

RESEARCH ON THE “COST OF NON-EUROPE”

BASIC FINDINGS

VOLUME 9

1991/92



THE “COST OF NON-EUROPE”
IN FINANCIAL SERVICES

Document

COMMISSION OF THE EUROPEAN COMMUNITIES

This publication was prepared outside the Commission of the European Communities. The opinions expressed in it are those of the author alone; in no circumstances should they be taken as an authoritative statement of the views of the Commission.

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by

Price Waterhouse

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The "Cost of Non-Europe"
in Financial Services

Price Waterhouse

Price Waterhouse International Economic Consultants

THE COST OF 'NON-EUROPE' IN FINANCIAL SERVICES

Executive Summary



Price Waterhouse





CONTENTS

	PAGE NO.
SECTION 1: INTRODUCTION	1 - 2
SECTION 2: METHODOLOGICAL ISSUES	3 - 4
SECTION 3: MACROECONOMIC AND SECTORAL ANALYSIS	5 - 7
SECTION 4: ANALYSIS OF THE STRUCTURE OF FINANCIAL SERVICES MARKETS	8 - 9
SECTION 5: QUANTIFICATION OF THE EFFECTS OF REGULATIONS	10 - 18
SECTION 6: ESTIMATING THE GAINS FROM EUROPEAN ECONOMIC INTEGRATION	19 - 27

SECTION 1: INTRODUCTION

1.1 This report was prepared by Price Waterhouse and represents the results of an economic study of the costs of "Non Europe" in financial services. The study's geographical coverage was as follows:

Federal Republic of Germany, France, Italy, the United Kingdom, the Benelux countries and Spain.

1.2 The principal objectives of this study were to:

- . assess the importance of financial services to the Community economy;
- . analyse the present organisation of the market for financial services;
- . evaluate the economic impact of completing the internal market in financial services.

1.3 For clarity and ease of reference, the organisation of the main report is described below and a brief outline of each section is given in this executive summary.

- . In Section 2 a review of methodological issues is presented.
- . This is followed in Section 3 by a macroeconomic and sectoral analysis with the object of evaluating the importance of financial services to eight economies of the Community under review.
- . In Section 4 an overview of the present structure of the financial services market is set out. The focus of this section is on regulatory barriers which have the potential to affect the establishment of financial service institutions in overseas markets or the potential to affect cross border trade directly.
- . In Section 5 an analysis of the scope for quantitative assessment of the effects of completing the internal market is considered.
- . Finally, in Section 6, the estimation of the economic impact of integration is presented. Detailed analyses relating to a number of important areas of the study have been included as appendices to the main report.

1.4 In view of the complex and sensitive nature of the information and analysis in this report it is important that disclosure of specific parts of the study are not made out of context.

- 1.5 It should be appreciated that certain key assumptions were made in the conduct of our field work and in the preparation of this report. These include, inter alia, the assumption that the central aim of the Commission is to create a framework for a free and competitive internal market in financial services whilst at the same time ensuring adequate standards of consumer protection. The intention is that this will be achieved through a legislative programme which is aimed at stimulating cross-border trade and encouraging investment and establishment in foreign territories.
- 1.6 It is also envisaged that the economic climate thus created will lead to an intensified interest in Pan-European acquisition and merger opportunities and that this will need to be supported by an appropriate regime of freedom for capital movements. Our analysis considers the likely economic consequences for the Community of this scenario.
- 1.7 An evaluation of the likelihood of progress towards an integrated financial services market or the likely responses from national governments to opening up of the financial markets is outside of the scope of the study. Similarly, an evaluation of the likely response of producers in different countries to the assumed integrated market is outside the scope of this economic study.
- 1.8 It should also be recognised that in the achievement of the economic goals, summarised above, any significant changes in the pattern of market concentration may need to be kept under review in the early stages leading up to the following liberalisation in order to alleviate market distortion effects which undermine the aims of the 1992 initiative. This will have a wide range of implications for Commission competition policy, for example in the approach adopted towards multi-national industry groupings and the balance of investment opportunities between Community and external providers of financial services.
- 1.9 We would like to thank the Steering Committee for advice provided to the consultancy team during the course of the study and for input made by external advisors. We would also like to thank all individuals and institutions who provided information, during this study.

SECTION 2: METHODOLOGICAL ISSUES

2.1 The purpose of this section is to resolve three methodological problems:

- ° to provide a comprehensive operational definition of financial services.
- ° to identify producers and users of financial services.
- ° to clarify the link between liberalising the market for financial services and liberalising capital movements.

2.2 Definition of Financial Services

It was agreed with the Commission at the outset that financial services should be defined to include the provision of a financial service or the sale of a financial product or both and that the following activities should be included in the definition.

- ° international, commercial and private banking
- ° corporate financial services
- ° offshore banking and money market activities
- ° broking
- ° funds management
- ° assurance, insurance, and reinsurance
- ° consumer credit
- ° building societies
- ° stock exchange services.

A description of the financial products and services covered by each of these activities is outlined in the main report. The activities can be grouped under three headings:

- ° banking and credit services
- ° insurance services
- ° brokerage and securities services

These categories have been used, as far as possible, throughout the study, and particularly in the macroeconomic and sectoral analysis and in the analysis of the market. In the examination of the scope for a quantitative assessment of the effects of completing the internal market, representative services have been selected from each of the above groups of activities.

2.3 Identification of Producers and Users

It was necessary from a methodological viewpoint to decide how to treat the identification of producers and users in the sectoral analysis. It was also clear that, in identifying producers and users of financial services, segmental differences between countries would need to be recognised. In addition it was decided that only primary users could be identified.

This methodological decision implied the need for sectoral analysis to be undertaken on a country-by-country basis. It also highlighted the need to attempt to identify differences in the type and range of services offered by different institutions in different member countries. This issue is considered at some length under the section on macroeconomic and sectoral analysis in the main report. It should also be appreciated that in the analysis of the economic impact of integration in Section 6, consumers are defined as including all consumers including private, commercial and institutional groups.

2.4 The Link Between Trade in Financial Services and Capital Movements

An important methodological issue examined related to the link between trade in financial services and exchange controls. In view of its importance and complexity we consider this issue in detail in Appendix 3 of the main report. The main question addressed is the extent to which freedom of trade or overseas establishment can yield consumer benefits despite the persistence of controls on capital movements. The Commission's objective is a regime of freedom of capital movements as well as freedom to establish and trade, with home country prudential regulation being recognised in the first place. However it is important to assess also the consequences of a partial or intermediate stage in the achievement of this objective.

Our analysis indicates that maintenance of strict exchange controls may well inhibit the full consumer benefits from freedom of trade and freedom of establishment. This is principally because financial institutions will not be able to take full advantage of the economies of a wider market. Although an attempt to maintain a regime of strict regulation may well run into difficulties under a system of home country control, it is not certain that these regulations will create competitive disadvantages for home financial institutions. Market segmentation rather than global loss of competitiveness may often be the consequence.

Under host country regulations, the result of freedom of establishment may be very little improvement where uncompetitive market structures exist or may result. In contrast, the prospect for welfare gains from a liberalisation of exchange controls does not seem to depend so heavily on freedom of establishment, at least for financial services of a wholesale type.

At present the persistence of exchange controls prevents the free flow of capital from moving to the countries with the highest rates of return. Even if there were no differences between the efficiency of the financial services in various member states, the removal of exchange controls could therefore be expected to have beneficial effects.

SECTION 3: MACROECONOMIC AND SECTORAL ANALYSIS

3.1 In this section aggregate data is presented for each of the countries in the study to indicate the relative economic importance of the financial services sector. Data will be found covering:

- . employment;
- . value added;
- . output;

In the main report we also present information on the demand for financial services by households, companies and government. In addition data is presented on external transactions in financial services and on the profitability of the banking and insurance sectors.

3.2 Employment in Financial Services

Total Employment

Table 3.1 shows that employment in the banking, finance and insurance sectors in the countries studied exceeded 3.1 million in 1985. Banking and finance employed in excess of 1.7 million; and there were more than 700,000 employed in insurance (Note 1). Banking, finance and insurance represented 3.5 per cent of total employees in the eight countries in 1985. Individually, most countries were close to this average except Luxembourg at 7.7 per cent and Italy at 2.5 per cent.

**Table 3.1: Employment in Banking and Insurance by Country
1985 (See Note 2)**

Country	Banking and Finance	Employment ('000)		Total as % of Total Employees
		Insurance	Total	
B	89	30.0	119	3.9
D	604	230	834	3.7
ES	n.a.	n.a.	292	3.9
F	448	154	602	3.4
I	n.a.	n.a.	379	2.5
L	9.9	0.9	11	7.7
NL	111	42	153	3.5
UK	527	245	<u>772</u>	<u>3.6</u>
TOTAL			3,162	3.5

Source: Statistical Office of the European Commission (S.O.E.C.)

- Notes:**
- (1) These figures exclude Italy and Spain for which there is no breakdown between employment in insurance and banking.
 - (2) These data exclude agents not acting as principals in the financial sector.

3.3 Value Added

In the subsequent economic analysis, value added represents the sum of compensation of employees and profits accruing to the resources employed. It is an important indication of the economic significance of financial services. The table below shows value added for credit and insurance.

In the National Accounts data, transactions are classified by branch and by sector. Branches consist of units of homogeneous production engaged in the production of a single product or group of products and sectors are based on the institutional arrangements in force. The sectoral data shows a breakdown between credit and insurance and is broadly comparable with the employment data. Data on value added by both branch and sector are shown in the table below. The data on value added is provisional and may be subject to revisions.

In 1985, value added at market prices in credit and insurance on the basis of branch data represented 6.7 per cent of GDP. The countries with the highest contribution were Luxembourg (14.0%) and the UK (12.6%). The lowest percentages were in France Netherlands and Germany.

Table 3.2: Value Added in Credit and Insurance in 1983 & 1985

Country	1985 ECUm (Branch)	% GDP	1983 ECUm (Branch)	% GDP	1983 (ECUm) (Sector)	% GDP
B	5,966	5.9	4,442	4.9	4,584	5.1
D	44,417	5.5	40,925	5.7	41,874	5.7
ES	13,929	6.1	8,889	5.1	9,131	5.1
F	29,277	4.5	22,156	3.9	28,462	4.9
I	26,998	5.6	24,051	6.0	25,027	6.3
L (Note 1)	535	14.0	535	14.0	535	14.0
NL	8,537	5.4	8,049	5.4	8,207	5.5
UK	<u>70,240</u>	<u>12.6</u>	<u>53,896</u>	<u>11.2</u>	<u>30,004</u>	<u>5.9</u>
Total	199,899	6.7	162,943	6.2	147,824	5.6

(1) 1982 data

Source: S.O.E.C.

3.4 Output/Turnover in Financial Services

In this analysis a number of turnover measures are related to GDP as further indicators of the significance of financial services in each member state.

Table 3.3: Insurance Premiums, Bank Loans Outstanding and Stock Market Capitalisation as % of GDP

Country	Insurance Premiums 1984	Bank Loans 1984	Stock Market Capitalisation (Note 2)
B	3.9	142 (Note 1)	92
D	6.6	139	89
ES	2.5	99	69
F	4.3	93 (Note 1)	85
I	2.2	96	75
L	3.1	6,916	11,125
NL	6.1	130	165
UK	8.1	208	149

Source: S.O.E.C, Sigma, O.E.C.D., F.I.B.V

(1) 1982 data

(2) End 1986 data

Table 3.3 shows that relative to GDP the banking and securities markets were by far the largest in Luxembourg and that the insurance market relative to GDP was largest in the UK.

SECTION 4: ANALYSIS OF THE PRESENT STRUCTURE OF THE FINANCIAL SERVICES MARKETS

4.1 This section focuses on regulatory barriers and how they are implemented. In particular, attention is given to those barriers affecting the establishment of a financial service in a foreign state and affecting trade directly. In this section we use "foreign" to refer to other European Community countries as well as to countries outside the EC.

4.2 **Regulatory Barriers to Trade and Establishment in Banking**

In general there are no overt barriers to the establishment of foreign banks in the countries surveyed.

Foreign banks must in general comply with the same procedures as domestic banks. This does not imply that successful entry by a foreign bank is easy since the costs involved in meeting the requirements for establishment of branches and subsidiaries may be considerable. There is however control over the acquisition of domestic banks by foreign entities in all the countries in the study and some details of licensing requirements in each country are outlined in the main report.

In all countries except the UK, branches of banks are required to maintain their own minimum endowment capital. Some countries also impose solvency ratios. While it has not proved feasible to quantify the impact of differences in such ratios a study carried out by the Economists Advisory Group reflected a consensus in the banking world that lack of harmonisation in this area constituted a barrier to trade.

Moreover, there are often restrictions on the services which may be offered by a branch or subsidiary of a foreign bank.

The overall conclusion drawn in this section is that barriers lie not in overt rules or practices but in national practices that apply equally to all banks. Clearly differences in national practices may make some countries more attractive than others for foreign banks wishing to establish operations.

4.3 **Regulatory Barriers to Trade and Establishment in Securities**

Exchange controls may be a significant barrier in this market sector. Many of the operators in this market are banks and the points made earlier in relation to freedom of trade and establishment in banking apply equally.

The major obstacle to establishing a presence in a foreign securities market would appear to be regulations which prevent foreigners being licensed as brokers. However, this may not be a significant drawback if securities may be dealt directly between banks. Some difficulties may be encountered for companies which wish to offer only security trading, in markets such as Germany and Belgium, where full banking licenses can only be obtained if a full range of services is offered. There are some signs of an easing in this position though. There are also restrictions on the establishment of offices to solicit secondary market business and on dealing directly with the public to execute such business. In addition to exchange controls there are some restrictions on the balance sheet holdings of foreign securities. In addition, in a small number of countries discriminatory taxes are levied on purchases of foreign securities.

4.4 **Regulatory Barriers to Trade and Establishment in Insurance**

The position in insurance is similar to that in banking. In general there is freedom to establish but restriction on trade without establishment.

Generally a permanent presence is required in the importing country in order to sell insurance. This position may change following a recent case brought to the Court of Justice by the Commission. Compulsory insurances are exempt from the ruling but member states may insist that insurers have a permanent presence. Some of the eight countries again have discriminatory tax measures against foreign insurers.

4.5 **Exchange Control Restrictions on Trade in Financial Services**

Free movement of capital is allowed in Germany, the Netherlands, Belgium and Luxembourg, although there are reporting and authorising procedures in force for certain transactions. France and Italy are in the process of liberalising controls while they remain in Spain. Exchange controls have been removed in the UK. As we indicated earlier, exchange controls form an important barrier to trade in financial services where they continue to be applied.

SECTION 5. QUANTIFICATION OF THE EFFECTS OF REGULATIONS

5.1 Introduction and Review of Approaches

The object of this section is to determine the scope for a quantitative assessment of the effects of completing the internal market in financial services. In particular, the section provides quantitative measures of the effect of regulation, and of the lack of Community wide competition.

In the main report we present a quantification of the impact of regulation on the basis of a set of prices for selected financial services and products. We believe, however, that such an approach is on its own not sufficient and we have therefore obtained additional measures of the effects of regulation from other sources.

In attempting to quantify the effects of regulation we considered a wide range of approaches including the following:

- . Comparative prices of specific products/services;
- . Value added/output ratios;
- . Survey data on net margins;
- . Indirect measures of impact of specific regulations.
- . A case study of the impact of deregulation.

The rationale and the limitations of each of the above approaches are discussed below.

(1) Comparative Prices of Specific Products/Services

In reviewing comparative prices as a measure of the effect of regulation or market segmentation, there are both conceptual and technical difficulties to be resolved.

