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Eurodollars

by H. PETER DREYER

The year recently ended was one of unprecedented unrest and disturbance in the international monetary world. Severe overt crises alternated with periods of no less threatening strains and tensions below the surface.

Despite this evident malaise, and in some manner even because of it, the Eurodollar business flourished throughout 1968 as it had never before. New loan issues in Europe, at not much below $4 billion, climbed to yet another peak, nearly twice as high as in 1967. Thus, Eurodollars maintained the breathtaking pace that has characterized their development in the past half decade.

The flow of Eurodollar transactions in the money market cannot be measured as precisely as that of the more clearly circumscribed long-term placements. According to estimates by the Bank for International Settlements in Basel (itself a key operator in this market, both on its own account and on behalf of some European central banks), the available funds amounted to $16 billion at the end of 1967, up from $13 billion a year earlier. To this figure must be added between $3 billion and $4 billion in other Eurocurrencies, such as German marks and Swiss francs.

It would not be extravagant to assume that the market widened in 1968 at least as much, and quite possibly more than, in 1967. The high interest rates in the closing weeks of 1968, when spiraling credit costs in the United States boosted the demand of American banks for Eurodollars, may well have accelerated the expansion process and drawn in additional funds.

The interplay between these particular money and capital markets will be touched upon later; here it is sufficient to say that, in weathering the awesome tests of 1968, each in its own way gave further proof of its viability. All but the most inveterate sceptics will surely now accept these markets as here to stay. Their relative newness, as well as their frequently unorthodox nature, have nurtured many doubts hitherto.

Defining the Invisible

What are Eurodollars? How has such a huge volume of money become available? What makes it expand so fast? What, if any, parallels are there between the upsurge of Eurodollars and monetary integration efforts undertaken in the current decade?

Specific answers cannot always be given to such questions nor has one set of conditions always produced the same result. At times, in fact, disparate, and perhaps even contradictory, developments appear to have combined to establish the Eurodollar market. Yet, how it came into being is well known. Eurodollars are dollars which, instead of being kept in a bank account in the United States, are deposited with banks outside the United States, chiefly in Europe and including the foreign branches of American banks.

At the beginning, in the early 1960's, successive and mounting American balance-of-payments deficits provided European central banks with large dollar holdings. These banks often preferred to lend these dollars in Europe, at higher interest rates than they could earn if left in the United States. Today, however, foreign-based companies and individuals, turning local currencies into dollars, are commonly assumed to be generating a far higher share of the Eurodollar volume than do the central banks. If some years ago the U.S. payments deficits created the Eurodollar market, the U.S. Government's efforts last year to contain the deficit, must be credited with having given the Eurodollar business a major fresh boost by forcing American companies to borrow funds outside the United States.

How Eurodollars Work

Although revolving around dollars (reflecting that currency's dominating position in international finance) the Eurodollar market does not cut off the dollar from its fellow currencies. Together they form a single system: correlation is regulated simply, and at most times smoothly, by the combination of rate differentials and swap costs.

Once established in Europe, say in London, a Eurodollar deposit might be employed for inter-bank lending operations, of which there could be a whole chain of successive ones, or as a loan to a non-bank user, perhaps to finance imports, or for the transfer of funds from an American bank branch abroad to its U.S. head office.

Intrinsically, Eurodollar transactions are not different from ordinary domestic banking ones. What distinguishes them, however, is that they incorporate shifts of money across international borders which, customarily, are exempt from the controls still imposed to this day on many national money markets. The Eurodollar's mobility and its ability to respond quickly to demand and supply variations anywhere make this market unique. Needless to say, it has come into its own at a time when the number of manufacturing and trading firms operating on an international scale also keeps rising rapidly. One moment they need to shift funds quickly from one country to another, just as at another moment they may want to dispose of Eurodollars they have generated in a rush.

Fluidity Poses Problems

The very fluidity of the market also poses problems. Two principal ones are:

– The bank-client relationship of the traditional credit transaction does not, and cannot exist because huge amounts of money pass quickly from bank to bank, because speed is essential where minute interest percentage differentials furnish whatever profit there is, and because the lending bank knows only the immediate borrower in the chain, not its following members who may very well be in different corners of the globe. Were the chain to snap at any one point, it could produce far-reaching reverberations against which there can be little advance protection. Throughout the years, a few such cases have occurred, giving the Eurodollar market an aura of mystery, possibly also making it look a little shady to some people. The danger of more and even bigger "accidents" in the future certainly cannot be ruled out. In fairness, though, it must be said that those that have occurred to date have been small when measured against the overall volume of business transacted; and, judging by the continuing growth of the market, they have not had a lastingly deterrent effect.

– The Eurodollar business patently cuts across the frontiers of national markets. This, as stated, is, in fact, one of its major attractions. When commercial banks can turn to Eurodollars

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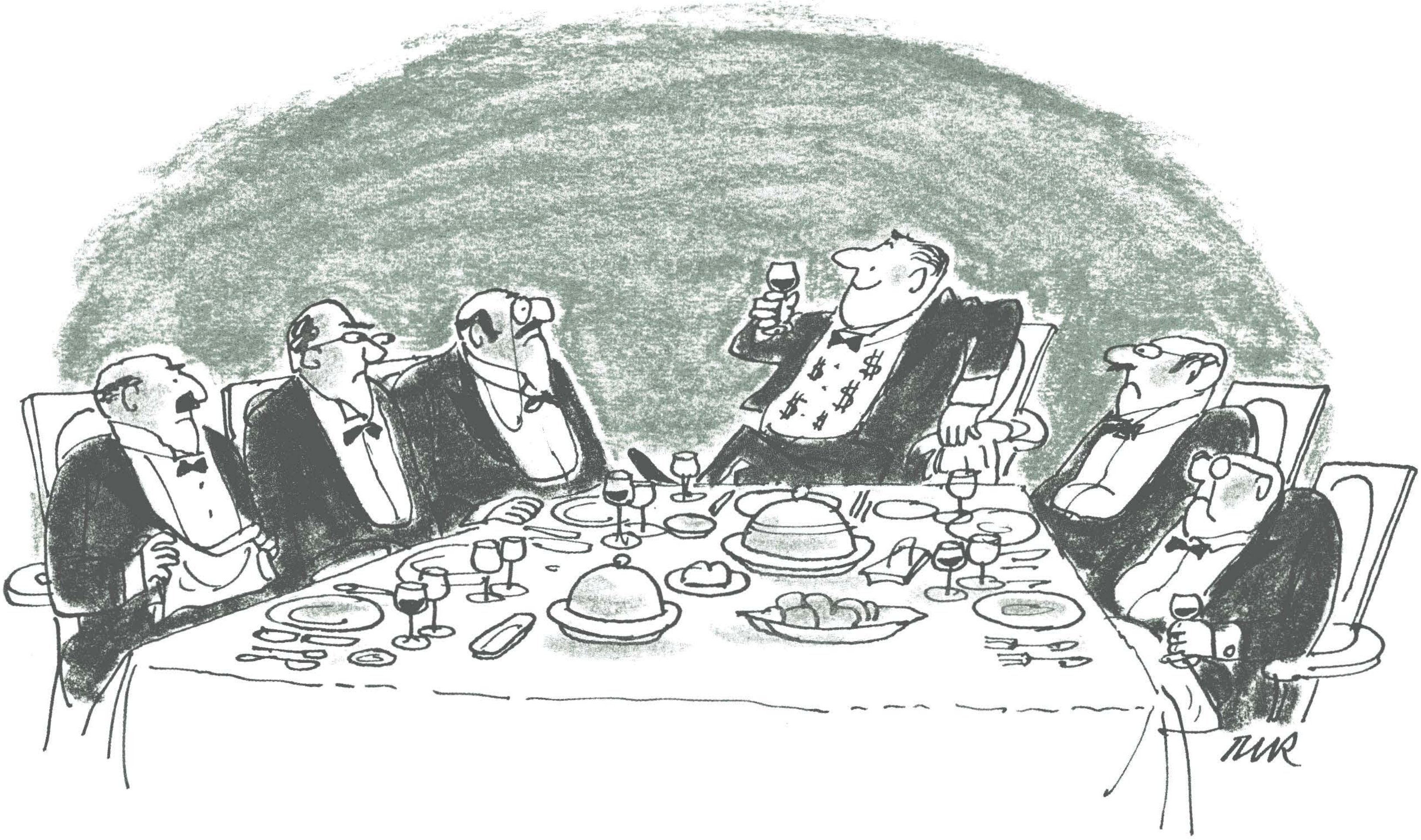


