

II

(Preparatory Acts)

ECONOMIC AND SOCIAL COMMITTEE

Opinion on the creation of a European Financial Area

(88/C 175/01)

On 22 December 1987 the Commission decided to consult the Economic and Social Committee, under Article 198 of the Treaty establishing the European Economic Community, on the creation of a European Financial Area.

The Section for Economic, Financial and Monetary Questions, which was responsible for preparing the Committee's work on the subject, adopted its Opinion on 12 April 1988. The rapporteur was Mr Delhomenie.

At its 255th plenary session (meeting of 27 April 1988), the Economic and Social Committee adopted the following Opinion with no dissenting votes but with one abstention.

1. Introduction

1.1. We welcome the fact that the Commission has decided to ask us for an Opinion on its Communication of 4 November 1987 on the creation of a European Financial Area, particularly as this is an essential step towards the establishment of the single internal market.

1.2. The liberalization of capital movements, the principle of which was established by the Treaty of Rome (Art. 67 et seq.) but which was not put into effect at the time, has already been the subject of several Directives, most recently that of November 1986 (86/566/EEC) amending the Directive of 11 May 1960. This 1986 Directive requires the Member States to refrain from introducing new authorization procedures more stringent than those prevailing on the date of entry into force of the Directive, to simplify as far as possible the authorization and supervisory formalities applicable to the conclusion and execution of transactions and transfers, and, if necessary, to discuss among themselves the process of simplification.

1.3. The new Commission proposals comprise two Directives and a Regulation.

1.3.1. The first proposal is for a Directive implementing Article 67 of the Treaty. It requires the Member States to eliminate all remaining restrictions on capital movements, lays down the conditions under which

national monetary regulatory measures will be permitted, provides a safeguard clause in case of monetary disturbances and establishes a timetable for implementation.

1.3.2. In the Commission's view, the liberalization of capital markets is an essential precondition, though not sufficient in itself, for completing the internal market. Prudential rules to counteract any risks and disequilibria, and the harmonization of tax regimes, are essential accompaniments to, although not preconditions for, this process. Liberalization will require the maintenance, or strengthening of exchange rate discipline and thus the participation of all the currencies in the mechanism of the European Monetary System (EMS). The Commission also points out the need for increased cooperation on monetary policy, and economic policy convergence. Finally, it stresses the need for real freedom to provide services in the banking and insurance sectors.

1.3.3. The second proposal for a Directive amends Directive 72/156/EEC, which is about regulating international capital flows and neutralizing their undesirable effects on domestic liquidity.

1.3.4. The proposals include measures limiting liberalized capital movements; these may be invoked after consultation with all the Member States in the event of external monetary shocks. The Commission argues that

these amendments are made necessary by the change in circumstances since 1972, a period which saw a large influx of capital into the Community, and the current liberalization of the markets.

1.3.5. The proposal for a Regulation provides for the establishment of a single medium-term financial support mechanism for the Member States' balance of payments. Its aim is threefold:

- to establish a single financial support mechanism by combining the medium-term financial assistance systems and the Community loan,
- to offer the possibility of temporary assistance to countries with balance-of-payments difficulties,
- to provide a back-up for the liberalization of capital movements by a Member State.

1.4. For the sake of completeness the Commission would like these three documents to be adopted together; it has fixed on 1 January 1989 as the target date for liberalization. A transitional period is provided for some Member States.

1.5. The Study Group of the Section for Economic, Financial and Monetary Questions heard the views on various aspects of the theme put into discussion expressed by the chairman of the committee of the governors of the Member States' central banks and of the representatives' committee of the central banks of Member States where the process of liberalization is most advanced, i.e. Germany, the United Kingdom and the countries of the Belgo-Luxembourg Economic Union.

The contributions showed that there is a consensus on the objective of liberalization. Reservations were expressed, however, about the prudential rules and safeguard clauses. As for the Commission proposals, there was agreement on the need for greater convergence of economic policy, strengthening of the EMS and very extensive use of the ECU. As regards the creation of a European central bank, which forms a longer-term objective, the central bank representatives intend to study in detail the plans put forward by several Member States.

2. General comments

2.1. We endorse the Commission's decision to introduce the legal instruments for a complete liberalization of capital movements. This, just as much as the free movement of goods and persons, is essential to the

completion of the internal market and also necessary for the improved economic competitiveness of the Community.

The very short deadline and the questions raised by the Commission itself do indeed make caution advisable but must not call the objective into question.

2.2. With these three texts the Commission proposes to bring about the complete liberalization of capital movements, without any preliminaries. While supporting the Commission's aims, we feel that liberalization ought to be accompanied by efforts in such important fields as harmonizing the operating rules for financial services and stock markets, the rules governing the solvency and stability of financial institutions, and tax harmonization. Liberalization cannot be achieved without stabilization of exchange rates. Efforts have already been made in this direction via the decisions taken at Basle and Nyborg.

