local and regional substance cycles. There must be an exchange of experience on co-operative projects so that the parties involved can learn from each other. The Commission is asked to draw up a summary outlining the availability and/or use of renewable energies in the accession countries. Building on this summary, consideration must be given to the development opportunities of rural areas in these countries if they apply the principles of sustainable development.

Brussels, 20 September 2000.

The President

of the Economic and Social Committee

Beatrice RANGONI MACHIAVELLI

Opinion of the Economic and Social Committee on 'Challenges posed by EMU to financial markets'

(2000/C 367/14)

On 2 March 2000 the Economic and Social Committee decided, under Rule 23(3) of its Rules of Procedure, to draw up an opinion on the Challenges posed by EMU to financial markets.

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 5 September 2000 The rapporteur was Mr Pelletier.

At its 375th plenary session of 20 and 21 September 2000 (meeting of 21 September) the Economic and Social Committee adopted the following opinion by 73 votes to 13 with ten abstentions.

1. **Introduction**

1.1. Monetary union has presented financial market operators with a dual challenge: at a technical level, it has been necessary to draw up common operational rules for the various national markets which have operated up to now on the basis of procedures and principles which have evolved over time to suit national needs.

1.2. The second challenge concerns the short deadlines for carrying out essential work, such as denominating all the securities traded on the various markets (shares — bonds — sovereign debt) in a single currency, the euro, and the rapid adoption of common rules for markets which presents various problems, one being that public holidays within the euro area vary from country to country.

1.3. The European Commission had the good sense to entrust the task of studying the impact of the introduction of the euro on capital markets and market conventions during the third phase of EMU to the groups of experts chaired by Mr Giovannini and Mr Brouhns [1].

1.4. The reports of these study groups have been very valuable in drawing up of this draft opinion.

1.5. It became apparent very quickly that it did not make sense for the Committee to employ the same approach as the one adopted by the eminent experts called upon by the Commission.

1.6. It was felt that undertaking another analysis of the problems which would hardly differ from those of the Giovannini and Brouhns reports, would not constitute a valuable use of the ESC, the role of which is to provide added value to those who read its opinions.

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(1) The impact of the introduction of the euro on capital markets was the subject of a Commission Communication dated 2 July 1997 (COM(97)338 final), which included the main recommendations of the Giovannini report on measures to be taken with regard to bond, equity and derivatives markets. The Committee drew up an opinion on this communication, for which the rapporteur was Mr R. Pelletier (OJ C 73, 9.3.1998, p. 141).

1.6.1. The ESC has issued no fewer than ten opinions [1] on EMU and the euro, covering the various aspects of its steady development towards greater EU integration. In these various opinions, the ESC has clearly expressed its support for the introduction of the euro and monetary union. This opinion does not wish to call into question the positions adopted by the ESC, or to launch a new discussion on the advantages and disadvantages of the euro as this debate has run its course. The aim of this opinion, which is clearly reflected in its title, is to try to take stock of the challenges, namely the problems which EMU poses to financial markets.

1.7. Accordingly, it has been considered best to refer only briefly to the various technical challenges, while stressing the commendable efforts made by the various financial centres in adopting common solutions, as well as the spontaneous, decisive role played by the markets in bringing about these adjustments.

1.8. However, it seems useful to raise the problems which have been only partly solved or not at all, in particular with reference to the January 2002 deadline when national currencies will disappear.

1.9. Moreover, it is manifest that although the technical problems relating to the operation of the financial markets have been well studied, the economic impact of the creation of a large, unified euro market has been examined much less exhaustively.

1.10. It is essential to place the analysis in the broader context of globalisation, the near-complete liberalisation of capital movements, and the development of new technologies.

1.11. With regard to both the players and methods used, in particular the striking trend towards mergers between banks, financial institutions and stock markets, and the rise of electronic trading methods (Internet), etc., it is impossible not to be struck by the fact that the euro area — however important it may be to its Member States — constitutes but a fraction of a global market which is dominated by the United States, which brings all its influences to bear on the methods and operating procedures of the global financial market.

1.12. Although Europe's largest financial market — London — remains outside the euro area, in practice it plays a fundamental role in the different sectors of the financial market.

1.13. The question needs to be asked as to whether one of the key arguments put forward by the experts can be accepted without further consideration, namely that market consolidation, greater liquidity and stronger transnational competition will undoubtedly be beneficial to the financing of companies in general, irrespective of the size of company or sphere of activity.

1.14. Lastly, it should be stressed that a financial market will only function well if those who operate in it have fully assimilated the introduction of the euro, a development which is akin to a revolution. Even though no reliable statistics are available for the whole euro area, it would appear that, unlike the major groups and powerful companies — which are already highly internationalised — and of course the banking and financial sector, small and medium-sized companies still need to make considerable progress by 2002 to prepare themselves for the market changes which will take place [2].

1.15. With regard to private individuals — whose involvement in the operation of the markets is essential — everything points to the fact that in spite of the information initiatives and training measures undertaken by the European Commission and various professional and public bodies, there is still a long way to go before procedures and attitudes have fully adapted to the final deadline throughout the euro area, although it should be noted that differences exist between Member States in this respect [3].

