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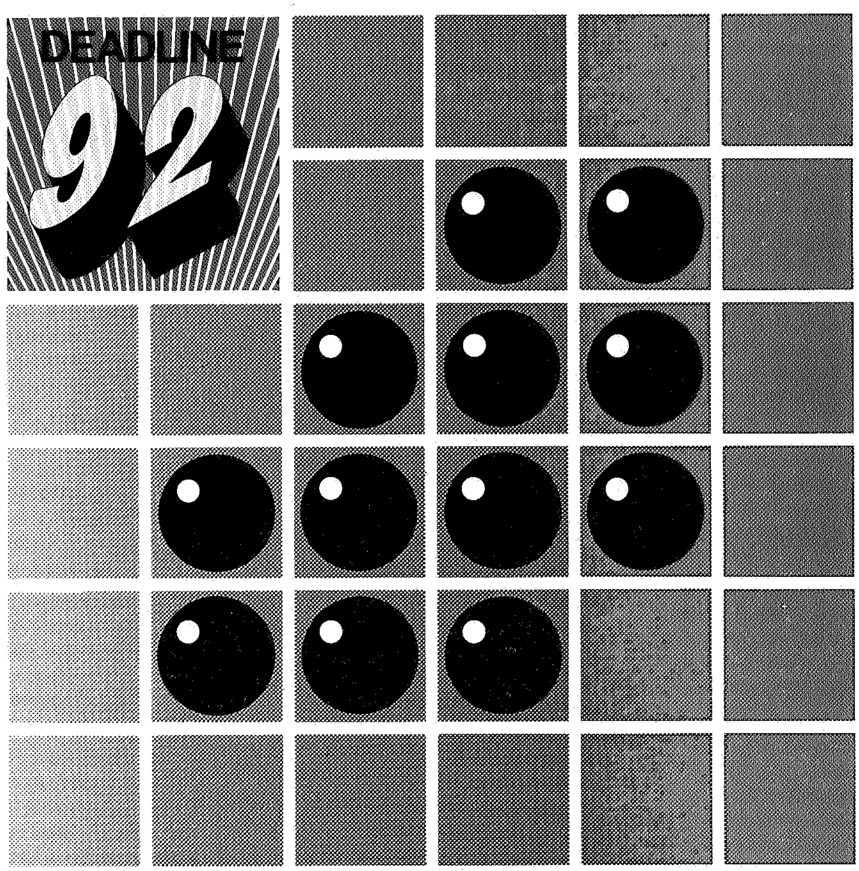
THE EUROPEAN FINANCIAL COMMON MARKET



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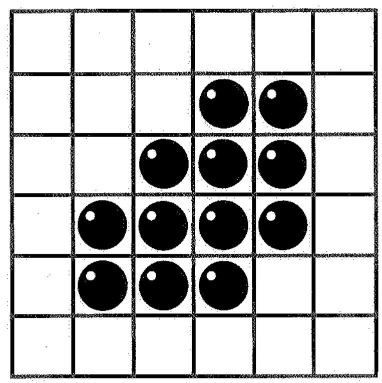

The European Community's single frontier-free market, in which persons, goods, services and capital can circulate freely, is due to completed by the end of 1992. The European financial common market is an essential part of this frontier-free internal market.

The European financial common market encompasses not only the free movement of money and capital for all citizens but also freedom of establishment and the freedom to provide services for financial undertakings and other own-account financial operators.

If the Community succeeds in its objectives, citizens in all Community Member States will be free to invest their money, open accoounts and take out loans and insurance policies as and where they choose. Banks and insurance companies will be free to offer their 'financial products' without restriction and securities will be quotable on all stock exchanges and issuable in all Community countries.

This brochure provides an overview of the current situation, the proposals made for 1992, the results already achieved and the benefits to be drawn from the single European market.

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Contents

I Introduction

The European financial common market as a cornerstone of the single European market programme

The European Community has set a new deadline for the achievement of one of its principal objectives. A single frontier-free market for goods, services, capital and persons is to be established by the end of 1992. Although the four basic principles of free movement of goods, free movement of workers, freedom to provide services and free movement of capital were enshrined from the start in the 1957 Treaties establishing the European Communities, their achievement was hampered by internal and external crises, in particular as regards the establishment of a European capital market and the freedom to provide financial services.

In recent years continued unemployment and the growing pressure of international competition, together with moves towards political reform in the Community's twelve Member States, have served to sharpen awareness of the benefits which Europe's firms and its 320 million consumers could draw from a single large market in which goods, services, capital and persons are able to circulate freely. The European Commission's 1985 White Paper on completing the internal market and the revision of the Treaties establishing the European Communities, which entered into force on 1 July 1987 as the Single European Act, provided the basic programme and the legislative and procedural framework required to achieve the aims set for 1992.

The European financial common market is an essential part of the frontier-free single European market, and encompasses not only the free movement of money and capital for all citizens but also freedom of establishment and the freedom to provide services for brokers and financial undertakings. If the Community succeeds in its objectives, citizens in all Community Member States will be free to invest their money, open accounts and take out loans and insurance policies as and where they choose. Banks and insurance companies will be free to offer their 'financial products' without restriction and securities will be quotable on all stock exchanges and issuable in all Community countries.

The Community is still a long way from achieving these objectives. In contrast to the free movement of goods, on which substantial progress could be made from an early stage, the integration of money and capital movements and the freedom of banks and insurance companies to provide services are proving harder to achieve. For better or for worse, money and capital movements are matters of national economic policy and are extremely sensitive (especially when speculative and divorced from trade in goods) to changes in interest and exchange rates, which are in turn instruments of the monetary policies pursued by individual governments or central banks. Movements of capital can therefore vitiate important economic objectives such as balance-of-payments equilibrium, price stability or growth.

The very specific nature of financial services is a further reason for particular difficulties in the integration of financial markets. In contrast to trade in goods, insurance and banking services in the individual Member States are strongly influenced by varying traditions of company supervision and investor and consumer protection.

Full attainment of a European financial common market therefore implies not simply that financial institutions and insurance companies enjoy complete freedom of establishment and the freedom to provide services, and that consumers are free to open accounts, purchase securities and take out insurance policies or bank loans in any Member State, but also that money and capital are able to circulate freely across intra-Community frontiers. And finally it implies a common monetary policy capable of providing a stable framework, secure against external disruption, within which the benefits of such a financial common market may unfold.

II The benefits of a European financial common market

Prospects for the financial services sector (Cecchini report)

Financial services such as banking and insurance will be among those to benefit most from the removal of all barriers and the completion of a large internal market. A report prepared for the European Commission on the economic consequences of the internal market (Cecchini report) talks of the pivotal role of financial services within the economy. Basing its figures on a survey conducted on the three main areas of financial services activity (banking and credit, insurance, and brokerage and securities), the report forecasts gains of ECU 22 000 million for the eight Community countries Belgium, France, Germany, Italy, Luxembourg, the Netherlands, Spain and the United Kingdom. It points to enormous price differences (50 % and over) in this sector, with margins at their widest in the prices charged for motor insurance, home loans, consumer credit and securities. Prices are, it seems, likely to fall furthest in Belgium, France, Italy and Spain, although substantial drops can also be expected on the British, German and Luxembourg markets.

The report supplies a number of figures to illustrate the central role played by financial services. For example, the value-added generated by the credit and insurance sectors alone accounted for some 6.5 % of the Community's gross domestic product in 1985, and although these sectors employ a mere 3 % of the Community's workforce, their share in overall Community compensation amounted to approximately 6 %. In the eight Community countries studied, insurance premiums amounted to 5 % of GDP, while bank loans and stock market capitalization accounted for 142 % and 116 % respectively.

The benefits would be even greater if the freedom to provide services within a European financial common market could be linked immediately to a common currency, since exchange costs would disappear and businesses and individual consumers could achieve substantial savings. Finally, the liberalization of capital movements and the freedom to provide financial services would enhance the attractiveness of Europe as a location for financial business and help to channel a greater proportion of existing savings into European businesses and investment projects. The harmful effects of the compartmentalization of capital markets in the Community were noted by the Commission in a report on financial integration dating back to April 1983. For example, although gross savings in the Community amounted in 1980 to ECU 430 000 million compared with ECU

Macroeconomic consequences of EC market integration for the Community in the medium term

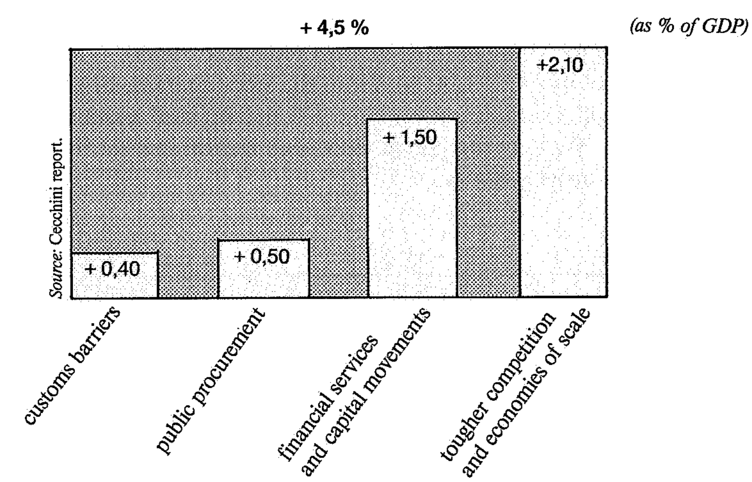
This table shows the positive or negative effects on GDP, consumer prices etc. of a number of measures connected with the single market: abolition of customs formalities, open public procurement, liberalization of financial services, and supply-side effects

	Abolition of customs formalities	Open public procurement	Liberalization of financial services	Supply-side [1] effects	Total
GDP (%)	0.4	0.5	1.5	2.1	4.5
Consumer prices (%)	— 1.0	— 1.4	— 1.4	— 2.3	— 6.1
Employment (thousands)	200	350	400	850	1 800
Budgetary balance (% of GDP)	0.2	0.3	1.1	0.6	2.2
External balance (% of GDP)	0.2	0.1	0.3	0.4	1.0

[1] Economies of scale, increased competition etc.

Source: 'The Economics of 1992' in *European Economy,* No 35, March 1988 (Cecchini Report).

Additional growth likely to be generated through achievement of the 1992 objectives

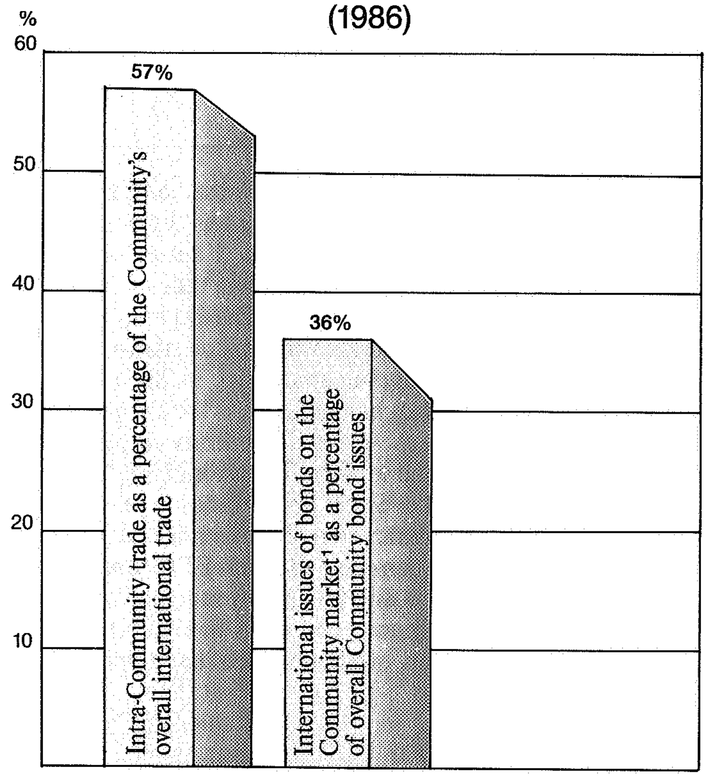


340 000 million in the United States, the Commission observed that only a fraction of this amount was mobilized by the national financial markets, and that the overall issuing volume for securities on the five leading markets (France, Germany, Italy, the Netherlands and the United Kingdom) was far lower than that on the US market (ECU 142 000 million compared with ECU 212 000 million). The disparity was apparently even more glaring in equity capital, with the market value of the shares quoted on stock exchanges throughout the Community not even amounting to 40 % of the market value of shares quoted on the New York stock exchange alone. As the Commission commented: 'Generally speaking, financial flows between the Community countries have grown far less rapidly than movements of goods and services. The astonishing fact is that long-term capital movements between the Member States are 20 times lower in value terms than movements in goods. The compartmentalization of the Community's financial markets appears even less explicable when one considers that non-EEC countries float loans on the same markets for higher amounts — and for an only marginally smaller percentage of their requirements — than the Community countries. In 1981 intra-Community loan issues amounted to USD 2 200 million, while non-EEC issues attained USD 10 000 million.'