2.2.1. But liberalization presupposes even more radical action. Unstable exchange rates and sudden fluctuations pose a considerable danger for the economies of the various Member States. The resulting unpredictability of costs and threat to competitiveness cause firms, especially SMEs, to abandon domestic and international investment plans.

2.2.2. It is becoming more and more difficult to conduct a coordinated Community policy with floating exchange rate and fixed parity currencies co-existing side by side. The EMS, after all, is founded on the twin principles of stabilization of exchange rates (inflation, balance of payments, public sector finances and productivity) on the one hand, and on the other convergence of economic and monetary policy, the two naturally complementing each other.

2.2.3. The EMS, then, needs to be completed and strengthened. It is, after all, logical that economies of a comparable degree of development should be subjected to the same disciplines. We feel that at the same time as capital flows are liberalized the remaining non-EMS currencies should be brought into the system, subject to the commonly agreed margins of fluctuation. Entry into the system would, of course, only take place at the end of the transitional period in the case of those Member States covered by the provisions of Article 6

of the first proposal for a Directive (1990 for Ireland and Spain and 1992 for Greece and Portugal).

As proposed in Article 3 of the same document, provision should also be made for any necessary adjustments or adaptations.

2.2.4. Liberalization also presupposes greater economic cohesion at the earliest possible stage through greater coordination of the Member States' economic policies. Economic policy autonomy would be completely at odds with coordinated exchange rate discipline. In this way the country practising the most 'sound' policy would not be obliged to serve as a model for the economic and monetary policy of all twelve Member States. The concerted interest rate movements which have occurred since the Nyborg agreement are the first step towards this necessary coordination.

2.2.5. It will also be necessary to develop the role of the ECU. The Community needs a common reference and reserve currency and a common means of payment. If the ECU is to fit the bill, its role needs to be strengthened in two areas:

- as a unit of account and medium of exchange which will help bring about greater stability in international trade;
- the ECU would probably also be more suitable than other currencies for intervening in external foreign exchange markets without accentuating the strains within the EMS.

2.2.6. Finally, there is the question of a Community institution to manage this policy. The role of this institution and its relations with national and Community bodies, and with the central banks of the Member States, need to be defined. The need to resolve these and other questions will probably mean that the setting-up of a European Central Bank is a long-term project. But steps in this direction can be envisaged in the shorter term, e.g. a different system for issuing ECUs and the setting-up of a European Monetary Fund.

2.3. We have also been consulted on the draft second Directive on the coordination of banking and the freedom to provide services. This proposal is closely linked with the texts currently under consideration. This aspect should be underlined in welcoming this further stage in the progress towards a European financial area.

3. Specific comments

Whilst expressing our general approval, we feel it appropriate, as indeed the Commission has done, to

look at certain aspects in more detail and make a few suggestions.

3.1. *Coordination with other institutions*

The proposal for a Directive should include a complete nomenclature of liberalized capital movements; this would make it possible to define each category, gain a clear overview of the transitional regimes and safeguard clauses, and facilitate liaison with other bodies which are considering similar inventories, mainly the Organisation for Economic Co-operation and Development (OECD).

3.2. *Prudential rules*

3.2.1. The Commission has not failed to tackle the issue of prudential rules, which are a necessary accompaniment to liberalization. But the coordination of prudential rules, which should if possible be achieved simultaneously, is largely a matter for the second Directive coordinating the supervisory arrangements for the credit sector, and in particular the list of banking activities in respect of which credit institutions are to have freedom to provide transnational financial services.

3.3. *Taxation*

3.3.1. In parallel with the process of liberalization which is essential to the creation of the internal market, it must be ensured that liberalization does not provoke a flight of certain types of business to more flexible tax systems or tax havens outside the Community.

3.3.2. The Commission has not neglected this problem. Furthermore, this draining away of savings to third countries would have a detrimental effect in terms of the cost of financing the Community's policies, as the Community would have to borrow on external markets at high interest rates.

3.3.3. Measures are under consideration by the Commission to prevent the migration of capital within the Community. The first is the taxation of interest income through a withholding tax levied at a uniform rate by all the Member States. The second, more stringent, solution would be for credit institutions to be required to disclose to their tax authorities information on interest earned by Community residents. This would mean the abandonment of banking secrecy by the Member States.

3.3.4. We feel that tax harmonization should not be tackled piecemeal but should be seen in a broader perspective, bringing in the question of savings. Harmonization must also take into account the economic,

social and budgetary variables influencing tax legislation and the redistributive function of tax.