(1) Opinion of 26 October 1995 on the Green Paper on the Practical Arrangements for the Introduction of the Single Currency, OJ C 18, 22.1.1996, p. 112, Opinion of 26 September 1996 on the Impact of Economic and Monetary Union: Economic and social aspects of convergence and measures to increase awareness of the single currency, OJ C 30, 30.1.1997, p. 73, Opinion of 31 October 1996 on Market implications of the legislation and regulations required for the transition to the single currency, OJ C 56, 24.2.1997, p. 65, Opinion of 29 May 1997 on Arrangements for stage three of economic and monetary union: stability and growth pact for ensuring budgetary discipline, reinforced convergence procedures, and a new exchange rate mechanism, OJ C 287, 22.9.1997, p. 74, Opinion of 11 December 1997 on Practical aspects of the introduction of the euro, OJ C 73, 9.3.1998, p. 130, Opinion of 26 March 1998 on the External aspects of economic and monetary union, OJ C 157, 25.5.1998, p. 65, Opinion of 9 September 1998 on Employment and the euro, OJ C 407, 28.12.1998, p.282, Opinion of 2 December 1998 on Employment policy and the role of socio-economic organisations in the third phase of economic and monetary union, OJ C 40, 15.2.1999, p. 37, Opinion of 21 October 1999 on the Impact of implementing EMU on economic and social cohesion, OJ C 368, 20.12.1999, p. 87, and Opinion of 2 March 2000 on An assessment of the introduction of the single currency, OJ C 117, 26.4.2000, p. 23.

(2) According to a survey published by the European Commission in December 1999, on average the euro accounts for 1,9 % of domestic payments by companies and 0,8 % of the value of payments by private individuals.

(3) Commission Communication on Communications strategy in the last phases of the completion of EMU (COM(2000) 0057 final).

1.16. The European Commission has reminded Member States of their communication obligations with regard to the euro, stating that its first concern is that SMEs will get the impression that transition to the euro does not pose any problems, while many of them have failed to incorporate the strategic dimension, and that efforts must be made to ensure that companies do not find themselves once again in a big bang situation. The Commission's second concern relates to raising awareness among vulnerable individuals (1).

2. The challenges facing the banking industry

2.1. Against a background of internationalisation of markets, continental European banks appear relatively poorly placed in relation to increased competition with British and US banks, as in recent years they have been operating in a less favourable economic environment. This inferiority is reflected in their return on assets employed (2) and their resulting stock market rating. These weaknesses are much less pronounced, however, if the whole of the EU banking system is considered, including third-country banks operating from London.

2.2. Although there are clear signs of an improvement, operating margins continue to decline and risk provisions have risen considerably in the course of recent crises, including the property market recession, the financing of Russia, and the Asian crisis. At the same time, the very favourable economic cycle in the United States has allowed US banks to make lower provisions against loans to small businesses and private customers compared with banks in the euro area.

2.3. The upturn in economic activity in Europe which has been underway since 1999 is making it possible gradually to repair the damage done by these crises to balance sheets. The most recent data from the banking analysis and rating agency, Fitch, points to a sharp recovery in profits over the final quarter of 1999 and the first quarter of 2000.

2.4. In 1999 the managed assets, shareholders' funds and after-tax profits of the EU banking sector as a whole exceeded the corresponding figures for the US banking sector.

2.5. Another reason for investors' lack of enthusiasm is the feeling that, despite the technological developments of recent years, European banks still very clearly belong to the 'old economy', in contrast to the high-technology sectors and the new forms of electronic access to markets of the 'non-banks'.

2.6. New start-ups and 'non-banks' are trying to undercut the banks' cumbersome and outdated methods of winning new customers. This aggressive competition is creating an awareness throughout the financial sector of the need for radical change both in the internal management and in the structures of the industry (3).

2.7. The most visible forms of this new awareness of the challenge are cooperation arrangements between banks, mergers, and particularly specialisation agreements.

2.8. These changes of strategy include — particularly in Germany — a tendency to redeploy financial assets, and to withdraw from the traditional business of providing capital to industrial and other firms. This trend has been given a strong impetus by the recent reform of German law on the taxation of portfolio gains.

3. To what extent is this massive restructuring attributable to the advent of monetary union and the euro?

3.1. Most observers agree that the real triggers have been:

— the large scale liberalisation of capital movements, the main milestones in which were the Single Act of February 1988 and the Treaty of Maastricht, which established a frontier-free area in the European Union, which was extended to cover capital on 1 July 1990;

— the almost complete liberalisation of the right of establishment as of 1 January 1993, with the mutual recognition of authorisations granted by the Member States of the European Union (European passport). De facto and de jure opening of the markets of the Union to branches of credit institutions based in the USA, Japan etc.

3.2. These processes gave free rein to unfettered competition and a world capital market on a scale extending beyond the euro area.

(1) The European Commissioner, Pedro Solbes, rang the alarm bell once again on 13 July 2000 with regard to the delay among companies and private individuals in adapting to the euro. The Ecofin Council of 17 July 2000 drew attention to the lack of sufficient awareness of the imminent changes in euro area countries.

(2) For the period 1995 to 1998 European banks made a 0,68 % pre-tax return on assets, compared with 1,58 % for US banks. Net operating profit on lending was 1,83 % in the EU and 2,96 % in the United States. See Commission staff working paper SEC(2000) 190.

(3) A DG Bank study covering the period 1985 to November 1999 suggests that the number of banks in the euro area has fallen from 18 851 to 8 312 units. The German bank estimates that the total number of banks in the Eleven will fall to 7 700 units by the end of 2000.

3.3. The creation of the euro area — soon to consist of twelve out of the fifteen Member States — accelerated the awareness that 'nothing would ever be the same again'.

3.4. With or without a monetary union of eleven Member States, however, the trend towards globalisation of capital movements and banking activity would probably in any case have produced the same result.

4. The challenge of harmonising supervisory procedures in the banking sector

4.1. The monitoring and surveillance of compliance with prudential regulations is one of the most important tasks of states, which delegate this responsibility, usually to central banks or bodies close to the central banks, or more rarely, as in Germany for example, to an authority enjoying a high level of autonomy.

4.2. At all events, these are powerful supervisory bodies, employing a large number of highly qualified staff with a detailed understanding of the management methods employed by banks, their specific features, their strengths and weaknesses, especially with regard to risk-taking.