As recently observed by banking experts, a European capital market could easily withstand comparison with the financial markets of Japan and the United States as regards both depth and variety, provided the existing fragmentation were overcome. For example, in purely arithmetical terms the total fixed-interest yield of the major EC markets (Belgium, Denmark, France, Germany, Italy, the Netherlands, Spain and the United Kingdom) amounted to more than ECU 1 800 million at the end of 1987.

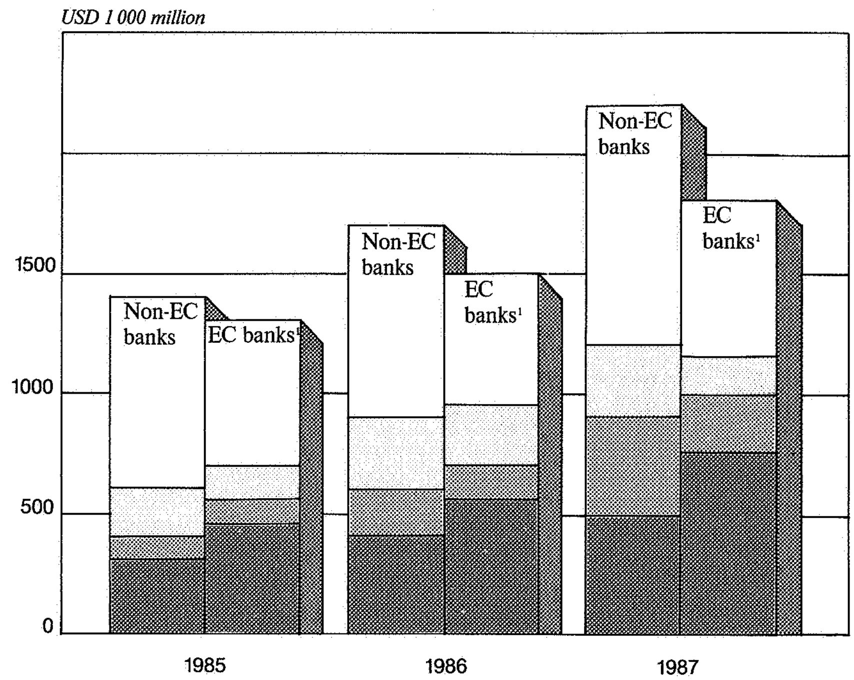
This corresponds to approximantely two-thirds of the US market yield and, on these figures, exceeds the volume of fixed-interest returns in Japan. With a market capitalization of approximately ECU 1 000 million, the stock markets of these EC countries are approximately two-thirds the size of the US market and around half the size of the Japanese market. With an integrated European capital market these ratios would shift even further in Europe's favour.

Commercial and financial integration in the Community (1986)



[1] Defined as an international issue on one of the Community markets or in one of the Community currencies (including the ecu)

External liabilities in national and foreign currencies of Community banks[1] and other banks reporting to the Bank for International Settlements



Vis-à-vis banking and non-banking sectors in the Community (EUR 12).

Vis-à-vis banking and non-banking sectors in Japan.

Vis-à-vis banking and non-banking sectors in the United States.

Vis-à-vis banking and non-banking sectors in rest-of-world.

Source: BIS ·

[1] Community banks reporting to the BIS: B, DK, D, E, F, I, IRL, L, NL, UK.

The European Parliament too, in its opinion on the Commission's May 1988 proposals on the establishment of a European financial common market pointed out that it was crucial for Europe to gain worldwide recognition as a financial centre. Europe's status on the international capital market was not, it observed, commensurate with its economic and trade potential. Savings in Europe should be spent primarily on European products. The opening up of capital markets should benefit citizens and business investors alike and was therefore to be seen as a force for growth and economic and social cohesion in Europe. Three-quarters of international financial business was, it observed, currently conducted outside the Community.

III Previous developments

(a) Legal framework

Since the establishment of a European financial common market encompasses numerous individual fields, the corresponding provisions of the EEC Treaty are extensive. These include the provisions on right of establishment (Article 52 *et seq.*), the freedom to provide service (Article 59 *et seq.*) and capital movements (Article 67 *et seq.*).

Under the terms of the Treaty, freedom of establishment and the freedom to provide services should in fact already have been achieved by the end of the 12 year transitional period in 1969, and the Commission did indeed submit for both areas the required general programmes, which were adopted by the Council in December 1961. On the other hand, the Treaty's provisions on freedom of establishment and the freedom to provide services made clear reference to capital movements, which, as the Treaty in turn stipulated, were only to be deregulated 'to the extent necessary to ensure the proper functioning of the common market' (Article 67).

The Treaty states that freedom of establishment encompasses the taking up and carrying out of own-account gainful activities such as the founding and management of undertakings, in particular companies, 'subject to the chapter on capital movements' (Article 52). The link with capital movements is made even clearer in respect of services. Here the Treaty stipulates that the freedom of banks and insurance companies to provide the services linked with capital movements is to be 'established in step with the gradual liberalization of capital movements' (Article 61).

Admittedly, the actual provisions on capital movements repeatedly call upon the Member States to adopt a positive attitude towards integration, requiring them to 'be as liberal as possible in granting exchange authorizations' (Article 68) and to 'endeavour to avoid introducing within the Community any new exchange restrictions on the movement of capital and current payments connected with such movements' (Article 71). On the other hand, the Treaty's provisions allow equal scope for the application of protective measures if circumstances require. Such circumstances include disruptions in the functioning of the capital market in any Member State (Article 73) and balance-of-payments difficulties (Articles 108 and 109). Also of importance are the provisions on conjunctural policy, which the Treaty describes as 'a matter of common concern' (Article 103). In overall terms, the provisions of Articles 103 to 109 provide the framework for the economic and monetary coordination central to the establishment of a European financial common market.

Article 70 provides for the coordination of exchange policies in respect of third countries, and was supplemented by a number of new provisions through the Single European Act. For example, the Member States are called upon to attain the highest possible degree of liberalization in this field, and unanimity is required for any measures representing a backward step in the liberalization of capital movements.

Article 102a, which was introduced via the Single European Act, marks a wholly new addition to the Treaty. In order to ensure the convergence necessary for the Community's further development, this Article requires the Member States to draw on the experience acquired in cooperation within the framework of the European Monetary System (EMS) and in developing the ecu, and to take account of existing competences. It is expressly stated that any institutional changes affecting the future conduct of economic and monetary policies require a conference of government representatives to be called in accordance with Article 236.

(b) Initial measures

In 1960 and 1962 respectively, the Council of Ministers adopted two Directives setting out initial obligations for the lifting of restrictions on capital movements in the Member States. Priority was given in these Directives to the deregulation of capital transactions associated with the other basic freedoms of the common market, i. e. short-term and medium-term credits in respect of commercial transactions, investments, personal capital movements and trade in quoted securities (Lists A and B). Other operations were deregulated conditionally. These included the issuing of bonds and longer-term loans (List C). However, these predominantly financial transactions were to remain deregulated in those Member States in which restrictions had already been lifted, i. e. Belgium, the Federal Republic of Germany and Luxembourg. Deregulation was not extended to short-term capital movements (List D), which are chiefly associated with currency speculation and which national governments are therefore particularly anxious to control via monetary policy.

The Commission in fact submitted a proposal for a third Directive in April 1964. This was intended to remove the remaining discrimination in national legislation as regards the issuing and placing of securities, stock exchange listing and the acquisition of securities through financial institutions. However, the proposed Directive was rejected by the Council of Ministers.

Directive

A Directive is a Community act adopted by the Council or the Commission. Directives are binding on any Member State to which they are addressed as regards the result to be achieved but leave the choice of form an methods to the national authorities. They state the reasons on which they are based, are communicated to the countries to which they are addressed, and take effect on the date of their communication. They generally lay down a time-limit for implementation. They are published in the *Official Journal of the European Communities.*

For a long time liberalization remained at — or even below — this level. Even a full-scale report on the development of a European capital market, prepared for the Commission by a committee of experts in 1966 (the Segré report), failed to generate any new impetus.

(c) Reasons for delay

World economic circumstances were largely behind not just the early successes of 1960 and 1962 in the gradual liberalization of capital movements but also the subsequent long period of standstill and setback. Following a period of positive and harmonious economic development in the first half of the 1960s came a succession of international crises triggered initially by the leading reserve and key currency, the US dollar, and subsequently exacerbated by the oil crises. These resulted not only in the reintroduction by numerous Member States of controls on capital movements but also, in the 1970s, in the failure to implement the phased plan for economic and monetary union first agreed by the Hague Summit in March 1969 (see Chapter IX, p. 43) and adopted by the Council of Ministers on 22 March 1971.

The major factor influencing developments was the loss of confidence in the dollar, which led to massive flows of capital to Europe. On 15 August 1971 US President Nixon suspended the unrestricted dollar—gold convertibility. The subsequent international agreement on a new exchange rate stability, with a fluctuation margin against the dollar of approximately 2.25 % (Smithsonian Agreement) brought only temporary respite, and continued lack of confidence in the dollar soon resulted in renewed and substantial speculative flows of capital to Europe. This in turn led to the floating of exchange rates, with the Community countries endeavouring to maintain their currencies within a 2.25 % margin of fluctuation via block floating against the dollar. By late 1973 the first wave of oil price increases had led to economic difficulties and balance-of-payments problems in most countries, and in 1979 a second wave of oil price increases began.

(d) Use of safeguard clauses

During this period of crises the EC countries were again obliged to resort to exchange controls, which may be authorized by the Commission in the event of balance-of-payments difficulties (Article 108 of the EEC Treaty). Such measures may also be introduced autonomously by a Member State as a precautionary measure, but must subsequently be approved by the Commission (Article 109). France had already been obliged in 1968 to reintroduce substantial restrictions on capital movements, amounting virtually to a curtailing of all capital movements subject to deregulation. Italy too, in the wake of the first oil crisis in 1974, was authorized to introduce obligatory deposits in respect of capital investments held abroad. From May 1971 measures were even taken in the traditionally liberal-minded Federal Republic of Germany, albeit in this case to restrict capital flows (cash deposits). These measures did not, however, make use of a safeguard clause — or else concerned capital movements to which the obligation to deregulate did not apply — but were based instead on a Community Directive of March 1972 on the regulation of international financial flows and the counteraction of their adverse effects on internal liquidity. When Denmark, Ireland and the United Kingdom joined the Community in 1973, they too brought with them strict controls on capital movements, which they were initially allowed to maintain by virtue of the transitional provisions of the Treaties of Accession and authorizations granted by the Commission.

IV A fresh start

(a) International challenges

The early 1980s saw signs of a new awareness and the chance of a fresh start. In his 1977 Jean Monnet lecture to the European University Institute in Florence, the Commission President Roy Jenkins had already paved the way for new initiatives in monetary policy. These were given substance in the European Monetary System (EMS), which entered into force on 13 March 1979 (see Chapter IX (a), p. 43).

The need for new measures was dictated partly by shared experience of the United States' dollar policy, which took little account of the other industrialized countries' interests, and partly by the burgeoning of the international financial markets.

Substantial international financial flows had already been triggered during the 1970s not only by the United States' economic policy but also by the recycling of oil revenues, and had helped to give rise to the Euromarkets, which remained largely outside the national supervisory systems. This was followed in the early 1980s by further changes in the structure of international capital markets, representing a challenge to the Community. Due chiefly to a shift towards securitization, a new expansion of the financial markets now began, bringing with it numerous innovations such as currency swaps, interest-rate swaps, options, forward-rate agreements and zero bonds. Advances in information technology and communications led very rapidly to worldwide, round-the-clock stock-exchange dealing, a development helped along by increased deregulation aimed at eliminating government intervention.

The new information and communication technologies and the globalization of capital markets led to a considerable increase in the number of financial transactions. A European Parliament report of the time noted that the volume of such transactions exceeded turnover in world trade in real terms by a factor of 25. Thus, while the international dollar-payments handled by the major New York banks' computer-aided clearing system amounted to USD 300 000 million daily, turnover in world trade did not exceed a daily total of USD 15 000 million. In the light of this rapid international integration of the financial markets, the continued compartmentalization of the Community's individual financial markets appeared increasingly out of step with the times.