A conceptual difficulty with using price differences as a measure of the effect of regulation is indicated by the fact that there are significant price differences within national markets although suppliers in these markets are faced with the same regulations. It is, therefore, unlikely that the removal of regulatory barriers to trade would result in a single price. It is also important to realise that there are market as well as regulatory barriers to trade. An example of a market barrier is the information required to gain entry. We formed the opinion that price divergence within countries may well be due to information barriers as well as to legislative obstacles. *

In addition to this conceptual difficulty there are severe technical difficulties in measuring prices. Firstly, there is the question of comparability of products. For example the price of motor insurance for the same class of insurance etc may differ as a reflection of differences in the underlying risk. The issue of comparability of price data is particularly important and the difficulties in obtaining strictly comparable data are discussed in detail in the main report. A second problem arises due to the effect of cross subsidies between financial services products.

In our analysis, we have selected a range of products/services in such a way as to attempt to minimise these factors. There are also severe practical difficulties in obtaining price comparisons as relative prices can change rapidly and clearly given significant price variations within countries there is also a danger that price divergences between countries may reflect sampling errors.

(2) Value Added/Output Ratios

In considering value added to output ratios we have attempted to quantify the effect of market segmentation by measuring the resources used in producing a unit of output. In many service industries the ambiguity of the concept of output, and the difficulty of measuring it, has often led statisticians to turn to resource inputs themselves in order to overcome these difficulties. It should be appreciated that the measure of output used has to be conceptually independent of inputs.

There are also deficiencies in using value added/output ratios as an indication of efficiency and these are discussed in detail in the main report. These deficiencies are likely to be particularly severe in making comparisons between individual financial institutions. Aggregation over all institutions, and the use of time series for cross-country comparison will tend to reduce limitations in this respect. Notwithstanding the residual problems which have been recognised we believe this provides a useful aggregate check on the micro data.

(3) Survey Data on Net Margins

An alternative approach to examining prices is to look at differences in the costs or profits obtained by different financial institutions in the different countries. In particular, an examination of margins in the banking sector and of cost-to-output ratios in such sectors as insurance can be of use in evaluating the effect of regulations. This represents a micro cross-check on the value added to output ratios considered above.

(4) Indirect Measures of Impact of Specific Regulations

It was recognised at the outset of the study that the impact of selected specific regulations could also provide useful input into the quantification of the effect of regulation. This, however, would only measure static effects. In addition, it would only measure the impact on institutions who decided to "pay the cost" of meeting the regulations. Our judgement is that such an approach is very unlikely to prove worthwhile. For illustrative purposes we have however reported on the results of selective research on the impact of specific regulations in the banking and insurance sectors.

(5) Case Studies of Impact of Deregulation within a National Boundary

A potential approach to quantifying the effect of regulation is offered by individual case studies on the price impact of deregulation within a national boundary. This could be a useful additional source of input into the evaluation of the effects of removing or reducing regulations in Europe. We have, therefore, taken as a case study the example of deregulation of the UK securities business.

The remainder of this section sets out the quantified data for comparative prices, value added/output ratios, survey data on net margins, indirect measures of the impact of specific regulations, and the case study of impact of deregulation.

5.2 Quantification of Comparative Prices

In the following paragraphs we present a quantification of comparative prices for a range of financial services products in the eight countries. We present details of prices in the banking and credit sectors, in insurance, and in the securities and brokerage sectors. In particular, we analyse details of prices for the following services/products:

- . cost of commercial loans;
- . cost of consumer credit;
- . cost of mortgages;
- . cost of credit cards;
- . cost of purchasing foreign exchange drafts and travellers cheques;
- . cost of letters of credit;
- . cost of current bank accounts;
- . cost of term insurance;
- . cost of home and contents insurance;
- . cost of motor insurance;
- . cost of fire and theft insurance;
- . cost of public liability insurance;
- . and cost of stock exchange transactions.

Our selection of products was designed and agreed with the Commission to overcome some of the difficulties referred to earlier in Section 5.1.

Many of the prices have been obtained directly via a sample of financial providers. As we have already noted however, it is important to treat comparative price data with care. Prices of financial services change frequently and the data presented represents a "snap-shot" at a given point in time. Also of critical importance is that for a wide range of financial services there is a substantial variation in possible prices on offer, and in many cases there is cross-subsidisation between different financial services.

Another important issue relates to how representative the chosen products are, of the output of the financial services sector as a whole. This is a difficult issue to judge but given the large number of different services chosen which cover both private consumer and commercial services in the banking, insurance and securities sectors, these services are believed to be broadly representative. The services covered do not include advisory services. The reason for this is methodological in that it was not felt possible to obtain prices for standardised advisory services. The sources of the data presented are indicated.

It should be appreciated that we have attempted to present information in a standard manner for the same financial services products in different countries. In certain cases regulatory or market practices have prevented this and these cases are discussed in our main report. We have also attempted to standardise the presentation for different types of financial services products.

A key issue in interpreting the price data is that we have attempted to focus on the cost of the service provided by the financial institutional and have adjusted the figures to remove the influence of interest rate differentials. The impact of interest rate differentials is considered separately in Section 6. In the table overleaf we define the financial services and products for which prices were obtained. As many of the products represent the margin over wholesale money market rates the prices do not represent the cost to the consumer. This is consistent with our economic modelling requirements. The data would not be suitable as a definitive measure of consumer prices in different countries.

TABLE 5.1

"Standard" Service	Description of Service
Banking Services	
Commercial Loans	Annual cost to a medium size firm of a commercial loan of 250,000 ECUs. Measured as excess over inter-bank rates.
Consumer Credit	Annual cost of consumer loan of 500 ECUs. Excess interest rate over money market rates.
Credit Cards	Annual cost assuming 500 ECU debit. Excess interest rate over money market rates.
Mortgage	Annual cost of home loan of 25,000 ECU. Excess interest rate over money market rates.
Commercial Draft	Cost to a large commercial client of purchasing a commercial draft for 30,000 ECUs.
Travellers Cheques	Cost for a private consumer of purchasing 100 ECU's worth of Travellers Cheques.
Current Cheque Account	Annual cost assuming 200 cheques P.A., 20 standing orders, 50 cash withdrawals, 20 credits.
Letter of Credit	Cost of letter of credit of 50,000 ECUs for three months.
Insurance Services	
Term Insurance	Average annual cost of term insurance.
Home Insurance	Annual cost of fire and theft cover for house valued at 70,000 ECUs with 28,000 ECUs contents.
Motor Insurance	Annual cost of comprehensive insurance, 1.6 litre car, driver 10 years experience, maximum no claims bonus.
Commercial Fire and Theft	Annual cover for premises valued at 387,240 ECUs with stock and contents at 232,344 ECUs.
Public Liability Cover	Annual premium for Engineering company with 20 employees and annual turnover of 1.29 million ECUs. Includes employer liability cover.
Brokerage Services	
Private Equity Transactions	Commission costs of cash bargain of 1,440 ECUs.
Private Gilts Transactions	Commission costs of cash bargain of 14,000 ECUs.
Institutional Equity Transactions	Commission costs of cash bargain of 288,000 ECUs
Institutional Gilt Transactions	Commission costs of cash bargains of 7.2m ECUs.

Prices of a number of the financial services examined in the eight countries are presented below. Additional details are presented in the main report.

Table 5.2: Comparative "Prices" of Purchases of a Range of Financial Services in the Eight Countries

	B	D	ES	ECU F	I	L	NL	UK
<u>Banking Services</u>								
Commercial Loans	4,500	5,000	5,625	4,375	5,125	5,000	6,750	6,875
Consumer Credit	12	46	27	40	43	14	26	43
Credit Cards	94	84	66	37	99	46	75	61
Mortgages	480	575	800	653	350	499	343	290
Foreign Exchange								
Drafts	43	53	120	63	50	54	22	47
Travellers Cheques	7.3	5.0	7.0	7.5	6.6	5.0	7.2	5.0
Current Accounts	0	117	2	10	240	8	0	112
Letters of Credit	<u>575</u>	<u>425</u>	<u>750</u>	<u>438</u>	<u>515</u>	<u>600</u>	<u>550</u>	<u>510</u>
<u>Insurance Services</u>								
Term Insurance	380	225	294	285	392	355	195	150
House Insurance	118	144	135	195	253	220	164	266
Motor Insurance	494	436	758	413	942	671	354	316
Commercial Fire and Theft	1,296	2,023	1,765	3,587	4,896	1,204	1,412	1,797
Public Liability Cover	968	1,257	1,364	1,852	1,508	934	714	798
<u>Securities Services</u>								
Private Equity Transactions	14	11	17	9	10	11	22	23
Private Gilts Transactions	65	108	180	69	21	72	148	77
Institutional Equity Transactions	1,727	2,302	3,453	1,292	2,014	2,302	1,726	719
Institutional Gilt Transactions	21,583	5,395	8,993	8,844	10,791	3,597	4,640	n/a

Source: Survey Results

- 1) Consumer credit in Italy assumed to be equal to the average of Germany, France and UK
- 2) The London Gilt market is now on a net of commission basis
- 3) Mortgages in Luxembourg assumed to be equal to average in other Countries

Caution must be exercised in interpreting the above price comparisons, and the analysis in the report concerning cross subsidisation and the problems in price comparability must be noted. It is also important to stress as indicated earlier that many of the products represent the margin over wholesale money market rates and therefore the "prices" do not represent the cost to the consumer. This is consistent with our economic modelling requirements but the data would not be suitable as a measure of consumer prices. Prices are also exclusive of consumer taxes.

5.3 Value-Added to Output Ratios

The value-added to output ratios provided in the main report gave some indication of the resources used to produce a unit of output, since value-added represents the return to labour and capital before allowance for depreciation and excluding transfers. In the case of banking, the measure of output generally used is loans outstanding. This is not entirely satisfactory since it does not take account of a number of elements affecting the output of banks such as differences in risk attaching to loans, the extent of deposit and money transmission services, and a number of off-balance sheet transactions. The comparisons made using aggregate data across countries tend to reduce some of these difficulties but nevertheless problems remain. Taking insurance as an example the use of premiums as a measure of output masks the problem that for some policies the premium may cover more than one year and in others may partly represent a pure investment sum.

Insurance

Value-added in the insurance sector does not include interest and dividend earnings which, for national accounts purposes, are regarded as transfers. The value-added to premiums ratio in 1983 was highest in the UK at 25.5% and lowest in France at 6.0%. However, when net interest earnings are taken into account the UK percentage falls to 1.1% and that of France rises. Belgium's percentage was highest at 32.2% in this case. When dividend earnings are also added to the value-added figure Germany emerges with the lowest ratio and Belgium remains the highest.

Banking

In the banking sector the value-added to loans ratio (including interest earnings) was lowest in the UK and the Netherlands at 3.0% and highest in Italy at 6.3% on average over the period 1978-84.

5.4 Survey Data on Net Margins/Costs

This approach represents a micro cross-check on the value-added to output measures considered above. The data relating to 1982 shows that the gross earnings margin in large banks was highest in the UK at 4.72% of assets and lowest in the Netherlands at 2.9%.

A sample of the accounts of insurance companies in different countries was evaluated to establish the ratio of expenses to premiums. Non-life insurance management expenses and commissions were the largest percentage of premiums in Belgium at 39.6% and lowest in the UK at 21.2%.

In life insurance the percentage was highest in Spain and lowest in the UK though it was possible to identify life business separately in the published accounts for only three countries.

5.5 Indirect Measures of Specific Regulations

This section summarises the main findings of studies carried out by EAG (1) on "the impact of prudential regulations on banking" and by Carter and Morgan (2) on the impact of regulation on insurance.

Banking

Banks in different countries may be required to observe a combination of minimum absolute capital requirements, gearing ratios, own funds/risk assets ratios, fixed asset ratios and large loan ratios. The EAG study indicated that it would not be possible to provide quantitative comparisons of the effects of these requirements but on the basis of the opinions of those interviewed it was felt that in the three major banking countries, the UK, France and Germany, French banks had a significant advantage over the other two. Banks in the UK probably enjoyed a slight competitive advantage over those in Germany.

Insurance

In life insurance the degree of regulation varied between countries. The supervisory authorities generally control the mortality rates to be used in premium calculation (apart from the UK) but controls in some cases cover interest rates, the calculation of expense overheads and the distribution of profits. The study carried out in 1986 by Carter and Morgan showed that the mortality rates used in the calculation of term insurance were in most cases 2-4 times more conservative than in the UK. The UK is the only country in which the mortality rates used are based on insured lives rather than population averages. As an example, pure premiums for a 20 year term using UK and Belgian mortality rates and 6 and 4% interest rates were calculated. This showed a difference of 227% of which only one 25th was accounted for by the interest differential.

From this it can be seen that the measurement of the effect of specific regulations is difficult to quantify and more importantly, is likely to under-estimate the costs of "Non-Europe".

5.6 Case Study Example of the Impact of the Deregulation

The impact of deregulation of the London Stock Exchange has been taken as an example of the effects of regulation. The effect may be seen by examining commission rates, the number of market makers, equity dealing spreads and the depth of markets for different types of shares. These are considered in detail in the main report. Overall, the case study indicated that while there were small increases in commissions for small transactions, for the institutional transactions sector, commission rates fell by between 20 and 36 per cent. It is not certain however if these price reductions will remain given the level of capacity in the market.

- (1) An Evaluation Of The Consequences Of The Existence Of Different Prudential Ratios For Competition Between Credit Institutions In The European Community, EAG Report 1986, Report Prepared for European Commission.
- (2) Carter R.L., Morgan E.V. Freedom To Offer Life Insurance Across EEC State Boundaries, EAG Report 1986.

SECTION 6: ESTIMATING THE GAINS FROM EUROPEAN ECONOMIC INTEGRATION

- 6.1 In this section we present our estimates of the gains from European economic integration. In particular we consider two aspects of this important issue. Firstly, we examine our estimates for the microeconomic gains from integration of European financial services markets. Secondly we review the macroeconomic welfare gains from integration of the European capital markets. In this connection we also consider the gains from risk pooling and equalisation of interest rates.
- 6.2 Our estimates of the costs of "Non-Europe" are based primarily on assumptions of the likely movement of prices in an integrated financial market. Earlier in this study, data on the existing prices of financial products was presented. The data indicated a wide range of prices both within and between countries and it is clear that while prices for certain financial services were lower in some countries, the prices of other services were higher than in the other countries examined. Later in this section we consider our assumptions for the likely prices of financial services in an integrated market.
- 6.3 At present in a non-integrated Europe the various barriers to the completion of the internal market in financial services result in different prices being charged in the different countries. The net effect is as if there were a set of tariffs protecting the producers of financial services in the high price countries.
- 6.4 From this perspective the evaluation of welfare gains (i.e. net economic benefits) from the completion of the internal market involves an exercise similar to the calculation of the gains (in terms of consumer surplus, etc.) from a move to free trade, or the establishment of a customs union.
- 6.5 In our main report we consider in detail a methodology for moving from assumptions of the likely range of future price changes to economic welfare gains. In this executive summary we focus on our assumptions for future prices and the results of our calculations.

Future Price Levels

- 6.6 The level by which prices of financial services will change in an integrated European market is by definition speculative and difficult to verify. Our analysis in this report is intended to provide a basis for producing estimates of the potential change in the value added element of prices that could be expected. In particular our estimates are guided by a number of factors including data on existing price differentials, value added/output ratios, net margins/cost data and the extent of specific regulations. Our future price scenarios are also guided by the case study example of the impact of deregulation within national boundaries.