4.3. Large banks have such an influence on national markets, as a result of the number of their depositors, the size of the assets they manage and the economic and financial inter-relationships involved that any difficulties they may experience can impact on the whole national (or even international) economy, not to mention employment.

4.4. Given the level of risk involved, the problems of leading banks directly concern governments and this is an area where the concept 'too big to fail' really applies.

4.5. Banking supervisory committees, intended to be independent, are nonetheless required, in the event of major problems, to inform their governments and to take account of their recommendations.

4.6. Intervention by the political authorities in banking supervision is not peculiar to Europe. During the crisis in the Japanese banking system the government, relying on the Bank of Japan, intervened massively to rescue Japanese banks which were in some cases on the verge of collapse.

4.6.1. The US government and the Fed also intervened on a large scale during the crisis affecting certain hedge funds like LTCM, which could have started a domino effect in view of the scale of the reciprocal commitments entered into by banks and non-regulated institutions.

4.7. The serious difficulties of Crédit Lyonnais were detected in time by the French banking supervisory committee and Treasury directorate. There was a real risk of the crisis affecting the country's whole financial sector.

4.8. In view of the scale of the systemic risks involved, it is neither reasonable nor appropriate to accuse the supervisory authorities, which in these cases are subject to political control, of not keeping the public fully informed of the seriousness of these situations.

4.9. In the event of serious difficulties being experienced by a leading bank, the duty of the supervisory authorities is to underpin public confidence in the solidity of the country's banking system.

5. Towards the establishment of a European banking supervisory body?

5.1. The creation of the euro, the spectacular rise in cross-border mergers and joint ventures and the intensification of links between financial markets make banking supervision a Community problem.

5.2. The principle of increased collaboration between supervisory bodies appears in the financial services action plan adopted by the European Commission on 11 May 1999.

5.3. The fact that the basic prudential regulations, including those relating to solvency ratios, are now laid down at world level by the Basle Committee on Banking Supervision considerably strengthens the argument that common rules should be the subject of common supervision.

5.4. On the initiative of the ECB, the representatives of the banking committees of the EU Member States have agreed to establish a banking supervision forum, which would enable information to be exchanged on supervisory methods and which would constitute a first step towards harmonisation.

5.5. In view of the extreme complexity of banking supervision, the multitude of national peculiarities and the importance which national authorities attach to their independence, the time is not yet ripe for the establishment of a true European supervisory body, and yet a large number of bankers believe that the path is already marked out and that the outcome is not in doubt, provided that this does not result in a pyramid of national, European and international (BIS) supervisory activities, which would only result in paralysis.

5.6. One of the problems to be resolved is how to make new Internet businesses and 'non-banks', whose presence in the various markets is growing, subject to the same prudential rules as banks. This concern has been expressed forcefully in previous ESC opinions [1].

6. Improving the institutional framework of European stock-market regulation

6.1. The arguments put forward for the creation of a European banking supervisory authority are just as relevant and probably even more pressing in relation to the regulation and surveillance of financial markets and stock markets.

6.2. Stock market alliances and the development of ECNs [2] on the European market raise the problem of regulating European stock markets.

6.3. The basis for European stock-market regulation is set out in the directives which lay down a minimum definition of a regulated market and rules for the proper operation of markets and for the protection of investors. Each national stock-market authority lays down rules for its own domestic market. The various national authorities may cooperate with each other.

6.4. Since the establishment of the Forum of European Securities Commissions (FESCO) two and a half years ago, European regulators have stepped up their cooperation within the common institutional framework, for example laying down rules of conduct to which providers of investment services are subject when offering cross-border services to investors.

6.5. FESCO thus proposed a harmonised definition of a professional investor, to whom certain rules of good conduct would apply. The purpose of this initiative is to move beyond the debate centring on home or host country rules.

6.6. Similarly, in order to facilitate mutual recognition of flotation prospectuses, a harmonised model document has been studied; once the document had been approved in the country of listing, the issuer would be able to expand the offer on the basis of a simple memorandum and a summary in the national language.

6.7. In the light of this initiative it would be logical to envisage supranational regulation, which would not be a stage additional to the national level but which would progressively take on certain powers which the Member States decided to transfer to it from the national authorities.

6.8. The network of national regulators would deal with divergences in the application of the directives rapidly and with greater flexibility. It would probably be necessary to give the standards drawn up by the regulators legal force to set up a mechanism identifying divergences in the application of the directives with a view to a rapid response. This body of law would not be a substitute for the directives but would rather complement them.

7. Monetary union is changing the methods used for the financing of companies

7.1. Although there is a general trend towards market-based financing, particularly for large European companies, the model still differs perceptibly between continental Europe on one hand and the United Kingdom and United States (Anglo-Saxon model) on the other.

7.2. In continental Europe the most common form of financing for companies — apart from (generally minority) holdings by banks — is still bank lending.

7.3. Recourse by SMEs to financial markets and syndicated loans as a source of direct finance is still less developed than in the United States and Great Britain for example. Issuing costs (compliance, accounting adjustments, public relations) are still a deterrent for the smallest old-economy companies.

7.4. The internationalisation of markets and the creation of the euro area enable securities markets to take on a role formerly played by the banking system. In its 1999 annual report the ECB notes that ‘generally speaking, the role of financial markets in the allocation of financial resources is growing relative to the role of financial intermediaries’ [3]. Banks nonetheless play a decisive role in helping companies to gain access to the market.

7.5. Stock-market flotations, issues of shares by means of capital increases and bond issues are changing financing methods.