There was, furthermore, growing awareness that exchange controls and restrictions conceal rather than solve basic economic problems. The success of the EMS exchange rate mechanism, which was introduced in 1979, also acted as a spur to new initiatives. In the Member States themselves, economic policies of consolidation and stabilization began to command increasing support, thus facilitating closer links and agreement between the partners. This was accompanied by a renewed and powerful awareness of the need for reform, since international competition was becoming more acute and the United States and Japan were increasingly able to exploit the benefits of their large internal markets. Unemployment in the Community remained an ever-present challenge. Finally, the Community's increasingly acute financial crises, caused by its unsolved agricultural problems, gave added impetus to the new desire for reform.

(b) The European Commission's White Paper

In mid-1985 the Commission presented its White Paper on completing the internal market, which contained concrete plans for the removal of all remaining physical, technical and fiscal barriers between the EC countries by the end of 1992, as well as related proposals for approximately 300 individual decisions.

The White Paper also outlined what remained to be done in the field of capital movements and financial services in order to bring about a European financial common market and called for new and stricter criteria for application of the EEC Treaty's safeguard clauses and closer monitoring of exchange controls. It also announced an extension of the hitherto scarcely amended 1960 and 1962 Directives on the liberalization of capital movements.

As regards financial services, i. e. the free movement of financial products, the Commission aimed at a new policy. The exchange of financial products such as insurance policies, home-ownership savings contracts and consumer credit was to be governed by three major principles, i. e. minimum coordination of individual national rules, mutual recognition and home-country control. In setting out these principles, the Commission drew on the successful approach adopted for the movement of goods, which was based on the European Court of Justice's 'Cassis de Dijon' judgement of 1979. This judgement prohibits restrictions on the free movement of any product within the Community (except in those cases specifically mentioned in Article 36 of the EEC Treaty), provided it has been manufactured in due compliance with the appropriate regulations in its country of origin. Strict application of this principle is, however, less possible in the field of financial services.

(c) The Single European Act

The legal and procedural bases to enable timely achievement of the single European Market by 1992 were provided by a revision of the EEC Treaty, which entered into force on 1 July 1987 as the Single European Act. Where not already provided for in the Treaty, majority decisions were introduced for numerous decisions facing the Council of Ministers, in particular those affecting establishment of the single European Market and the European financial common market. The role of the European Parliament was also strengthened. However, decisions on fiscal matters, which are also central to establishment of the financial area, remained subject to unanimity. The objective of economic and monetary union was endorsed, although institutional decisions in this area remained subject to unanimity and ratification in the Member States. The Heads of Government also declared their continued support for the objective of European political union. The green light for implementation of the decisions on the single European market — and hence the financial common market — was finally given by the Heads of Government on 11-12 February 1988 in Brussels, when they adopted — together with far-reaching agricultural and financial reforms — Commission President Jacques Delors' plan 'The Single European Act must succeed', which set out the major prerequisites for achievement of this objective.

V The programme for the liberalization of capital movements

(a) The gradual lifting of restrictions

The extent to which the climate in the Community had shifted in favour of new initiatives was reflected not only in more rapid decision-making in the Council of Ministers but also in voluntary measures taken by the Member States. Since the Federal Republic of Germany had removed all temporary controls on capital movements by 1981 (having already begun the process in 1974/75) and the United Kingdom had lifted all restrictions at a stroke in 1979, the chief concern was to ensure that decisive steps were taken in other EC countries. France and Italy, for example, had stepped up their protective measures in the wake of the second oil crisis in 1981, and Denmark and Ireland still operated strict exchange controls.

As a result of the Commission's initiatives on the liberalization of capital movements, which were first expressed in a communication in 1983 on financial integration, 1984 saw the start of a gradual, broad-based process, resulting in the virtual elimination of exchange controls in most EC countries by the end of 1988. The starting point was a new Commission policy pursued alongside the planned liberalization of capital movements. Thus, while the Commission authorized France, Ireland and Italy to prolong the application of certain protective measures in December 1984, it restricted their scope and limited their extension to two years in the case of France and three years in the case of Ireland and Italy. At the same time, an earlier authorization granted to Denmark was revoked, while an initial limit of three years was set for special measures taken by Greece in November 1985 in response to a balance-of-payments crisis. Other exceptional arrangements associated with the accession of Spain and Portugal to the Community were maintained until the end of 1990 and the end of 1992 respectively.

The Member States themselves also encouraged the gradual lifting of controls on capital movements, and by May 1987 the Commission was able to welcome the progress made in France and Italy. France's renewed authorization to apply certain protective measures, which had been granted in December 1984, was revoked in June 1986 and that granted to Italy at the end of July 1987. Only Ireland's authorization to apply particular measures was again extended until the end of 1988. Thus, with the exception of the transitional arrangements applying to Spain and Portugal, which had joined the Community in 1986,

Percentage differences in prices of standard final products in eight Community Member States compared with the average of the four lowest national prices

	Germany	Belgium	Spain	France	Italy	Luxembourg	Netherlands	UK
Banking services								
1. Consumer credit	136	—41	39	n.a.	121	—26	31	121
2. Credit cards	60	79	26	—30	89	—12	43	16
3. Mortgages	57	31	118	78	—4	n.a.	—6	—20
4. Letters of credit	—10	22	59	—7	9	27	17	8
5. Foreign exchange drafts	31	6	196	56	23	33	—46	16
6. Travellers cheques	—7	35	30	39	22	—7	33	—7
7. Commercial loans	6	—5	19	—7	9	6	43	46
Insurance services								
1. Life insurance	5	78	37	33	83	66	—9	—30
2. Home insurance	3	—16	—4	39	81	57	17	90
3. Motor insurance	15	30	100	9	148	77	—7	—17
4. Commercial fire and theft	43	—9	24	153	245	—15	—1	27
5. Public liability cover	47	13	60	117	77	9	—16	—7
Brokerage services								
1. Private equity transactions	7	36	65	—13	—3	7	114	123
2. Private gilts transaction	90	14	217	21	—63	27	161	36
3. Institutional equity transactions	69	26	153	—5	47	68	26	—47
4. Institutional gilt transactions	—4	284	60	57	92	—36	21	n.a.

Source: 'The Economics of 1992' in *European Economy*, No 35, March 1988 (Cecchini Report).

as well as a renewed extension in favour of Greece until the end of 1989, all protective measures applicable solely by virtue of special authorizations — and hence at odds with the degree of liberalization already achieved — had been abolished by the end of 1988.

(b) The first stage in the new liberalization programme

In May 1986 the Commission presented an initial programme for the further liberalization of capital movements. It was approved by the Council of Ministers as little as six months later, in November of the same year, and entered into force on 28 February 1987 as the Directive amending the First Directive of 11 May 1960 for the implementation of Article 67 of the EEC Treaty. The capital transactions fully deregulated under this initial measure were chiefly those essential to the smooth functioning of the common market and the integration of the national securities markets (List C under the previous Directives, (see Chapter III (b), p. 14). This list comprises the following three categories of transaction:

- long-term credits relating to commercial transactions;
- the acquisition of unlisted foreign securities (shares, bonds or units issued by undertakings for collective investment in transferable securities (Ucits), i. e. by investment funds);
- the admission to the capital market of one Member State of securities issued by a company in another Member State. This concerns shares and bonds traded on, or recently admitted to, a Community stock exchange, as well as units in undertakings for collective investment in transferable securities (investment funds), whose free movement was already covered by the harmonization rules adopted by the Council (see Chapter VIII, p. 39)

The new Directive also brought the dual-exchange market system operated by Belgium and Luxembourg into line with liberalization, providing for its gradual abolition by 1992.

(c) The June 1988 decisions on the full liberalization of capital movements

A few months later, in October 1987, the Commission forwarded to the Council of Ministers a communication on the establishment of a European financial common market, the cornerstone of which was the removal of all remaining controls on capital movements by mid-1990 in most Member States (Greece, Ireland, Portugal and Spain having been given until the end of 1992). A corresponding Directive was adopted on 24 June 1988.[1]

In its communication on the establishment of a European financial common market the Commission not only listed the required legal texts but also set out in full the conditions to be met if the project was to succeed. These include important basic prerequisites for the harmonization of bank supervision rules, e. g. protection for savers and depositors (see Chapter VI, p. 27), the alignment of taxes on capital yield and corporation taxes, the removal of certain discriminatory measures at national level and problems of capital movements with non-EEC countries. The Commission also noted that in order to achieve full liberalization of capital movements, parallel progress would have to be made in cooperation on monetary policy within the European Monetary System (EMS) (see Chapter IX, p. 43 *et seq.*).

Liberalization of the remaining controls on capital movements was provided for in the Council Directive of 24 June 1988 for the implementation of Article 67 of the EEC Treaty.[1] The movements covered by this Directive are chiefly transactions of a monetary or quasi-monetary nature, i. e. mainly short-term transactions, and include financial credits, operations in current and deposit accounts, the opening of accounts abroad and transactions in money-market instruments.

The Directive contains a special safeguard clause which, however, leaves the already existing safeguard clauses (Articles 73, 108 and 109 of the EEC Treaty) intact. The purpose of this specific safegurad clause is to allow the Member States to take protective measures against short-term capital movementes, for a period not exceeding six months, in cases where their monetary and exchange-rate policies are disrupted as a result of the liberalization programme. The Directive lists those measures which Member States may themselves take on grounds of urgency, stipulating, however, that the Commission and the other Member States must be informed. The Commission then decides, after consulting the Monetary Committee and the Committee of Governors of the Central Banks, whether or not the Member State concerned may continue to apply these measures. Under the terms of the Directive, Belgium and Luxembourg undertake to abolish their dual-exchange market system by the end of 1992.

The Directive contains an important special provision reflecting the fact that, in the absence of a common European currency, monetary policy remains the responsibility of the national authorities. The Member States may therefore continue to take measures to regulate bank liquidity which have a specific impact on capital transactions carried out by credit institutions with non-residents. They must, however, restrict such measures to what is necessary for the purposes of domestic monetary regulation and must inform the Committee of Governors of the Central Banks, the Monetary Committee and the

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([1]) Council Directive 88/361/EEC.

Commission, at the latest by the date on which the measures enter into force. The two Committees then provide the Commission with opinions on the cases concerned. The provisions on relations with non-EEC countries and on tax questions are described in Chapter X (b), p. 55 and Chapter IX (b), p. 51.

In addition to the decision on full liberalization of capital movements, the Community's finance ministers agreed on a new facility for medium-term financial assistance. This was intended not only to help Member States to overcome balance-of-payments crises — as was hitherto the case — but also to facilitate the implementation and continued observance of decisions concerning the liberalization of capital movements. The two existing assistance mechanisms were amalgamated through Council Regulation 1969/88 of 24 June 1988. The aim here was not simply to ensure that financial assistance was available at times of crisis but also to use the now more flexible arrangements to underpin the liberalization of capital movements.

The first of the previously separate assistance mechanisms was the medium-term financial assistance introduced in March 1971 in the wake of the dollar crisis. In accordance with the mutual assistance provided for in Article 108 of the EEC Treaty, Member States could, under this system, grant a partner country medium-term credits (i. e. of between two and five years) to carry it through periods of sustained balance-of-payments disequilibrium.

The second assistance mechanism, the system of Community loans, was introduced in February 1975 in order to offset the substantial balance-of-payments deficits caused in a number of Community countries by the oil crisis. Under this system, whose various arrangements were adjusted after the second oil crisis in February 1981, the Community used its high credit-rating to raise funds either on capital markets or directly from non-Community countries and credit institutions. These funds were then passed on to a given Member State in the form of a loan. Under both systems, recipient countries were required to establish economic recovery programmes, and this requirement is maintained in the new combined facility. The overall ceiling for loans granted is ECU 16 000 million, in addition to which there are a number of subsidiary ceilings.

Funds raised by Community loans on the capital markets carry an upper limit of ECU 14 000 million (previously ECU 8 000 million), while the ceiling for Member States' total direct contributions remains unchanged from the previous medium-term assistance facility at ECU 13 925 million. However, priority is given to fianance through loans, and the Regulation stipulates that use should only be made of Member States' contributions if the terms available on capital markets or with financial institutions are unsatisfactory or the leeway provided is insufficient.

Generally speaking, these arrangements represent a marked improvement in financing capacity. The Regulation also sets out details concerning economic monitoring and compliance with requirements.