- 6.7 The study of price reductions resulting from deregulation within a national market summarised earlier, referred to the UK securities market. This case study indicated that while there were small increases in commission for small transactions, for institutional transactions commission rates fell by between twenty and thirty six per cent. In arriving at an estimate of the costs of barriers, we have utilised scenarios where prices for the financial services sector are assumed to decline by between one and twenty six per cent in different countries. Again we stress that these assumed "price" reductions do not represent absolute reductions in consumer prices as in the banking sector they are based on prices or costs in excess of money market rates. The implied reduction in real consumer prices in these cases would be significantly less than the assumed price reductions used in this study. In view of the difficulties inherent in estimating likely price movements we have also considered in the main report the sensitivity of our findings to alternative price assumptions.
- 6.8 It is possible to construct a wide range of possible price scenarios which could emerge in an integrated market. For example one could assume that prices would fall to the level of the lowest existing price observation. Indeed there would be some grounds for assuming that the expanded market opportunities presented by an integrated European financial services market would enable prices to fall below existing lowest prices, as economies of scale are exploited. In this study we have taken a more conservative estimate of the potential gains which could be secured.
- 6.9 Our price scenarios are based on assuming a range of price reductions. In order to highlight the reasoning behind our future price scenarios it is useful to consider the existing price differentials. The points raised regarding relative prices in Section 5 of the report should be noted in interpreting the analysis in this section. In the main report we also analyse some of the other factors referred to in 6.6 above.
- 6.10 The price comparisons are based on assuming for each category of financial services (e.g. banking, insurance and securities) a weighting for each of the financial services prices presented within the category, based on estimates of the relative economic importance of the particular service. Details of the weighting system used are presented in the main report.
- 6.11 In table 6.1 comparative "prices" for financial services in the eight countries are presented. In particular we present calculations of differences in prices compared with the average of the four lowest price observations together with figures for the implied potential price falls and assumed potential price falls. The costs of current accounts are excluded in recognition of the widespread belief that these are very significantly affected by cross subsidisation. The cost of credit cards and letters of credit used represent the particular examples referred to and defined in Section 5.

- 6.12 The comparative costs of insurance products and stock exchange transactions are also presented in the table overleaf. These include both consumer, company and institutional transactions. The particular examples used in the calculations were described and defined in Section 5.
- 6.13 We believe the assumption that prices would fall to the average of the four lowest observations as measured by the implied weighted price reductions would still tend to overestimate the economic gains from integration. There are a number of reasons for this including the fact that the value added figures used in our economic model include value added incurred in producing financial services which are sold outside of the Community and also services at present subject to intense international competition.
- 6.14 In addition, differences in prices undoubtedly reflect in part differences in underlying risks which are unlikely to be affected by European integration.
- 6.15 In view of these factors and the recognised difficulties in obtaining comparative price figures we have therefore scaled down these implied price reductions to arrive at the assumed reductions which have been used in our estimates of economic welfare gains. In particular we have used a range of assumptions of between 40-60 per cent of the implied price reductions. We have also in our estimates of the economic gains from integration constructed a range of assumed potential price falls of five percentage points above and below our estimates. As indicated earlier these are based on our analysis of existing price levels and are also guided by our analysis of margins, cost structures and the extent of specific regulations. A more detailed analysis of the reasoning behind these price assumptions is included in our main report.

Results of Impact of European Integration

- 6.16 Using the assumptions regarding future price changes it is possible to estimate the impact of European integration. In the table on page 24, estimates of the economic impact of European integration of financial services as measured by the change in consumer surplus are presented for each of the countries examined. The estimates indicate that the gain in consumer surplus would be in the range 11-33bn ECUs. The lower estimate is based on a lower assumed price reduction while the higher estimate is based on a scenario of greater price reductions.

TABLE 6.1: DERIVATION OF PROPOSED FALLS IN FINANCIAL PRODUCT PRICES AS A RESULT OF
 COMPLETING THE INTERNAL MARKET
 UNWEIGHTED "PRICES" (1) COMPARED WITH AVERAGE OF FOUR LOWEST (See Footnotes Overleaf)

	Belgium	Germany	Spain	France	Italy	Luxembourg	Netherlands	United Kingdom
Banking								
Commercial Loans	-4.6	6.0	19.2	-7.3	8.6	6.0	43.0	45.7
Cost of Consumer Credit (4)	-41.0	135.9	38.5	105.1	121.0	-26.9	30.8	121.5
Cost of Credit Cards	79.0	60.0	25.7	-29.5	88.6	-12.4	42.9	16.2
Cost of Mortgages (5)	31.3	57.3	118.8	78.5	-4.3	36.5	-6.3	-20.7
Cost of Letters of Credit	21.8	-10.0	58.9	-7.2	9.1	27.1	16.5	8.1
Cost of Foreign Exchange Drafts	6.2	30.9	196.3	55.6	23.5	33.3	-45.7	16.1
Cost of Travellers Cheques	35.2	-7.4	29.6	38.9	22.2	-7.41	33.3	-7.4
Implied Potential Price Fall (2)	16.0	33.0	34.0	25.0	18.0	16.0	10.0	18.0
Assumed Potential Price Fall (3)	8.0	13.0	20.0	13.0	9.0	8.0	5.0	9.0
Insurance								
Cost of Contents and House Insurance	-15.9	2.7	-3.7	39.0	80.4	56.9	16.9	89.7
Cost of Motor Insurance	30.0	14.7	99.5	8.7	147.9	76.6	-6.8	-16.8
Cost of Fire and Theft	-8.7	42.5	24.4	152.8	245.0	-15.2	-0.5	26.6
Cost of Public Liability	13.4	47.3	59.9	117.0	76.8	9.5	-16.3	-6.5
Cost of Term Insurance	77.6	5.1	37.4	33.2	83.2	65.9	-8.9	-29.9
Implied Potential Price Fall	31.0	10.0	32.0	24.0	51.0	37.0	1.0	4.0
Assumed Potential Price Fall	16.0	5.0	19.0	12.0	26.0	19.0	0.5	2.0

TABLE 6.1 CONTINUED

	Belgium	Germany	Spain	France	Italy	Luxembourg	Netherlands	United Kingdom
Securities								
Cost of Private Equities	35.9	6.8	65.0	-12.6	-2.9	6.8	113.6	123.3
Cost of Private Gilts	14.4	90.1	216.9	21.5	-63.0	26.8	160.6	35.6
Cost of Institutional Equities	26.4	68.5	152.7	-5.4	47.4	68.5	26.3	-47.4
Cost of Institutional Gilts (6)	284.1	-4.0	60.0	57.4	92.0	-36.0	-17.4	-47.4
Implied Potential Price Fall	53.0	11.0	44.0	23.0	33.0	9.0	18.0	12.0
Assumed Potential Price Fall	26.0	6.0	26.0	12.0	17.0	5.0	9.0	6.0
PRICE FALLS FOR TOTAL FINANCIAL SERVICES SECTOR								
Implied Potential Price Fall	23.0	25.0	34.0	24.0	29.0	17.0	9.0	13.0
Assumed Potential Price Reduction	11.0	10.0	21.0	12.0	14.0	8.0	4.0	7.0
Assumed Range of Price Reductions (7)	6 - 16	5 - 15	16 - 26	7 - 17	9 - 19	3 - 13	1 - 9	2 - 12

Caution must be exercised in interpreting the above data. See footnote to Table 5.1.

- (1) While the data is referred to as "prices" it should be noted that the data in the banking sector refers to the cost over money market rates and therefore do not represent the cost to consumers. Data is also exclusive of consumer taxes.
- (2) Implied price fall is calculated as weighted average of price comparisons compared with average of the four lowest observations. The weighting system used was designed to attempt to reflect the importance of the different services in value added. Details are presented in the main report. Also of significance is the fact that where prices are below the average of the four lowest it is assumed that no increase in prices would result from integration.
- (3) Assumed price fall is calculated as a percentage of implied price fall (see main report for details)
- (4) Cost of Consumer Credit in Italy assumed to be equal to the average of Germany, France and the UK.
- (5) Cost of mortgages in Luxembourg assumed to be equal to the average in the other countries.
- (6) Cost of institutional gilts in the UK assumed to have the same price difference as institutional equities.
- (7) Assumed range is derived as five percentage points above and below the assumed price reduction.

6.17 In the event of the consumer surplus gains being used as a measure of economic welfare gains we believe it would be prudent to use the mid-point in the range as the upper estimate of economic welfare gains. The results represent a snapshot of the position before and after integration. The figures also assume a competitive market structure after integration and indicate the net gains in consumer surplus country-by-country but do not make any assumptions about the redistributive effects between producers in different countries. Thus the results indicate the benefits to the consumers in each country and the overall gain in consumer surplus to the Community, after all of the benefits of integration have been achieved.

Table 6.2

Estimated Gain in Consumer Surplus Resulting from Integration of European Credit and Insurance Markets

	ECUs M	
	<u>Range</u>	<u>Mid Point*</u> <u>Estimate</u>
B	366 - 1,081	685
D	2,264 - 7,074	4,619
ES	2,376 - 4,040	3,189
F	2,105 - 5,330	3,683
I	2,516 - 5,542	3,996
LU	16 - 73	44
N	86 - 796	347
UK	<u>1,415 - 8,837</u>	<u>5,051</u>
	11,144 - 32,710	21,614

* Mid point refers to mid point in assumptions regarding price range and not the mid point in estimated gain in consumer surplus.

6.18 The extent to which the above estimates represent a gain in economic welfare depends on the assumptions made regarding the extent to which the price reductions used result in a loss in producer surplus. The particular framework which we have adopted would indicate that it would be necessary to subtract from this gain in consumer surplus some estimates of the likely decline in producer surplus. In so doing we recognise that it could be argued that this results in an underestimation of the gains from European economic integration but consider that a conservative approach is more likely to represent the real situation as barriers are removed. In an appendix to our main report we present a methodology for estimating economic welfare gains.

Macroeconomic Implications

6.19 In addition to estimating the microeconomic impact of integration of the European financial services sector it is also necessary to consider the macroeconomic welfare gains from integration of European Capital markets. In particular it is important to consider the gains from risk pooling, and equalisation of interest rates. These issues are summarised in subsequent paragraphs.

Conclusions Regarding Risk Pooling by Capital Markets

- 6.20 Our analysis of risk pooling indicates that the European capital markets are not integrated in the sense that rates of return do not fully reflect all diversification possibilities. Furthermore, investors who are restricted to domestic assets can not achieve as good a trade-off between risk and return as if there were freedom to choose from foreign assets.
- 6.21 In terms of the importance of greater portfolio diversification possibilities, some estimates can be obtained by computing the expected rate of return on an internationally diversified portfolio with the same risk as the actual risk of the market portfolio in the particular country. The difference between this and the actual market return represents the annual gain in rate of return which could result from integration. For example, using data from previous research (Levy & Sarnat) an appropriately levered international portfolio could generate mean returns almost three-quarters as high as the mean return on the EEC-6 market portfolio, for the same risk. In fact research indicates a mean levered return, for the same risk, over 11% per annum higher. More recent US research, referring to the US rather than EEC-6, also suggests very substantial gains from international diversification.

Equalisation of Risk Free Rates

- 6.22 At present the existence of exchange controls prevent the free flow of capital from moving to the countries with the highest rates of return. Even if there were no differences between the efficiency of the financial services industries in the various Member States, the removal of exchange controls could be expected to have beneficial effects through the convergence of real interest rates.
- 6.23 Given information on the marginal efficiency of capital and the real interest rates prevailing in the different countries, it is possible to quantify the gains from a move to common interest rates. A caveat should be recognised in respect of the assumption that the removal of exchange controls would necessarily equalise the real rates of interest across Europe. Until there is a much tighter exchange rate mechanism in the EMS, and one covering all of the countries, convergence of real interest rates will remain imperfect. In order to consider the potential benefits it is nevertheless useful to consider the economic impact of an equalisation of interest rates, resulting from the integration of European capital markets.
- 6.24 The size of the welfare gains to be achieved from equalisation of real interest rates depends both on the size of the differences and on the responsiveness of the demand for capital to interest rate changes in different countries.
1. Levy, Sarnat "International Diversification of Investment Portfolios" American Economic Review 1970.

6.25 The table below shows estimates, for real interest rates, of the responsiveness of the demand for capital to a one percentage point decline in the real cost of capital and deviations from the equilibrium real interest rate. The equilibrium rates are derived on the basis of an assumption that interest rates would tend over time to equalise. This analysis is based largely on O.E.C.D. (1) research and is described in detail in the main report. It is important to stress that real interest rate reductions will also affect consumer's income and welfare.

Table 6.3

Welfare Gains from the Equalisation of Real Interest Rates					
	Real Interest Rates	Rates 1986	Changes in Demand for Capital	Deviations From Equilibrium Short Term Interest Rate	Deviations From Long Term Interest Rate
	Short Term	Long Term	* ECU BN	Rate	Rate
	Percentage Points				
	1	2	3	4	5
B	9.4	6.9	16	1.3	0.8
D	7.6	6.4	135	-0.4	0.3
ES	5.7	3.6	33	-2.3	-2.5
F	8.6	6.3	80	0.6	0.2
I	8.8	6.2	104	0.7	0.8
L	9.4	6.9	0.6	1.3	0.8
NL	8.2	7.4	28	0.2	1.3
UK	7.9	5.9	96	-0.1	-0.2

* As a result of a 1 percentage point decline in interest rates.

Sources: Real Interest Rates - Central Banks

6.26 The potential welfare gains from equalisation of interest rates can be calculated using the deviations of real interest rates from equilibrium (columns 4 + 5 above), the estimates of the change in the demand for capital shown (column 3) and using the formula outlined in our main report for the approximation of the loss of non-integration. In view of the primary focus of this study on the microeconomic gains and the nature of the methodology described above we have not presented the results of the macroeconomic gains of interest rate equalisation in this report. The results using this methodology, however, indicate a much smaller welfare gain compared with our estimates of microeconomic benefits.

(1) See "Internationalisation of Financial Markets: Some Implications for Macroeconomic Policy and for the Allocation of Capital". Furao, M. Hanozaki, M; OECD Working Paper, November 1986.

Conclusion

- 6.27 Our research indicates that there are significant potential gains to be secured in terms of increases in consumer surplus and economic welfare, resulting from integration of the European financial services markets.

As we have indicated though, extreme caution must be exercised in interpreting any quantification of the potential gains as the results will of necessity be speculative. Viewed in this context our estimates indicate that the gain in consumer surplus would be of the order of 11-33bn ECUs. If the consumer surplus calculations are used as a measure of the net economic welfare gains we believe it would be prudent to use the mid-point in the price range namely, 22bn, as the upper estimate of the potential welfare gains. These gains represent the potential microeconomic benefits of integration of the main European Community financial services markets.

- 6.28 In addition to the above gains, it is also likely there will be macroeconomic welfare gains from integration of the European capital markets. The gains from risk pooling by capital markets could generate mean returns almost three-quarters as high as the return on existing market portfolios. Also of importance is the potential gains from equalisation of interest rates.
- 6.29 The gains from integration will result from the dynamic effect of economic integration and not simply as a result of removing the costs of meeting some of the existing regulations. In all countries consumers will benefit from European integration but some producers will come under pressure to survive in the single market. It is important to stress however that these benefits would only occur in a competitive market.
- 6.30 In this study the importance of financial services in terms of output and employment was indicated. The critical macroeconomic importance of capital markets was also highlighted. From an economic standpoint, in view of the potential benefits of European integration of both financial and capital markets it is important that steps are taken to rapidly complete the internal market in financial services within the framework of free competition between and within member states.