The guest who came to dinner . . . In the early 1960's, mounting U.S. balance-of-payments deficits provided European central banks with large dollar holdings, which were lent in Europe at higher interest rates than they could have earned if left in the United States. In 1968, the U.S. Government's efforts to contain the deficit gave the Eurodollar business a fresh boost by forcing American companies to borrow funds outside the United States.

instead of having to operate within the confines of national regulations, however, it becomes much harder for central banks to keep them as tightly controlled as they might like to and as they would otherwise. (Similarly, the placement of Eurobonds may well interfere with any ideas national governments might have for the screening off of their own capital markets.)

On the whole, national authorities and central banks seem to have accepted this aspect of the Eurodollar market with reasonable grace, and for a sound reason. Used intelligently, the Eurodollar market considerably enlarges central bankers' operating scope, so that it is an advantage as well as, occasionally, a hindrance. The financial scene throughout much of last year, for instance at the time of the German mark revaluation scare, furnished abundant proof. As billions of dollars in speculative funds poured into Germany, it was the ready mechanism of the Eurodollar market that allowed the German monetary authorities quickly to pump out most of this money again.

Naturally, the usefulness of the Eurodollar market does not guarantee its permanent acceptance. Almost certainly, it is a question of size and proportions. Were Eurodollar operations to become so enormous as to completely overshadow those taking place in national markets, were central banks to feel that they were no longer the masters in their own respective houses, were the market to be upset by major disturbances, there would be at the very least a strong temptation to introduce some measures of supervision or restraint, or even specific curbs. Such attempts at control would not necessarily occur in all countries at the same time.

Community Not Responsible for Eurodollar

The Eurodollar internationalization of the money flow has happened at a time of increasing economic integration in Western Europe and of spectacular expansion in world trade to which it has made an important contribution and from which it has derived strength. Pervading not merely Europe, but sweeping across other continents as well, the Eurodollar market is obviously not identifiable with the European Community as such, even though some Common Market nations are most actively participating in it. The undisputed center of this market is and always has been London.

Through London at least 60 per cent, and perhaps as much as 80 per cent, of all Eurodollar transactions passes at one time or another, though the volume, of course, can only be roughly estimated. Branch offices of American banks handle the bulk of the business, either from their London offices or facilities in major continental cities. Nor is their importance surprising. For one thing, they have built up organizations which the European banks do not usually match. For another, they are in constant business contact with the many multinational companies which figure so prominently in the Eurodollar business as both borrowers and suppliers of funds. Among them the American corporations stand out, much bigger and more numerous now as the result of successive years of huge U.S. investments.

Still another element underscores the American banks' leading position. Since this business revolves around the dollar, banks whose "home" currency is the dollar can more easily play the chief part. With head offices located in the United States, they would have, or claim they would have, less trouble at any moment than would banks of other nationalities in making up deficiencies in either deposit supplies or loan requirements.

Cause and effect cannot always be simply separated here. Because London is the center, because in past years home offices of U.S. banks have repeatedly drawn upon their London branches for Eurodollar remittances, and because so many of the banks' original clients now do business in Europe (among it Eurodollar business), more and more banks from the American "hinterland" are joining the long-established big New York finance institutes in London and opening branches there, thus magnifying the American bank presence in the British capital and, presumably,reinforcing those banks' participation in Eurodollar transactions.

Eurobonds: Realm of Banking Syndicates

No focal point comparable to London exists, nor would one be required for Eurodollar bond issues since large banking syndicates make the overwhelming majority of Eurodollar bond placements. These groups, representing many countries, may and usually do vary in size and composition with each individual issue.

In the realm of Eurodollars, as in national markets, there is a correlation between money and capital markets. Though the money market is virtually preempted by strictly commercial operations, and the capital market deals chiefly with the long-term investor, neither could operate in watertight compartments. The extent of their interaction is a matter of controversy among the experts, but it is widely conceded that there are some special links. Thus, industrial bonds like those placed so extensively last year will generate cash which the issuing company is unlikely to require, or to require in full immediately. Until such moment as the money is needed to pay for, say, the construction of a new plant, it will undoubtedly try to find a profitable use for it and, as likely as not, put it in the Eurodollar market.

Likewise, if the balance-of-payments program put into effect by the United States at the beginning of 1968 compelled American firms in Europe to search in the Eurodollar market for the short-term funds which their home banks could no longer supply, it also gave a powerful impetus to new bond placements. Of the $2 billion of bonds issued in 1967, American corporations and their European subsidiaries accounted for about 31 per cent. Last year, with such borrowing almost twice as high, the American firms' share rose to 64 per cent.

The Eurodollar money and capital markets appear to have another trait in common. Perhaps because they are still new and flexible and not yet weighed down by decades of tradition, they are forever evolving new forms, especially for tracking down and attracting fresh funds. In the money market, the gradual emergence in London since 1966 of negotiable dollar certificates of deposit has been a case in point. As they have become more popular, they have done much to bridge the medium financing (one to five years) gap.

1968 and the Future

In the capital market last year, there were two developments which before then had been of rather minor significance.