[1] Opinion of 28 January 1998 on the Communication from the Commission to the European Parliament, the Council, the European Monetary Institute and the Economic and Social Committee: Boosting customers' confidence in electronic means of payment in the single market, OJ C 95 , 30.3.1998, p. 15.
Opinion of 27 January 1999 on the Proposal for a European Parliament and Council Directive on the taking up, the pursuit and the prudential supervision of the business of electronic money institutions, and the Proposal for a European Parliament and Council Directive amending Directive 77/780/EEC on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions, OJ C 101, 12.4.1999, p. 64.

[2] Electronic Communication Networks.

[3] European Central Bank 1999 Annual Report, p. 4.

7.6. Institutional investors, managers of collective investment funds and pension funds — very often American — have become ubiquitous players in the financial markets. This justifies the Commission's initiatives to promote the development of pension funds in the economic union.

7.7. Investors specialising in high-risk investments — the small number of which was until very recently one of Europe's acknowledged weaknesses vis-à-vis the United States — are undergoing a spectacular development.

7.8. The establishment of the NASDAQ in the United States in 1971 is finding imitators, and new markets have been established in Europe, the main function of which is to finance new-economy and high-technology start-up companies, which are particularly popular with Internet-based speculators.

7.9. The creation of the euro area, breaking down the compartmentalisation of national currencies, has brought to the market a depth and a liquidity without parallel in recent times.

8. Vigilance is still required with regard to the conditions for the financing of small and medium-sized enterprises

8.1. Greater reliance of companies on the market for financing has important consequences for creditor-debtor relations.

8.2. The European Central Bank's 1999 Annual Report [1] states that 'in the past, banks in the euro area have been the main providers of financial services in rather fragmented and sheltered domestic markets. However, as barriers between various domestic or local markets have been reduced, banks are facing more competition from one another as well as from other providers of financial services'.

8.3. The progress of information technologies is changing traditional forms of bank-customer relations. The information needed for financing decisions can now be obtained easily and at little cost.

8.4. Computerised credit-risk management techniques, applying to companies but based on the credit scoring used for consumer credit or mortgage lending, are changing traditional banking practices. This standard method of risk assessment is relatively unfavourable to SMEs.

8.5. The strengthening of prudential rules arising from work of the Basle Committee on Banking Supervision is causing banks to exercise greater prudence in the management of their outstanding exposure. They are looking for SMEs which are a good risk.

8.6. The failure of large numbers of debtors during the recent crisis has made a deep impression on senior managers who are increasingly placing reliance on computerised risk-calculation models.

8.7. The development of cross-border financial relations is still limited — outside border regions — to large and medium-sized firms which did not wait for monetary union before entering into trans-national links.

8.8. On the other hand, an increasing number of banks and insurance companies are entering into cooperation agreements for the exchange of cross-border services.

8.9. Among the reasons quoted for the delay in stepping up intra-Community and cross-border competition, linked to monetary union, are the slowness of the process and the high cost of penetrating the relatively mature markets of the economic union.

8.10. Less and less mention is made of institutional obstacles, but experts stress the weight of cultural factors and the persistence of specific national features [2]. Differences related to language, tax, accounting conventions and the absence of a harmonised law on bankruptcy etc. are helping to slow cross-border establishment and financing.

9. The monetary union is changing the sales channels for financial services

9.1. The use of the Internet for the sale of the financial services raises the problem of investor protection.

9.2. It is highly desirable that a maximum level of protection should be provided. The Proposal for a Directive on the Distance Selling of Financial Services takes this concern on board, whilst retaining the principle of maximum harmonisation.

9.3. Maximum harmonisation means establishing a legal basis common to all the Member States. The Member States may neither add to nor take anything away from this core legislation.

(1) European Central Bank 1999 Annual Report, p. 15.

(2) Cf. W.R. White — The euro and the European financial markets — IMF, 1997.

9.4. This initiative gives the European Community the essential level of investor protection, whilst leaving open the option of subjecting professional investors to different rules appropriate to their level of skill and information.

10. The influence of the monetary union on the bond market

10.1. It was generally accepted that the euro would create a market with uniform interest rates throughout the area, with greater competition between issuers and consequently lower costs for borrowers. The saver was to benefit from a major reduction in transaction costs — and the traditional banks would see a corresponding reduction in the volume of their commissions.

10.2. According to the European Commission [1]'[…] the volume of new euro-denominated bond issues has exceeded all expectations […]. In fact, international euro-denominated bonds have amounted to about 40 per cent of the total for all currencies in the first half of 1999, against 30 and 20 per cent in 1998 and 1997 in the component currencies and in ECU. If we add to this domestic issuance in euros, the amount of euro issues is comparable to the value of those denominated in US dollars, evidence of the growing depth and liquidity of European bond markets. These conditions will favour cross-border transactions by European investors'. In 1999 the value of euro issues overtook that of dollar-denominated issues. It should be borne in mind, however, that euro-denominated issues are usually the subject of dollar swaps, which affect the dollar exchange rate. According to statistics compiled by Capital Data Bondware, the dollar has recovered its dominant position in the bond market (43,87 % of the market with $342,9 billion, as against 40,68 % and 317,9 billion respectively for euro issues).

10.3. One reassuring statistic is the market's preference for low-risk issues, and the massive preponderance of securities equivalent to government bonds, with AAA-rated issues accounting for 43 % and AA issues for 44 % of the market in the second half of 1999. As an encouraging footnote to the enlargement of the market, the Commission states that issues rated A by the international agencies have gone from less than 2 % of the market in January 1999 to 10 % in the course of the second half of 1999.

11. EMU is changing the configuration of the European government bond market

11.1. A pan-European government bond market now occupies the number-one slot in the world, ahead of the United States.

11.2. 'By removing foreign currency risk as well as interest rate differentials, the euro has made the liquidity of individual bonds the overriding factor in government bond yield evaluation, while the importance of credit risk itself has receded [2].'