COST OF 'NON EUROPE' IN FINANCIAL SERVICES

Full Report

Price Waterhouse



<u>CONTENTS</u>	<u>PAGES</u>
<u>SECTION 1: INTRODUCTION</u>	1
<u>SECTION 2: METHODOLOGICAL ISSUES</u>	3 - 5
2.1 INTRODUCTION	
2.2 DEFINITION OF FINANCIAL SERVICES	
2.3 IDENTIFICATION OF PRODUCERS AND USERS	
2.4 LINK BETWEEN TRADE IN FINANCIAL SERVICES AND CAPITAL MOVEMENTS	
<u>SECTION 3: MACROECONOMIC AND SECTORAL ANALYSIS</u>	6 - 59
3.1 INTRODUCTION	
3.2 EMPLOYMENT	
3.3 VALUE ADDED AND COMPENSATION OF EMPLOYEES	
3.4 OUTPUT/TURNOVER	
3.5 PROFITABILITY	
3.6 BREAKDOWN OF AGGREGATE DEMAND	
3.7 EXTERNAL TRANSACTIONS	
<u>SECTION 4: ANALYSIS OF PRESENT STRUCTURE OF FINANCIAL SERVICES MARKETS</u>	60 - 95
4.1 INTRODUCTION	
4.2 REGULATORY BARRIERS TO TRADE AND ESTABLISHMENT IN BANKING	
4.3 REGULATORY BARRIERS TO TRADE AND ESTABLISHMENT IN SECURITIES	
4.4 REGULATORY BARRIERS TO TRADE AND ESTABLISHMENT IN INSURANCE	
4.5 EXCHANGE CONTROLS RESTRICTIONS ON TRADE IN FINANCIAL SERVICES	
<u>SECTION 5: QUANTIFICATION OF THE EFFECTS OF REGULATION</u>	96 - 138
5.1 INTRODUCTION AND REVIEW OF APPROACHES	
5.2 QUANTIFICATION OF COMPARATIVE PRICES	
5.3 VALUE ADDED/OUTPUT RATIOS	
5.4 SURVEY DATA ON NET MARGINS/COSTS	
5.5 INDIRECT MEASURES OF IMPACT OF SPECIFIC REGULATIONS	
5.6 CASE STUDY EXAMPLE OF IMPACT OF DEREGULATION	
<u>SECTION 6: ESTIMATION OF ECONOMIC IMPACT OF INTEGRATION</u>	139 - 179
6.1 INTRODUCTION AND REVIEW OF METHODOLOGY	
6.2 POTENTIAL FUTURE PRICE CHANGES	
6.3 KEY NON PRICE ASSUMPTIONS	
6.4 BASE CASE ESTIMATES AND RESULTS OF INTEGRATION	
6.5 MACROECONOMIC IMPLICATIONS	
6.6 CONCLUSIONS	

APPENDICES

APPENDIX 1: TERMS OF REFERENCE

APPENDIX 2: NOTE ON EMPLOYMENT AND VALUE ADDED CLASSIFICATION

APPENDIX 3: DETAILED METHODOLOGICAL REVIEW OF LINK BETWEEN
TRADE IN FINANCIAL SERVICES AND CAPITAL MOVEMENTS

APPENDIX 4: TABLES ON OVERVIEW OF AREAS OF COMPETITION BETWEEN
FINANCIAL INSTITUTIONS

APPENDIX 5: BASIS FOR WEIGHTING SYSTEM USED IN PRICE COMPARISONS

APPENDIX 6: MAPPING OF FINANCIAL SERVICE GROUPINGS USED IN
DIFFERENT SECTIONS OF THE REPORT

APPENDIX 7: USE OF HERFINDAHL INDEX TO ESTIMATE ECONOMIC WELFARE GAINS

SECTION 1: INTRODUCTION

- 1.1 This report was prepared by Price Waterhouse and represents the results of an economic study of the costs of "Non Europe" in financial services. The study's geographical coverage was as follows:
- Federal Republic of Germany, France, Italy, the United Kingdom, the Benelux countries and Spain.
- 1.2 The principal objectives of this study were to:
- . assess the importance of financial services to the Community economy;
 - . analyse the present organisation of the market for financial services;
 - . evaluate the economic impact of completing the internal market in financial services.
- 1.3 For clarity and ease of reference, the organisation of the report is described below.
- . In Section 2 a review of methodological issues is presented.
 - . This is followed in Section 3 by a macroeconomic and sectoral analysis with the object of evaluating the importance of financial services to eight economies of the Community under review.
 - . In Section 4 an overview of the present structure of the financial services market is set out. The focus of this section is on regulatory barriers which have the potential to affect the establishment of financial service institutions in overseas markets or the potential to affect cross border trade directly.
 - . In Section 5 an analysis of the scope for quantitative assessment of the effects of completing the internal market is considered.
 - . Finally, in Section 6, the estimation of the economic impact of integration is presented.
- 1.4 For those readers who only require an analysis of the economic implications of the cost of Non Europe it would be sufficient to read Section 5 to 6. To place the significance of financial services in context it would be necessary to read Section 3 while Section 4 examines the existing barriers to trade. The detailed analyses of a number of important areas of the study have been included as appendices. We would in particular draw attention to Appendix 3 which considers the link between trade in financial services and capital movement. A background report of a sectoral analysis of financial services was presented as a separate statistical annex.

- 1.5 In view of the complex and sensitive nature of the information and analysis in this report it is important that disclosure of specific parts of the study are not made out of context.
- 1.6 It should be appreciated that certain key assumptions were made in the conduct of our field work and in the preparation of this report. These include, inter alia, the assumption that the central aim of the Commission is to create a framework for a free and competitive internal market in financial services whilst at the same time ensuring adequate standards of consumer protection. The intention is that this will be achieved through a legislative programme which is aimed at stimulating cross-border trade and encouraging investment and establishment in foreign territories.
- 1.7 It is also envisaged that the economic climate thus created will lead to an intensified interest in Pan-European acquisition and merger opportunities and that this will need to be supported by an appropriate regime of freedom for capital movements. In addition it is assumed that a competitive market environment would exist after the single market is created. Our analysis considers the likely economic consequences for the Community of this scenario.
- 1.8 An evaluation of the likelihood of progress towards an integrated financial services market or the likely responses from national governments to opening up of the financial markets is outside of the scope of the study. Similarly, an evaluation of the likely response of producers in different countries to the assumed integrated market is outside the scope of this economic study.
- 1.9 It should also be recognised that in the achievement of the economic goals, summarised above, any significant changes in the pattern of market concentration may need to be kept under review in the early stages leading up to the following liberalisation in order to alleviate market distortion effects which undermine the aims of the 1992 initiative. This will have a wide range of implications for Commission competition policy, for example in the approach adopted towards multi-national industry groupings and the balance of investment opportunities between Community and external providers of financial services.
- 1.10 We would like to thank the Steering Committee for advice provided to the consultancy team during the course of the study and for input made by external advisors. We would also like to thank all individuals and institutions who provided information, during this study.

SECTION 2. METHODOLOGICAL ISSUES

2.1 This section deals with three methodological problems which were identified at the outset namely:

- to provide a comprehensive operational definition of financial services;
- to identify the producers and users of financial services;
- to clarify the link between liberalising the market for financial services and liberalisation of capital movements.

2.2 Definition of Financial Services

In defining financial services it was agreed with the Commission that financial services should be defined to include the provision of a financial service or a sale of a financial product or both. In particular we decided the following activities should, where possible, be included: international commercial and private banking, corporate financial services, offshore banking, and money market activities. We decided it should also include: broking, funds management, assurance, insurance and reinsurance; consumer credit including building societies and stock exchange businesses. In the examination of the economic significance of financial services it was evident that detailed comparative data would not be obtainable at a very disaggregate level but it was decided that aggregate data should include as wide a definition of financial services as feasible. In the review of the effects of regulations it was possible to target in more specifically on some of the sub sectors identified.

The above definition of financial services needed to be placed in the context of a conceptual framework. We decided that the most appropriate classification would be a threefold one comprising of banking and credit markets, the insurance markets and the brokerage and securities market. Our macroeconomic and sectoral analysis has used this classification where feasible. Similarly in our analysis of the structure of the markets we have considered regulatory barriers in each of these groups of financial services. Finally, in our quantitative assessment of the effects of completing the internal market we have chosen representative services in each of the above areas.

2.3 Identification of Producers and Users

It was necessary from a methodological viewpoint to decide how to treat the identification of producers and users in the sectoral analysis. It was clear that in identifying the producers and users of financial services it was important to ensure that segmental differences between countries were recognised. It was also decided that only primary users could be identified.

This methodological decision implied the need for the sectoral analysis to be undertaken on a country by country basis. It also highlighted the need to attempt to identify differences in the type and range of services offered by different institutions in different member countries. This issue is considered in the section on macroeconomic and sectoral analysis. In the analysis of the economic impact of integration of financial markets, consumers are defined as including all consumers including private, commercial and institutional groups.

2.4 The Link Between Trade in Financial Services and Capital Movements

The most difficult and important methodological issue to be examined related to the link between trade in financial services and exchange controls. In view of its importance and complexity we consider this issue in detail in Appendix 3. The question addressed is to what extent freedom of trade in financial services or freedom of establishment can yield consumer benefits despite the persistence of controls on capital movements. The Commission's objective, of course, is a regime of freedom of capital movements as well as freedom to establish and trade, with home country prudential regulation being recognised. However it is important to assess the consequences of a partial or intermediate stage in the achievement of this objective.

The dichotomy between trade and capital movements is somewhat artificial in the context of financial services, albeit familiar from the world of goods, and relevant, in particular, to existing GATT contractual commitments. Nevertheless it is a dichotomy which may well have practical implications for the future development of the internal market, as it may be some time before all member states have liberalised their exchange controls to the extent envisaged as an objective.

The discussion in the appendix is necessarily somewhat speculative, reflecting the scarcity of relevant research findings. Furthermore, to avoid undue pedantry, only a selection of issues has been touched upon. The general conclusion however seems clear. Maintenance of strict exchange controls may well inhibit the full consumer benefits from freedom of trade and freedom of establishment for financial services in Europe. This is partly because financial institutions will not be able to avail of the

economies of a wider market. Although an attempt to maintain a regime of strict regulation will run into difficulties under a system of home country control, it is not certain that all of these regulations will create impossible competitive disadvantages for home financial institutions. Market segmentation rather than global loss of competitiveness may often be the consequence.

Under host country regulations, the result of freedom of establishment may be very little improvement where uncompetitive market structures exist or may result. In contrast, the prospect for welfare gains from a liberalisation of exchange controls does not seem to depend so heavily on freedom of establishment, at least for financial services of a wholesale or standard type. An analysis of the rationale for these conclusions is presented in Appendix 3.

SECTION 3: MACROECONOMIC AND SECTORAL ANALYSIS

3.1 INTRODUCTION

The objective of this section is to assess the importance of financial services to the Community economy. A review of published data sources at Community and at national central statistics office levels has been undertaken. In addition, the main associations of financial services were contacted and available data reviewed. This has been supplemented by numerous individual data sources. Every attempt has been made to tackle the problems of the difficulty of measuring the output of services and the variation of data coverage between countries. While significant progress has been made in these areas some data gaps not surprisingly remain, although it has been possible to provide a comprehensive overview of the economic significance of financial services in the eight countries. Where feasible, data on banking, insurance and securities markets is presented.

In this section we present aggregate data for financial services, covering, for each of the countries included in the study;

- a) turnover or output, value added, employment and profitability;
- b) the demand for financial services by households, companies and general government;
- c) external transactions.

The data presented in this section includes both detailed cross-sectional analysis as well as time series. It primarily represents a macroeconomic analysis although some sectoral data is also presented. A detailed sectoral analysis is however presented as a separate statistical annex as background information to this study. This sectoral analysis presents the results for banking and credit markets, for the insurance markets and for brokerage and securities markets in each of the eight countries.

In view of the fact that different services are provided by different institutions in each of the countries, we have prepared detailed transition tables which present a comparative overview of the areas of competition between financial institutions. These tables are presented in Appendix 5. Appendix 6 indicates the links between the different groupings of financial services and institutions used in the report.

In the remainder of this section we present data on the economic significance of financial services in the eight countries. In particular we analyse employment, value added and compensation of employees, output/turnover, profitability, breakdown of aggregate demand and external transactions.

3.2 EMPLOYMENT IN FINANCIAL SERVICES

Total Employment

Table 3.1 shows, in column 4, that 70 per cent of employment in Banking, Finance and Insurance in the eight countries is in Germany, the UK and France. From column 5 it may be seen that the proportion of total employment within each country represented by Banking, Finance and Insurance is highest in Luxembourg at 7.7 per cent. The other countries, with the exception of Italy (2.5%), range between 3.4% and 3.9% of total employment.

Total employment in the eight countries in Banking, Finance and Insurance totalled more than 3.1 million. This does not include a range of other activities described in the statistics as ancilliary to banking and finance which include brokers acting as agents.

**TABLE 3.1: EMPLOYMENT IN BANKING AND INSURANCE
BY COUNTRY, 1985**

Country	Employment ('000)				
	(1) Banking and Finance	(2) Insurance	(3) (1)+(2)	(4) (3) % of Total of (3)	(5) (3) as % of Total Employment
B	89	30	119	4	3.9
D	604	230	834	26	3.7
ES	n.a.	n.a.	292	9	3.9
F	448	154	602	19	3.4
I	n.a.	n.a.	379	12	2.5
L	9.9	0.9	11	0.3	7.7
NL	111	42	153	5	3.5
UK	527	245	772	25	3.6
Total			3162	100	

Source: Tables which follow below.

Table 3.2 shows that the fastest growth in employment in banking finance and insurance since 1978 has been in Luxembourg (50%) followed by Italy (25%) and the UK (23%). There was almost zero growth in Spain and the remaining countries had total growth of between 8% and 14% over the seven year period. Growth in banking and insurance in Luxembourg was the same over the period while in the UK, Germany, Belgium and the Netherlands banking employment rose faster than that in insurance. Employment in insurance decreased in Germany over the period.

TABLE 3.2: RATE OF GROWTH IN EMPLOYMENT IN BANKING AND INSURANCE BY COUNTRY, 1978-1985

Country	Employment growth,		
	Banking & Finance	% Insurance	Total banking and finance
B	11.0	8.3	10.2
D	15.0	-5.7	8.4
ES	n.a.	n.a.	0.7
F	8.6	23.9	12.2
I	n.a.	n.a.	25.5
L	50.0	50.0	50.0
NL	15.1	11.9	14.2
UK	24.0	21.3	23.1

(1) 1980-85

Source: Based on Tables Below

Belgium

Employment in financial services in Belgium rose by 10 per cent between 1978 and 1985, banking grew slightly faster than insurance. Total employment in the economy fell over the period and there was an increase in the proportion of total employment accounted for by financial services from 3.4 per cent in 1978 to 3.9 per cent in 1985.

TABLE 3.3: EMPLOYMENT IN FINANCIAL SERVICES IN BELGIUM, 1978-84

	Employment ('000)					
	1978	1981	1982	1983	1984	1985
Banking and Finance	80.2	83.9	84.6	85.7	87.7	89.0
Insurance	27.7	29.1	29.1	29.7	30.0	30.0
Total Banking, Finance & Insurance	107.9	113.0	113.7	115.4	117.7	119.0
Total Employees in Employment	3,132.4	3,099.4	3,051.2	3,007.9	2,997.5	3,017.5
Employment in Banking, Finance & Insurance as a % of Total	3.4	3.6	3.7	3.8	3.9	3.9

Source: (Statistical Office of the European Commission; S.O.E.C.; Employment and Unemployment 1987.