– One was the upsurge in convertible issues placed by American companies which amounted to nearly $1.6 billion for the year. At a time when "straight" dollar bonds, despite their very high yield, were no longer a very saleable commodity, the convertibles, combining a satisfactory interest coupon with the prospect of participating in the company's growth through conversion into stock, hit the right note.

– The other was an impressive increase in new German mark bond placements. It reflected the desire of the German Government, confronted as it was and is with substantial balance-of-payments surpluses, to make a genuine contribution to the export of long-term capital.

It might be tempting to speculate how fast and in what direction the Eurobond business will move in the months and years ahead and whether or not it can sustain its staggering pace of both 1967 and 1968. Yet, considering the unforeseen and often unforeseeable changes which have marked its course so far, this would hardly be a profitable venture.

Instead, in conclusion, it is perhaps more appropriate to state that, like the money market, the bond field, too, has its problems. National restrictions still make it difficult for many institutional investors to acquire Eurobonds. In addition, because the issuing syndicate must rely mainly on individual purchasers, it often has a hard time evaluating the prospects of an upcoming issue.

Also, for many Eurobond issues there exists either no secondary market or, at best, a poor one. In the long run, if the bonds (now totaling perhaps $8 billion) are to be a prime investment instrument, adequate facilities must be created to enable bond owners to sell without incurring substantial losses as easily as they would in national markets.

These complaints may be teething troubles to be relegated, sooner or later, to the past. Another complaint, though, must be taken more seriously. The Eurobond market clearly does not operate in a vacuum. Because 80 per cent of all issues are denominated in dollars, any new crisis of confidence in the dollar would be bound to shake gravely this business. New issues would grind to an abrupt stop, and chaos would prevail in the secondary market, thin even now. Important though these bonds are at this stage, more important though they may well become, they still are, and may remain, vulnerable for quite some time.

The Communist Parties

by WALTER KENDALL

Western Europe's Communist parties remain a major political force in at least two European Community countries, even though none has achieved the revolutionary goals set 48 years ago when the Communist International was founded.

In France and Italy the Communist Party apparatus overshadows its competitors' and commands a larger degree of working-class support than its Socialist rivals. After the death of Stalin, Palmiro Togliatti, the Italian Communist leader, emerged as a figure of global importance in the Communist world. Despite a significant drop in power and influence from their post-war peak, these organizations still play a role that has repercussions far beyond the boundaries of their national states.

After the emergence of an independent Chinese Communist Party and until the Soviet invasion of Czechoslovakia, Western European Communist parties' single-minded allegiance to the Soviet Union on all key issues had made them important factors of diplomacy. The tendency towards polycentrism did not alter this phenomenon. It may actually have allowed this allegiance to strengthen by offering greater scope for accommodation to varied national circumstances.

Strongest in France and Italy

All the Communist parties in the European Community have been affected by the changes in the Communist world since Stalin's death. The Italian party, under strong pressure from rival contenders for working class allegiance, has proven the most flexible and remains the most successful Communist party in the Community. The French party, on the other hand, until the Russian occupation of Prague, was solidly fixed in the Stalinist mold in which its now dead leader, Maurice Thorez, had cast it.

In the other Community countries, the Communist parties are of little significance. In the Germany Federal Republic, but not West Berlin, the Communist Party was banned in 1956. The Federal authorities have, however, allowed the foundation of a new organization, which was set up last September 26. In Luxembourg, the Communist Party gained one seat in the December 1968 election, raising their number in the 56-seat parliament to six.

All the Communist parties in the Community, with varying degrees of emphasis and success, weld together a strange mixture of revolutionary mythology and essentially social-democratic practice; a social program, which in some aspects, as in France, is openly regressive and reactionary, with calls for nationalization; and a reliance on Soviet patriotism and Russian revolutionary myth, which is, at the same time, accommodated with an often openly chauvinistic national pride and self-assertion.

Relying on a hard-bitten bureaucratic cadre organized on the military principles of democratic centralism, the Communist parties also embrace important groups or militant members and exercise influence over a wider range of passive members and supporters in the nation at large. Although their repeated apocalyptic prophesies of doom over the Marshall Plan, German revanchism, and the Community have failed to materialize, the Communist parties still manage to tap radical and forward-looking leaders badly needed elsewhere to instigate changes in European society.

Mr. Kendall is a fellow of the Center for Contemporary European Studies at Sussex University, England. His article is the fifth and last in the series on political parties in the European Community. European Community *No. 115 contains the first three, on the socialists, the Christian Democrats, and the Liberals; No. 118 contains the fourth, on Gaullism.*

Italy: A Strong but Flexible Force

The membership of the Italian Communist Party (PCI) has dropped to 1.5 million from its post-war peak of 2 million. Nevertheless, its immense size and the quality of leadership, provided until recently by Palmiro Togliatti, have made it the most influential Communist party in the Community.

Largely obliterated by Mussolini's secret police, the party's organization was rapidly re-established during the partisan operations after Italy's capitulation in 1943. As a component of the post-war coalition government, the party followed a policy of cautious conservatism, restraining wage demands and going so far as to vote for the re-endorsement of Mussolini's Lateran Pact with the Vatican (a step which the Socialists themselves refused to take). It was expelled from the coalition in May 1947, immediately before the announcement of the Marshall Plan and the Czech coup caused the final lines in the Cold War to be drawn. Nevertheless, the party's vote has remained surprisingly steady. Between 1948 and 1968 it has won between a quarter and a fifth of the votes for the lower legislative house.

After 1956, the Socialist-Communist alliance broke down, and the Nenni Socialists' decision to enter the center-left coalition in 1963 tended to limit Communist influence. The emergence of a powerful non-Communist Italian Confederation of Free Trade Unions (CISL) has been an equally important curb on the PCI and now rivals in power the Italian General Confederation of Labor (CGIL), led jointly by Communists and Nenni Socialists.

The current party leader, Luigi Longo, a veteran of the Spanish Civil War, has none of Togliatti's Machiavellian brilliance. Behind Mr. Longo stand party officials like Arturo Raffaello Colombi, Edoardo D'Onofrio, Pietro Secchia, Mario Scoccimarro and Umberto Terracini, but there are also important voices of dissent.

Giorgio Amendola has proposed tactics for a Socialist reunification— the integration of PCI forces into a center-left coalition—even at a heavy price, as a means to social progress in Italy. Pietro Ingrao, party leader in the Chamber of Deputies, is more concerned with global politics and has sought to take advantage of the recent changes in Vatican attitudes to enable the PCI to move closer to Christian Democracy at home and increase its influence on government policy at home and abroad.

The Italian Communist Party is a heterogeneous organization. About a third of its members belong to the industrial working class, slightly more are peasants, and middle-class and intellectuals comprise most of the remainder. Nevertheless, the PCI rivals the Christian Democrats as the strongest political force on the Italian scene today. The center-left coalition which collapsed in 1968 after failing to justify the hopes of its participants, did not rebuff the PCI as some participants had hoped.

