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REPORT

drawn up on behalf of the Committee on Economic and Monetary Affairs

on the Communication from the Commission of the European Communities to the Council (Doc. 1-231/83 - COM(83) 207 final) on financial integration in the Community

Rapporteur : Mr Brendan HALLIGAN

PE 86.720/fin.

English Edition

On 16th May 1983, the President of the European Parliament referred this communication on financial integration in the Community to the Committee on Economic and Monetary Affairs as the Committee responsible and to the Committee on External Economic Relations for an opinion.

At its meeting of 25/26 May 1983, the Committee on Economic and Monetary Affairs appointed Mr HALLIGAN rapporteur.

The Committee on Economic and Monetary Affairs considered the Commission's proposal and the draft report at its meeting of 20-21 December 1983 and adopted it by unanimity and 1 abstention.

The following took part in the vote : Mr Jacques Moreau, chairman; Mr Hopper, vice-chairman; Mr Halligan, rapporteur; Mr Beazley, Mr Bonaccini, Mr Beumer (deputizing for Mr Vergeer), Mrs Boot (deputizing for Mr van Rompuy), Mr Caborn, Mr Carossino (deputizing for Mr Leonardi), Mrs Desouches, Mr Friedrich (Ingo), Mr Hutton (deputizing for Ms Forster), Mr Giavazzi, Mr de Goede, Mr Herman, Mr Notenboom (deputizing for Mr Franz), Mr Orlandi (deputizing for Mr Cingari) Mr Papantoniou, Sir Brandon Rhys Williams, Mrs Theobald-Paoli, Mr Wedekind (deputizing for Mr Schnitker), Mr Radoux (deputizing for Mr Wagner), Mr Welsh, Mr von Wogau.

The Committee on External Economic Relations has decided not to present an opinion.

The report was tabled on December 22, 1983.

C O N T E N T S

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A

The Committee on Economic and Monetary Affairs hereby submits to the European Parliament the following Motion for a Resolution together with Explanatory Statement:

Motion for Resolution on Financial Integration in the Community

The European Parliament :

- having regard to the communication from the Commission on financial integration in the Community (COM(83)207 final - Doc. 1-231/83);
- having regard to the report by the Committee on Economic and Monetary Affairs (Doc. 1-1237/83),

A. noting the present economic situation in the Community marked by a slow rate of recovery, continuing high unemployment, low rates of profitability and investment;

B. stressing the vital importance of productive investment in ensuring the recovery of the European Economy;

C. having regard to the positive role that can be played by the creation of an integrated capital market in ensuring that European savings are mainly directed into investment within the Community;

D. aware that, nonetheless, balance of payments problems and regional disparities make more difficult substantial liberalisation of capital movements;

E. drawing attention to the need for a process of liberalisation to be accompanied by adequate measures to ensure that capital is also made available in those sectors and regions where there is a need for ongoing investment;

Need to revitalise the process of Financial Integration

1. Supports the proposals contained in the communication from the Commission for a resumption of the process of financial integration on a phased basis; believes that the optimal allocation of resources is only possible in circumstances where all the factors of production are fully employed and in which the free movement of the factors is achieved in practice;

2. Expresses its regret, therefore, at the interruption of the process of liberalization of capital movements within the Community begun with the Council Directives of 11th May 1960 and 18th December 1962[1] and further notes with regret that there has been no subsequent progress in the direction of an integrated capital market.

3. Draws attention to the existence of a vast international money market (EuroMarket) which allows short term financing and arbitrage operations between various currencies, the existence of which highlights the value of a single European capital market.