Germany

Table 3.4 gives details of employment in financial services in Germany. It is clear that employment in insurance has been falling while that in banking and finance has grown. Employment in financial services accounted for over 3.7 per cent of total employment in 1985 compared to 3.4 per cent in 1978.

TABLE 3.4: EMPLOYMENT IN FINANCIAL SERVICES IN GERMANY, 1978 - 85

	Employment ('000)				
	1978	1982	1983	1984	1985
Banking and Finance	525.4	572.5	582.5	588.5	604.4
Insurance	244.1	231.2	231.6	230.0	230.1
Total Banking, Finance & Insurance	769.5	803.7	814.1	818.5	834.5
Total Employees in Employment	22,268	22,742	22,333	22,352	22,487
Employment in Banking, Finance & Insurance as % of total	3.4	3.5	3.6	3.7	3.7

Source: S.O.E.C. Employment and Unemployment 1987.

Table 3.5 shows that the decline in employment in insurance in Germany between 1980 and 1985 was felt equally across the main sectors of the industry as indicated by employment data for members of the Federation of Insurance Companies in Germany.

TABLE 3.5: EMPLOYMENT IN INSURANCE IN GERMANY, 1980-85

	Employment ('000)			
	1980	1983	1984	1985
Total Insurance	202.3	200.1	198.1	197.3
- Non-Life	104.8	103.6	102.6	102.2
- Life	67.2	66.5	65.8	65.5
- Health	27.5	27.2	26.9	26.8
- Re-insurance	2.8	2.8	2.8	2.8

Source: Federation of Insurance Companies in Germany

Spain

Table 3.6 shows that employment in banking and finance in Spain barely increased between 1980 and 1985. The proportion of total employment in banking and finance increased as employment elsewhere in the economy fell.

TABLE 3.6: EMPLOYMENT IN FINANCIAL SERVICES IN SPAIN, 1980-85

	1980	1983	1984	1985
	'000			
Banking Finance & Insurance	290	299	295	292
Total Employees in Employment	8,137	7,789	7,572	7,412
Employment in Banking and Finance as % of Total	3.6	3.8	3.9	3.9

Source: S.O.E.C. Op Cit

France

Employment in financial services has grown less rapidly in France than in the other large European countries apart from Germany. Table 3.7 shows that while insurance grew quite rapidly growth in banking employment was much more sluggish. Banking, Finance and Insurance accounted for 3.4 per cent of employees in employment in 1985 compared to 3.1 per cent in 1978.

TABLE 3.7: EMPLOYMENT IN FINANCIAL SERVICES IN FRANCE, 1978-85

	1978	Employment ('000)			
		1982	1983	1984	1985
Banking and Finance	412.0	429.2	439.3	443.8	447.6
Insurance	124.6	145.6	149.6	152.3	154.4
Total Banking, Finance & Insurance	536.6	574.8	588.9	596.1	602.0
Total Employees in Employment	17,516	17,992	18,036	17,911	17,794
Employment in Financial Services as Percentage of Total	3.1	3.2	3.3	3.3	3.4

Source: S.O.E.C. Op Cit

Italy

In Italy the proportion of total employment accounted for by Banking, Finance and Insurance increased very rapidly between 1978 and 1985. The proportion of this sectors employment in total employment reached 2.5 per cent in 1985 compared to 2.0 per cent in 1978.

TABLE 3.8: EMPLOYMENT IN FINANCIAL SERVICES IN ITALY, 1978-85

	1978	Employment ('000)			
		1982	1983	1984	1985
Banking, Finance and Insurance	302	358	362	372	379
Total Employees in Employment	14,665	15,119	15,007	14,949	15,098
Employment Credit and Insurance as a Percentage of Total	2.0	2.4	2.4	2.5	2.5

Source: S.O.E.C., Op Cit

Luxembourg

Both banking and insurance grew rapidly, though the insurance sector is small relative to banking. Employment in financial services increased more rapidly in Luxembourg than in any other country surveyed, with a rise of 50 per cent between 1978 and 1985. Employment in banking and finance accounted for 7.7 per cent of employment in 1985 compared to 5.4 per cent in 1978.

**TABLE 3.9: EMPLOYMENT IN FINANCIAL SERVICES IN LUXEMBOURG,
1978-85**

	1978	1981	1982	1983	1984	1985
Banking	6,600	7,900	8,400	8,900	9,400	9,900
Insurance	600	700	800	800	800	900
Total Banking & Insurance	7,200	7,600	9,200	9,700	10,300	10,800
Total Employment ('000)	133.3	138.7	138.7	138.5	138.3	140.6
Employment in Banking and Insurance as a percentage of Total	5.4	5.5	6.6	7.0	7.4	7.7

Source: S.O.E.C. Op Cit

Netherlands

Table 3.10 shows that employment in the Netherlands in banking and finance grew at a faster pace than in insurance over the 1978 to 1985 period. Employment in financial services accounted for 3.5 per cent of total employees in 1985 compared to 3.3 per cent in 1978.

**TABLE 3.10: EMPLOYMENT IN FINANCIAL SERVICES IN THE NETHERLANDS
1978-85**

	1978	1981	1982	1983	1984	1985
Banking and Finance	96.2	111.1	111.2	n.a.	112.0	110.7
Insurance	37.9	40.4	38.8	43.8	43.3	42.4
Total Banking, Finance & Insurance	134.1	151.5	150.0	n.a.	155.3	153.1
Total Employees in Employment	4,026.0	4,161.0	4,077.1	3,976.5	4,296.8	4,407.2
Employment in Banking, Finance & Insurance Services as a % of total	3.3	3.6	3.7	n.a.	3.6	3.5

Source: S.O.E.C Op Cit

United Kingdom

Tables 3.11 and 3.12 give alternative series for employment in financial services in the UK. Employment in both banking and insurance has increased rapidly since 1978.

The financial services sector accounted for 3.6 per cent of employees in employment in 1985 as compared to less than 2.8 per cent in 1978.

**TABLE 3.11: EMPLOYMENT IN FINANCIAL SERVICES IN THE UK,
1978 - 1985**

	Employment ('000) (1)				
	1978	1982	1983	1984	1985
Banking and Finance	425	477	490	513	527
:Staff in Building Societies	n.a.	58	61	63	n.a.
Insurance	202	226	229	235	245
Total Banking, Finance & Insurance	627	703	719	747	772
Total Employees in Employment	22,462	21,370	20,883	21,081	21,290
Employees in Banking, Finance and Insurance as % of Total	2.8	3.3	3.4	3.5	3.6

Sources: S.O.E.C. Op Cit; Building Societies Fact Book
(1) 1979 & 1980 data available.

Table 3.12 shows some more detail of the composition of employment in the banking sector from a national source. It shows that though banking and bill discounting has grown, more rapid growth was experienced in other financial institutions.

TABLE 3.12: EMPLOYMENT IN FINANCIAL SERVICES IN THE UK, 1981-86

	Employment ('000)			
	Sept 81	Sept 84	Sept 85	Sept 86
Banking and Finance	465.3	506.7	518.3	542.3
- Banking and bill discounting	360.9	389.6	395.1	409.4
- Other financial institutions	104.4	117.0	123.2	132.8
Insurance, except social security	223.8	223.0	230.7	236.8

Source: Department of Employment; Gazette Table 1.4 Various issues

3.3 VALUE ADDED AND COMPENSATION OF EMPLOYERS IN FINANCIAL SERVICES

An important indication of the economic significance of financial services is data on value added and compensation of employees. This is also useful as an indication of the resources used by the sectors. In this section we examine value added and compensation of employees in credit and insurance institutions.

The data presented in this section is in nominal terms and given the inflationary period under review it is necessary to consider annual changes with caution. The objective of this section is however to present an overview of the economic significance of financial services and this can be seen by the ratios of value added and other variables as a percentage of national output. Where available we have utilised international published sources such as Eurostat or OECD and this has been supplemented by national sources. The usual reservations regarding these sources apply.

In the national accounts transactions are classified by branch and by sector. Branches consist of groups of units of homogeneous production engaged in the production of a single product or group of products. Sectors are groupings of institutional units and their output may fall into one or more branches. In some of the tables data is presented by branch and by sector. The sectoral breakdown corresponds reasonably closely with the breakdown of employment data above. The credit and insurance branch data is reasonably close to the sum of the credit and insurance sectors apart from the UK and France.

In 1985 value added at market prices in credit and insurance on the basis of branch data, represented 6.7 per cent of GDP. The countries with the highest percentage were Luxembourg (14.0%) and the UK (12.6%). The lowest percentages were the Netherlands, France and Germany. The overall picture is broadly the same on the basis of sector data apart from the UK where credit and insurance sector appears as a much lower proportion of GDP (1).

(1) These data are provisional and may be subject to revision.

TABLE 3.13: VALUE ADDED IN CREDIT AND INSURANCE IN 1983 & 1985

	1985 ECUm (Branch)	% GDP	1983 ECUm (Branch)	% GDP	1983at (ECUm) (Sector)	% GDP
B	5,966	5.9	4,442	4.9	4,584	5.1
D	44,417	5.5	40,925	5.7	41,874	5.7
ES	13,929	6.1	8,889	5.1	9,131	5.1
F	29,277	4.5	22,156	3.9	28,462	4.9
I	26,998	5.6	24,051	6.0	25,027	6.3
L(1)	535	14.0	535	14.0	535	14.0
NL	8,537	5.4	8,049	5.4	8,207	5.5
UK	70,240	12.6	53,896	11.2	30,004	5.9
TOTAL	199,899	6.7	162,943	6.2	147,824	5.6

Source: Based on Tables 3.15 - 3.22 below

(1) 1982

In the tables which follow only data based on the sectoral analysis is shown.

Between 1978 and 1983 value added by the credit and insurance companies in the eight countries studied rose from 4.7 to 5.6 per cent of GDP. The banking sector expanded more rapidly, with value added rising from 3.9 to 4.8 per cent of GDP; insurance value added stayed constant at 0.8 per cent of GDP. Compensation of employees in the credit and insurance sector rose by 0.3 per cent of GDP between 1978 and 1983.

TABLE 3.14: VALUE ADDED IN CREDIT AND INSURANCE IN EIGHT COUNTRIES, 1983

Category	Value Added (ECU m)		% of GDP	
	1978	1983	1978	1983
Services of Credit and Insurance Companies	79,259	147,824	4.7	5.6
: credit (1)	65,122	125,871	3.9	4.8
: insurance	14,137	21,953	0.8	0.8
Compensation of Employees (Credit and Insurance)	43,039	77,026	2.6	2.9

Source: Based on Tables 3.15 - 3.22 below.

(1) For Luxembourg credit and insurance are both in this heading. The data is for 1980 rather than 1978.

Trends over time in value added are shown for each country in Tables 3.15 - 3.22.

Belgium

In Belgium value added for banking and insurance rose as a proportion of GDP - from 4.2 to 5.1 per cent between 1978 and 1983 - although in 1983 the share of GDP remained lower than in the other countries except France and Spain.

TABLE 3.15: VALUE ADDED IN CREDIT AND INSURANCE IN BELGIUM, 1978 AND 1983

Category	1978		1983		1985
	Value Added (ECU m)	% GDP	Value Added (ECU m)	% GDP	% GDP
Services of Credit and Insurance Companies	3,146	4.2	4,584	5.1	
: Credit	2,604	3.5	3,979	4.4	
: Insurance	542	0.7	605	0.7	
Compensation of Employees (Credit and Insurance)	2,369	3.3	3,296	3.8	3.7

Source: S.O.E.C - National Accounts by Sector, National Accounts by Branch.

Germany

Table 3.16 shows that in Germany the credit and insurance sectors expanded rapidly, with the share of value added in GDP rising from 4.4 to 5.7 per cent between 1978 and 1983. As in Belgium, the main source of growth was the credit sector.

TABLE 3.16: VALUE ADDED IN CREDIT AND INSURANCE IN GERMANY 1978 AND 1983

Category	1978		1983		1985
	Value Added (ECU m)	% GDP	Value Added (ECU m)	% GDP	% GDP
Services of Credit & Insurance Companies	23,046	4.4	41,874	5.7	
: Credit	16,706	3.3	33,902	4.6	
: Insurance	5,340	1.1	7,972	1.1	
Compensation of Employees (Credit and Insurance)	11,160	2.3	17,655	2.4	2.4

Source: S.O.E.C. - National Accounts by Sector, National Accounts by Branch.

Spain

Table 3.17 shows in Spain the overall share of credit/insurance value added in GDP fell between 1980 and 1983 - the only other country in this position was Luxembourg. In Spain there was a large fall in value added in banking as a proportion of GDP.

**TABLE 3.17: VALUE ADDED IN CREDIT AND INSURANCE IN SPAIN
1980 AND 1983**

Category	1980		1983		1985
	Value Added (ECU m)	% GDP	Value Added (ECU m)	% GDP	% GDP
Services of Credit and Insurance Companies	9,030	5.9	9,131	5.1	
: Credit	8,567	5.6	8,638	4.8	
: Insurance	463	0.3	493	0.3	
Compensation of Employees (Credit and Insurance)	4,564	3.0	5,505	3.1	3.0

Source: S.O.E.C. - National Accounts by Sector,
National Accounts by Branch.

France

In France there was a relatively low overall rate of increase in value added as a proportion of GDP. However, this was due to a fall in value added by insurance, while the banking sector expanded rapidly between 1978 and 1983.

**TABLE 3.18: VALUE ADDED IN CREDIT AND INSURANCE IN FRANCE
1978 - 1983**

Category	1978		1983		1985
	Value Added (ECU m)	% GDP	Value Added (ECU m)	% GDP	% GDP
Services of Credit and Insurance Companies	15,568	4.2	28,462	4.9	
: Credit	13,695	3.7	27,046	4.6	
: Insurance	1,873	0.5	1,416	0.2	
Compensation of Employees (Credit and Insurance)	6,865	1.9	11,761	2.1	2.2

Source: S.O.E.C. - National Accounts by Sector,
National Accounts by Branch.

Italy

In Italy the contribution to GDP by the insurance sector remained constant but an increase in banking value added raised the overall contribution to GDP from 5.7 per cent in 1978 to 6.3 per cent in 1983.

**TABLE 3.19: VALUE ADDED IN CREDIT AND INSURANCE IN ITALY
1978 AND 1983**

Category	1978		1983		1985
	Value Added (ECU m)	% GDP	Value Added (ECU m)	% GDP	% GDP
Services of Credit and Insurance Companies	11,828	5.7	25,027	6.3	
: Credit	11,197	5.4	23,861	6.0	
: Insurance	631	0.3	1,166	0.3	
Compensation of Employees (Credit and Insurance)	6,100	2.9	12,716	3.1	3.0

Source: S.O.E.C - National Accounts by Sector,
National Accounts by Branch.

Luxembourg

In Luxembourg the contribution of credit and insurance institutions to GDP fell from 17.1% of GDP to 14.0% in 1982. However, in 1982 Luxembourg remained the country with the most significant banking and insurance sector relative to the size of the economy.

**TABLE 3.20: VALUE ADDED IN CREDIT AND INSURANCE IN
LUXEMBOURG 1978 AND 1982**

Category	1978		1982	
	Value Added (ECU m)	% GDP	Value Added (ECU m)	% GDP
Services of Credit and Insurance Companies	478	17.1	535	14.0
Compensation of Employees	157	5.7	275	7.2

Source: S.O.E.C. - National Accounts by Sector,
National Accounts by Branch.