(1) Commission staff working paper, SEC(2000) 190, 8.2.2000, p. 67.

11.3. The conditions for government financing will in future depend on liquidity, i.e. the volume of government bond issues on the euro market. Analysis of the state's finances will thus lose its importance. This trend is unfavourable to bond issues by small countries.

11.4. At the same time, an increase in private-sector issues is noted, with rating differences reflecting the standing of the issuer [3].

12. The impact of economic and monetary union on the operation of the financial market

12.1. It is still too early to carry out a serious analysis of the impact of the revolution ushered in on 1 January 1999 by the redenomination in euros of all securities, shares, bonds and other public and private-sector paper.

12.2. The euro market has thus reached a volume close to that of the United States, with a credible critical mass, and even if the changes in the markets are still far from complete, a relatively accurate picture of the major trends can still be formed.

12.3. There is a consensus among the majority of experts as to the favourable effects of monetary union:

- increase in cross-border transactions in securities;
- acceleration in the integration of national markets and increase in market liquidity;
- development of a corporate debt market with issuers being subject to risk evaluation methods in the United States;
- level playing field in rules governing the operation of markets (rules on delivery, compensation etc.).

12.4. Competition between financial centres and particularly securities markets has begun aggressively, with two major focal points:

- a segmented alliance between the London and Frankfurt stock exchanges (incorporating cooperation with the NASDAQ); this project now seems to be cast into doubt as a result of the negative reaction of a significant proportion of LSE members;

(2) Commission staff working paper, SEC(2000) 190, 8.2.2000, p. 68.

(3) ESC Opinion on The role of the European Investment Bank (EIB) in European regional policy, with regard to the role of the EIB in supporting the euro bond market, CES 1001/2000.

— a highly integrated form of alliance between the Paris, Brussels and Amsterdam bourses (Euronext), with interconnection of settlement systems, and bringing together, in addition to Euronext, seven international stock exchanges, including New York, Tokyo and Hong Kong, in a Global Equity Market operating 24 hours a day throughout the world. This vast market will total $20 trillion, i.e. 60 % of world stock-market capitalisation (agreement in principle announced in Tokyo on 7 June 2000) ([1]).

12.5. Experts generally think that there are too many stock markets in the single currency area and that, under the unifying influence of the euro, they should be combined. This necessary merger should however respect the rules of competition.

12.6. These groupings are being carried out on the basis of specialisation, with London, for example, having a dominant position in the market for large-capitalisation stocks and Frankfurt in derivatives and high-technology stocks.

12.7. Pan-European groupings would also take place on the basis of specialisation by each member exchange with a single electronic transaction system.

12.8. The process of consolidation is being driven by technological innovation. The introduction of electronic real-time stock quotations on the Internet means that the location of a stock market is losing some of its importance.

12.9. Mechanisms for order routing, compensation, settlement and delivery of certificates are of decisive importance in a competition which, in the final analysis, is not so much European as global.

12.10. The risk inherent in a significant proportion of transactions being conducted on unregulated markets, either directly or via the growing number of ECNs, which have still not been properly evaluated, cannot be dismissed.

12.11. Europe's OTC ([2]) derivative markets are very dynamic. European rules are needed governing the standard contracts used for transactions in financial instruments. The European Banking Federation (EBF) has drawn up a standard European contract, the Euromaster, which has been approved by all the European banking associations. This contract incorporates standard clauses applicable throughout the Union. The use of this standard contract should be promoted throughout the Community.

([1]) According to the International Federation of Stock Exchanges, at the end of 1999 the total stock market capitalisation of the euro area amounted to $4 274 430 million, as against $13 935 045 million for the New York Stock Exchange and the NASDAQ together.

([2]) Over-the-counter.

13. **The euro-dollar exchange rate poses a challenge to the markets**

13.1. The internationalisation of the European securities market — going beyond the traditional blue chips — has been considerably reinforced by the introduction of uniform euro quotations.

13.2. The share of US pension funds in total European stock market capitalisation remains a positive aspect of monetary union.

13.3. The extreme volatility of these investments is a source of concern, however.

13.4. The euro's margin of fluctuation against the dollar has been as much as 25 %. This has led to the large-scale withdrawal of international investors from European securities. Securities transactions are a negative item in the balance of payments. European investment in US securities exceeds US investment in Europe.

13.5. Although there are large number of reasons for this deficit — including the different degree of dynamism of the economies on either side of the Atlantic — the euro has clearly led to greater market volatility compared with the previous situation of the larger national stock markets which, whilst being open to the world, enjoyed the support of local investors and their confidence in the exchange rate of the national currency (franc and German mark).

13.6. The goal — which appears, at least for the time being, to be out of reach — is a euro-dollar exchange rate which is more representative of economic fundamentals. The paradoxical divergence has wrong-footed most experts in their forecasts.

13.7. The conduct of monetary policy by the European Central Bank (ECB), faced with this unforeseen situation, has caused what the markets dislike most, uncertainty.

13.8. The main economic players consider the ECB's practice of reacting solely by means of interest rate increases, aimed at bolstering the euro exchange rate or at least stopping its slide, to be inappropriate. The ECB has taken account of this concern by taking a very measured approach to increases in its refinancing rate (+0,25 % at the end of August 2000).

13.9. Inflation is low and the long-awaited upturn in economic activity has been confirmed. The markets might therefore react badly to a situation where the ECB, faced with the inflationary pressure of rising oil prices which has little to do with the fundamentals of the euro area, were to act as if a global inflationary risk existed. It is therefore essential that the ECB keep the public fully informed on its policy.

13.10. Some politicians have made little secret of their doubts as to whether the ECB is capable of steering a coherent political course between the necessary upturn in activity and reduction of unemployment on the one hand and support of the euro on the other. Whilst respecting the independence of the ECB, it will be up to the Council and the Presidency to draw up a coherent, complementary statement of policy.