3.3.5. Pending the eventual completion of the process of overall tax harmonization, the Section feels that the introduction of a generalized withholding tax on all types of investment income accruing to residents and non-residents alike, levied at a uniform rate in all the Member States, could be a way of allaying the concerns of the country with the most stringent tax rules, about the liberalization of capital movements.

3.3.6. And finally, there is agreement with the Commission's view that the discriminatory provisions of certain countries' taxation systems, encouraging individuals to invest in domestic securities, and restrictions imposed on investments by pension funds, should disappear. The same applies to the tax concessions and discriminatory provisions applied to the various forms of investment fund existing in some Member States. But the beneficiaries of these provisions are usually persons with average or low incomes, and so measures should be discussed with the Member States which, whilst not impeding the liberalization of capital movements, will safeguard such investments.

3.3.7. Convergence on tax matters should at all events be sought with the European Free Trade Association (EFTA) and the OECD-countries.

3.4. *Safeguard clauses*

3.4.1. The Commission has made provision for a safeguard clause enabling the Member States to reintroduce controls on short-term capital movements if these threaten seriously to undermine the Member State's monetary and exchange rate policy. Such measures may be imposed only by means of an agreed Community procedure and for a period not exceeding six months.

3.4.2. This safeguard clause should be used only to counter speculation and at all events for as short a period as possible.

3.4.3. We are aware that there are major disparities between the Member States determined by structural factors and variables such as the role of the two sides

of industry, the skills of the workforce, productivity, the role of the central banks and even climate and geography, etc. Reducing these inequalities is largely a matter for other policies and procedures already applied or to be applied by the Community bodies.

3.5. *Protection of savers and consumers*

3.5.1. Complete liberalization of capital movements will for the first time offer small savers the opportunity to invest their savings in other Member-States, including those with strong currencies. Savers should not be misled by this new-found freedom into thinking that such investments carry minimal risk and that the same provisions for the protection of savers exist in all the Member States.

3.5.2. There is no reason why the increased availability of financial services arising from the liberalization of capital movements and the freedom to provide banking services should give the consumer any cause for concern, provided that any disputes are dealt with, as stipulated by international civil law, by the courts of the consumer's country of residence, and in accordance with that country's laws.

3.5.3. The creation of a European financial area should neither override these rules nor restrict their application. The laws of the individual Member States should continue to apply and be administered by the country's own courts, or by other courts in accordance with the Brussels Convention on jurisdiction or the rules of international civil law protecting contracting parties.

3.5.4. In the longer term the Commission should consider harmonizing legal protection, which would considerably reduce risks and simplify the consumer's task in the event of litigation. Tripartite discussions with providers of services and consumers' representatives would be appropriate.

3.6. *Economic and social consequences*

3.6.1. As has already been pointed out in the general comments, liberalization of capital movements requires close coordination of the Member States' economic policies, but also coordination of economic and monetary policy. The aim of this economic coordination and liberalization should be to promote job-creating growth. This purpose can be served by helping to facilitate business investment, particularly by prevent-

ing, as far as possible, any draining away of financial resources. This will require international monetary and fiscal policy initiatives.

3.6.2. But will employment really benefit from the proposed measures and the reduction in financial costs which will probably result? This does not follow automatically, and experience shows that it depends on the way decisions are made—on a purely financial basis or also taking into account economic and social factors. The latter course would require involvement and consultation of the two sides of industry enabling them to have their say in determining the solutions adopted.

3.6.3. Liberalization of capital movements should also help put small businesses, craft industries and the cooperative sector, which are the main sources of new jobs, on a more equal footing with big business as regards access to capital. Improved provision of information is vital. This can be achieved via Community information centres, but also via information networks set up by the various professional organizations. It would also be a good idea to harmonize the rules of the co-operative, mutual and non-profit sector. (Economic aid must at all events be the subject of negotiation

with a view to radically improving the situation of the countries concerned.)

3.7. *Comments on the amendment of the 1972 Directive and the Regulation*

3.7.1. One cannot but agree with the Commission's statement in the explanatory memorandum of the proposal amending the 1972 Directive that the Member States must have available a set of protective instruments for the purpose of discouraging untimely capital flows. Here the Commission is responding to certain problems affecting relations with third countries. This justifies the Commission's decision to publish this amendment at the same time as the Directive on the liberalization of capital movements.

3.7.2. The draft Regulation establishing a single support facility contains a new feature, compared with previous systems, viz. a support mechanism to deal with difficulties arising from liberalization.

3.7.2.1. Only one country ever had recourse to the previous system. Is it therefore really necessary to set up a new system which, for the same reasons, may be little used? There ought in any case to be guarantees attached to the decision-making procedure. More specifically, balance-of-payments assistance should be the subject of negotiation to permit a radical improvement in the situation of the countries concerned.

Done at Brussels, 27 April 1988.

The Chairman
of the Economic and Social Committee
Alfons MARGOT