Netherlands

In the Netherlands the share of GDP accounted for by value added in the credit and insurance sectors rose from 4.4 to 5.5 per cent between 1978 and 1983, with banking accounting for all of this increase in share of GDP. The share of the insurance sector remained constant at 1.30 per cent of GDP.

TABLE 3.21: VALUE ADDED CREDIT AND INSURANCE IN THE NETHERLANDS 1978 AND 1983

Category	1978		1983		1985
	Value Added (ECU m)	% GDP	Value Added (ECU m)	% GDP	% GDP
Services of Credit and Insurance Companies	4,762	4.4	8,207	5.5	
: Credit	3,324	3.1	6,244	4.2	
: Insurance	1,438	1.3	1,963	1.3	
Compensation of Employees (Credit and Insurance)	2,695	2.6	4,012	2.8	2.7

Source: S.O.E.C.- National Accounts by Sector, National Accounts by Branch.

United Kingdom

The share of value added by credit and insurance in GDP grew significantly in the UK between 1978 and 1983, and the UK was second to Luxembourg in having the largest value added as a proportion of GDP. As in other countries, growth was mainly due to the credit sector.

TABLE 3.22: VALUE ADDED IN CREDIT AND INSURANCE IN THE UK 1978 AND 1983

Category	1978		1983		1985
	Value Added (ECU m)	% GDP	Value Added (ECU m)	% GDP	% GDP
Services of Credit and Insurance Companies	12,401	4.8	30,004	5.9	
: Credit	8,551	3.3	21,666	4.3	
: Insurance	3,850	1.5	8,338	1.6	
Compensation of Employees (Credit and Insurance) (1)	12,376	5.1	31,903	6.6	7.1

Source: S.O.E.C. - National Accounts by Sector, National Accounts by Branch.

(1) This is branch data whereas the data in the remainder of the table is sectoral. Differences in branch and sector data for the UK have been referred to above.

3.4 OUTPUT/TURNOVER IN FINANCIAL SERVICES

In examining the economic significance of financial services it is useful to consider some output/turnover measure of financial services as an indication of activity. There are of course very significant difficulties in defining output in financial services. In this section we utilise a turnover type measure of output for the key financial services sectors. In particular we use premiums for the insurance sector, loans outstanding in the banking sector and market capitalisation for the security markets.

INSURANCE

Table 3.23 gives details of trends in gross premium income in insurance as a proportion of GDP in each of the countries between 1978 and 1984. In each of the years, (except 1980), the highest proportion of premium income to GDP was experienced in the UK. The UK average over the period was 7.0 per cent compared with Germany and the Netherlands averaging 6.2 and 5.9 per cent respectively and Belgium and France with middle rankings of 4.0 and 3.9 per cent respectively. In the UK, Germany, France and the Netherlands there was a clear tendency for insurance gross premium income to rise as a proportion of GDP.

TABLE 3.23: GROSS INSURANCE PREMIUM INCOME AS A PERCENTAGE OF GDP, 1978-84

Country	% GDP							
	1978	1979	1980	1981	1982	1983	1984	Average
B	4.1	4.0	4.0	4.1	4.0	3.9	3.9	4.0
D	5.6	5.8	6.6	5.8	6.5	6.6	6.6	6.2
ES	n.a.	n.a.	2.6	2.6	2.6	2.5	2.5	2.6
F	3.6	3.6	3.7	3.8	3.9	4.1	4.3	3.9
I	2.1	2.0	2.0	2.1	2.1	2.2	2.2	2.1
L	2.9	3.0	3.0	3.1	3.2	3.1	3.1	3.0
NL	5.5	5.8	6.0	6.0	6.0	6.1	6.1	5.9
UK	6.2	6.4	6.5	7.0	7.2	7.4	8.1	7.0

Source: S.O.E.C., Sigma (Swiss Reinsurance Company)

Premiums per head of population show a similar pattern for total insurance, though the highest premium is in Germany. Income levels per head of population are likely to have a significant influence on these results. Life premiums per head in the UK exceed those in Germany and non-life is corresponding lower.

TABLE 3.24: PREMIUMS PER HEAD OF POPULATION IN 1984 (ECU)

Country	Total	Non-Life	Life
B	352.0	254.5	97.5
D	675.8	398.7	277.1
ES	89.8	78.5	11.3
F	441.6	307.8	133.8
I	164.4	142.0	22.4
L	349.7	268.5	81.2
NL	544.8	299.6	245.2
UK	596.6	243.7	352.9

Source: Sigma

BANKING

Between 1978 and 1984 there was a marked rise in loans outstanding for each of the banking sectors. The most rapid rate of growth was in the UK, with loans doubling from 1980 to 1983 and rising by a further 25 per cent in 1984. By 1984 Germany had slipped to second place in terms of loans outstanding, followed by France, (on the basis of the 1982 level) Italy and Spain.

TABLE 3.25: BANKING LOANS OUTSTANDING, 1978-84

Country	ECU billion						
	1978	1979	1980	1981	1982	1983	1984
B	63.5	75.1	92.3	116.4	122.7	n.a.	n.a.
D	524.4	n.a.	649.1	713.1	800.9	923.8	968.6
ES	94.6	118.1	n.a.	135.2	177.3	162.2	201.5
F	318.3	361.7	411.8	462.8	515.6	n.a.	n.a.
I	199.7	224.6	252.6	244.8	292.2	341.2	429.4
L	49.5	n.a.	n.a.	n.a.	103.9	112.5	137.7
NL	100.1	115.9	130.2	144.1	157.4	171.0	185.4
UK	256.9	n.a.	392.6	599.7	697.8	786.8	987.8

Source: OECD Financial Statistics

Table 3.26 shows that in all of the countries except Italy the amount of loans as a proportion of GDP increased. The rate of increase was marked in the UK (+81 per cent), Belgium (+67 per cent 1978-82), Luxembourg (56 per cent), less rapid in Germany (19 per cent) and the Netherlands (27 per cent), and slow in Spain, France and Italy. By 1984 the UK had loans outstanding of more than twice GDP, compared with about 140 per cent in Belgium, the Netherlands and Germany, and less than 100 per cent in Spain, France and Italy. In Luxembourg loans were almost 70 times GDP in 1984.

**TABLE 3.26: BANKING LOANS OUTSTANDING AS A PERCENTAGE OF GDP
1978 - 84**

Country	1978	1979	1980	1981	1982	1983	1984
B	85.3	94.8	109.1	135.5	142.2	n.a.	n.a.
D	116.8	n.a.	124.5	130.7	133.5	140.9	139.0
ES	82.5	82.7	n.a.	80.4	96.4	91.1	98.7
F	85.3	86.2	87.3	89.8	92.9	n.a.	n.a.
I	97.1	94.6	88.7	77.0	82.2	85.3	96.0
L	4,428	n.a.	n.a.	n.a.	6,502	6,334	6,916
NL	102.5	111.3	118.0	125.0	122.4	125.9	130.2
UK	115.2	n.a.	117.9	152.8	164.9	178.6	208.3

Source: OECD Financial Statistics

SECURITIES

An indication of the importance of securities markets in the eight countries can be obtained by examining data on stock market capitalisation. In Table 3.27 details of stock market capitalisation are presented as a measure of output for securities markets. The figures show that the UK and Germany had the largest securities markets as measured in this way. As a proportion of GDP however the securities market in Luxembourg is very large compared to that in other countries. Relative to GDP the securities markets in the Netherlands and the UK are next largest though considerably smaller than in Luxembourg.

TABLE 3.27: STOCK MARKET CAPITALISATION - END 1986

Country	Par Value of Bonds & Debentures	Market Value of Equity Shares	Total	% of GDP
ECU bn				
B	68	35	103	92
D	558	241	799	89
ES	74	89	163	69
F	229	143	372	85
I	256	131	387	75
L	599	24	623	11,125
NL	90	78	168	165
UK	374	442	816	149

Source: Federation Internationale Des Bourses des Valeurs
Annual Report 1986.

3.5 PROFITS OF FINANCIAL SERVICES

In this section we consider the question of the profits of financial services. In particular we review profits in the banking and insurance sectors.

BANK PROFITS

The most profitable banking sectors, when measured in relation to loans outstanding and to GDP, were in Italy and Spain. German and UK banks also had high profitability while the French, Dutch and Belgian banking sectors were less profitable.

TABLE 3.28: PROFIT BEFORE TAX OF BANKS, 1982

Country	ECUm	% of GDP	% of Loans Outstanding
B	389	0.45	0.32
D	5,024	0.84	0.63
ES	2,482	1.24	1.4
F	2,317	0.42	0.35
I	3,658	1.03	1.8
NL	365 (1981)	0.32	0.35
UK	4,032	0.95	0.68

Source: OECD Costs and Margins in Banking - Statistical Supplement, Financial Statistics

Belgium

Belgian banking profitability grew by 22 per cent from 1979 to 1982. Profits of the savings banks fell from their 1979 level, while there was an increase in the profits of commercial banks and "big banks".

TABLE 3.29: BELGIUM BANKING PROFITABILITY, 1978-82

Year	Big Banks	Commercial Banks	Profits (ECU m)	
			Savings Banks	Total
1982	119	188	82	389
1981	102	184	68	354
1980	34	165	52	251
1979	82	129	109	320
1978	97	150	n.a.	247

Source: OECD - Costs and Margins in Banking

Germany

In Germany the savings banks accounted for more than half of profits earned by the banking sector between 1978 and 1982 and had the most rapid growth in profits (Table 3.30). The profits of the "big banks" and commercial banks fell from 1978-81 before recovering in 1982, while there was a large fall in the profits of the giro banks. Overall profitability of the sector rose by one-third from 1978 to 1982.

TABLE 3.30: GERMAN BANKING PROFITABILITY, 1978-82

Year	Big Banks	Commercial Banks	Profits (ECU m)		TOTAL
			Giro Banks	Savings Banks	
1982	700	1,429	242	2,653	5,024
1981	474	1,083	204	1,811	3,572
1980	486	1,034	246	1,427	3,193
1979	555	983	405	1,285	3,228
1978	630	1,213	450	1,507	3,800

Source: As for table 3.29

Spain

Spanish banking profits rose by 71 per cent between 1978 and 1982, with the most rapid growth rate being 88 per cent by the "big banks". The share of total profits accounted for by the private banks fell from 48 per cent in 1978 to 39 per cent in 1982.

TABLE 3.31: SPANISH BANKING PROFITABILITY, 1978-82

Year	Big Banks	Private Banks	Profits (ECU m)	
			Savings Banks	Total
1982	864	975	643	2,482
1981	792	1,043	531	2,366
1980	615	861	451	1,927
1979	497	787	373	1,657
1978	459	699	292	1,450

Source: As for Table 3.29

France

French banking profitability rose by 45 per cent between 1978 and 1982. Profits of the "big banks" rose by only 26 per cent compared to 51 per cent for other banks.

TABLE 3.32: FRENCH BANKING PROFITABILITY, 1978-82

Year	Big Banks	Profits (ECU m)		Total
		Other Banks		
1982	483	1,834		2,317
1981	662	1,981		2,643
1980	663	1,816		2,479
1979	432	1,319		1,751
1978	382	1,213		1,595

Source: As for Table 3.29

Italy

Italian banking profits rose by 180 per cent from 1978 to 1982 and each of the major banking sectors more than doubled profits. The "big banks" profits grew by 280 per cent, compared with 179 per cent and 150 per cent for the commercial and savings banks. However, in 1982 the commercial banks accounted for 70 per cent of banking sector profits.

TABLE 3.33: ITALIAN BANKING PROFITABILITY, 1978 - 82

Year	Big Banks	Commercial Banks	Profits (ECU m)		Total
			Savings Banks		
1982	384	2,565	709		3,658
1981	146	1,934	465		2,545
1980	168	1,494	343		2,005
1979	98	1,019	284		1,401
1978	101	919	283		1,303

Source: As for Table 3.29

Netherlands

The Netherlands banking sector profits fell between 1978 and 1981, from ECU 859 m to ECU 365 m. Almost all of this drop in profitability was experienced by the commercial banks.

TABLE 3.34: NETHERLANDS BANKING PROFITABILITY, 1978-81

Year	Commercial Banks	Profits (ECUm)		TOTAL
		Savings Banks		
1981	314	51		365
1980	616	53		669
1979	911	66		977
1978	793	66		859

Source: As for Table 3.29

United Kingdom

Profitability of the UK banking sector rose by 37 per cent from 1979 to 1982, with the most rapid growth in profits being by the building societies (Table 3.35). The clearing banks had a poor performance, with profits rising by only 10 per cent.

TABLE 3.35: BRITISH BANKING PROFITABILITY, 1978-82

Year	Clearing Banks	Building Societies	Profits (ECU m)		TOTAL
			Trustee Savings Banks		
1982	2,670	1,146	216		4,032
1981	2,488	984	119		3,591
1980	2,464	599	167		3,230
1979	2,431	379	142		2,952
1978	n.a.	533	136		n.a.

Source: As for Table 3.29.

Profits in Insurance

An aggregate measure of profits in insurance has been derived from the national accounts by subtracting from value added in insurance plus net transfer income the amount paid to employees. This figure represents premiums and other income less intermediate consumption, interest paid and employee costs. It is akin to profits before depreciation and tax in company accounts but would exclude profits of foreign subsidiaries which were not repatriated. Details are presented below.

TABLE 3.36: PROFITS IN INSURANCE, 1983 (ECUm)

	Value Added Plus Net Transfer Income(1)	Compensation of Employees	Profits	% of Premiums
B (2)	1,157	576	581	16.7
D (2)	9,438	5,183	4,255	10.8
F	5,618	2,660	2,958	12.5
I	2,041	1,136	905	10.2
NL	2,554	1,458	1,096	13.2
UK	9,070	8,032	1,038	3.2

(1) Net interest receipts plus other income less interest imputed to policy holders and critical interest paid.

(2) 1982

Source: S.O.E.C. Detailed Sector Accounts Table 2 Various Issues; Sigma April 1985.

The above figures shows that profits, (as defined), as a percentage of premiums exceeded 10 per cent in all the countries shown apart from the UK.

Profits in the UK at 3.2 per cent of premiums were the lowest of the six countries.

Profits earned by non-life insurance companies are derived almost entirely from investment earnings in the sense that non-life insurance makes an underwriting loss in all but one of the five countries shown. The underwriting results are mainly determined by the relation of earned premiums to claims and operating costs. The table overleaf sets out the experience of non-life companies since 1980.

TABLE 3.37: NON LIFE INSURANCE - UNDERWRITING RESULTS
% OF PREMIUMS

	1980	1981	1982	1983	1984	Average
D	+0.3	-0.4	-0.2	+0.6	-0.2	0.0
ES	-4.8	-1.7	-3.8	-6.5	-2.3	-3.8
F	-10.5	-11.9	-14.4	-12.4	-11.2	-12.1
NL	+1.3	-0.5	-3.9	-5.5	-5.7	-2.9
UK						
home business	-1.7	-1.1	-8.0	-7.0	-13.1	-6.2
foreign business	-6.9	-12.2	-13.0	-13.2	-16.6	-12.4

Source: Sigma.

In Germany the average over the five years was zero compared to losses of over 12 per cent in France and on the foreign business of UK companies. The average loss in the Netherlands and Spain was around the 3 per cent level.

