 million; 1964, \$2 808.68 million.

(11) Of which shares : 1959, \$813.5 million or 2.1 % of the assets; 1964, \$1 258.6 million or 2.3 % of the assets.

(12) All other loans and credits not secured by mortgage.

TABLE 29

Bank lending and security investments (1)

	\$ million	As % of total for year					Average percentage 1960-65
		1960	1961	1962	1963	1964	
<i>Germany</i>							
Short-term credit	990	68.7	56.3	35.8	30.1	39.2	39.1
Medium-term credit	324	10.2	13.3	23.4	18.7	10.0	18.6
Long-term credit	636	22.4	22.5	30.2	37.9	31.6	29.0
Shares	57	6.6	2.0	-0.2	1.9	3.2	2.2
Fixed-interest securities	179	-7.9	5.9	10.8	11.4	16.0	8.7
Total	2 186	100.0	100.0	100.0	100.0	100.0	100.0
<i>France</i>							
Short-term credit	1 741.9	86.9	72.3	74.8	76.0	57.4	79.3
Medium-term credit	465.9	9.2	16.6	22.7	19.6	35.7	20.1
Long-term credit	0.3	0.4	5.6	0.1	—	2.6	1.0
Securities	0.7	3.5 (%)	5.5 (%)	2.4	4.4	4.3	0.7
Total	2 208.8	100.0	100.0	100.0	100.0	100.0	100.0
<i>Italy</i> (2)							
Short-term credit	1 877.2	89.2	87.8	83.3	83.9	24.7	61.8
Medium- and long-term credit	311.8	7.5	9.6	7.5	10.6	53.5	22.1
Securities	188.3	3.3	2.6	9.2	5.5	21.8	16.1
Total	2 377.3	100.0	100.0	100.0	100.0	100.0	100.0

<i>Netherlands</i>							
Short-term credit	208.0	(⁴)	20.3	47.5	85.2	51.7	33.8
Medium-term credit	90.6	(⁴)	47.7	31.5	-12.6	23.3	44.5
Long-term credit	75.4	(⁴)	16.9	5.0	17.8	20.3	16.0
Securities	45.7	(⁴)	15.1	16.0	9.6	4.7	5.7
Total	419.7		100.0	100.0	100.0	100.0	100.0
<i>Belgium</i>							
Short- and medium-term credit	410.7	69.7	60.5	-18.8	108.3	91.4	70.6
Shares	1.9	-0.3	-0.1	0.1	0.7	0.5	0.6
Fixed-interest securities	169.2	30.6	39.6	118.7	-9.0	18.	28.8
Total	502.3	100.0	100.0	100.0	100.0	100.0	100.0

Sources : Germany : Monthly reports of the Deutsche Bundesbank. France : Rapport du Conseil National du Crédit. Italy : Report of the Banca d'Italia. Netherlands : Annual Reports of the Nederlandse Bank. Belgium : Bulletin d'information et de Documentation of the Banque Nationale de Belgique.

(¹) Excluding all other assets.

(²) Including "immobilizations".

(³) Including the "Casse di Risparmio", "Monti di Prima Categoria" and "Istituti Centrali di Categoria", which account for 18-19 % of the total.

(⁴) As bank lending and investment decreased on balance in 1960, the percentages would be meaningless.

TABLE 30

Lending and security investments (1) of specialized institutions (2) (3)

Lending and security investments	\$ million	Per cent						
		Average amount 1960-64	1960	1961	1962	1963	1964	
<i>Germany</i>								
I Credit to :								
Public authorities (4)								
— Short-term	33	1.5	2.4	— 2.8	1.6	3.7	1.5	
— Medium-term	3	0.2	1.3	0.4	—	— 0.9	0.1	
— Long-term	471	22.0	20.1	11.3	25.4	23.8	20.9	
Business (5)								
— Short-term	7	— 13.7	2.3	3.9	1.1	1.9	0.2	
— Medium-term	133	9.0	6.2	4.6	5.3	5.8	5.9	
— Long-term	1 079	52.5	45.6	54.5	44.6	45.5	47.8	
Other financial institutions								
— Short-term	51	1.2	1.5	1.7	1.7	4.3	2.3	
— Medium-term	13	0.9	0.4	0.7	— 0.2	1.2	0.6	
— Long-term	391	24.6	17.6	21.9	17.0	10.6	17.4	
II Securities								
Variable-yield		0.2						
Fixed-interest	— 74	1.6	2.6	3.8	3.5	4.1	3.3	
Total	2 255	100.0	100.0	100.0	100.0	100.0	100.0	
<i>France</i>								
I Credit to :								
Public authorities (4)								
— Medium- and long-term	28	2.6	1.9	4.4	2.5	1.8	2.5	
Industry and commerce								
— Short-term	26	—	1.6	1.7	3.2	3.0	2.3	
— Medium-term	— 37	— 7.5	— 9.2	— 1.0	— 4.3	0.7	— 3.3	
— Long-term	206	15.4	17.0	20.5	20.4	17.4	18.3	
Building and construction								
— Medium-term	52	0.9	4.9	4.0	3.1	7.3	4.6	
— Long-term	400	55.3	46.2	33.0	31.7	26.7	35.5	
Agriculture								
— Medium-term	50	— 0.3	3.7	3.8	6.6	5.4	4.5	
— Long-term	393	32.2	33.2	33.0	36.2	36.9	34.9	
II Securities								
Variable-yield		1.4	0.7	0.6	0.6	0.8	0.7	
Fixed-interest	{ 8							
Total	1 072	100.0	100.0	100.0	100.0	100.0	100.0	