14. **The challenge of the foreign exchange markets**

14.1. The operation of a free market, which is subject to recurrent shocks related to the activities and sentiment of a large number of players, is perhaps not a challenge in the strict sense of the word, to the extent that it is part and parcel of the normal operation of a market economy, which is, in principle, driven by rational behaviour.

14.2. There has been no shortage of explanations for the weakness of the euro against the dollar from economists and in the press. Whilst it is not possible to reproduce these commentaries exhaustively, the following arguments can be briefly summarised:

— a persistent disparity between the performance of the economies of the euro area and that of the United States over the last four years. Europe's average volume GDP growth is estimated at 3,4 % for 2000, that of the United States at 5,3 % (second quarter 2000);

— the gap between US and European market interest rates which attracts the mass of mobile capital on the world market to the dollar, to the detriment of the euro (1);

— the confidence of the financial markets in the policy of the Federal Reserve which takes care not to break the expansionary cycle, whilst curbing the inflationary tensions inherent in full employment;

— the spectacular recovery of US public finances which, thanks to economic expansion, has seen the traditional deficit disappear and even the appearance of a budget surplus;

— the extreme ease with which the United States finances a substantial deficit on the balance of payments on current account ($339 billion in 1999) thanks to the inflow of global savings and the enormous stock of dollars held throughout the world, which is tantamount to a zero-interest loan to the government of United States. This gives the Americans, freed from concerns as to the balance on their external accounts, unequalled leeway in the conduct of their economic policy.

14.2.1. To sum up, the fundamentals of the US economy — with the exception of the external deficit — point to the continuation of strong pressures for the appreciation of the dollar against the euro in the medium term.

14.3. The backdrop to management of the euro is far less favourable. Under the Treaties, the European Central Bank (ECB) is not responsible for the euro exchange rate. It does have the means to intervene in the foreign exchange markets by selling dollars through the European central banks and other 'friendly' intermediaries. But this kind of intervention is generally costly and of limited effectiveness. In its most recent monthly report (August 2000) the ECB seems to acknowledge a degree of powerlessness to control the euro-dollar exchange rate.

14.4. The depreciation of the euro encourages exports from the euro area and is playing a not insignificant role in the current resumption of economic expansion. Governments and public authorities well remember the efforts made by the European monetary authorities to maintain stable exchange rates between the euro area countries in the period following Maastricht, at the cost of a sometimes dramatic fall in economic activity. On the other hand, the depreciation of the euro offers US pension funds and companies considerable opportunities for taking control of European companies cheaply. About 50 % of the capitalisation of the French stock market is held by US and British pension funds. And this phenomenon is not exclusive to France.

14.5. The idea that the behaviour of the foreign exchange markets is a result of failings on the part of the governments of the euro area countries is wide of the mark. The 'deafening silence' of policy is a response to the evident concern not to increase the anxiety of market players. The golden rule in these circumstances is to keep quiet, which does not mean that the European Union's finance ministers are indifferent to the weakening euro, witness the ongoing close consultation within the Euro Eleven Council.

14.6. Statements by the monetary authorities on the solidity of the euro and its chances of short-term recovery have been without effect, or even counter-productive. In a nervous market this kind of statement simply increases players' anxiety and scepticism.

(1) This gap appears to be on a strongly narrowing trend: in mid-May 2000 10-year T-Bunds yielded 5,4 %, French Treasury bonds 5,5 % and 10-year Fed funds 6,4 %. Subsequently, the increase in Fed interest rates and the stabilisation of ECB rates widened the gap to some extent. On 8 June 2000 the ECB increased the refinancing rate to 4,25 % (+0,5 %). In June 2000 3-month deposits yielded 6,52 % in the United States compared with 4,3 % in the EU. If account is taken of the respective inflation rates, the real interest rates are comparable.

14.7. In its May monthly report the German Bundesbank expressed the widely held view that such a loss of value was not good for the reputation of a young currency. The efforts made to minimise the psychological effect of the euro's loss of external value is testimony to the growing politicisation of the problem.

14.8. Accepting the globalisation of capital movements means accepting a loss of control over a market prices, i.e. exchange rates. At all events, neither the monetary authorities nor governments are nowadays able to influence the markets, except by pursuing policies designed to restore confidence in the dynamism of the Eleven.

14.9. The only weapon at the ECB's disposal is the ability to raise interest rates to offer returns competitive with the dollar, but there is little room for manoeuvre if the danger of stopping economic growth in its tracks is to be avoided, which means that the ECB carries a heavy responsibility.

14.10. In the final analysis, it is clear that no action to stabilise world foreign exchange markets will be credible unless the United States and the ECB are supporting the efforts of the national central banks. It is equally clear that the United States is fundamentally opposed to any intervention aimed at derailing the free play of market forces, the dollar exchange rate being the subject of 'benign neglect'.

15. **Institutionalised solidarity**

15.1. Solidarity between financial centres has taken on an institutional form. A standing Eurocurrency Committee was set up under the auspices of the BIS in order to establish a range of crisis-prevention instruments based on greater transparency of fundamental data relating to the positions of the central banks, and the public and private sectors in the euro area.

15.2. The Eurocurrency Committee became aware of the impossibility of isolating the euro market from monetary and financial activity in the rest of the world. At the beginning of 1999 it was decided to convert the standing Eurocurrency Committee into the Committee on the Global Financial System.

15.3. This can be seen as recognition that a euro area with autonomy of action and its own powers is illusory.

16. **A major challenge: the establishment of a tax system consistent with EMU**

16.1. The awareness of the importance of the tax system for the establishment of a genuine, unified EU market goes back to the very origins of the Union.