Belgium

TABLE 3.38: PROFITS IN INSURANCE, 1978 - 83 (ECUm)

	1978	1979	1980	1981	1982	1983
Value Added & Net						
Transfer Income	879	1,002	n.a.	n.a.	1,157	n.a.
Compensation of Employees	465	515	525	539	576	n.a.
Profits	414	487	n.a.	n.a.	581	n.a.
Profits % of Premiums	13.6	15.3	n.a.	n.a.	16.7	n.a.

Source: S.O.E.C.; Sigma

Profits in insurance in Belgium, as defined earlier, were in excess of 13 per cent in 1978 and 1979 and in 1982 reached 16.7 per cent of premiums.

Germany

TABLE 3.39: PROFITS IN INSURANCE, 1978 - 83 (ECUm)

	1978	1979	1980	1981	1982	1983
Value Added & Net						
Transfer Income	6,588	6,988	7,194	7,759	9,438	9,621
Compensation of Employees	3,482	3,820	4,160	4,374	5,183	n.a.
Profits	3,106	3,168	3,034	3,385	4,255	n.a.
Profits % of Premiums	12.2	11.1	8.8	10.8	10.8	n.a.

Source: S.O.E.C.; Sigma

In Germany, the profits of insurance companies calculated from national accounts were in the 9 - 11 per cent range for all years shown except 1978.

The table below shows profits after tax in the various categories of non-life insurance and life insurance in Germany. The percentage of total premiums remained steady at around 1.5 per cent in the years 1979 - 84, reflecting the degree of control exercised over the industry.

TABLE 3.40: PROFITS AFTER TAX IN GERMANY

	1979	1980	1981	1982	1983	1984
Total (% of Premiums)	1.4	1.4	1.4	1.7	1.8	1.6
Life Assurance (% of Premiums)	0.5	0.5	0.5	0.6	0.7	0.7
Health Insurance (% of Premiums)	0.6	0.7	1.0	1.2	1.4	1.1
Non-Life Insurance (% of Premiums)	2.4	2.3	2.2	2.7	2.8	2.5

Source: Statistical Yearbook of German Insurance GDV 1986.

France

TABLE 3.41: PROFITS IN INSURANCE, 1978 - 83 (ECUm)

	1978	1979	1980	1981	1982	1983
Value Added & Net						
Transfer Income	3,501	3,384	4,046	4,772	4,721	5,618
Compensation of Employees	1,551	1,750	2,028	2,302	2,520	2,660
Profits	1,950	1,634	2,018	2,470	2,201	2,958
Profits % of Premiums	14.5	14.8	11.6	12.5	10.1	12.5

Source: S.O.E.C.; Sigma

In France profits as a percentage of premiums fell from about 14.5 per cent in 1978 and 1979, to 10.1 per cent in 1982 before recovering to 12.5 per cent in 1983.

Italy

TABLE 3.42: PROFITS IN INSURANCE, 1978 - 83 (ECUm)

	1978	1979	1980	1981	1982	1983
Value Added & Net						
Transfer Income	892	1,076	1,345	1,403	1,743	2,041
Compensation of Employees	582	646	786	913	995	1,136
Profits	310	430	559	490	748	905
Profits % of Premiums	7.1	8.9	10.9	7.3	9.9	10.2

Source: S.O.E.C.; Sigma

In Italy profits as a percentage of premiums were between 7.1% and 10.9 per cent in the period 1978 - 83.

The Netherlands**TABLE 3.43: PROFITS IN INSURANCE, 1978 - 83 (ECUm)**

	1978	1979	1980	1981	1982	1983
Value Added & Net						
Transfer Income	1,748	1,939	2,134	2,295	2,333	2,554
Compensation of Employees	1,022	1,092	1,159	1,225	1,377	1,458
Profits	726	847	975	1,070	956	1,096
Profits % of Premiums	13.5	14.1	14.8	15.5	12.5	13.2

Source: S.O.E.C.; Sigma

In the Netherlands profits, derived from national accounts data, as a percentage of premiums were at least 12.5 per cent in each year and reached a peak of 15.5 per cent in 1981.

UK**TABLE 3.44: PROFITS IN INSURANCE, 1978 - 83 (ECUm)**

	1978	1979	1980	1981	1982	1983
Value Added & Net						
Transfer Income	4,213	5,162	7,115	6,738	8,160	9,070
Compensation of Employees	3,000	4,646	5,342	6,146	7,317	8,032
Profits	1,213	516	1,773	592	843	1,038
Profits % of Premiums	8.7	3.0	8.1	2.1	2.7	3.2

Source: S.O.E.C.; Sigma

In the UK profits (national accounts definition) as a percentage of premiums have been around 3 per cent in 1979 and 1981 - 83. The level in 1978 and 1980 was considerably higher at about 8%.

The table below shows non-life profits as a percentage of non-life premiums in the UK for 1980 - 83. The data is for both domestic and foreign activities of UK companies and shows clearly the importance of investment income to viability.

TABLE 3.45: UK PROFITS NON-LIFE INSURANCE, 1980-83

	% of non life premiums			
	1980	1981	1982	1983
Underwriting	-4.5	-7.2	-11.0	-11.0
Investment income	13.7	14.7	15.3	15.0
Long-term business	1.6	1.8	2.1	2.3
Other	0.1	0.3	0.5	0.7
Total:	10.9	9.6	6.9	7.0

Source: The British Insurance Industry RL Carter & AH Godden

3.6 BREAKDOWN OF AGGREGATE DEMAND FOR THE CREDIT AND INSURANCE SECTOR

In this section the demand for financial services is analysed using input - output data, bank lending and other bank balance sheet data and data on non-life insurance premiums and claims. The analysis shows the demand for these services by households, government and the external sector and, where possible, by industrial and service category.

Demand for Credit and Insurance

The table below shows an analysis of input-output data on the total consumption of the credit and insurance services as detailed by sector and end use. The analysis can be taken as describing the breakdown of output from the domestic credit and insurance industries in each country since imports are zero or negligible in both intermediate consumption and final uses in all countries.

TABLE 3.46: BREAKDOWN OF OUTPUT OF THE CREDIT AND INSURANCE SECTOR 1980 (1)

	D	ES	F	I	NL	UK
	% OF TOTAL USES					
Intermediate Consumption from all Origins						
1) Agriculture	0.4	1.6	0.6	1.6	1.3	0.6
2) Energy	0.3	2.1	0.3	0.3	0.3	0.8
3) Metals	0.9	6.1	1.6	3.5	0.8	3.8
4) Machinery and Equipment	1.3	4.2	1.6	2.5	0.8	5.0
5) Food, Drink and Tobacco	0.3	2.0	0.7	1.1	0.6	2.1
6) Textiles and Clothing	0.1	2.0	0.4	1.9	0.1	0.7
7) Timber, Paper and Printing	0.8	3.3	0.6	2.7	0.6	1.7
8) Construction	1.4	3.4	3.5	2.4	0.9	0.7
9) Transport and Communications	4.5	8.9	3.6	7.0	5.4	15.1
10) Credit and Insurance	61.0	48.4	69.1	67.3	60.0	44.8
11) Other Services	3.7	3.8	1.4	2.3	1.8	3.4
12) Non-Market Services	<u>1.6</u>	<u>0.0</u>	<u>0.3</u>	<u>1.3</u>	<u>1.0</u>	<u>7.2</u>
13) Total Intermediate Consumption (1-12)	76.5	85.8	83.8	94.0	73.6	85.9
Final Uses						
14) Household Consumption	23.0	11.5	14.6	4.1	22.3	22.9
15) Government Consumption	0	0	0	0	0	0
16) Total Consumption (14+15)	23.0	11.5	14.6	4.1	22.3	22.9
17) Stock Changes and Capital Formation	-	-	-	-	-	-26.7
18) Exports to EEC countries	0.1	n.a.	0.5	0.3	1.8	3.8
19) Exports to 3rd Countries	0.3	n.a.	1.2	1.5	2.3	14.2
20) Total Exports (18+19)	<u>0.4</u>	<u>2.5</u>	<u>1.7</u>	<u>1.8</u>	<u>4.1</u>	<u>18.0</u>
21) Total Final Uses (16+17+20)	23.5	14.2	16.2	6.0	26.4	14.1
22) Total Uses (13+21)	100.0	100.0	100.0	100.0	100.0	100.0
23) Total Uses ECUm	36,999	11,631	26,955	20,682	8,385	27,464

**Source: S.O.E.C. National Accounts - Input Output Tables 1980
Tables on Intermediate Output and Final Use**

(1) No data is available for Belgium and Luxembourg

The analysis shows that consumption of credit and insurance in the process of producing other goods absorbed about 75 per cent or more of the output of the sector in all the countries shown. In Italy 94 per cent of output was absorbed by intermediate consumption. The two most important other users of the intermediate output of the sector were transport and communications, the other services sector and, in the UK, the general public sector under the non-market services category. In several countries construction was the next most important purchasing sector.

The most important final user of credit and insurance services was the household sector. In Germany, the UK and the Netherlands the household sector purchased about 23 per cent of total credit and insurance services used. In France and Spain the percentages were 14.6 and 11.5 respectively while in Italy it was only 4.1 per cent. Total exports were in the range of 0.4 per cent to 4.1 per cent of total uses for all the countries shown, except the UK, for which the figure was 18 per cent.

The table below shows the percentage of total inputs represented by credit and insurance, in each of the 12 sectors in 6 countries.

TABLE 3.47: INTERMEDIATE CONSUMPTION OF CREDIT AND INSURANCE FROM ALL ORIGINS AS A PERCENTAGE OF TOTAL INPUTS

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
D	1.0	0.3	0.3	0.6	0.3	0.4	0.7	1.4	2.8	71.0	3.8	1.4	5.1
ES	1.9	1.8	3.2	4.0	1.3	4.1	4.9	3.4	5.0	71.2	6.9	0.2	7.1
F	0.9	0.2	0.9	1.1	0.5	1.0	0.8	3.3	1.8	71.9	1.4	0.4	6.1
I	2.4	0.3	1.6	1.6	0.8	1.8	2.5	2.6	3.4	78.2	5.5	2.2	6.7
NL	1.9	0.2	0.4	0.7	0.3	0.6	0.7	0.6	3.2	74.7	2.9	1.2	5.6
UK	1.4	0.8	2.2	3.3	1.8	1.6	2.1	0.8	7.4	60.6	13.6	8.3	7.2

- (1) Agriculture
- (2) Engineering
- (3) Metals
- (4) Maintenance
- (5) Food, Drink and Tobacco
- (6) Textiles and Clothing
- (7) Timber, Paper and Printing
- (8) Construction
- (9) Transport and Communications
- (10) Credit and Insurance
- (11) Other Services
- (12) Non-Market Services
- (13) Total

Source: S.O.E.C. National Accounts - Input Output Tables 1980
Tables on Intermediate Output

The table shows that the intermediate output of the credit and insurance sector is a very large proportion of inputs to the sector itself. The transport, other services and construction sectors show the next largest proportion of inputs from credit and insurance. Among the countries shown, credit and insurance as a percentage of total inputs is highest in the UK and Spain at 7.2 and 7.1 per cent respectively and lowest in Germany at 5.1 per cent.

The table below shows the proportions in total household consumption and in total consumption and exports of credit and insurance services which were consumed directly by end-users. Consumption of credit and insurance services represented over 3 per cent of total household consumption in the UK in 1980, 2.69 per cent in Germany and 2.51 per cent in the Netherlands. Consumption was lowest in Italy at 0.45 per cent of household consumption. The percentages of total final consumption are smaller only because total final consumption includes government services as well as household consumption.

**TABLE 3.48: CREDIT AND INSURANCE FINAL USES IN 1980 (ALL ORIGINS)
AS PERCENTAGES OF TOTAL FOR ALL SECTORS**

	Household Consumption	Total Final Consumption	Exports to the EEC	3rd Country Exports
D	2.69	2.05	0.07	0.15
ES	1.27	1.07	n.a.	n.a.
F	1.31	1.06	0.27	0.61
I	0.45	0.36	0.26	0.84
NL	2.51	1.94	0.35	0.91
UK	3.25	2.41	3.10	7.15

**Source: S.O.E.C. National Accounts - Input Output Tables 1980
Tables on Intermediate Output**

Demand for Bank Lending

The table below shows an analysis of bank lending to all industries and services excluding financial institutions in 1986. The table shows that manufacturing accounted for the largest percentage of loans ranging from 35% in Germany to 65% in Belgium. The exception to this was the Netherlands, where the biggest percentage of banking lending goes to the distributive sector accounting for 30% of loans while manufacturing accounted for 28%. Within the manufacturing sector itself the engineering industry in all countries obtained the biggest proportion of loans.

Loans which to "other services", accounted for the next largest proportion of bank loans. The next largest proportions were accounted for by transport and communication in France and Belgium obtaining 13% and 9% of total loans respectively. In Spain energy accounted for 14% while in Germany and the UK the distributive sector received 30% and 33% respectively of total loans.

TABLE 3.49: BANK LENDING BY SECTOR OF ECONOMIC ACTIVITY

	B	D	ES	F	I	NL	UK
	% of Total						
Agriculture	3.6	7.9	4.3	5.4	8.1	1.8	9.2
Manufacturing	65.4	35.3	38.8	40.0	38.7	27.5	36.9
- Metal Manufacturing	4.8	5.1	4.5	0	2.2	1.3	1.4
- Chemicals	11.6	2.0	3.5	0	3.4	3.9	2.6
- Engineering	23.9	14.4	25.6	0	16.0	9.1	13.2
- Food, Drink and Tobacco	9.0	5.1	5.2	6.3	4.8	6.2	7.0
- Textiles, Leather and Clothing	4.6	2.8	0	0	5.8	1.4	2.3
- Other Manufacturing	11.4	5.8	0	33.7	6.5	5.6	10.4
Energy	7.4	7.4	13.8	4.2	1.9	4.2	6.3
Construction	4.9	8.7	9.7	2.7	9.9	5.5	8.4
Distribution Trade	0	29.4	12.8	0	0	29.8	33.3
Transport and Communication	8.8	11.3	4.1	13.1	6.6	11.4	5.8
Other Services	9.9	0	16.7	34.9	34.9	19.8	0
Total	100	100	100	100	100	100	100

Source: Central Bank Reports

Demand for Bank Assets and Liabilities

Demand for basic banking services may be regarded both as a demand for loans and a demand for deposit taking services. On the assets side the service provided meets demand for borrowing from Government, the rest of the domestic sector and the rest of the world (1). On the liabilities side the demand for deposit services may similarly be broken down between these sectors.

The table below shows a summary of the assets of banking institutions, excluding the Central Banks, for seven of the countries in the survey.

For the total of the seven, 34 per cent of the claims of banks were on the "other domestic sector", and 28 per cent on the "rest of the world" at end 1985. The UK accounts for 16 percentage points of the rest of the world figure. Claims on General Government accounted for 12 per cent of the total. The claims of the UK and German banking sectors accounted for 65 per cent of the claims of the banking sectors of the seven countries.

TABLE 3.50: FINANCIAL ASSETS OF BANKING INSTITUTIONS - End 1985

ECU BN	B(1)	D	ES	I(2)	L	NL	UK	Total	% of Total
				End of 1985					
Total Claims on:	167	1475	291	621	163	252	1299	4267	100
Institutions of the Group (*)	11	364	23	76	18	13	290	794	19
Other Financial Institutions	5	39	49	114	0.1	8	56	271	6
General Government	32	209	54	129	0.1	43	30	498	12
Other Domestic Sectors	32	695	149	248	5	99	230	1458	34
Rest of the World	86	129	15	52	140	80	674	1176	28
Not Allocable		39		2		7	22	70	1

(*) The group refers to institutions in the banking sector.