VI The liberalization of banking services

(a) Previous legislation

The foundations for a European common market in banking services were already laid in 1973 with the Council Directive on the abolition of restrictions on freedom of establishment and the freedom to provide services in respect of self-employed activities of banks and other financial institutions. In essence, however, this Directive achieved little more than the freedom of establishment — based on non-discrimination between nationals and non-nationals — called for in the EEC Treaty.

The first steps towards harmonizing the rules governing credit institutions — and hence towards establishing a common market for banking services — were taken in 1977 with the First Council Directive on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions. Home-country control (i. e. the overall supervision of a credit institution operating in several Member States by the competent authorities in the Member State where it has its head office), which was later to be regarded as a yardstick for further progress, was already mentioned in this first Directive on banking. Although the Directive introduced a system of authorization of credit institutions, it provided for subsequent further harmonization of the authorization criteria as and when the Member States had reached agreement on supervision requirements. The Directive also stipulated that a credit institution should possess 'adequate minimum own funds', while a further important provision prohibited the refusal of an authorization on the grounds of insufficient economic need (abolition of the needs-related examination). A further important feature of the Directive was the establishment of an Advisory Committee composed of three representatives from each of the bodies responsible for bank supervision in the Member States.

The Council's next step was to issue a Directive on consolidated accounts in 1983. This was not only important for the establishment of a common market for banking services but also reflected both the growing internationalization of banking business and similar moves towards coordination taken by the G-10 Group of most developed countries. The Directive extended the supervision of individual credit institutions to banking groups, including their domestic and foreign affiliates and their accumulated overall credit risk. For the purposes of such broader banking supervision, the Member States were required to remove all legal barriers restricting the exchange of information between the often multinational banking groups and the supervisory authorities. The Directive was, however, restricted to essential principles, leaving the Member States free to decide whether this extended system of banking supervision should also encompass minority holdings in banks and holdings in credit institutions of a special nature, such as mortgage banks.

A further step towards harmonization was taken in December 1986 with the Council Directive on the annual accounts and consolidated accounts of banks and other financial institutions,[1] which sets out special rules applying the general provisions on the annual accounts of joint-stock companies (fourth and seventh company-law Directives) to the banking sector. Under the Directive, credit and financial institutions are required at the end of each financial year to publish harmonized statements of their economic and financial situation and results in the form of a balance sheet, profit and loss account, financial report and corresponding annex. In order to ensure the comparability of annual accounts — and hence of the information provided to creditors, debtors and shareholders — the Directive provides for harmonization of the layout and content of balance sheet and profit and loss account items, nomenclature, terminology and valuation rules.

The rules on annual accounts are supplemented by the Council Directive of February 1989 on the obligations of branches established in a Member State of credit institutions and financial institutions having their head offices outside that Member State regarding the publication of annual accounting documents.[2] Broadly speaking, the main implication of the obligations set out in the Directive is that it is sufficient for the branches of institutions having their head offices in other Member States to publish the annual accounting documents of their institution as a whole.

At the end of 1986 the European Commission issued two recommendations to the Member States. Although these were non-binding, the Commission's programme of work for 1989 makes clear that they are to be transposed into the binding form of a harmonizing Directive. The recommendations concern the supervision and monitoring of large-scale credits issued by credit institutions and the establishment of savings protection schemes.

The aim of the recommendation on the supervision and monitoring of large-scale credits is to restrict the scope of banks to overconcentrate their credits on a single client or group of clients. The recommendation defines a large risk as a totality of risks in respect of the same beneficiary amounting to 15 % of the bank's own funds. In addition, no single large risk in respect of the same beneficiary may exceed 40 % of own funds, nor may the cumulative amount of all large risks exceed 800 % of own funds. Large risks must be reported to the supervisory authorities at least once a year.

(1) Council Directive 86/635/EEC.
(2) Council Directive 89/117/EEC.

The recommendation on the establishment of savings protection schemes is aimed at ensuring that such schemes are introduced in those Member States in which they do not yet exist. As well as containing a timetable which reflects the situation in the various Member States, the recommendation sets out a number of minimum requirements for savings protection.

(b) New initiatives and decisions pending

The fresh start marked by the Commission's White Paper on the internal market (see Chapter IV (b)) is reflected in the field of banking services by a proposal of February 1988 for a second Directive on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions (subsequently referred to as the Second Directive on banking).

In this proposal the Commission sets out all the conditions still to be met if restrictions on trade in financial services in the Community are to be fully removed. The basic principle is that referred to in the 1977 First Directive, i. e. that any credit institution duly authorized in its country of origin should be allowed to take up establishment and offer its services anywhere in the Community without requiring further authorization in the other Member State(s) concerned. Previous harmonization measures had left three major restrictions untouched, i. e. that banks wishing to establish a branch in another Member State required authorization from the supervisory authority of the host country concerned, that host countries could still apply legislation restricting the activities of such branches and, finally, that the initial capital required of branches in most Member States was equivalent to that usually required of new banks.

Underpinning the proposed new Directive is the issue of a single authorization, covering a range of precisely defined activities, valid for all Community countries. These activities were set out by the Commission in a list based on the liberal all-purpose bank model, and the Commission attaches particular importance to the inclusion of all transactions in securities, including trade in securities, participation in the issue of securities and portfolio management and consultancy.

In addition to the proposed Second Directive on banking, which is described as the 'cornerstone of banking liberalization', the Commission has outlined the individual areas in which further harmonization is required in order to achieve a free market for banking services. In this regard, the Second Directive itself provides for a minimum initial capital of ECU 5 million for banks, supervision of the principal shareholders of credit institutions and a limit on their holdings in non-bank undertakings.

Thus, credit institutions may not maintain non-bank holdings in excess of 10 % of own funds, nor may the overall value of such holdings exceed 50 % of own funds. Further provisions concern the requirement to provide information on the distribution of equity capital, cooperation between the supervisory authorities in the various Member States and an embryonic Community procedure *vis-à-vis* non-Community countries aimed at ensuring reciprocal access (see Chapter X (b)). The Directive also provides for the two-stage abolition of the initial capital previously required of branches.

In addition to the provisions of the Second Directive itself, the Commission considers that four further measures are required in order to achieve a free market in banking services. These would comprise two Directives — one on own funds and one on the solvency of credit institutions — and the two abovementioned 1986 recommendations on the issue of large-scale credits and savings protection.

Common standards for the own funds of credit institutions were already agreed upon in principle by the Council of Ministers in February 1988. Because own funds are crucial to the activities of credit institutions, the protection of savers and bank supervision, the Directive finally adopted on 17 April 1989[1] is of particular importance. Own funds not only serve to cushion losses but also provide supervisory authorities with an important yardstick by which to assess the solvency of credit institutions. Minimum harmonization is necessary, since divergent rules in the Member States could lead to substantial distortions of competition.

The Directive sets out in numerous individual provisions the items attributable to own funds, distinguishing between original own funds and additional own funds of lesser status. Thus, subject to a number of conditions set out in the Directive, own funds comprise paid-up capital reserves, revaluation reserves, funds for general banking risks, value adjustments, the commitments of the members of credit cooperatives, cumulative preferential shares and subordinated loan capital. Additional own funds must not exceed the amount of original own funds. The Directive specifies sample criteria for particular items of own funds, leaving the Member States free to apply stricter criteria if they see fit.

The definition of own funds is also central to the Commission's April 1988 proposal for a Directive on solvency ratios, which is again important for the achievement of a free market in banking services. Solvency is the capacity of a bank to meet the risks incurred through lending to its customers, and the Commission's corresponding proposal sets out common definitions and methods for its calculation based on a provisional 8 % minimum for capital and reserves. Both the above Directives are not only of importance to harmonization within the Community but also reflect broader international agreements concluded within the G-10 Group of most developed countries (Cooke Committee).

The new programme for liberalization of the banking sector is completed by a proposal of December 1988 on liberalization of the services offered by brokers, investment advisers

([1]), Council Directive 89/299/EEC.

and securities administrators. As in the Second Directive on banking, the aim is to base the freedom to provide services on a single authorization valid in all Community countries, and the proposal therefore goes some way towards harmonizing rules on supervision. It also sets out requirements regarding the minimum capital of brokerage firms, as well as the establishment of a guarantee fund in each Member State to protect investors against any losses they may incur as a result of such firms' insolvency.

The Commission's programme for what it regards as essential minimum harmonization in the banking sector encompasses a number of earlier proposals on which the Council of Ministers has not yet reached agreement. These include the December 1984 proposal for a Directive on freedom of establishment and the freedom to provide services in the field of mortgage loans. This proposal supplements the 1977 First Directive on banking and aims to ensure that the freedom of establishment and freedom to provide services required by this Directive are indeed achieved. Because the field of mortgage loans in particular has developed its own very divergent traditions, there are still numerous rules impeding achievement of this objective, and the Commission's proposal therefore aims to open up the Member States' markets to the different types of mortgage loan.

In December 1985, the Commission issued a proposal for a Directive on the coordination of laws, regulations and administrative provisions relating to the reorganization and the winding up of credit institutions. This proposal sets out the necessary conditions for the recognition and application in other Member States of reorganization procedures instituted in the home country of a credit institution on the basis of that country's legislation. The proposal further describes the role of the competent authorities in instituting winding-up procedures, as well as the conditions for withdrawal of an institution's authorization. It also contains rules to protect investors against the winding up of a credit institution established in more than one Member State.

A number of the Commission's proposals concern not only credit institutions but also the interests or rights of citizens. In January 1987 the Commission proposed several measures aimed at ensuring that every citizen was able to use his bank card throughout the Community. One such proposed measure was the establishment of a European code of conduct for the undertakings concerned, together with the formulation of common standards and measures to ensure consumer protection.

Acting on a Commission proposal, the Council of Ministers had already adopted in December 1986 a Directive for improving consumer protection as regards credit agreements. The Directive's main provision is the requirement to state an annual percentage rate of charge, whose precise method of calculation is, however, contained in an additional proposal yet to be adopted by the Council. The Directive also contains provisions on the form and terms of credit agreements, as well as rules on early repayment, the repossession of goods, means of payment, securities, joint and several liability and the supervision of creditors. The Member States themselves are, however, free to apply stricter regulations.

Also in December 1986 the Commission put forward a measure covering both the insurance and the banking sectors with its proposal for a Regulation on the guarantees given by credit institutions and insurance companies. Under this proposal, the public authorities in all Member States are required to accept all guarantees given by a duly authorized bank or insurance undertaking, thus making such guarantees valid in all Member States.

VII The liberalization of insurance services

As with the banking sector, early moves were also made to achieve freedom of movement and the freedom to provide services in the field of insurance. However, delays were even greater here because the Member States' widely differing arrangements for insurance operations, supervision and consumer protection hampered the formulation of adequately coordinated rules. It was not until December 1986, when the European Court of Justice delivered a significant judgment on these questions and forced the issue of further liberalization, that the way was opened for new initiatives.

(a) Previous legislation

Efforts to achieve a common market for insurance services began with the entry into force in August 1964 of a Directive on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of reinsurance and retrocession. Basically this Directive did little more than confirm the existing situation, since this activity (the insurance of insurers) was subject to only limited restrictions in the Member States.

This was followed by two further Directives on property insurance. With the entry into force on 1 February 1975 of the Directive on the abolition of restrictions on freedom of establishment in the field of direct insurance other than life insurance, Member States were required to remove numerous obstacles. Above all, the Directive firmly established the right of insurers to take up establishment in a host country under the same conditions and with the same rights as residents of that country. Other provisions concerned evidence of professional repute, the right to belong to a professional organization and a prohibition on subsidies likely to distort competition.

A further closely related measure, which entered into force on 1 February 1976, was the Directive on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct insurance other than life insurance. This Directive provided for a certain minimum harmonization encompassing the legal form of insurance companies, restrictions on their activities, supervision, cooperation between supervisory authorities, technical reserves, balance sheet values and solvency margins.

The basic 1975/76 Directives on property insurance were later supplemented by a number of individual provisions. In December 1984 the Council issued a Directive incorporating in the first Directive, which had entered into force in February 1975, certain insurance services for tourists. In June 1987 the Council approved two further additions. These concerned credit and suretyship insurance (Council Directive amending, as regards credit insurance and suretyship insurance, First Directive 73/239/EEC on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct insurance other than life insurance) and legal expenses insurance (Directive on the coordination of laws, regulations and administrative provisions relating to legal expenses insurance). The main objective of both initiatives was the removal of the Federal Republic of Germany's prohibition on the simultaneous undertaking of the various types of insurance activity, which restricted the freedom of establishment of companies from other Member States. To offset this removal, the Directives provided for additional guarantees in the field of credit insurance and for measures to preclude any conflict of interests between insurer and insured in the context of legal expenses insurance.