The general elections of May 1968 did not cause a major shift in popular allegiance, either way. The Communists did, however, make the biggest gains, winning over 8.55 million votes, compared with 7.76 million in 1963—26.9 per cent of the total vote as against 25.3 per cent in 1963. Their representation in the Chamber rose from 166 to 177. Milan was their stronghold, followed by Rome, Bologna, and Turin. The Communists remain the second largest party in the Chamber, after the Christian Democrats. Third are the Socialists, with 19 seats.

France: Rigid Stalinism

The French Communist Party (PCF), under Waldeck Rochet, successor to Maurice Thorez, followed a rigidly Stalinist course until the Soviet intervention in Czechoslovakia shocked him into making an unprecedented condemnation of the Kremlin. Thorez, like Togliatti, took his party into a coalition at the end of the Second World War, in this case under General de Gaulle. As the Cold War rose to full intensity, Thorez in turn was ejected from the party, in May 1947.

The French Communist Party first seriously challenged the Socialists in the years following the Popular Front Government of 1936. Banned by the government in 1939, the PCF did not oppose the Nazis until the Soviet Union was attacked in 1941. The PCF then became the most important single component of the Resistance, and in the 1945 elections won 5 million votes, slightly more than the number of ballots cast for the Socialist SFIO.

The Communist vote has remained surprisingly solid as Socialist strength has declined. The French Communist Party's power is greatly increased by its unchallenged domination of the *Confédération Générale du Travail* (CGT), the largest French labor union confederation, representing 2 million workers.

The isolation of the Communist Party from the French political process was undoubtedly a major cause of instability in the post-war French Republic, until the rise of General de Gaulle.

In the 1965 presidential election, Francois Mitterand, with support from all anti-Gaullist elements including the Communists, won 10.6 million votes against the General's 12.6 million. In the general election of June 1968, however, both Communists and the Federation of the Left suffered a setback at the expense of the Gaullist party. The Communists now have 33 of the 487 seats in the National Assembly, compared with 72 previously. The Federation of the Left has 57 seats, compared with 118 in the previous Assembly. These two groups secured 20 per cent and 16.5 per cent of the first ballot votes, respectively; the Gaullists, 43.6 per cent.

The Federation of the Left, to which the French Socialist Party belongs, has been discussing with the Communists the establishment of a common program. These negotiations have led to limited but real progress. The Communist attitude to General de Gaulle remains ambiguous, because his anti-Americanism, his withdrawal of facilities for NATO on French soil, and his nationalistic, rather than supra-nationalist, attitude are all in line with the Communist Party's own, nationalistic, anti-American, pro-Russian stance.

An alliance before the General's retirement could give strength to the Communist Party which has lost about half its members and a large number of its militants since 1945. The PCF, whose membership includes many peasants and small proprietors, maintains its position less because of its own merits than because of the weakness of its rivals, the outdated attitudes of the French ruling elite which drive many workers towards its ranks, and, not least, the revolutionary traditions of 1789, 1848, and 1871 which it has successfully claimed as its own.

Germany: A New Party Organization

Germany, until Hitler's rise to power, had the largest Communist party in the world outside of Russia. In the immediate post-war years, it emerged as a significant force, especially in the Ruhr, and in the elections of 1949 won 1.36 million votes. The Ulbricht regime, however, almost completely destroyed Germany's faith in the Communist Party; and, when banned in 1956, the party organization had already been reduced almost to the status of a sect. On September 26, 1968, about thirty former party members announced, in Frankfurt, their plans to form a new Communist Party which would respect the constitution. Though legal once more, in view of the German people's post-war experience, the new Party is unlikely to become a serious political force.

Benelux: Small Membership

The Communist Parties of the Netherlands, Belgium, and Luxembourg are small and insignificant in comparison with their brother parties in France and Italy.

In the 1963 elections, the Netherlands Communist Party mustered 170,000 votes, 3 per cent of the ballots cast. In the 1967 elections, the Party won five Second Chamber seats (about 3.6 per cent of the vote) against the Labor Party's 37 seats and the rival left-wing Pacifist Socialist Party's four. Given the social, political, and religious attitudes of the Dutch people, this situation is not likely to change materially in the foreseeable future.

By comparison, the Belgian Communist Party, founded in 1921, is stronger and less sectarian. In the election of 1965, it won 237,000 votes, 5 per cent of the ballots cast, and returned six deputies against the Socialists' 64. In the general election of March 1968, however, Belgium's Communists won only five seats, 3.3 per cent of the ballots cast. The Belgian Communist Party has had trouble with left-wing critics in its ranks and is handicapped by the existence of a solidly-based Socialist party.

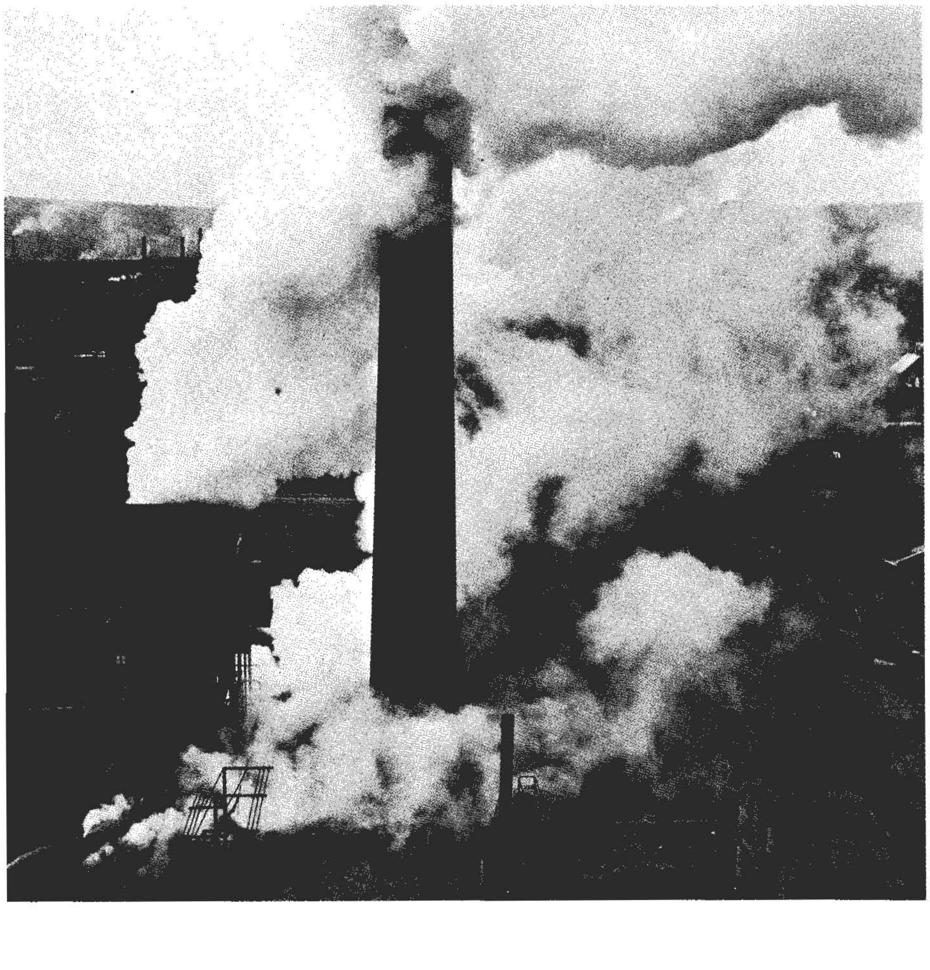
In Luxembourg, the Communists are particularly strong in the industrial south. In the 1964 election, the Communist Party, led by Dominic Urbani, returned five deputies, against 21 Socialists and 22 Christian Socialists. In the December 1968 election, the Communists picked up one more seat, giving them six seats in the 56-man legislature. Until recently, the Communist-controlled labor unions in Luxembourg were affiliated with the World Federation of Trade Unions (WFTU), with headquarters in Prague, but now belong to the International Confederation of Free Trade Unions (ICFTU).