16.2. It is impossible to quote here all the communications and reports drawn up by the Commission or expert groups on the subject. Several ESC opinions should also be mentioned here in connection with what is undoubtedly the most difficult aspect of European construction.

16.3. In a document dated 22 October 1996 entitled Taxation in the European Union — Report on the development of tax systems [1] the Commission noted: 'As regulatory restrictions are disappearing, those tax hindrances or distortions that do remain are becoming increasingly visible, and taxation is widely seen as one of the most important areas in which the Single Market has not been fully achieved'.

16.4. EMU reinforces the effect of tax distortions by abolishing exchange risk and by the convergence of interest rates and the diminution of transaction costs. A completely fluid market makes the taxation of investments a decisive influence on investor behaviour.

16.5. But the taxation system applicable to income from investments is only one consideration — if perhaps the most important one — in allocating resources and deciding where to invest.

16.6. The burden of tax and social levies, the definition of the tax base, the rules governing the calculation of corporation tax — which are just as important as interest rates — are not without their effect on competition and the operation of EMU. Competition between tax areas, far from diminishing, is actually increasing.

17. **A pragmatic approach by the Commission respecting national sovereignty**

17.1. The tax question goes to the very heart of national sovereignty. Deep disparities exist both in terms of tax as a proportion of GDP and as regards its distribution between direct and indirect taxation and social levies.

17.2. Unification, or even far-reaching harmonisation of the laws relating to the tax base and the rates of taxation and levies, is, as things stand, a pipe dream.

17.3. The Commission, which is aware of these constraints, including the rule that decisions on tax require unanimity in the Council, has adopted a pragmatic approach [2]:

(1) COM(96) 546 final, 22.10.1996, p. 5

(2) Communication from the Commission to the Council — Towards tax co-ordination in the European Union — A package to tackle harmful tax competition, COM(97) 495 final, 1.10.1997.

1) putting an end to unfair competition by defining, in the framework of a code of good conduct, acceptable and unacceptable practices of a fiscal nature, including the area of state aid (resolution of the Council of 1 December 1997);

2) consideration of EU competitiveness at world level (major problem with tax havens outside the EU which are the subject of consultation in the OECD);

3) measures aimed at eliminating distortions relating to the level of taxation of income from capital:

   — the measure should cover only interest paid in a Member State to physical persons who are not resident in the state for tax purposes, but rather in another Member State;

   — the co-existence of two systems; either establish a minimum withholding tax or require the exchange of information on income from savings between Member States.

18. **Towards a minimalist solution**

18.1. The solution proposed by the Commission, which commanded a fairly broad consensus, failed at the Helsinki European Council in December 1999 and at the Lisbon Ecofin Council on 7 and 8 April 2000.

18.2. Agreement was reached at the Feira Council in June 2000 on the co-existence of two systems for a 10-year period:

— withholding tax, respecting banking secrecy, for a transitional period of seven years;

— lifting of banking secrecy with exchange of information between tax administrations — system to be generally introduced towards 2010.

18.3. The Feira agreement should also make it possible to develop the code of good conduct which it is intended should introduce a minimum level of discipline to the taxation of companies.

18.4. The approval of a code of good conduct on damaging competition in the field of corporation tax would seem to require a reform of the decision-making process in tax matters, with decision-making by qualified majority, in the course of the major institutional reform to be discussed at the Nice Summit in December 2000.

18.5. The Feira agreement incorporates binding conditions, including an alignment of Switzerland, Liechtenstein and other financial centres on the solutions adopted by the EU. Negotiations are to be entered into to encourage the adoption of equivalent measures in non-Community countries and territories associated with the EU Member States (Isle of Man, Channel Islands, Monaco etc.).

18.6. A directive based on the Feira agreement will be submitted to the Council at the end of 2002. Before then important decisions will need to be taken, e.g. with regard to the rates of withholding tax to be applied by countries which have chosen this option.

18.7. Reactions to the outcome of the Feira Council have been diverse. At all events, the ultimate objective of tax harmonisation in the EU remains a distant goal.

19. **Conclusions**

19.1. The main hurdle which EMU has had to overcome is making a success of monetary union in the absence of political union, which is without historical parallel.

19.2. The majority of economists and internationally renowned economic research institutions, including most holders of the Nobel Prize for economics [1], held out little chance of success for the euro.

19.3. It is still too soon to assess the success of monetary union. It is, however, worth noting that the immense technical challenge of the establishment of the euro has been overcome. The same is true of the control of inflation and the alignment, without major problems, of the Eleven on the Maastricht criteria and disciplines [2].

19.4. Eighteen months after the financial markets' transition to the euro European stock markets have reached record levels under the combined influence of renewed growth, the developing dynamism of the 'new economy' in Europe and the technological revolution in electronic access to markets. It is generally thought that stock markets anticipate the future of economies. If this is so, it appears that the euro area has entered upon a long cycle of strong growth.

19.5. EMU stood up well to the Asian crisis of August 1997, which was followed by the Russian crisis and then the Brazilian crisis in 1998.

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(1) The sole notable exception is Robert Mundell who is in favour of the euro.

(2) The President of the German Bundesbank considers that the success of the ECB should be measured more in terms of price stability than of exchange rates.

19.6. Barring any unforeseen reversal of the current trend, concerns about the effect of a possible overvaluation of the euro against the dollar and the yen have so far proved groundless.

19.7. It would be premature, however, to consider that the challenges facing emu have been finally surmounted. These challenges are closely bound up with the rest of the world economy, to the extent that any distinction between the problems posed by the globalisation of foreign exchange markets and the liberalisation of capital movements on the one hand, and those which are peculiar to the monetary union on the other is purely artificial.