The activities of insurance agents and brokers were covered in a Directive on measures to facilitate the effective exercise of freedom of establishment and freedom to provide services in respect of the activities of insurance agents and brokers, which entered into force in June 1978. This Directive requires Member States with rules governing the taking up of such activities to recognize as sufficient qualification the pursuit of these activities over a reasonable and sufficiently recent period of time. It has since been largely superseded by the mutual recognition of diplomas, certificates and other formal qualifications.

May 1978 saw the adoption of a Council Directive on the coordination of laws, regulations and administrative provisions relating to Community co-insurance.[1] This Directive concerned risks requiring the participation of more than one insurer. Until the European Court of Justice delivered the judgment referred to above (see following paragraph), it remained unclear whether the leading insurer had to be established in the country in which the risk is covered.

On 15 September 1980 the First Council Directive on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life insurance[2] entered into force. The implications of this Directive match those of the two above mentioned Directives on property insurance. A special Directive on the lifting of restrictions on freedom of establishment was no longer thought to be required, since the removal of such restrictions had since been endorsed by a judgment of the European Court of Justice (Case 2/74 *Reyners*).

Two Directives on motor insurance were of particular importance to the free movement of persons. The First Directive on the approximation of the laws of Member States relating to insurance against civil liability in respect of the use of motor vehicles, and to

(1) Council Directive 78/473/EEC.
(2) Council Directive 79/267/EEC.

enforcement of the obligation to insure against such liability,[1] which entered into force on 1 January 1974, removed the requirement for drivers travelling to another Community country to carry the green insurance card. Thus, the validity of third-party insurance in all the Member States was extended to cover the entire Community territory with a view to removing the need for corresponding frontier controls. The agreement was subsequently supplemented by a Second Directive on the approximation of the laws of Member States relating to insurance against civil liability in respect of the use of motor vehicles, which came into force at the end of December 1988. The purpose of this Directive was to align the sometimes widely varying cover afforded by insurance policies in the individual Member States.

(b) The European Court of Justice's judgment of December 1986

The European Court of Justice's judgment of 4 December 1986 gave fresh impetus to the waning efforts to achieve a free European insurance market. In response to the Commission's legal action against four Member States (Denmark, France, the Federal Republic of Germany and Ireland), the judges declared that the restrictions placed by these Member States on the authorization of insurance companies from other Community countries were in part illegal but also in part justified. Such restrictions were, the judges said, in principle compatible with the EEC Treaty provided they fulfilled certain requirements. The judges were referring here mainly to consumer protection, which is of particular importance in the field of insurance. On the other hand, the judges excluded from such restrictions all companies or parties for which the question of such protection does not arise. These mainly include well-known companies, leaders in their branch, whose contracts are mostly large-scale and whose expertise renders special consumer protection unnecessary. This at least opened the way for further progress towards a deregulated insurance market for large industrial risks, although comprehensive harmonization of supervision and protection provisions was still required for general insurance business.

The beneficial effects of the Luxembourg judgment were soon felt. In June 1988 the Council of Ministers adopted the Second Council Directive on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life insurance and laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 73/239/EEC.[2] This Directive reflects the Court of Justice's judgment by attaching initial priority to the achievement of a free insurance market for large industrial risks in which the principles of home-country control and

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([1]) Council Directive 72/166/EEC.
([2]) Council Directive 88/357/EEC.

mutual recognition of supervision rules by the Member States apply. On the policy holders' side, large risks are defined in such a way that policy holders engaged professionally in an industrial or commercial activity must meet at least two of the following three criteria: a workforce of more than 500 employees, turnover in excess of ECU 24 million or a balance sheet total in excess of ECU 12.5 million. These values are to be halved after 1992. The Directive also provides for special transitional arrangements for Greece, Ireland, Portugal and Spain. As regards general risks, i. e. the insurance typically held by the average citizen, the Directive provisionally leaves control and supervision rules in the hands of the Member State where the risk is situated. Further harmonization is required here in order to achieve the principles of home-country control and mutual recognition set out in the Commission's White Paper on the internal market.

(c) Other subsequent decisions and proposals and matters to be settled

The programme for the achievement of a free insurance market is completed by a small number of earlier proposals for Directives (still to be adopted by the Council of Ministers) and by new Commission initiatives taken in response to the European Court of Justice's judgment. A December 1986 proposal, which draws on the general provisions applying both to the annual accounts of joint-stock companies and to the banking sector, sets out special rules also applicable to the insurance sector (Directive on the annual accounts of insurance undertakings). Also in December 1986, the Commission presented a proposal on the compulsory winding up of direct insurance undertakings (Council Directive on the coordination of laws, regulations and administrative provisions relating to the compulsory winding up of direct insurance undertakings). This proposal sets out rules governing the role of supervisory authorities and the distribution of assets in the event of compulsory liquidation.

The Commission's most recent proposals concern Directives on the liberalization of the Community's life assurance market, as well as two further Directives on motor insurance. Under the proposal on life assurance presented in December 1988, all Community citizens would be free to take out a life assurance policy on their own initiative in a Member State other than that in which they are resident, but would have to accept the degree of protection and supervision prevailing in that country. This would therefore mean that the principle of home-country control aimed at by the Commission would come into play. If, however, an agreement is concluded outside the country of residence on the insurer's initiative, the provisions applicable would be those of the country where the risk is situated. This Commission proposal again reflects the European Court of Justice's judgment referred to above. As with the Second Coordinating Directive on direct insurance other than life assurance, further harmonization of the individual Member

States' provisions will be necessary if the Commission's White Paper objective of home-country control based on mutual recognition for all insurance risks is to be given a real chance of success.

Both of the Commission's December 1988 initiatives on third-party motor insurance concern increased harmonization of the existing legal provisions and the incorporation of this field in the Second Coordinating Directive on direct insurance other than life assurance, from which it had been excluded due to a large number of special problems.

The proposal for a Third Council Directive on approximation of the Member States' legal provisions on third-party motor insurance aims to reduce what are still, despite the two earlier Directives, substantial variations in cover in the Member States. Its chief objective is to ensure that the victims of road accidents are treated as uniformly as possible, regardless of the Member State in which the accident occurred. In particular, the cover of passengers under third-party insurance is still subject to wide variations in a number of Member States.

The proposal for a Directive on the freedom to provide motor insurance services, which also dates from December 1988, aims to extend application of the principles formulated by the European Court of Justice (and included by the Commission in its proposal for the Second Directive on direct insurance other than life assurance) to compulsory third-party motor insurance and comprehensive insurance. This entails a distinction between large and general risks. Under the proposal, the motor insurances of major industrial and commercial concerns are fully subject to home-country (or country-of-origin) control. Insurers do not require authorization in the country in which the risk is situated and may constitute and invest their provisions in accordance with the rules of the country of origin. Among the still unresolved problems dealt with in the Directive are the operation of national guarantee funds for the indemnification of victims of accidents caused by uninsured or unknown vehicles, operation of the green card system and, in general terms, the safeguarding of road-accident victims' interests.

VIII A single European market for securities

A European financial common market without restrictions requires a single securities market where investors can issue and trade securities across national borders freely and without hindrance. The removal of the numerous national restrictions still existing has become all the more urgent with the rapid internationalization of securities markets and the need for the Community to achieve a dimension in this area equal to that of other major financial markets, such as those of the United States or Japan.

The Community began early with its efforts to harmonize at least to a minimum degree the different regulations of the Member States on the admission of securities to stock-exchange listing and the information to be provided to investors, and thus the protection of investors. As early as 1972, in a proposal for a first Directive in this area, the Commission stated that the omissions and differences in the information provided to the public regarding securities constitute a 'second barrier' for capital movements between the Member States which prevents the capital markets benefiting in full from the advantages already achieved by the partial removal of currency restrictions. The second consideration, in addition to the provision of information for the public and the protection of investments, was the operation of a single securities market. Since 1979 the Council of Ministers has adopted a series of important Directives in this area. The first stage was the adoption on 5 March 1979 of a Directive coordinating the conditions for the admission of securities to official stock-exchange listing.[1] The Directive sets out the conditions that must be met by issuers of securities, including the minimum issue price, the company's period of existence, free negotiability, sufficient distribution and the provision of appropriate information for investors. However, the Member States were free to impose stricter requirements.

Closely connected is the Directive adopted by the Council on 17 March 1980 coordinating the requirements for the drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock-exchange listing.[2] The Directive lays down the many items of information which must be published when shares, debt securities and certificates representing shares are admitted to stock-exchange listing.

(1) Directive 79/279/EEC.
(2) Directive 80/390/EEC.

The third stage followed on 15 February 1982 with the Council Resolution on the Directive on information to be published on a regular basis by companies whose shares have been admitted to official stock-exchange listing.[1] Under the Directive companies listed on a stock exchange must publish half-yearly reports on their activities and profits and losses.

A milestone decision was taken by the Council on 18 November 1985 with two Directives on the free marketing of units issued by investment funds (undertakings for collective investment in transferable securities). Both Directives implement for the first time in the securities sector the 'new approach' called for in the White Paper on completing the internal market, namely the principle of mutual recognition of the legal provisions of the Member States based on a minimum level of coordination of national provisions and control by the country of registration or country of origin (see Chapter IV (b), p. 18). A coordination Directive sets out the framework for the approximation of legal provisions so as to achieve approximately equal conditions of competition and effective protection for investors in all EC countries. Under a liberalization Directive the Member States are required to remove all restrictions on the free marketing of units. The provisions of the coordination Directive cover the field of application, the admission conditions, the structure of investment funds and their investment policy. The provisions also cover the information to be supplied to unit-holders, the general obligations of funds, such as the ban on borrowing, the observance of the laws of the Member State in which the units are marketed, the rights and obligations of the supervisory authorities and the creation of a Contact Committee consisting of persons appointed by the Member States and of representatives of the Commission.

The 'new approach' set out in the White Paper resulted in a further decision by the Council of Ministers. This was the Directive of 22 June 1987 amending Directive 80/390/EEC coordinating the requirements for the drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock-exchange listing.[2] The aim of the Directive is to ensure that listing particulars compiled in accordance with the earlier Directives and approved in one Member State are automatically recognized on the stock exchanges of other Member States without the need for additional approval.

The Council took two further steps towards greater transparency in the latter half of 1988. On 12 December it reached agreement in principle on a Directive on the information to be published when a major holding in a listed company is acquired or disposed of.[3] The aim of the Directive is to ensure that investors and the public are informed of major shareholdings, changes in holdings above or below certain thresholds and changes in voting rights for listed companies in the Community. The requirement comes into ef-

(1) Directive 82/121/EEC.
(2) Directive 87/345/EEC.
(3) Directive 88/627/EEC.

fect when a holding reaches 10 %, 20 %, 1/3, and 50 % and 2/3. The Member States may apply a single threshold of 25 % in place of the 20 % and 1/3 thresholds, and 75 % in place of the 2/3 threshold.

On 17 April 1989 the Council adopted a Directive coordinating the requirements for the drawing up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public.[1] This Directive is a further major supplement to the above mentioned 1982 and 1987 Directives on transparency and investor protection on the securities markets. In addition to numerous individual provisions, the Directive introduces for securities offered to the public for the first time a similar obligation to provide information to that contained in the 1980 general prospectus Directive for listed securities.

Also aimed at transparency on the securities markets and equality of opportunity in industrial restructuring was a Commission proposal of December 1988 for a Directive on public takeover bids. The Directive is important mainly because with the completion of the internal market and increasing deregulation of capital movements merger and takeover activity has grown substantially and is expected to grow further. The aim of the Directive is to approximate the very different legal provisions on takeovers in the Member States in order to ensure fairness of business dealings and equality of opportunity. The main provisions are directed at banning partial public takeover bids, obliging a partial bidder (from 30 %) to extend his bid to all the stock and ensuring that a bidder states in advance his intentions regarding the assets and activities of the company concerned. Further provisions cover defence measures by companies for which public bids have been made, the retention of securities by a supervisory authority in each Member State and reciprocity arrangements with non-Community countries (see Chapter X (b)).