Evolving Opinion in the Community

The original Communist attitude to the Community was one of uniform and relentless hostility. The Community was condemned as an alliance of monopolies seeking to resolve the capitalist crisis at the expense of workers, peasants, and small proprietors; an attack on the national sovereignty of the European peoples; an attempt to extend the economic basis of NATO and undermine the growth of the "socialist" Eastern bloc, and a part of a U.S.-inspired anti-Communist crusade. The assumption seemed implicit that the Community would fail to achieve its goals. These criticisms were genuine, to a point, and their main strategic line was determined by a Russian adaptation of Lord Carteret's famous dictum: "England is safe only as long as Europe is divided."

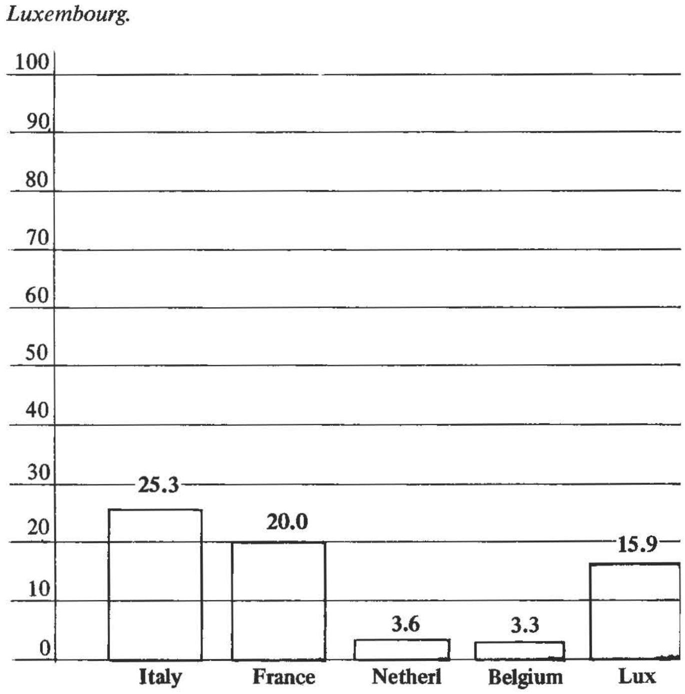
The evident permanence of the Community and its impact on economic growth and prosperity, particularly in Italy, have forced the Communists to rethink their attitude during the Sixties. The Italian Communists, under pressure by the Socialist wing of their labor federation, CGIL, *(see European Community* No. 115, page 11), have been in conflict with both the WFTU and the French Communist Party on this question. On an Italian initiative, the French and Italian Communist labor organizations have opened a joint CGIL-CGT lobby in Brussels for liaison with Community organizations. Both French and Italian parties are seeking full representation in Community organizations including representation in the European Parliament. So far, the main pressure has come from the Italians rather than the French Communists. Significantly, when Prime Minister Giovanni Leone took office in July, he announced that his Government had no objections to Communists' forming part of the Italian delegation to the European Parliament.

Communist Party strength lies in the industrial regions of the Community.



COMMUNIST PARTIES' STRENGTH

Percentage of votes for lower legislative house in latest general election: 1968 in Italy, France, and Belgium; 1967, the Netherlands, and 1968, Luxembourg.



Last month, after the formation of a new Government headed by Pietro Nenni, the Italian House and Senate appointed seven Communists to their 36-member delegation to the 142-member European Parliament so that it would reflect all the political views of Italians. Now the Parliament will have to decide on seating arrangements, as the Communists are not numerous enough to be an official parliamentary "group," which under current parliamentary rules must consist of no less than 12 members. The parliamentary rule was modified once before, in 1963, when the requirement was lowered from 17 to accommodate the Gaullists who had become isolated from the Liberal Group over the admittance of Britain to the Community and who wished to form their own group.

On nationalistic and pro-Russian grounds, the Communists have in the past impeded progress toward a united Europe. The ever-increasing gap between their formal revolutionism and their essentially social-democratic practice, the erosion of Moscow's direct control, and the steady decline in party membership from the post-war peak have all contributed to a widespread malaise in the parties themselves, Britain's entry into the Community, by bringing a mass, unified labor movement onto the European scene, would significantly shift the balance of working-class forces.

In that case, pressures might become great on Communist organizations to relate their words to their actions—to become authentic rather than alien representatives of working-class forces. Soviet-inspired divisions have undoubtedly been a major cause of political instability in post-war Europe and bear great responsibility for the limited successes gained in achieving working-class and Socialist demands. British entry could help to remedy this situation.

COMMUNITY NEWS

COMMON MARKET COMMISSION PROPOSES TAX REFORMS TO AID CROSS-FRONTIER MERGERS

The Common Market has taken its first steps towards a common tax system that would help companies in Europe to combine across frontiers.

The European Communities Commission on January 15 adopted and submitted to the Council of Ministers two draft proposals on the taxation of international mergers and international holdings. The proposals provided for common tax systems to be applied in all member states and removal of fiscal obstacles to mergers created by current tax requirements. Companies in the Common Market would thus be given a chance, through growth and modernization, to adjust to the large internal market of the Six and to meet international competition both within and outside the area.

The Commission made it clear that after any amalgamation, whether by merger or acquisition of holdings, there must still be no violation of the Community's antitrust rules, i.e., effective competition, freedom of operations and choice of suppliers, buyers, and consumers in the relevant markets must be maintained.

Taxation of International Mergers

Current tax regulations can be a major obstacle to mergers of companies from different member states. At the time of a merger there is often disclosure of untaxed capital gains (difference between the real value and the book value) in the assets of the company taken over which can result in substantial tax liabilities. Under present rules, national mergers are given preferential tax treatment in such a situation, while takeovers by foreign companies aren't. (Companies merging with a foreign company are regarded as liquidated and the tax is levied in the normal way. This may make the merger too costly.)