Gradual creation of a common market for Capital and Structural Intervention

4. Agrees, therefore, in principle with the Commission on the need to create a European financial area on a gradual basis;

5. Is convinced of the need for the Member States concerned, together with the Commission, to evaluate the overall economic impact of existing restrictions on capital movements currently applying in some Member States under safeguard clauses on direct investments, portfolio investments, capital movements of a personal character or connected with the supply of services and on those restrictions relating to the floatation of foreign securities on domestic markets, the introduction of foreign securities on domestic stock exchanges and transactions in unquoted securities;

6. Is convinced also of the importance of removing fiscal obstacles[2] which contribute to the compartmentalisation of the various national markets;

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[1] See OJ no. 43, 12.7.1960, page 921 and OJ no. 9, 22.1.1963, page 62

[2] See COM(83)218 final

7. Calls upon:

The Council to adopt the proposal for a directive presented by the Commission in 1976 on indirect taxes on transactions in securities[1], and once more draws attention to the need for gradual abolition of such taxes[2]; the Commission to revise its proposal for directive of 1975 on the harmonization of company taxation[3] giving due consideration to the points of view put forward by the European Parliament[4];

8. Further asks the Council and the Commission, in the areas for which they are responsible, to take measures:

- to continue the process of integration of the banking sector through the approximation of the various national legislative provisions;
- to reduce the present compartmentalization of stock exchanges in the Community, as previously indicated by Parliament[5];
- to resume liberalization measures in the insurance sector which were begun with the proposal for a directive on insurance other than life assurance of 1975.

9. Notes, with concern that the communication from the Commission makes no reference to the necessity of ensuring that, within an integrated market, adequate capital flows are directed towards the regions and sectors with structural problems;

10. Draws attention to the fact that a liberalization of the capital market could be detrimental to those Member States which are currently suffering from imbalances in their balance of payments unless such liberalization was simultaneously accompanied by domestic measures of economic policy and by additional structural measures by the Community and its institutions so as to restore balance.

11. Believes it, therefore, essential for the Commission, for the sake of completeness to consider this also within its action programme for greater financial integration between Member States, how the instruments and resources of regional policy, including investment incentives in certain regions and countries, could be used for the purpose of alleviating wherever possible disparities within a single market for goods, labour, services and capital;

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1 See Doc. 1-62/76, 30.4.1976

2 See Dykes report (Doc. 1-315/76)

3 See OJ no. C253, 5.11.1975

4 See Nyborg report (Doc 1-104/79)

5 See Collomb report (Doc 1-290/81)

The EMS and the European capital market

12. Reaffirms its conviction[1] of the need for the EMS to be strengthened and supports, therefore, in line with the report recently adopted by the European Parliament[2] the Commission's proposals for further development of the ECU, in order to promote liberalization of capital movements and the improvement of the operation of the Euromarkets[3];

13. Instructs its President to forward this resolution to the Council, the Commission and the parliaments of the Member States of the Community;

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[1] See Ruffolo report (Doc. 1-63/80) and Purvis report (Doc. 1-971/81)

[2] See Bonaccini report (Doc. 1-474/83)

[3] See COM(83)274 final

B

EXPLANATORY STATEMENT

I. Introduction

1. The Treaty establishing the EEC provides that one of the Community's fundamental objectives must be to abolish obstacles to freedom of movement for capital (Article 3(c)). While many of the other basic objectives laid down by the same article have on the whole been achieved, the creation of a truly integrated European capital market, as defined in Articles 67 to 73 of the Treaty, continues to be unachievable.

2. The first and only occasion on which progress was made towards liberalizing capital movements came with the adoption early in the 1960s of the first two directives[1], which abolished restrictions on certain types of capital movement, such as credits tied to commercial transactions, direct investments and purchases of shares traded on a stock exchange. However, other important transactions are still subject to restrictions. These include short-term capital movements, the granting and repayment of loans and credits not linked to commercial transactions - or linked to transactions in which there is no domestic participation - and of personal loans, and other special transactions.

3. The initial trend towards liberalization within the Community stopped almost immediately and in the early 1970s actually began to be reversed. The draft third directive, which was intended to complete the liberalization of capital transactions, was shelved by the Council of Ministers for several years and was finally withdrawn by the Commission in January 1977.

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[1] Council Directives of 11 May 1960 (OJ No. 43 of 12.7.1960, p. 921) and 18 December 1962 (OJ No. 9 of 22.1.1963, p. 62).

II. Examination of the communication from the Commission

A. The need to revitalize the process of financial integration

4. The creation of a European capital market has been traditionally justified by the need for an optimum allocation of resources. Common markets based on the free movement of goods, it is argued, cannot achieve the desired goal of optimizing the productive structure unless accompanied by the free movement of all the factors of production.