Four further initiatives by the Commission complete the programme for the creation of a single European securities market. The proposal for a Council Directive relating to indirect taxes on transactions in securities of 14 April 1987 is aimed at abolishing indirect taxes on such transactions, following the failure to reach agreement on an earlier 1976 proposal on harmonization in this area. The fact that taxes on stock-exchange transactions on major financial markets, for example in the United States and Japan, have been removed or are to be reduced is a further argument in favour of abolition. Investor protection, the removal of distortions in a single European financial common market and the combat of fraud are the subjects of the proposal for a Directive of 28 April 1987 coordinating regulations on insider dealing. Insider dealing is the use of confidential stock-exchange information available only to certain persons through their jobs. The use of such confidential information is generally prohibited. The Directive is aimed at harmonizing the different codes of behaviour in the Member States. Growing abuse and spectacular cases have increasingly concentrated international attention on insider dealing.

([1]) Directive 89/298/EEC.

Finally, mention must be made of efforts to link EC stock exchanges. Since 1984 the chairmen of the stock exchanges of the Member States, in collaboration with the Commission, have been working on a stock-exchange link-up system known as the IDIS (Interbourse data information system). The Commission itself has completed examination of how links can be created or improved between the national clearing systems for securities transactions.

IX Basic prerequisites for the European financial common market

(a) Monetary policy

Financial and capital flows are much more volatile than goods flows and are the subject of government financial and monetary policy. As capital moves increasingly freely between Member States, governments become more restricted in their ability to pursue an independent monetary policy and it also becomes all the more important, for the purpose of maintaining stable exchange rates as agreed by eight Member States in the European Monetary System (EMS), to work together and coordinate economic policies.

The Single European Act reforming the EEC Treaty, which entered into force on 1 July 1987, specifically confirms the objective of an economic and monetary union, but makes clear at the same time that institutional changes in this field require unanimous approval and ratification in the Member States. An economic union means that exchange rates will be tied irrevocably. While there is now a broad consensus that the creation by the end of 1992 of an internal market without frontiers for goods, services, capital and persons does not necessarily require immediate monetary union, there is also clear agreement that the establishment of a European financial common market with totally free capital movement requires a higher degree of monetary cooperation between Member States than currently exists.

1. Previous developments

The first step towards the progressive creation of an economic and monetary union was taken by the Member States on the basis of the decisions of the 1969 Hague Summit. On 22 March 1971 the Council of Ministers adopted the Werner Plan, named after the former Luxembourg Prime Minister, for the progressive creation of an economic and monetary union. The Plan foundered on the dollar and oil crises of the following years (see Chapter III (c), p. 15). What remained was essentially only an exchange-rate system in which the rates could fluctuate up or down by up to 2.25%, with the participating countries jointly allowing their currencies to float against the dollar (block floating or snake). The system was unstable in so far as several Member States temporarily withdrew from it. Non-Community countries such as Sweden and Norway also participated for a time.

It was not until 13 March 1979 that a new system with many new binding agreements and mechanisms came into force in the shape of the European Monetary System. The margin of fluctuation remained 2.25%, but a margin of 6% was granted to Italy because of special economic difficulties. The United Kingdom did not join the system. The main new feature was the creation of the European Currency Unit, the ecu (the name of a French coin from the Middle Ages). The ecu is defined as a basket of weighted amounts of the Member States' currencies, including the UK pound, although the United Kingdom is not a member of the system. The ecu is used as a reference point for several aspects of the new system. Its role in the EMS is that of a reserve unit and instrument for the settlement of central-bank balances resulting from joint exchange-rate support operations on the currency market (intervention). It serves as a reference for setting the central rates in the exchange-rate mechanism, and for the divergence indicator. The latter serves as a warning system for Member States to initiate economic measures if their currencies deviate from the central rate by a specified percentage. EMS transactions are conducted via the European Monetary Cooperation Fund (EMCF), founded as long ago as 1973, which is managed by the governors of the central banks. The Member States have transferred 20% of their gold and dollar reserves to the EMCF in exchange for ecu, which are used as a non-cash means of settlement between central banks.

The EMS exchange-rate system was extremely successful in its first 10 years of existence. In spite of numerous crises on the world currency markets and a number of parity changes within the EMS, exchange rates remained far more stable overall than in the rest of the world. Inflation rates in the Member States were reduced substantially and brought closer together. Economic policies in all the Member States converged towards greater stability. On the other hand, the plan to move the EMS to a second stage after only two years and to provide it with an institutional basis with the creation of a European Monetary Fund failed. The time was not yet right.

2. The EMS reforms of Palermo and Basle/Nyborg

The finance ministers and central bank governors nevertheless succeeded twice in the past few years in agreeing on major reforms of the system. The first series of measures was adopted in Palermo in April 1985. The interest payable on the ecu held by the central banks was made more attractive and tied to market rates instead of average discount rates. The possibility was created for non-Community central banks and international bodies such as finance organizations to acquire ecu (other holder status). Also new was the rule that the central bank of a Member State could obtain dollars or other currencies from the EMCF in exchange for ecu for use in currency-support operatins (ecu mobilization). And lastly, a higher acceptance quota for ecu was introduced for settlements between central banks.

A second package of technical reforms was agreed by finance ministers and central bank governors in Basle and Nyborg in September 1987. The period of very short-term finance granted for exchange-rate support operations was extended and the ceiling raised for the duration of the extension. The possibility was created of making use of very short-term financing even before the agreed intervention rates had been reached, under the intra-marginal intervention scheme. The limit for the acceptance of official ecu by the central banks was raised to 100%. And lastly, coordination of economic and monetary policy was improved by closer monitoring in the EC Monetary Committee and the Committee of Governors of the Central Banks with the aid of economic and monetary indicators. The first positive effects of these reforms included several concerted interest-policy measures by governments and central banks.

3. The private ecu market

Over the years a private ecu market has grown up alongside the offical ecu market, with brisk interbank trade in ecu deposits and loans. These transactions were made easier technically when, in October 1986, several of the banks in the ecu bank association created, with the support of the Commission, a settlement system at the Bank for International Settlements (BIS) in Basle. The value of the transactions processed daily is estimated at some ECU 10 000 million.

The ecu has become particularly important on the bond market where, well behind the dollar and after the German mark, Swiss franc and yen, it has become the fifth most important currency. The European institutions, including the Commission and the European Investment Bank, have played a major role in the development of the ecu bond market. The total international ecu bank loan and deposit market exceeds ECU 80 000 million. According to Commission figures, total ecu issues of fixed-interest securities on the international markets amounted to ECU 9 200 million in 1988. ECU 3 900 million of that total was accounted for by non-Community issuers. The ecu's attractiveness for the bond markets resides in the fact that as a basket currency representing the average value of its individual constituent currencies, including interest, it provides greater stability than a single curency. As a result, in the initial stage of the ecu bond market, investors were mainly from hard-currency, low-interest countries, whereas participants from weak-currency, high-interest countries tended to be borrowers.

The rapid development ot the ecu on the bond markets has temporarily slowed. The Bank for International Settlements (BIS), in its February 1989 quarterly report, concluded that expansion had waned following the dynamic growth in the first half of the 1980s. According to the BIS, ecu bank lending between the end of 1985 and the end of September 1988 increased by 62% to ECU 104 000 million. However, ecu bond activity has recently again acquired substantial momentum.

Less widespread, although decreasingly so, is the use of the ecu as an invoicing currency in external trade and as a clearing unit in multinational companies. Attempts to make the ecu also more accessible to the general public, by means of ecu savings accounts and ecu traveller's cheques, have so far been of a pioneering nature and remained limited, not least because of the charges involved.

However, support for the private ecu is growing. This applies not only to the Community institutions and their borrowing activities. The Commission also wishes to use the ecu in future for disbursements under the reformed Structural Funds (Regional, Social and Agricultural Structural Funds), as well as for the creation of a harmonized card payment system in the Community. The European Parliament has backed the further development of the ecu, and the Member States themselves are becoming more actively involved. The ecu is now recognized by all as a currency, even if the Deutsche Bundesbank refuses to rediscount ecu bills. The ecu is quoted on many Community stock exchanges. Belgium has minted gold and silver ecu coins which are legal tender but are not used as such because of their excessively high issue price. Since October 1988 the British government has been regularly issuing ecu treasury bills. This initiative has helped to develop an ecu money market and give a boost to ecu markets in general. The Italian government regularly raises short and medium-term funds through the sale of government debt instruments. The French government joined this initiative in April 1989 and issued a large government loan denominated in ecu.

Growing support is also coming from private industry. An association of leading industrialists with a rapidly growing membership has been calling for some time for the strengthening of the European Currency Unit.

Although the official ecu in the EMS and the private ecu are strictly separate, they are also interlinked. The exchange-rate stability in the EMS, as evidenced by the fact that there were no parity adjustments between 1983 and 1986, and none since early 1987, reinforces the stable nature of the private ecu. This also applies to every step towards the extension of monetary cooperation between the Member States because it bolsters confidence in the European Currency Unit.

4. The mandate issued by the Heads of Government in June 1988

The debate on further improvement of monetary cooperation between the Member States was triggered by recognition that the complete liberalization of capital movements agreed for most Member States for mid-1990 could substantially increase monetary flows, particulary speculative flows, reduce the scope for national monetary and exchange-rate policy and render it more difficult to retain the desired exchange-rate stability in the EMS. But it is just such a minimum level of exchange-rate stability that the planned single European market requires in order to function. For these reasons, a group of experts appointed by the Commission concluded in April 1987 that during a transition from a restricted to a free system of capital movements, greater adherence to binding principles of agreed monetary policy was required if the EMS was to function effectively. According to the group's report, the removal of exchange controls would be a critical test for the weak institutional structure of the system. However, the Member States remained divided on the scope and nature of greater monetary cooperation. Many held the view that the planned internal market requires major progress towards a monetary union, including the creation of a European central bank. Others considered that the existing rules and institutions were sufficient. Discussions were made more difficult by the fact that the pound sterling, a major EC currency, is not a member of the EMS exchange-rate mechanism. Problems also arose because the German mark, an international reserve currency, carries an extraordinary weight in the EMS with the result that the participating countries are often literally obliged to adopt the same economic priorities as Germany, even if they do not consider those priorities to be appropriate in the context of their own economic situation.

Following numerous contributions to the debate from the Member States, the EC Heads of State and Government agreed at their Summit in Hanover on 27 and 28 June 1988 to have the question of greater monetary cooperation examined by a Committee chaired by Commission President Jacques Delors. The governors of the twelve Community central banks were asked to serve as experts on the Committee, together with a second member of the Commission and three additional experts.

On 12 and 13 April 1989 in Basle the Delors Committee successfully completed its work and finalized a report on economic and monetary union in the European Community. The Committee not only redrafted the political, economic and institutional conditions for an economic and monetary union but also put forward a concrete three-stage plan for its realization and developed a precise concept for a federally structured, independent European System of Central Banks (ESCB) and for the reform of existing procedures used for coordinating economic policy. Other major features of the Delors Report include emphasis on the unavoidable need for further amendment of the basic Rome Treaties, parallel economic and monetary development, acceptance of the principle of subsidiarity, under which only as many functions as absolutely necessary would be transferred from the national to the Community level, and the importance of further regional and structural policy measures for eliminating imbalances between the Member States. Reference is made to the possibility of Member States progressing at different speeds in the integration process (this is frequently referred to as the two-speed or variable-geometry Europe). The Report begins with a general description of the aim of economic and monetary union, experience to date with the European Monetary System (EMS) and ecu (European Currency Unit), and new Community activities stemming from the Single European Act and the single European market programme (see also previous chapters).

The stage-by-stage plan proposed by the Delors Committee contains a precise timetable for stage one, which is to begin on 1 July 1990 at the same time as the liberalization of capital movements already agreed in principle for most Member States. No date is specified for the end of stage one, nor for the end of stages two and three. However, it can be deduced from the programme proposed that stage one will certainly encompass the completion of the European financial area with the complete liberalization of capital movements and the implementation of the single European market programme planned for the end of 1992. Further steps towards coordinating the economic policies of the Member States are considered necessary.

Stages two and three are described only as regards content. Whereas stage three largely describes a completed economic and monetary union, the decisive qualitative advances under the plan are due to take place in stage two. Before stage two can begin, the Member States must agree and ratify the appropriate Treaty amendments at Community level as well as the legal adjustments at national level. The creation of the proposed European System of Central Banks would also be initiated during stage two. It is contended that the ecu will ultimately be able to become the planned single Community currency. In contrast, the experts do not consider it appropriate to develop a parallel currency to the ecu that would progressively replace national currencies. Opinions of the Committee members differ on whether a separate European Reserve Fund (ERF) should already be created during stage one and foreshadow the future European System of Central Banks.