The Commission has proposed that the problem be solved by a general tax deferment, by which the payment of a tax on capital gains would be postponed until the company that takes over actually realized the gains by converting them into cash. Consequently, no tax would have to be paid on capital gains at the time of the merger.

A similarly favorable solution was proposed for tax-exempt general or special reserves built up by the acquired company. These reserves would remain tax-free as long as they continued to be justified by business needs.

Double Taxation

The Commission has also examined taxation of companies with foreign affiliates since in a merger a company being taken over usually survives an affiliate of the absorbing company and continues to be taxed by the country where it is located. The Commission found that the tax situation between the country of the parent company and that of its affiliate remained unsatisfactory despite bilateral double taxation agreements. The Commission stated that special care had to be taken to avoid any double taxation of the profits of foreign affiliates. It proposed that member states give affiliates of foreign companies as favorable tax treatment as that granted domestic companies engaged in the same activity.

The Commission also proposed that for the time being the "territorial principle" be maintained, i.e., the principle of tax exemption in the country of domicile and taxation exclusively in the country of the foreign affiliate. For the longer term, the Commission would prefer to see taxation in the country where the company has its registered office, which would be more in line with the needs of the Economic Community. However, corporation tax rates would then have to be brought closer together to avoid firms' locating their operations in a country merely because of lower tax rates.

"World Profits" System of Taxation

As a step toward the long-term goal, the Commission thought that all member states should allow companies to opt for a "world profits" system of taxation. Under such a system, all profits of a company, including the profits of foreign affiliates, would be taxed in its country of domicile. However, double taxation arising because profits of foreign affiliates have already been taxed abroad would be avoided by cutting tax to a corresponding extent in the domicile country. The system would offer companies the additional advantage of being able to deduct any losses of foreign affiliates from their taxable profits.

This world profits system would cover all those affiliates of the same parent company operating in the Common Market and would apply for a minimum of five years. If requested, it could also be applied to affiliates outside the Common Market, providing that this application were permissible under double taxation agreements. In this case, the companies would be given an opportunity to limit the system's application to one or more states, thus providing an incentive for Common Market companies to invest outside the Community and particularly in the associated states and developing countries.

The Commission said that later it would submit more detailed proposals for the operation of the system.

Taxation of International Holdings

The acquisition of holdings, unlike mergers, is already standard international practice. Problems still exist, however, which relate to taxation of current profits rather than to the acquisition of holdings as such. Since double taxation often occurs at this point, the Commission proposed that profits distributed by a subsidiary and taxed before distribution should normally be exempted from taxation at the parent-company level. The member states would, except in special cases, refrain from levying a withholding tax on profits so distributed. The withholding tax, currently effective in almost all member states, often leads to double taxation of profits redistributed by the parent company if these profits are again subject to withholding tax.

"Consolidated Profits" Proposed

The Commission also proposed longer-term plans enabling firms to opt for a system of "consolidated profits" when a parent company has major holdings in other companies. Under this system, the profits of the subsidiaries would be taken over by the parent company and included in its profit calculations. Double taxation arising because the subsidiaries' profits have already been taxed would be avoided by a corresponding reduction in the tax burden borne by the parent company. The system would give the parent company an opportunity to deduct any losses suffered by its subsidiaries from its own taxable profits, thus it appeared to be a suitable means of easing industrial mergers through acquisition of major holdings. It would be the logical counterpart, in respect to foreign subsidiaries, of the world profits system proposed for affiliates.

FRONTIERS TO VANISH FOR COMMON MARKET FARMERS

Italians will be free to grow grapes for wine in France and Dutch dairy farmers will be able to keep cows in Germany when the European Communities Council of Ministers approves two new proposals by the Commission.

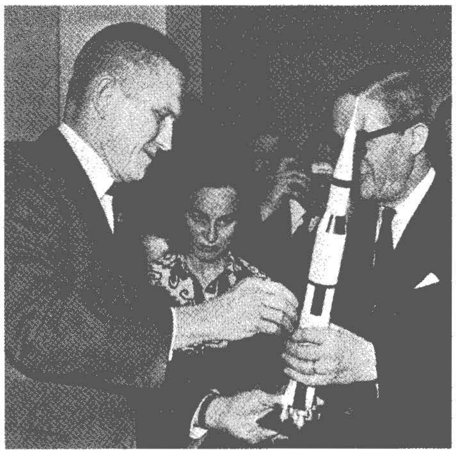
The proposals, sent to the Council on February 6, guarantee freedom of establishment for all self-employed persons in agriculture. One covers agriculture proper and the second deals with agricultural services.

The first proposal would enable Common Market farmers, whatever their nationality, to settle and farm in any member country of the Six they choose. Nationality would be no bar to the frontier-crossing farmer who still would enjoy the same rights and privileges as all other farmers, including access to cooperatives, credit facilities, and other aids. The directive would apply to all farming activities: general farming; vine and fruit growing; seed production; truck farming; flower and plant growing; raising livestock, poultry, fur-bearing animals, and bees; and the production of milk, wool, hides, furs, eggs, and honey.

The other proposal would give freedom of establishment to agricultural technicians who perform services, such as weed and pest control, and to persons who rent out farm machinery. Persons benefiting from the free establishment of agricultural services would also enjoy equal access to credit, grants, and subsidies and tax benefits.

Veterinarians and specialists on the staffs of animal hospitals are excluded from this directive. The removal of restrictions on freedom of establishment on these occupations and the simultaneous recognition of degrees or diplomas will be dealt with in future proposals by the Commission.

U.S. ASTRONAUT WELCOMED



Colonel Borman (left) presents Jean Rey with a replica of the Atlas rocket.

Colonel Frank Borman was received in Brussels on February 7 by Jean Rey, President of the European Communities Commission, and his colleagues. President Rey expressed the Commission's admiration for the exploits and courage of Colonel Borman and the other American astronauts.

President Rey received a model of the Saturn 5 rocket from Colonel Borman and presented him with an historical atlas of Europe.

After the reception, Colonel Borman participated in a round-table discussion moderated by Commission Vice President Fritz Hellwig on progress in space research in the United States. Mr. Hellwig has primary responsibility in the Commission for research and technology.

COMMISSION BACKS FIAT-CITROEN ACCORD

The European Communities Commission strongly favors mergers and cooperation agreements between firms in different Community countries, such as the one recently proposed between the Fiat and Citroën car companies.

Answering a written parliamentary question from Astrid Lulling (Luxembourg Socialist) and Adriaan Oele (Dutch Socialist) about the Fiat-Citroën accord, the Commission stated that concentration within national frontiers would only imperfectly meet the need to strengthen the structure of industry in the Six. It was likely to tempt firms which dominate at the national level to seek government support instead of improving their management and planning.