5. Equality in terms of marginal productivity is essential if resources are to be optimally allocated and this is primarily ensured through the transfer of capital from those regions, sectors or countries where it is less scarce to where it is comparatively more scarce relative to the other factors of production. In other words, there must be a movement towards eliminating the differences in the cost of the factors of production in the various Member States. This is achieved by the free movement of capital. Hence the need for an integrated capital market.

6. A further argument advanced in favour of capital flow liberalization - also linked to the process of economic integration - is that for example expressed in the report drawn up in 1966 by a group of experts under the chairmanship of Professor SEGRE'[1]. This report contends that because of the expansion of markets, the free movement of capital is essential to obtain the additional resources needed to exploit the possibilities afforded by the development of larger markets and to finance the consequential industrial restructuring process.

7. The arguments invoked in the preceding paragraphs to justify the creation of a European capital market have not, however, carried sufficient weight to convince some government authorities to continue the work of liberalization and to remove the various obstacles that have been erected. Why has the objective of liberalizing the capital markets not been achieved, when similar objectives have been achieved in markets for goods?

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(1) See 'The Development of the European Capital Markets', Commission of the European Communities, Brussels, November 1966

This question is especially pertinent in view of the fact that, in place of the development of an integrated European capital market, we have witnessed the extraordinary growth, on a world-wide scale, of a parallel but unregulated European financial market : the so-called Euro-market[1].

8. The existence of a vast international money market in which there are no restrictions on short-term financing arrangements and arbitrage operations between different currencies suggest that the Community's existing financial structures are able to provide virtually all the services necessary for transactions within a compact capital market. That is not to say, however, that the money and financial markets can function properly on their own. In this connection, the observation on page 10 of the Commission's communication is particularly relevant : 'However, the Euromarkets' contribution to connecting up national markets is indirect and imperfect, because of the wide variety of national exchange rules governing the conditions in which residents have access to Euromarkets. In particular, communication via the Euromarkets usually involves non-member currencies and conditions beyond the control of the authorities of the member countries.' In other words, the Euromarket is not a fully satisfactory alternative to an integrated European capital market. It does however indicate both as to the potential and practical importance of such a market.

9. From the viewpoint of economic policy, the present overall level of liberalization, which is lower today than in the early 1960s and is characterized by striking discrepancies between the Member States, can be explained as follows. The individual national authorities have found it impossible simultaneously to ensure the mobility of capital, safeguard the autonomy of their national monetary policies and keep a tight rein on

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[1] See 'Le marché euro-obligatoire en 1982', Banque Internationale à Luxembourg, Bulletin financier No. 1 of 5.1.1983

exchange rate fluctuations [1]. This situation has been further complicated by the requirement to give due consideration to another fundamental principle of the Treaty of Rome : freedom of trade. As the Commission text points out, the Member States attempted to resolve this dilemma by adopting various compromises and loosening one or more constraints, usually opting for what they considered the weakest constraint : the free movement of capital. The alternative was to accept that the entire burden of balance of payments adjustments would be placed on monetary policy with obvious deflationary consequences expressed in increased unemployment. Clearly this was a price which some member States were not willing to pay, and are still not prepared to pay.

10. In addition, further difficulties arose with the onset of the world depression following the oil shocks which created conditions in which the full employment of the factors of production was no longer the reality as it had been in the sixties. Since the optimal allocation of resources, both in theory and practice, depends on the full employment of all these factors, then it became clear to some authorities that totally free movement of capital could result in imbalances between different countries and regions thereby accentuating existing disparities rather than correcting them. Regrettably, the Community did not address itself to this practical problem and failed signally to produce policies which could simultaneously marry a single totally integrated market with the requirement of balanced harmonious growth between all regions. Hence, the different approaches by the various national authorities towards integrating the capital market and the current impasse within the Community on this issue.