Although the Committee sets no specific date for the implementation of the individual stages and makes them dependent on previous achievements, it emphasizes the integrated nature of the process to be initiated and the importance of a rapid start. One of the major political recommendations is the immediate commencement of preparatory work for negotiations on a new treaty. The responsible Community bodies are to work out proposals for stages two and three of the economic and monetary union which are to form the basis for negotiations at a Government Conference to be called by the Council of Heads of State and Government. A similar approach was adopted by the Community for the Single European Act, the latest reform of the Treaties.

The second political recommendation of the Delors Committee is to combine the decision on stage one with a clear commitment to the final phase. This is an unequivocal statement that the decisions in stage one will not only be useful *per se* but will represent a decisive first step towards economic and monetary union.

The principal steps proposed by the Delors Committee for phase one, which is to start on 1 July 1990 at the latest, are:

— removal of physical, technical and fiscal barriers, in line with the single European market programme, and strengthening of Community competition policy;
— implementation of the reform of the structural Funds and the doubling of their resources;
— stengthening of the rules applicable to date regarding economic and fiscal policy coordination (based on a 1974 Council Decision on economic convergence) by a new process of multilateral economic surveillance based on agreed indicators;
— full implementation of the European financial common market;

— inclusion of all Community currencies in the EMS exchange-rate mechanism, with the same rules applying to each;
— removal of all impediments to the private use of the ecu;
— redefinition of the mandate of the Committee of Central Bank Governors set out in the 1964 Council Decision, with the strengthening of the coordination function and the setting up of sub-committees for monetary policy, foreign-exchange policy and banking supervision.

The Committee's proposals for stage two include:
— review and consolidation of the results achieved through the implementation of the single market programme;
— enlargement of the resources for structural policies and research and infrastructure investments;
— stengthening and extension of the new procedure for the coordination of economic policy introduced in stage one, with the adoption of policy guidelines by majority decision;
— setting up of the European System of Central Banks (ESCB);
— recourse to exchange-rate realignments only in exceptional circumstances;
— transition from the coordination of independent national monetary policies to a common monetary policy formulated and implemented by the ESCB itself, with a gradual transfer of decision-making power to a Community institution;
— pooling of part of the exchange reserves for intervention on the currency markets;
— narrowing of the margins of fluctuation within the exchange-rate mechanism 'as circumstances permitted and in the light of progress made in the process of economic convergence'.

The Committee qualifies its remarks by stating that it does not consider it possible to propose in advance a detailed blueprint for the transfer of decision-making power from national authorities to a Community institution, as this would depend on progress achieved during stage one, the provisions of the Treaty, and on decisions to be taken by the new institutions.

The principal steps in stage three include:
— irrevocable locking of exchange rates;
— if necessary, further strengthening of structural and regional policies;
— rules and procedures of the Community to be made binding, in particular as regards constraints on national budgets and transfers of resources for structural policies, and to be applied by the Council of Ministers, in cooperation with the European Parliament;

— new form of representation and assumption of the full role of the Community in the process of international policy cooperation;
— decisions on exchange-market intervention in third currencies to be made on the sole responsibility of the ESCB Council;
— maintenance of official currency reserves at the ESCB;
— transition and change-over to a single currency.

The centrepiece of the institutional changes proposed by the Delors Committee is the creation of a European System of Central Banks (ESCB), which would be given the full status of an autonomous Community institution. In the experts' view, it would operate in accordance with the provisions of the Treaty and could consist of a central institution (with its own balance sheet) and the national central banks. At the final stage the ESCB — acting through its Council — would be responsible for formulating and implementing monetary policy as well as managing the Community's exchange-rate policy *vis-à-vis* third currencies. The national central banks would be entrusted with the implementation of policies in conformity with guidelines established by the Council of the ESCB and in accordance with instructions from the central institution. The Delors Committee's detailed proposals for the ESCB are as follows:

Mandate and functions

— The System would be committed to the objective of price stability;
— subject to the foregoing, the System should support the general economic policy set at Community level by the competent bodies;
— the System would be responsible for the formulation and implementation of monetary policy, exchange-rate and reserve management, and the maintenance of a properly functioning payment system;
— the System would participate in the coordination of banking supervision policies of the supervisory authorities.

Policy instruments

— The policy instruments available to the System, together with a procedure for amending them, would be specified in its Statutes; the instruments would enable the System to conduct central banking operations in financial and foreign-exchange markets as well as to exercise regulatory powers;
— while complying with the provision not to lend to public-sector authorities, the System could buy and sell government securities on the market as a means of conducting monetary policy.

Structure and organization

— A federative structure, since this would correspond best to the political diversity of the Community;

— establishment of an ESCB Council (composed of the governors of the central banks and the members of the board, the latter to be appointed by the European Council), which would be responsible for the formulation of and decisions on the thrust of monetary policy; modalities of voting procedures would have to be provided for in the Treaty;
— establishment of a board (with supporting staff), which would monitor monetary developments and oversee the implementation of the common monetary policy;
— national central banks, which would execute operations in accordance with the decisions taken by the ESCB Council.

Status

— Independence: the ESCB Council should be independent of instructions from national governments and Community authorities; to that effect the members of the ESCB Council, both governors and the Board members, should have appropriate security of tenure;
— accountability: reporting would be in the form of submission of an annual report by the ESCB to the European Parliament and the European Council; moreover, the chairman of the ESCB could be invited to report to these institutions. Supervision of the administration of the System would be carried out independently of the Community bodies, for example by a supervisory council or a committee of independent auditors.

At almost the same time as the Delors Committee was completing its work, the European Parliament also adopted a plan for economic and monetary union.

In presenting a draft statute for a European central bank and rejecting a parallel currency, the plan has much in common with the Delors Committee's Report but specifically calls for completion of the monetary union by 1 January 1995.

(b) Fiscal problems

In a deregulated financial area distortions would occur in the relationship between savings capital and investors without a minimum degree of tax harmonization. The gravity of the problem was demonstrated in 1988 in the Federal Republic of Germany when the mere announcement of the introduction of a law for the automatic deduction of a tax prepayment on income from capital investments (withholding tax) led to major capital outflows. For these reasons, the Commission, in its communication on the European financial common market, set out those sectors in which a minimum degree of fiscal harmonization is needed, and presented initial proposals on 8 February 1989. These proposals related to the taxation of interest income from savings capital. In the case of company taxation, the Commission wishes to supplement a proposal for a Directive on the harmonization of corporation tax systems of August 1975 by a proposal for the harmonization of the tax base.

The proposal for the taxation of interest on savings capital put forward by the Commission on 8 February 1989 provides for a single rate of withholding tax of not less than 15%. The proposal is combined with a proposal for a Directive strengthening cooperation between the tax authorities in the Member States in order to limit tax evasion. The rate of 15% applies to all interest payments made to EC residents. The Member States may exempt from withholding tax residents of non-member countries, as well as interest income from Eurobonds. The Commission justifies both measures on the grounds that the attractiveness of the Community for financial business must be maintained in an international context. Further exemptions include the savings of small savers, provided that the latter are not subject to tax, interest in Member States which require banks to notify automatically to the tax authorities details of interest paid, transactions between companies, and interest paid by private individuals.

The Commission considers that the growing tendency in the Member States to encourage the acquisition of domestic securities and bonds is also contrary to the requirements of a free European financial common market. This also applies to the practice of some Member States of prohibiting or restricting the purchase of foreign securities by resident pension funds. The Commission wishes to start discussions on the subject with the Member States.

(c) Other prerequisites

A further important prerequisite which the Single European Act also specifically states must be met if the planned common single European market and European financial common market are to succeed, is the economic and social cohesion of the Member States. Less developed countries on the edges of the Community can only participate in a fully integrated financial common market if they are able to attain the Community average through financial solidarity. The Heads of State and Government of the Member States therefore decided in February 1988 in Brussels, at the same time as adopting other major reforms, to double in stages the appropriations for the Community's structural Funds (regional, social and agricultural) to an annual level of approximately ECU 13 000 million by 1993. Adaptation was also the aim of the development of a social dimension in the internal market, the combination of the systems of providing assistance with the balance of payments (see Chapter V (c), p. 25) and the deadlines for the liberalization of capital movements (see Chapter V (c), p. 24), which are designed to help these countries improve their less advanced financial systems.

X Outlook

(a) Relations with the EFTA countries

The new dynamism generated in the Community by the plans for the completion of the internal market by 1992 has had a major impact on other West-European countries, notably those in the European Free Trade Association (Sweden, Norway, Finland, Iceland, Switzerland and Austria). Relations within this group of countries, which had originally been created as an alternative to the Community but with less pronounced political aims, have always been influenced by the development of the Community. This is the result of the accession to the Community of a number of former EFTA members (United Kingdom, Denmark and Portugal) and the almost-accession of Norway. Norway and Sweden also participated for a time in the period after 1971 in the first Community exchange-rate system, known as the 'currency snake' (see Chapter IX (a), p. 43).

Recognizing that in view of their multifarious economic links with the Community the EFTA countries could not be excluded from efforts to reach economic unification in Europe, the Community and EFTA, at a ministerial conference in Luxembourg, signed on 9 April 1984 a Joint Declaration on cooperation which has since become increasingly important through numerous working parties and several individual agreements. The aim is for the Community and EFTA jointly to create a single European economic area of some 350 million inhabitants. This of course involves extension of the Community financial common market to the EFTA countries.

The way in which and the extent to which this can be achieved, however, depends on developments in individual EFTA countries and their mostly politically motivated and totally disparate attitudes towards the Community. Switzerland has so far made it unmistakably clear that Community membership is out of the question for the foreseeable future, whereas it cannot be excluded that Austria will apply to join the Community. Norway had already negotiated the conditions for accession to the Community before the United Kingdom, Ireland and Denmark became Members in 1973, but withdrew its application following a referendum. There is continuing debate in Sweden and Finland on the shape of future relations with the Community.

Switzerland and Austria occupy a special position in relation to the Community as regards monetary policy. Both countries have for many years maintained close contacts as regards exchange-rate policy and the necessary coordination with their neighbour, the Federal Republic of Germany, whose monetary and economic policy is of special importance for relations within the Community because of the standing of the DM as an international reserve currency. In practice, this has meant a close parallel development of the exchange rates of these countries and the DM. In principle, the European Monetary System provides for European countries with particularly close economic relations with the European Community to participate on an associate basis in the Community's exchange-rate and intervention mechanism. Finland, Norway and Sweden pursue a monetary policy which links their exchange rates within certain margins to a currency basket in which the Community currencies have a certain weighting.

The wide range of monetary relations between the EFTA countries and the Community is matched by the disparity of their interest in the freedom of capital movements and financial services. Following their Luxembourg Declaration, the Community and EFTA have jointly created a group of experts on financial services, as well as a working party on capital movements. As regards the freedom to provide financial services, the aim will be to achieve a similar level of harmonization and mutual recognition of supervisory regulations for banks and insurance companies as that agreed between the Member States as a precondition for the completion of the free financial market.

Two developments could help accelerate the process of creating a European economic common market and a European financial common market extending beyond the confines of the Community. The first was the launching by the Commission President, Jacques Delors, of a debate on new forms of closer cooperation with EFTA which led to the creation of joint decision-making and administrative bodies. However, the effectiveness of such closer cooperation will depend on the manner in which cooperation is organized internally by EFTA itself. The second element is the fact that individual EFTA countries have voluntarily and independently embarked on a course of harmonization with the Community Member States. The number of examples of such harmonization is growing. Towards the end of 1988, the Swiss National Bank acquired the status of other holder of official ecu, something that was made possible by the EMS reforms at Palermo in 1985 (see Chapter IX (a) 2, p. 44). In January 1989, Austria loosened many of the restrictions in its rigid foreign-exchange law that had applied for many years. Efforts towards liberalization were also made in the Scandinavian EFTA countries in the latter half of 1988. In December 1988, Norway allowed businesses to obtain loans abroad without the prior authorization of the central Bank. In Sweden, there were ever clearer calls for the loosening of existing currency restrictions following the removal of all remaining controls in Denmark on 1 October 1988. There is also discussion in Sweden of the possibility of linking the Swedish krona to the EMS and adapting economic policy accordingly. A further example of a common economic policy in a European financial area was the concerted increase of bank rates on 19 and 20 January 1989 in the Federal Republic of Germany, France, the Netherlands and Belgium, as well as in Switzerland and Austria, which are EFTA members.