Although the situation varies from sector to sector, the Commission indicated that the arguments in favor of inter-European mergers contained in the draft Second Medium-term Economic Policy Program applied to the automotive industry, as long as the agreements followed the Community's competition rules. Although the Fiat-Citroën accord has not been referred to it, the Commission is gathering information on the details of the agreement to see if it conforms with the Treaty.

The Commission suggested that state intervention, such as occurred in the Fiat-Citroën affair (see *European Community* No. 118, page 21) and in *Compagnie Française des Pétroles'* bid to acquire a 30 per cent holding in the German energy concern *Gelsenberg,* may sometimes be motivated by a government's concern over preventing unemployment and maintaining balanced regional development. Nonetheless, the action of the authorities in these two cases was, in the Commission's view, likely to deter companies in different member states from seeking to cooperate in the future.

Answering another question, from German Socialist Hans Apel, the Commission affirmed that under the Rome Treaty governments are not legally entitled to block company decisions involving the right of establishment and the free movement of capital. Although there was no government ban in the Fiat-Citroën affair, the Commission noted that governments could informally influence company decisions and that such attempts would be likely to have "negative effects" in discouraging the creation of transnational companies.

COMMISSION BRINGS SUIT IN COURT AGAINST FRANCE

The European Communities Commission has asked the Communities Court of Justice to rule on France's failure to keep its agreement on export credit rates.

On July 23, 1968, the Commission authorized France to grant French exporters a preferential rediscount rate until January 31, 1969, on commercial claims arising from sales outside the Community. This authorization was one of several temporary safeguards intended to relieve French balance-of-payments difficulties following the nation-wide strikes of May and June. However, the Commission had stipulated that between November 1, 1968, and January 31, 1969, the preference rate should not be more than 1.5 points below the Bank rate.

In the petition filed with the Court of Justice in Luxembourg on January 31, 1969, the Commission noted that France during that period had maintained a spread greater than 1.5 points. Between November 1 and November 12, when the Bank rate was 5 per cent, the French rediscount rate was 2 per cent, a spread of three points. When the Bank rate rose to 6 per cent on November 12, no change was made in the preferential rediscount rate, so that the spread increased to 4 points. On January 1, 1969, the preferential rediscount rate was raised to 3 per cent, while the Bank rate remained 6 per cent, reducing the spread to 3 points, still 1.5 points higher than the limit set by the Commission in July.

On December 20, 1968, the Commission sent France the necessary "reasoned opinion," calling upon France to comply within 21 days. Finding, at the end of this period, that France was still failing to fulfill its Community obligations, the Commission agreed at its meeting on January 25, 1969, to refer the matter to the Court of Justice of the European Communities.

EIB MAKES FIRST LOAN IN THE NETHERLANDS

The European Investment Bank has made its first loan in the Netherlands, for the construction of three chlorine plants in Delfzijl, named a "development center" by the Dutch Government.

The borrowers *N.V. Koninklijke Nederlandsche Zoutindustrie* (KNZ) is a major Dutch chemical company and one of the leading producers of salt in Europe. The new plants will increase the company's output of chlorine and provide 200 new jobs. The project, scheduled for completion by early 1970, will cost $26.5 million. The EIB is lending $10 million, for 10 years at an annual interest rate of 6.5 per cent.

Other loans announced during the month were the following:

– *Gabon:* a loan of $506,000 at 6.5 per cent annual interest for 10 years. The *Société Meunière et Avicole du Gabon* will use thee proceeds of the loan to build a flour mill and a poultry farm at a total cost of $1.44 million. The project is part of the Gabon Government's diversification plan.

– *France:* a loan of $16.2 at 6.875 per cent annual interest for 20 years. The *Société Nationale des Gaz du Sud-Ouest* a public gas company, will use the proceeds of the loan to improve marketing and transportation of natural gas. This project, to be executed at a cost of $46.6 million, is part of the first stage of a ten-year program to extend the natural gas supply network in Southwest France.

– *France:* a loan of $18.2 million at 6.5 per cent annual interest for 12 years. *Electricité de France* will use the proceeds of the loan to build a new steam power plant in the Loire Atlantic area at Cordemais. The plant, to be built at a total cost of $100.7 million, will enter service by the end of 1970.

– *Turkey:* a loan of $7.6 million for the construction of a power transmission line, intermediary stations, and relays from Gokcekaya via Seyitomer to Izmir. The borrower, *Etibank* is controlled by the Turkish Ministry of Energy and Natural Resources.

The loan is being made under the financial clause in the Community's association agreement with Turkey which specifies that loans for infrastructure be made for a maximum term of 30 years at 3 per cent annual interest.

EUROPEANS EXPECT PRICE AND TAX HIKES IN 1969

Public officials and governmental spokesmen have had their say, safely couched in well-qualified terms, about the outlook for 1969. But how does the European public feel about the year ahead? Opinion polls taken by Gallup International last December in six European countries show a general pessimism, except in Germany where the man-in-the-street appears to have the most optimistic outlook.

While the Germans, along with the Dutch and Swiss, feel that 1969 will be prosperous, the British and French are pessimistic about economic and employment trends. The Swedes take a mixed view. However, the public in all six countries seem equally sure that both prices and taxes would rise in 1969; and the majority, in all but France, felt that the year in international affairs would be marked by numerous conflicts rather than peace.

The replies received were analyzed as follows:

	Britain	*Germany*	*France*	*Netherl.*	*Sweden*	*Switzerland*
Economic outlook						
Prosperous	11	58	12	57	37	53
Difficult	71	15	71	23	38	32
Don't know	18	27	17	19	25	15
Jobs						
Full employment	13	69	15	48	30	70
Unemployment	62	10	71	26	40	22
Don't know	25	22	14	26	30	8
Prices						
Rising	86	68	88	95	78	74
Falling	3	9	3	0	4	13
Don't know	11	23	9	5	18	13
Taxes						
Higher	73	67	83	79	72	73
Lower	6	4	4	3	2	10
Don't know	21	29	13	17	26	17
International affairs						
Many conflicts	47	47	26	60	56	55
Year of peace	24	15	45	19	33	34
Don't know	29	28	29	21	11	11

LABOR UNIONS APPEAL FOR COMMON POLICIES

Europe can have no future without common policies, warned the Executive Committee of the European Trade Union Secretariat after examining Europe's recent monetary problems and the crisis in the European Atomic Energy Community.

In a statement issued last month, the Executive Committee stated that events in the Community had confirmed fears repeatedly expressed by labor that the European customs union was not likely to survive without a common monetary policy. Monetary difficulties were being handled by purely national measures which did not enhance Common Market unity and which, in some countries, were openly deflationary.

The Committee supported the appeal of the International Confederation of Free Trade Unions for the immediate convening of an international monetary conference and called for an open discussion at Community level of the monetary question. It stated that the delicate nature of the subject was no excuse for taking decisions in secret that affected the entire community.