19.8. The fact remains that the economic and monetary union is benefiting from a very favourable economic situation and that it has not yet proved its ability to withstand a systemic shock or a crisis in the international monetary system. The same challenge exists with regard to its competitiveness vis-à-vis the dynamism of the US economy and the growing strength of the emerging countries. The ESC has however on several occasions expressed its confidence in the ability of emu to overcome these problems. The role played by the ECB and the markets' perception of the soundness of its monetary policy are vital for the credibility of the euro and thus the economic attractiveness of the euro area. The bank must therefore practise great transparency in the presentation of its decisions to make them easily understood by the markets. And whilst its main objective is the maintenance of price stability, it is also required to support general economic policies in the Community. Its monetary policy statements should therefore take account of this concern in order to prevent any debate damaging to the stability of the euro.

19.9. It is essential for Europe to profit from this economic situation to achieve the rapid establishment of a harmonised European framework for the financial markets which takes account of the methods of financing used in the Community and thus contributes to the creation of a European development model.

19.9.1. Eighteen months after the financial markets of the eleven Member States' transition to the euro and the mergers resulting from this, it should be noted that the most recent directive adopted in this area (the 1993 Investment Services Directive) is already seven years old.

19.9.1.1. The procedure for adapting the European regulatory framework needs to be changed as a matter of urgency with the establishment of a procedure at the level of the national regulators which will be more flexible and faster than the directives in dealing with points not specifically mentioned or insufficiently developed in the directives. European conditions for the supply of capital and intermediation thus need to be improved:

— by spelling out the status of the electronic alternative trade systems in relation to regulated markets;

— by establishing a European issue prospectus;

— by defining the status of informed investors in a pragmatic way;

— by adopting European accounting standards tailored to quoted companies.

19.9.1.2. In parallel, the demand for capital in Europe needs to be promoted. Two proposals for directives should be rapidly adopted, concerning:

— the rapid establishment of pension funds which in the medium to long term will become a source of capital for European companies;

— the adoption of a revised European passport for the management of UCITS which takes account of modern asset management tools (derivatives, feeder funds etc.); this would enable European asset management to rival its US counterparts.

19.9.2. Bank loans remain a major source of finance for European SMEs. For companies of a certain size this is often a cheaper source of finance than recourse to the markets.

19.9.2.1. It is therefore essential that the prudential ratios laid down in connection with the solvency ratio do not penalise loans in relation to stock-market funding. In this connection, it would be a good idea for the Commission to launch a study of ex ante credit-risk provision in order to smooth out economic cycles and thus the conditions for the granting of loans to SMEs.

19.9.2.2. The prudential ratios applicable to banks' portfolios of loans to very small companies, which are a major source of job creation in Europe, should be reduced to take account of the division of risk inherent in the diversity of the sectors involved and the small amounts lent to individual firms.

19.9.2.3. The European banks, via the European Banking Federation, put forward specific proposals on the subject during the consultation on the European solvency ratio launched by the European Commission. The Commission should take account of their concerns.

19.9.3. The European development model cannot be a purely wholesale market model. The protection of consumers makes it necessary to lay down maximum rules for the least well-informed. The maximum harmonisation approach adopted by the Commission for the Directive on the Distance Selling of Financial Services is therefore the right approach. It is consistent with, and should be coordinated with, the harmonised definition of informed investors advocated above.

19.10. In more general terms and with a view to the medium-term outlook, the effect of the enlargement of the EU and the danger of its fragmentation, with the euro area becoming an exclusive club with rules and aspirations different from those of the rest of the Union, have not been evaluated. This is undoubtedly a new challenge which goes well beyond its impact on financial markets.

19.11. The ESC can only endorse the view of ECB President Wim Duisenberg, who stated in the ECB's most recent annual report [1]: 'The euro got off to a good start, but making the euro and the Economic and Monetary Union a success is clearly a long-term process'.

(1) European Central Bank — 1999 Annual Report, p. 4.

Brussels, 21 September 2000.

The President

of the Economic and Social Committee

Beatrice RANGONI MACHIAVELLI

Opinion of the Economic and Social Committee on the 'Follow-up, evaluation and optimisation of the economic and social impact of RTD: from the Fifth Framework Programme towards the Sixth Framework Programme'

(2000/C 367/15)

On 2 March 2000, the Economic and Social Committee, acting under Rule 23(3) of its Rules of Procedure, decided to draw up an opinion on the: 'Follow-up, evaluation and optimisation of the economic and social impact of RTD: from the Fifth Framework Programme towards the Sixth Framework Programme'.

The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 1 September 2000. The rapporteur was Mr Bernabei.

At its 375th plenary session (meeting of 21 September 2000) the Economic and Social Committee adopted the following opinion by 46 votes to one.

1. **Recommendations**

WHEREAS

1.1. the new strategy and innovative integrated approach of the Fifth Framework Programme, aiming to solve the problems of individuals, companies and society, have gained the confidence of the Community institutions and their national partners;

1.2. there is still a need to raise the profile and boost the impact of Community research, and for it to take account of the new challenges posed by globalisation, an increasingly knowledge-based economy, and enlargement of the European Union in the near future;

1.3. there is a need to carry out a preliminary critical analysis of the inherent management, organisational and architectural shortcomings which keep the Fifth Framework Programme from achieving its ambitious objectives;

1.4. there is an urgent need to switch from a project funding approach to one based on quality and excellence, achievement of results and follow-up, which should underpin the legitimacy, assessment and correction of integrated research efforts;

the Economic and Social Committee

1.5. calls on the Commission, the European Parliament and the Council, during the forthcoming review of the Fifth Framework Programme, and with a view to optimising its social and economic impact, to:

1.5.1. boost and enhance the mechanism for key actions, whose lifecycle must be justified by evaluation, monitoring, assessment and planning mechanisms;