(b) Relations with other non-Community countries

The creation of a European financial area also raises major problems for relations with other non-Community countries such as the USA and Japan, as well as for relations with the EFTA countries. On the one hand, the management of parities with the dollar, still one of the world's key currencies with its effect on the stability of European money and capital markets, is of crucial importance (see Chapter III (c), p. 15). On the other hand, the Community must ensure that the planned internal market, and especially the introduction of the right of establishment and provision of services in the financial sector, do not give exclusive privileges to companies from non-Community countries, including EFTA countries, without those countries granting similar access to economic operators from the Member States. The Community has taken both these important elements into account in its basic decisions on and proposals for the European financial common market. When taking the decision on 24 June 1988 on the complete liberalization of capital movements (see Chapter V (c), p. 23 *et seq.*), the Member States reaffirmed their intention of applying the same degree of liberalization in respect of capital movements to or from non-Community countries as that applied to operations between Member States (known as the *erga omnes* rule). At the same time, however, they agreed a procedure for counteracting external monetary or financial shocks of the type already occasioned many times by United States dollar policy. The Directive on the liberalization of capital movements states:

'Where large-scale short-term capital movements to or from third countries seriously disturb the domestic or external monetary or financial situation of the Member States, or of a number of them, or cause serious strains in exchange relations within the Community or between the Community and third countries, Member States shall consult with one another on any measure to be taken to counteract such difficulties. This consultation shall take place within the Committee of Governors of the Central Banks and the Monetary Committee on the initiative of the Commission or of any Member State.'

In addition, it was decided that the Monetary Committee would examine at least once a year all regulatory measures concerning credit which could have an impact on international capital movements, and submit a report to the Commission. These measures replace a 1972 Directive on measures *vis-à-vis* third countries adopted because of the international capital movements and dollar crisis at the time. In the long term, a stable European currency area based on the European Currency Unit could be a major factor in a new international currency system including the US dollar and Japanese yen.

The Community's second major stance in the financial sector *vis-à-vis* third countries was set out in the Commission proposal for the total freedom of banks to provide services (Second Directive on banking, (see Chapter VI (b), p. 29 *et seq.*)). The Commission's proposal is that when banks from third countries seek establishment for the first time checks should be made to ensure that market access is indeed reciprocal in order to guarantee Community undertakings fair access and equal treatment. If Community undertakings are found to be discriminated against in a third country, the Commission should be able to order suspension of the settlement authorization of a bank from the third country. This rule, which has raised many fears of Community protectionism, is closely linked, however, with the Uruguay Round international trade negotiations currently in progress within the General Agreement on Tariffs and Trade (GATT). Negotiations are still continuing on the inclusion of services in GATT, which applies throughout the world. The Directive of 24 June 1988 on the liberalization of capital movements (see Chapter V (c), p. 23 *et seq.*) specifically states that the endeavour to attain the same degree of liberalization *vis-à-vis* third countries as that which applies to operations between the Member States shall not prejudice any reciprocal conditions 'concerning operations involving establishment, the provision of financial services and the admission of securities to capital markets'.

(c) Europe as an attractive financial market

Success in achieving a European financial common market and removing existing barriers will ultimately determine whether Europe remains attractive as a financial market compared with other trade and finance centres. This thinking already played a role in the Commission's proposal to introduce a withholding tax, albeit at a low rate, on interest income (see Chapter IX (b), p. 52), as well as in the work on a Community-wide stock-exchange link-up system (see Chapter VIII, p. 42). Many major stock exchanges (London, Paris and Frankfurt) have already recognized the signs of the times and have implemented or are preparing radical stock-exchange reforms. In the final analysis, however, as revealed in a study conducted by eminent private experts on stock exchanges and capital markets in January 1989, no single European country will have the infrastructure to survive alone. A major European capital market can only be created by the development of common standards and the integration of national trade and settlement systems at European level.

Annex I

Completion of the internal market

A. Initiatives and proposals adopted by the Commission and the Council

(situation at end of May 1989)

Banks, insurance, transactions in securities and capital movements sectors

The following list shows the proposals presented in the context of the completion of the internal market which have been adopted by both the Commission and the Council. Numbers refer to the total number of decisions taken by the Council.

NB: In the 'Comments' section, the term 'implementation date' means the date on which the Member States are expected to apply the legislation concerned

Subject	Adoption date
Part one: The removal of physical barriers	
Part two: The removal of technical barriers	
Section IV — Common market for services	
1. Financial services	
1.1 Banks	
1. Accounts of banks	adopted 8. 12. 1986 Dir. 86/635 OJ L 372, 31. 12. 1986

Comments:
Implementation date: 31 December 1990
(facility for Member States to apply implementing rules for the first time for financial year accounts beginning 1993)

2. Foreign accounts: banks	adopted 13. 2. 1989 Dir. 89/117 OJ L 44, 16. 2. 1989

Comments:
Implementation date: 1 January 1991
(facility for Member States to provide that provisions shall apply for the first time to annual accounts for the financial year beginning on 1 January 1993 or during the calendar year 1993)

3. Own funds of credit institutions — banks	adopted 17. 4. 1989 Dir. 89/229 OJ L 124, 5. 5. 1989

Comments:
Implementation date: 1 January 1993.

2. Commission recommendations: — Recommendation on the setting up of a guarantee system of deposit within the Community	adopted 22. 12. 1986 Com. Rec. 87/63 OJ L 33, 4. 2. 1987

Comments:
Implementation requirements do not apply.

— Recommendation on control of large exposures	adopted 22. 12. 1986 Com. Rec. 87/62 OJ L 33, 4. 2. 1987

Comments:
Implementation requirements do not apply.

1.2 Insurance

4. Coordination of laws relating to legal expenses insurance	adopted 22. 6. 1987 Dir. 87/344 OJ L 185 4. 7. 1987

Comments:
Implementation date: 1 July 1990.

5. Credit insurance	adopted 22. 6. 1987 Dir. 87/343 OJ L 185/87, 4. 7. 1987

Comments:
Implementation date: 1 July 1990.

6. Non-life insurance	adopted 22. 6. 1988 Dir. 88/357 OJ L 172, 4. 7. 1988

Comments:
Implementation date: 29 June 1990

1.3. Transactions in securities

7. Collective investment undertakings for transferable securities	adopted 20. 12. 1985 Dir. 85/611 OJ L 375, 31. 12. 1985

Comments:
Implementation date: 1 October 1989
(Member States may grant additional period of 12 months to comply with those rules for Ucits existing on that date; facility for Greece and Portugal to postpone application up to 1 April 1992.)

8. Ucits Directive: special measures concerning certain investments	adopted 22. 3. 1988 Dir. 88/220 OJ L 100, 19. 4. 1988

Comments:
Implementation date: 1 October 1989
Derogation for Greece and Portugal up to 1 April 1992 with the possibility that the Commission may suggest an extension of the derogation.

9. Information to be published when major holdings are acquired or disposed of	adopted 12. 12. 1988 Dir. 88/627 OJ L 348, 17. 12. 1988

Comments:
Implementation date: 1 January 1991.

10. Prospectus to be published when securities offered for sale to the public — coordination of requirements on drawing up, scrutiny and distribution	adopted 17. 4. 1989 Dir. 89/298 OJ L 124, 5. 5. 1989

Comments:
Implementation date: 17 April 1991.

Section V — Capital movements

11. Liberalization of units in collective investment undertakings for transferable securities	adopted 20. 12. 1985 Dir. 85/583 OJ L 372, 31. 12. 1985

Comments:
Implementation date: 1 October 1989
Derogation for Portugal up to 31 December 1990.

12. Liberalization of operations such as transactions in securities not dealt in on a stock exchange, admission of securities on the capital market and long-term commercial credits	adopted 17. 11. 1986 Dir. 86/566 OJ L 332, 26. 11. 1986

Comments:
Implementation date: 28 February 1987
Spain and Portugal may, in connection with the Act of Accession, postpone liberalization until respectively:
— 1 October 1989 and 31 December 1990 for transactions on units in collective investment undertakings in transferable securities,
— 31 December 1990 and 31 December 1992 for other transactions liberalized
NB:
It was announced on 25 February 1987 that Greece, Italy and Ireland have been allowed to extend derogations in this field (in accordance with Article 108 of the Rome Treaty) to some of the newly liberalized operations up to: end 1987 for Italy and Ireland and end 1988 for Greece. However, operations representing inflows of capital and long term commercial credits are liberalized as from 28 February 1987

13. Liberalization of capital movements	adopted 24. 6. 1988 Dir. 88/361 OJ L 178, 8. 7. 1988

Comments:
Implementation date: 1 July 1990
Derogations possible for Spain, Portugal, Greece, Ireland, Belgium, Luxembourg.
The Commission shall submit to the Council by 31 December 1988 proposals aimed at eliminating or reducing risks of distortion, tax evasion and tax avoidance linked to the diversity of national arrangements for taxation of savings.
The Council shall take a position on these Commission proposals by 30 June 1989.

Total number of proposals finally adopted by the Council in the financial services and capital movements sectors: 13

Banks:	3
Insurance:	3
Transactions in securities:	4
Capital movements:	3

B. Proposals submitted by the Commission to the Council in the context of the completion of the internal market which still require Council adoption

(situation at end of May 1989)

Banks, insurance, transactions in securities and capital movements

- Proposals marked with an asterisk (*) were presented since the publication of the White Paper (14 June 1985)
- Proposals marked with two asterisks (**) await European Parliament opinion or first reading
- Where the cooperation procedures applies:
  - FR indicates that Parliament has completed its first reading
  - CP indicates proposals upon which a common position has been reached
  - SR indicates that Parliament has completed its second reading (second readings are delivered on common positions — common positions exist until final adoption by the Council)
- Voting procedures are indicated in the Council column thus:
  U = unanimity
  QM = qualified majority
  SM = simple majority

Subject	Date of Commission's proposal	Projected date of adoption by Council as per White Paper
Part one: The removal of physical barriers		
Part two: The removal of technical barriers		
Section IV — Common market for services		
1. Financial services		
1.1 Banks		
1. Freedom of establishment and freedom to supply services in the field of mortgage credit — COM (84) 730 COM (87) 255	1985	1988 (QM) FR
2. Reorganization and winding up of credit institutions COM (85) 788, COM (88) 4	1985*	1987 (QM) FR
3. Second Directive on coordination of credit institutions COM (87) 715	1987*	1989 (QM) FR
4. Directive on solvency ratios COM (88) 194	1988*	1989 (QM) FR
1.2 Insurance		
5. Insurance contracts COM (79) 355 and COM (80) 854	1979	1988 (QM) FR
6. Annual accounts — insurance undertakings COM (86) 764	1986*	1989 (QM) FR
7. Winding up of insurance untertakings COM (86) 768	1986*	1989 (QM) FR
8. Motor liability insurance COM (88) 791	1988*	1989** (QM)
9. Third Directive concerning motor liability insurance COM (88) 644	1988*	1989** (QM)
10. Life insurance: freedom to supply services COM (88) 729	1988*	1991** (QM)

1.3 Transactions in securities		
11. Directive on insider trading COM (87) 111 COM (88) 549	1987*	1989 (QM) FR
12. Investment services COM (88) 778	1988*	1989** (QM)

Annex II

Withholding tax on dividends, interest on bonds and interest on bank and saving accounts
(Situation at 1 January 1989)

Member State	Withholding tax on dividends		Withholding tax on interest on bonds		Withholding, tax on interest on bank & saving accounts	
	residents (subject to the provisions of double taxation conventions)	non residents (subject to the provisions of double taxation conventions)	residents (subject to the provisions of double taxation conventions)	non residents (subject to the provisions of double taxation conventions)	residents (subject to the provisions of double taxation conventions)	non residents (subject to the provisions of double taxation conventions)
Belgium	25%	25%	25%	25%	25%	25%
Denmark	30%	30%	Automatic communication from banks to administration			
FR of Germany	25%	25%	10%	10%	10%	10%
Greece	42% for registered quoted shares; 45% for bearer quoted shares; 47% for registered non-quoted shares; 53% for bearer non-quoted shares		companies: — with permanent establishment: 25% — without permanent establishment: 49% public loans and bonds of corporations engaged in industrial activities		companies: — with permanent establishment: 25% — without permanent establishment: 49%	

Spain	20%	20%	20%, 0%	20%, 0%	20%	20%
France	0%	25%	0% or 25% discharging of debt (residents) but automatic commu-nication from banks to administration	0%	0% or 45% discharging of debt for residents	45%
Ireland	—	—	35%, 0%	35%, 0%	35%	0%
Italy	10%	32.4%	12.5% discharging of debt (no choice for the beneficiary)		30%	
Luxembourg	15%	15%				
The Netherlands	25%	25%	Automatic commu-nication on from banks to admini-stration			
Portugal	25%	25%	25%	25%	20%	20%
United Kingdom	—	—	25%, 0% certain public loans		25% residents	0%

Further reading

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