The Executive Committee, which represents unions in the Community affiliated with the International Confederation of Free Trade Unions, also expressed its concern over the future of Euratom and pledged the support of the free labor union movement for Euratom's research workers and staff.

EIGHT FARM IMPROVEMENT PROJECTS APPROVED

Eight projects to improve farming in the European Community have been allocated the sum of $3,425,877 from the European Agricultural Guidance and Guarantee Fund.

When the Commission made this announcement on February 6, it also said it would reach decisions in the first half of 1969 on the use of the EAGGF's remaining 1968 funds.

The eight projects are part of a series of 161 projects for which the Commission reserved $34,114,667 last December. Including credits from 1968, the European Agricultural Guidance and Guarantee Fund now amounts to $37,540,544.

POHER STEPS DOWN

Alain Poher has retired from the presidency of the European Parliament after a record three-year term of office. The assembly will elect his successor at the beginning of its next session, in March.

In his farewell speech in Strasbourg on January 24, Mr. Poher stressed the role that Parliament, in exercising its duties as the Community's democratic voice, had played in furthering European integration. He hoped public opinion would continue to campaign for political unity.

Mr. Poher, who was elected President of the French Senate last year, was the sixth president of the Strasbourg assembly. His predecessors were Robert Schuman (March 1958 - March 1960), Hans Furler (March 1960 - March 1962), Gaetano Martino (March 1962 - March 1964), Jean Duvieusart (March 1964 - September 1965), and Victor Leemans (September 1965 - March 1966).

REFORESTATION URGED

Leaders of the Community's paper-manufacturing industries have called on Commission Vice President Sicco Mansholt and Commission member Guido Colonna di Paliano in Brussels to urge a dynamic reforestation policy. They warned that the industry could face increasing difficulties in importing its raw materials. Trees could be planted on land where farming had been abandoned, they suggested.

7000 PUPILS ATTEND THE SIX EUROPEAN SCHOOLS

This year there are 7,062 pupils at the six European Schools, an increase of 430 over the previous scholastic year.

The school at Brussels, with 2,281 pupils, has the largest enrollment. The Luxembourg European School has 1,527; Varese 1,495; Mol-Geel 984; Karlsruhe 467; and Bergen 308.

These schools were founded by the Community to educate the children of Community employees. They award a diploma that entitles graduates to attend any university in any of the European Community countries, as well as Austria, and some British, Swiss, and American universities.

BANKS TO TAKE EUROCHECKS

Banks in 15 European countries, including Britain, the Six, and Scandinavia, have agreed to introduce a "Eurocheck" system. Instead of having to change currency or cash traveler's checks, tourists will be able to draw up to $200 a week at any of the participating banks' branches on presentation of their usual check book and a recognized credit card.

BIAS IN FRENCH TV ADS QUESTIONED BY MP

"Does the French broadcasting authority, ORTF, discriminate against foreign goods in television advertising?" Astrid Lulling, Luxembourg Socialist member of the European Parliament, asked the European Communities Commission.

The Commission replied that it has asked the French Government for further information so that it could give Miss Lulling a full reply. On October 1, 1968, French television began to accept brand advertising. However, Miss Lulling fears that the rigorous selection process used to select advertisers could lead to infringement of the Rome Treaty through exclusion of non-French firms.

PLAN APPROVED FOR NORDIC ECONOMIC UNION

Sweden, Norway, Denmark, and Finland in January simultaneously published a plan for the economic union of their countries. The plan includes:

– a common external tariff of 85 per cent on all imported commodities, except chemicals, clothing, footwear, glass, household appliances, and motorcars

– a preference system for Nordic agricultural and fish produce sold within the economic union, in order to encourage the Four to buy agricultural products from each other with the eventual aim of a common agricultural and fish market

– formation of a common finance institute, comprising an investment bank, a development fund, and a fishing fund

– abolition, in stages, of restrictions on the movement of capital between the Four, but in accordance with obligations within the Organization of Economic Cooperation and Development

– agreement on industrial legislation in the realm, for example, of company, patent, and bankruptcy law.

The plan now has to be approved by the four governments and by the Nordic Council, which is made up of representatives from all political parties in the four countries and Iceland.

ITALY'S EXPORT TAX ON ART WORKS RULED ILLEGAL

The Court of Justice of the European Community has ruled that Italy's tax on exports of works of art to other Community member states infringes the Rome Treaty.

The export tax was one of several measures imposed by the Italian Government to help keep its art treasures within its own borders. In January 1960, the Commission called on the Italian Government to abolish the tax but was obliged to take the case to the Court.

PUBLICATIONS AVAILABLE

QUESTIONS AND ANSWERS: THE EUROPEAN COMMON MARKET, THE EUROPEAN COMMUNITIES. Manhattan Publishing Company, New York, 1968, 79 pages ....free

This booklet contains a 55-page section of questions and answers with a table of contents. The second section contains a factual account of the Community's achievements. Also includes a bibliography and list of additional sources of information.

RESUME DE LA DECLARATION DE M. S. L. MANSHOLT, VICE-PRESIDENT DE LA COMMISSION DES COMMUNAUTES EUROPEENNES, LE 10 DECEMBRE 1968. Commission of the European Communities, Brussels, 27 pages (mimeographed) ....free

In this speech, Vice President Mansholt introduced the Commission's plan for agricultural reform to the Council of Ministers of the European Communities.

EXTERNAL TRADE OF THE EEC DURING THE FIRST TEN YEARS OF THE COMMON MARKET (1958-1967). *Information Memo* P-4, Commission of the European Communities, Brussels, January 1969, 19 pages (mimeographed) ....free

Analysis of the Community's trade with the world, major regions, and principal trading nations.

SECOND EUROPEAN DEVELOPMENT FUND, SITUATION AT JANUARY 1, 1969. *Information Memo* P-1, Commission of the European Communities, Brussels, January 1969, 13 pages (mimeographed) ....free

1968 IN RETROSPECT. *Information Memo* P-64, Commission of the European Communities, Brussels, December 1968, 30 pages (mimeographed) ....free

BASES TECHNIQUES ET PERSPECTIVES SOCIALES DE LA READAPTATION. *Collection de Traumatologie et Readaptation* No. 1, High Authority of the ECSC, Luxembourg, 1967, 233 pages $5.00

Proceedings of a symposium concerning the social and psychological effects of the readaptation of Community workers. The research was supported by the High Authority.

STEEL IN THE CHEMICAL INDUSTRY. Phraseological Glossary. Terminological Bureau of the Commission of the European Communities, Luxembourg, 1968, 487 pages $4.00

French, German Dutch, Italian, and English glossaries of technical terms used to describe the behavior of steels under extreme chemical and physical stress.

THE ECONOMIC SITUATION IN THE COMMUNITY No. 3/4, 1968. Commission of the European Communities, Directorate General for Economic and Financial Affairs, Brussels, December 1968, 131 pages $2.50

Report on the European Community's economy in 1968 and the outlook for 1969.

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