PART FOUR

A European Capital Market

THE CREATION OF A EUROPEAN CAPITAL MARKET: PROBLEMS AND SOLUTIONS

The main problem in the creation of a European capital market would seem to lie in the dual necessity of liberalising intra-Community capital flows and of simultaneously centrally controlling such capital movements. Without such co-ordination it is difficult to see how any successful degree of planning[1] can take place in the Community. To underline the necessity of some form of central control we need only note the huge inflows of capital into Western Germany in late 1970 and early 1971, which threatened to undermine the efforts of the West German Government in its attempts to control the monetary situation.

However, apart from the desires expressed in the Segré Report,[2] the necessity of setting up some form of European capital market[3] is fairly clear, if only to fill the savings gap which might occur in any of the Community's member states; such a situation is currently the problem facing France where there is a shortfall of capital for the financing of the Sixth National Economic and Social Plan. Unfortunately the necessity of filling such gaps, without the provision of adequate control, always presents the possible danger of borrowing from

[1] We should note that the principle of medium-term planning is already accepted in the E.E.C.

[2] *The Development of a European Capital Market* (Brussels: E.E.C. Commission, 1966).

[3] The authors are aware (as Table 3 below indicates) of the existence of the Euro-bond market. Nevertheless, in an economic and monetary union some centralised management of such a market seems desirable.

extra-Community sources – particularly from the Euro-dollar market – over which neither the member states nor the Community may have control.

The difficulties of co-ordination are also not to be underestimated. Currently, to take an important example, there is discord between Italy and her five Common Market partners over the insistence of the latter that she allow the issue of bearer shares, thus removing a source of information for the tax authorities who have to collect income tax dividends.

Apart from the problems hitherto noted, the question of the creation of a capital market is further complicated because of the degree of borrowing from the banks which takes place in the member states of the Community as compared with the situation existing in the United Kingdom. Thus, again as a result of this tradition and also owing to the relative narrowness of the market (as compared with London), borrowers having recourse to the capital market tend to be few and relatively large in size. In Britain, on the other hand, where the services offered in London tend to be varied and where the borrowers vary in size, it is unusual for small- and medium-sized firms to go outside the country for funds.

Finally, apart from the ever-present danger (until some centralised form of control is instituted) of borrowing from extra-Community sources, e.g. from the Euro-dollar market, we should not lose sight of the importance of bond issues – particularly the 'tap' issues in West Germany, and a somewhat similar situation in Britain where one has substantial local authority borrowing – sometimes outside the national capital market. As a recent E.E.C. study has shown,[1] official intervention in the markets for public issues floated by residents has three very different legal forms. Briefly, these are:

(1) Rules explicitly providing for intervention by the authorities to maintain equilibrium by rationing demand (in France, this applies to all issues in times of strain; in Italy, to all issues at all times; and in Germany and the Netherlands only in exceptional situations and in the public-sector demand).
(2) Rules designed mainly to protect the saver.

[1] *Policy on the Bond Markets in the Countries of the E.E.C.* (Brussels: The Monetary Committee, 1970) p. 9.

(3) An original type of legal basis for Central Bank intervention in respect of public issues as existing in the Netherlands.

Even if it should prove undesirable to harmonise these forms of intervention, some degree of central co-ordination of total disposable funds and total Community demand would seem to be desirable, if only in the interests of good planning.

A European capital market will not develop overnight. Further, owing to the varying needs and habits of the member states of the Community, it would probably be beneficial if a European Central Bank were to be created, which would make loans to national Central Banks as the necessity arose (rather than necessarily engaging in open-market operations), together with the setting-up of a Capital Issues Committee to co-ordinate the work of the different stock exchanges.

In order to hasten the creation of a possible European capital market, we would suggest the following proposals:

(1) The rapid creation of a European company law together with some co-ordination of company tax laws.

(2) The co-ordination of interest rates in the individual member states.

(3) The co-ordination of public authority bond issues and equity issues through the proposed Capital Issues Committee,[1] Central Bank and the work of the Committee of Central Bank Governors.

(4) The restriction of very short-term borrowing by European companies in extra-Community markets. Here we may note the British authorities' action in January 1971 in forbidding British companies from borrowing short-term in the Euro-dollar market.

(5) The vexed Euro-dollar question might be solved by increasing the reserve requirements of the commercial banks and/or compelling the banks to hold part of their reserves in dollars.

[1] Here, the description of the German experience (*The Banker*, Jan 1971, p. 62) is worthy of our attention: 'Also, a sub-committee within the framework of the Central Capital Market Committee has been in existence since the beginning of 1969. The latter . . . co-ordinates new issues of domestic loans with the requirements of the current market situation as regards timing, volume and conditions. The sub-committee has undertaken the corresponding action for foreign issues.'

(6) Until a European currency is formed, the continued encouragement of the floating of multi-currency loans in the moneys of the Community's member states.

(7) Eventually, the drawing-up of a series of rules common to all the Community's stock exchanges.

(8) The solution of the disquieting dollar problem through some form of 'Basle-type' arrangements. Thus, as in the case of sterling, a 'hard' dollar, which would be held by foreign institutions, would be created. The United States would thus be able (where necessary) to change the parity of its currency used in current commercial transactions.