TABLE 30 (cont.)

Lending and security investments	\$ million	Per cent						
		Average amount 1960-64	1960	1961	1962	1963	1964	
<i>Italy</i>								
I Credit to :								
Public authorities (4)								
— Short-term	6	2.0	2.7	— 2.5	— 0.9	2.2	0.4	
— Medium-term	22	1.4	2.3	4.0	0.9	— 1.1	1.6	
— Long-term	339	36.2	23.0	25.0	19.8	18.2	23.5	
Industry								
— Short-term	8	2.9	— 0.7	— 0.1	3.8	— 2.2	0.6	
— Medium-term	58	3.5	2.9	2.8	4.7	6.0	4.0	
— Long-term	445	19.7	27.9	29.9	33.5	38.6	30.9	
Building and construction								
— Medium- and long-term	417	23.4	29.6	28.7	32.7	28.2	28.9	
Agriculture								
— Short-term	70	2.3	5.1	9.0	2.0	4.4	4.9	
— Medium- and long-term	50	5.7	3.4	2.4	3.5	3.4	3.5	
II Securities								
Variable-yield	7	0.9	1.0	0.4	—	0.5	0.5	
Fixed-interest	18	2.0	2.8	0.4	—	1.8	1.2	
Total	1 441	100.0	100.0	100.0	100.0	100.0	100.0	
<i>Belgium</i>								
I Credit to :								
Public authorities (4)								
— Short-term	11	0.7	8.0	8.4	— 2.3	3.5	3.7	
— Medium-term	7	2.8	— 0.4	1.6	2.6	4.4	2.3	
— Long-term	113	37.7	37.1	34.8	42.6	41.5	38.9	
Industry and commerce								
— Short-term	1	—	0.7	1.4	1.2	— 1.3	0.3	
— Medium-term	5	0.8	5.0	— 0.7	3.6	0.6	1.8	
— Long-term	120	44.7	35.9	32.0	48.9	44.4	41.2	
Agriculture								
— Short-term	1	0.5	— 0.2	1.7	0.1	—	0.4	
— Long-term	12	1.9	3.1	6.3	4.8	4.5	4.2	
Housing								
— Short-term	9	3.0	3.5	3.7	1.9	2.7	3.0	
— Long-term	1	0.9	0.9	0.4	0.6	— 0.5	0.4	
II Securities								
Variable-yield	1	—	—	1.5	—	—	0.3	
Fixed-interest	6	6.2	6.3	7.9	— 4.1	— 3.4	2.2	
Securities not classified	4	0.8	0.1	0.8	0.1	3.6	1.3	
Total	291	100.0	100.0	100.0	100.0	100.0	100.0	

Notes and Sources for Table 30

Sources : Germany : Monthly Reports of the Deutsche Bundesbank. France : Rapport du Conseil National du Crédit. Italy : Report and Bulletin of the Banca d'Italia. Belgium : Bulletin d'information et de documentation of the Banque Nationale de Belgique and balance sheets of the institutions in question.

(^a) Excluding all other assets.

(^b) For Germany the following are covered : public and private mortgage banks, instalment credit institutions, and other specialized credit institutions. For France : Crédit National, Crédit Foncier de France, Caisses de Crédit Agricole, Caisse de Consolidation et de Mobilisation des Crédits à Moyen Terme, Caisses de Crédit Coopératif, Banque Française du Commerce Extérieur, and the financial establishments. For Italy : Institutions specializing in credit to industry, public works, agriculture, and building and construction. For Belgium : Société Nationale de Crédit à l'Industrie, Crédit Communal, Caisse Nationale de Crédit Professionnel, Office Central de Crédit Hypothécaire, Institut National de Crédit Agricole, Société Nationale de la Petite Propriété Terrienne.

(^c) It has not been possible to draw up corresponding statistics for the Netherlands and Luxembourg.

(^d) Credit to public authorities mainly consists of loans to central government and to local authorities in all the countries covered. Also included are : credit to the railways and post office in Germany and Italy, and in the latter country credit extended in connection with miscellaneous investment schemes carried out for account of the central government.

(^e) For Germany it has not been possible to distinguish between credit for trade and industry, agriculture and housing.

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