11. Bearing in mind that it is in principle essential to liberalize the Community's capital markets, the solution to the problem must therefore lie in a practical accommodation of the conflicting claims of freedom of trade, exchange rate control, the mobility of capital and the autonomy of national policies, while taking due account of the relevant Community objectives. Until such an accommodation is achieved within a Community framework, there will always be a temptation to ease up on each constraint, including the constraint of free trade, thereby placing the very foundations of the Community in jeopardy.

(1) The incompatibility here is described in economic literature as an 'irreconcilable triad'

B. Integration of the capital markets and structural intervention

12. It is nonetheless unarguable that the full integration of the capital market would undoubtedly represent a final and ideal solution to the problem of satisfactorily reconciling, within a Community framework, the four basic objectives : freedom of trade, controlled exchange rates, mobility of capital, internal stability. But precisely because it would be ideal, such a solution would be difficult to implement, especially if past experience is anything to go by. Consequently, it would be preferable for the creation of the capital market to be a gradual process based on solving concrete problems.

13. The action programme outlined by the Commission deserves to be supported (as recommended by Parliament) because of its emphasis on the need to encourage the free movement of capital by a series of practical proposals designed to establish a unified network for financial services. These would undoubtedly promote efficiency in the operation of the capital markets throughout the Community without adding to the regional and national disequilibria which already exist.

14. The Commission and Council, in the areas for which they are responsible, should put into force practical measures:

 - to continue work on encouraging integration of the banking sector through the alignment of the various national legislations;
 - to strengthen links between national stock markets, as previously recommended by Parliament;[1]
 - to continue measures in the insurance sector which were begun with the proposal for a directive of 1975 on insurance other than life insurance;
 - to develop financial instruments, as foreseen in the communication under examination, towards an effective interpenetration of financial circuits and an efficient tapping and circulation of capital within the Community.

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[1] See Collomb report (Doc. 1-290/81)

15. It must be pointed out, however, that the Commission document makes no reference to the structural problem closely boudn up with the free movement of capital within the Community : the likelihood of capital being channelled towards the more developed regions - to take advantage of their better infrastructures and more skilled manpower - rather than towards the regions whose need for capital investment is greater. This is a regretable analytical ommission.

16. In fact, a gradual liberalisation of the capital markets would be seriously prejudicial to the Member States suffering from balance of payments deficits, unless it were accompanied simultaneously by structural intervention at EEC level. Those states, which have to face constant pressure on the external value of their currencies, would probably either modify their exchange rate, if not fixed, with adverse consequences for trade; or, in the case of a fixed exchange rate, would take deflationary measures with negative consequnces for their GNP.

17. Therefore, for the sake of completeness, the Commission would do well to consider ways of tackling this structural problem within the framework of its action programme for the liberalization of capital movements, indicating how the instruments of regional policy, including investment incentives to other regions and countries, could be used to help find a solution.

18. Furthermore it is now opportune for the Commission and the Member States concerned to carry out a review of the restrictions on capital movements applied under the safeguard clauses as regards :

- restrictions on operations related to securities dealt with on the stock exchange and issued by European companies;

- discrimination against foreign securities including fiscal incentives for domestic companies.

An evaluation of the impact of these restrictions on the national economies concerned and on the Community economy as a whole would be most helpful in assessing further steps towards the integration of capital markets.

C. The EMS and the European capital market

19. Closer alignment of Member States' currencies is essential if the process of financial integration is to be successfully reactivated. The European Parliament has more than once drawn attention to the need to improve the EMS[1]. There can be no doubt that the EMS, by focussing attention on the need for convergence, is of key importance in furthering the process of integration, since it induces the Member States to tackle the basic problems in good time. It is therefore of the utmost importance that the currencies of all the Member States should fully participate in the EMS.

20. In this connection, the Commission deserves support in its efforts to encourage the further development of the ECU, in line with an opinion recently delivered by the European Parliament[2], with a view to promoting the liberalization of capital movements and improving the operation of the Euromarkets[3].

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[1] See the RUFFOLO report (Doc. 1-63/80) and the PURVIS report (Doc. 1-971/81)

[2] See the BONACCINI report (Doc. 1-474/83)

[3] See COM(83) 274 final.