(1) End 1983

(2) End 1984

Source OECD Financial Statistics

- (1) Rest of the world refers to claims and liabilities outside each of the countries. Intra-EEC claims and liabilities are not netted out.

On the liabilities side, it can be seen from the table below that the other domestic sector held 40 per cent of claims on banking institutions and the rest of the world 28 per cent. General Government accounted for only 3 per cent.

TABLE 3.51: FINANCIAL LIABILITIES OF BANKING INSTITUTIONS
- End 1985

	B(1)	D	ES	I(2)	L	NL	UK	Total	% of Total
	End of 1985								
Total Claims of:	159	1474	280	589	169	251	1326	4249	100
Institutions of the Group	10	379	23	72		14	290	788	18
Other Financial Institutions	2	47	30	67	23	11	57	237	6
General Government	1	93	24	25	.02	2	1	146	3
Other Domestic Sectors	47	815	177	335	10	127	185	1696	40
Rest of the World	97	83	25	81	136	73	703	1198	28
Not Allocable		56		6		24	87	173	4

(1) End 1983

(2) End 1984

Source: OECD Financial Statistics

BELGIUM

The assets of the banking institutions in Belgium accounted for 4 per cent of the total for the seven countries.

TABLE 3.52: BELGIUM

Some important components of the
Assets and Liabilities of Banking
Institutions
End 1983

ASSETS	ECU % OF		LIABILITIES	ECU % OF	
	BN	TOTAL		BN	TOTAL
Total Claims	167	100	Total Liabilities	159	100
of which:			of which deposits		
Short term loans:	39	23	other than cash &		
General Government	3		transferable		
Other Domestic			deposits	114	71
Sectors	18		General Govt.	1	
Rest of World	17		Other Dom. Sec.	11	
			Rest of World	101	63
Bonds issued by	24	14			
General Government	16				
Other domestic	2				
Rest of World	3				

Source: OECD Financial Statistics

Short term loans accounted for 23 per cent of total assets and bonds 14 per cent. Interestingly in Belgium cash and transferable deposits of the rest of the world accounted for 36 per cent of assets (not shown in above table). On the liabilities side 63 per cent were represented by time deposits from the rest of the world.

GERMANY

The assets of the German banking system amount to 34 per cent of those in the seven countries. About 60 per cent of the assets are long term loans, the majority of which are to the other domestic sector. Liabilities are more evenly spread between deposits other than cash and transferable deposits and other instruments.

TABLE 3.53: GERMANY

Some important components of the
Assets and Liabilities of Banking
Institutions
End 1985

ASSETS			LIABILITIES		
	ECU BN	% OF TOTAL		ECU BN	% OF TOTAL
Total Claims	1475	100	Total Liabilities	1474	100
of which			of which		
Long Term Loans	889	60	Deposits other		
General Government	173	12	than cash and		
Other Domestic			transferable		
Sectors	529	36	Deposits	355	24
Rest of World	66	5	Other deposits	339	23
			Short Term		
			Loans	275	19
			General Government	16	1
			Other Domestic	95	6

Source: OECD Financial Statistics

SPAIN

The total assets of banking institutions in Spain accounted for 7 per cent of the total in the 7 countries surveyed in 1985. As may be seen from the table below demand for short and long term loans accounted for 48% of claims of which the majority were to the other domestic sector.

TABLE 3.54: SPAIN

Some important components of the
Assets and Liabilities of Banking
Institutions

ASSETS			LIABILITIES		
	ECU BN	% OF TOTAL		ECU BN	% OF TOTAL
Total claims	291	100	Total Liabilitie	280	100
of which short & long term loans	140	48	of which deposits other than cash & transferable		
of which:			deposits	183	65
General Government	7		General Govt.	3	
Other Domestic Sectors	120	41	Other Dom. Sec.	122	43
Rest of World	7		Rest of World	22	

Source: OECD Financial Statistics

On the liabilities side 65 per cent of the total were deposits, other than sight and transferable deposits. The largest proportion of these were from the other domestic sector.

ITALY

In Italy the assets of the banking institutions are over 14 per cent of that in the seven countries surveyed. Short term loans accounted for 30% of assets at the end of 1984, bonds 20% and long term loans 18%. Most of the short and long term loans were to the other domestic sector and most of the bonds were Government issued.

TABLE 3.55: ITALY

Some important components of the
Assets and Liabilities of Banking
Institutions
End 1984

ASSETS	ECU		LIABILITIES	ECU	
	BN	% OF TOTAL		BN	% OF TOTAL
Total Claims	621	100	Total Liabilities	589	100
Short term loans	185	30	Cash & other transferable deposits	241	41
of which			General Government	14	
General Government	5		Other Domestic Sectors	151	25
Other Domestic Sectors	134	22	Rest of World	6	
Rest of World	46				
Bonds	123	20			
General Government	67	11			
Long Term Loans	111	18			
Other Domestic Sectors	86	14			

Source: OECD Financial Statistics

Cash and other transferable deposits accounted for 41 per cent of liabilities, the majority being to the other domestic sector. A further 29 per cent of liabilities were represented by time deposits of the other domestic sector, not shown above.

LUXEMBOURG

Assets of the banking institutions in Luxembourg accounted for 4 per cent of the total assets in the seven countries' banking institutions

TABLE 3.56: LUXEMBOURG

Some important components of the
Assets and Liabilities of Banking
Institutions
End 1985

ASSETS	ECU	% OF	LIABILITIES	ECU	% OF
	BN	TOTAL		BN	TOTAL
Total Claims	163	100	Total Liabilities	169	100
of which					
cash & transferable			cash & transferable		
deposits	39	24	deposits	82	49
General Government	-	-	Other domestic	7	4
Rest of World	30	18	Rest of World	66	39
Other Deposits	50	31	Other Deposits	69	41
Rest of World	42	25	Rest of World	60	35
Long Term Loans	36	22			
Rest of World	33	20			

Source: OECD Financial Statistics

Both the assets and the liabilities of the banking institutions are dominated by the importance of the rest of the world sector as can be seen from the above table. On the assets side 63 per cent is represented by cash, deposits and long term loans to the rest of the world. Deposit liabilities are 74 per cent from the rest of the world.

NETHERLANDS

In the Netherlands the assets of the banking institutions amounted to 6 per cent of the total in the 7 countries surveyed.

TABLE 3.57: NETHERLANDS

Some important components of the
Assets and Liabilities of Banking
Institutions
End 1985

ASSETS	ECU	% OF	LIABILITIES	ECU	% OF
	BN	TOTAL		BN	TOTAL
Total Claims	252	100	Total Liabilities	251	100
of which			of which		
Short & Long Term Loans	64	25	Deposits other than cash and transferable deposits	164	65
General Government	1	0.5	General Government	1	0.3
Other Domestic Sectors	32	13	Other Dom.Sec.	88	35
Rest of World	23	9	Rest of World	61	24
Debt Certificates	84	33			
General Government	3	1			
Other Domestic Sector	12	5			
Rest of World	70	28			

Source: OECD Financial Statistics

The table above shows that 25 per cent of assets were in the form of short term loans, most of the demand for which came from other domestic sectors (13%), and the rest of the world. The other important component was debt certificates issued in the main by the rest of the world. Deposits other than cash and transferable deposits were the main liabilities of the banks at the end 1985. The main users of these deposit facilities were the other domestic and rest of the world sectors.

UNITED KINGDOM

In terms of total assets the UK has the second largest banking sector of the seven countries, accounting for 31 per cent of total assets. The table below shows an aggregate analysis of the users of the main components of the UK's banking services.

TABLE 3.58: UK

Some important components of the
Assets and Liabilities
of Banking Institute

ASSETS			LIABILITIES		
	ECU BN	% OF TOTAL		ECU BN	% OF TOTAL
Total claims	1299	100	Total Liabilities	1326	100
of which:			of which:		
Deposits other than cash & transferable deposits	709	55	Deposits other than cash & transferable deposits	873	66
General Government	7		Other Domestic	97	7
Rest of World	458	35	Rest of World	529	40
General Government			General Government	-	-
Short Term Loans	410	32			
Other Domestic Sectors	224	17			
Rest of World	136	10			

Source: OECD Financial Statistics

On the assets side, deposits other than cash and transferable deposits account for 55 per cent in the UK. Most of these are with the rest of the world. Short term loans, accounting for 32 per cent of assets is the next largest component. Most of the loans are to the other domestic sector, but a significant proportion is to the rest of the world.

DEMAND FOR NON-LIFE INSURANCE

In this section and subsequently in this study we present data on the insurance sector. It should be noted that there are particular weaknesses in insurance statistics. For example in the case of premium income recent work carried out by a sub-group of the OECD Insurance Committee shows, premium income figures compiled on a national basis can mean all sorts of different things. Premium income may include reinsurance income as a receipt but be subject to a deduction for outgoing reinsurance. Or incoming reinsurance may not be included and outgoing reinsurance may not be deducted. In both cases, the figures may or may not include those for specialist reinsurance companies. The figures for any given country may represent the total premium income arising on risks located in that country, regardless of the ownership or location of the receiving insurers; While every attempt has been made to ensure comparability great caution is required.

Income

Total net accident insurance premiums (1) in 1983 are shown in the table below for Germany, France, Italy, Belgium and the Netherlands. Germany had the largest premium income at ECU 18,344 million, followed by France with ECU 14,880 million and Italy with ECU 6,087 million. However, between 1980 and 1983 premium income grew most rapidly in Italy and France, with much less rapid rates of growth (in current prices) in the other countries.

TABLE 3.59: TOTAL NET ACCIDENT INSURANCE PREMIUMS, 1983

Country	Premium Income (ECU m)	
	1983	% change 1980 - 83
B	2,038 (1982)	+ 7.1
D	18,344	+ 26.1
F	14,880	+ 63.8
I	6,087	+ 67.1
NL	3,741	+ 18.2 (1980-82)

Note (1) Premiums are net of Premiums ceded to countries abroad.

Source: S.O.E.C. Detailed Sector Accounts

In each of the countries the bulk of premium income is derived from domestic residents and comparatively little from other countries. Table 3.60 shows that in 1983 the Netherlands had the largest premium income from abroad in value terms followed by France. The Netherlands also had the largest proportion of premium income from abroad. Between 1978 and 1983 Germany and Belgium had an increase in the proportion of income from abroad.

(1) Accident insurance covers all non life business.

TABLE 3.60: NET ACCIDENT INSURANCE PREMIUM INCOME FROM ABROAD, 1980 AND 1983

Country	Income from abroad (ECUm)		% of income from abroad	
	1980	1983	1980	1983
B	77	86	3.9	4.2
D	99	242	1.1	1.3
F	138	190	1.3	1.3
I	0	0	0	0
NL	188	244	6.5	6.5

Source: S.O.E.C. Detailed Sector Accounts
Table 2 Various Issues

A breakdown of domestic premium income in 1983 is shown in Table 3.61 for households, government and other types of payment unit. Householders account for the majority of the premium income in each country, ranging from 53 per cent of the total in Belgium to 81 per cent in Germany. Similarly, in each country the second most important sector was the corporate sector which accounted for almost all of the remainder of the income.

TABLE 3.61: NET ACCIDENT INSURANCE PREMIUM INCOME BY CATEGORY,

1983

Category	% of total domestic income:				
	B (1)	D	F	I	NL
Households	53	81	66	58	63
Non-financial corporate & quasi- corporate	36	17	32	25	31
Insurance enterprises	7	1	1	14	4
General Government	4	1	1	1	2
Credit Institutions	0	0	0	1	0

(1) 1982

Columns may not total to 100 due to rounding.

Source: S.O.E.C. Detailed Sector Accounts
Table 2 Various Issues

Claims

The amount paid in claims in 1983 is shown in Table 3.56, together with the proportion paid outside of each country. Payments for claims are highest in the largest market - Germany - and follow market size. However, Table 3.56 also shows that the proportion of claims paid by resident insurance companies to foreigners varied from 10 per cent in Belgium to zero in Italy.

TABLE 3.62: NET ACCIDENT INSURANCE CLAIMS PAID AND PROPORTION PAID ABROAD, 1983

Country	Claims paid (ECUm)	% paid abroad
B	2,179 (1982)	10.1
D	18,357	1.9
F	15,132	0.3
I	6,088	0
NL	3,741	7.0

**Source: S.O.E.C. Detailed Sector Accounts
Table 2 Various Issues**

As with Table 3.61 the most important sectors for claims are households and the corporate sector. Table 3.63 shows that the proportion of total claims accounted for by households varied from 49 per cent in Belgium to 80 per cent in Germany and from 15 to 32 per cent for corporations in Germany and Belgium.

**TABLE 3.63: NET ACCIDENT INSURANCE CLAIMS PAID BY CATEGORY,
1983**

Category	% of total domestic income:				
	B	D	F	I	NL
Households	49	80	77	61	63
Non-financial corporate & quasi-corporate Insurnace enterprises	32	15	23	24	31
General Government Credit institutions	16	0	0	14	4
Private non-profit institutions serving households	3	4	0	0	1
	0	1	0	1	0
	0	0	0	0	0

(1) 1982

* Columns may not total to 100 due to rounding

**Source: S.O.E.C. Detailed Sector Accounts
Table 2 Various Issues**

3.7 EXTERNAL TRANSACTIONS IN FINANCIAL SERVICES (1)

In this section we consider the economic significance of financial services in terms of external transactions. The data in this section is based on Eurostat and IMF figures supplemented by national estimates and some confidential data from the statistical office of the EEC.

The table below is based on input-output data in Eurostat national accounts. It shows that total imports of credit and insurance services ranged between 0.3 per cent of total resources in the Netherlands and 6.6 per cent in Italy. Imports from EEC countries were much less in four of the six than imports from third countries. The picture for exports was similar. Exports ranged from 1.9 per cent of output in Germany to 12.1 per cent of output in the UK and exports outside the EEC were much larger in four of the six countries than exports to EEC countries.

TABLE 3.64: CREDIT AND INSURANCE RESOURCES AND USES 1980

Proportion of Total Resources							
RESOURCES	EUR-8	D	ES	F	I	NL	UK
Total Intermediate Input	516	481	459	493	603	490	542
Value Added - Market Prices	408	388	481	416	326	451	410
Actual output	933	878	940	921	934	951	965
Imports from the EC Countries	-	12	11	24	23	2	7
Imports From Third Countries	28	27	37	27	42	2	27
Total Imports	28	39	49	51	66	3	35
Total Resources	1000	1000	1000	1000	1000	1000	1000
USES							
Total Intermediate Output	786	811	760	781	885	690	630
Consumption of Households	115	128	81	95	54	150	161
Gross Fixed Capital Formation	57	42	126	51	-	111	88
Exports to EC Countries	-	6	15	22	12	29	25
Exports to Third Countries	42	13	18	51	49	21	96
Total Exports	42	19	33	74	61	49	121
TOTAL USES	1000	1000	1000	1000	1000	1000	1000

Source: S.O.E.C. National Accounts Input Output Tables 1980.
(Branch Data)

- (1) No data available for Luxembourg or Belgium.
(2) Data on the resources side do not add to 100 in most cases.

Table 3.65 summarises balance of payments data on trade in financial services for the eight countries. Insofar as could be identified this data relates to payment for services and excludes investment income and interest from lending/borrowing. Brokerage fees and commissions have been included where data was available but it should be noted that these may include earnings by other activities such as advertising and other agencies. This item is particularly large for Belgium. The data for trade with the EEC10 is not available for all the services and the data shown in this column thus understates the extent of intra-community trade.

The table shows, as expected, that export earnings of the UK financial sector at ECU 5.8bn are by far the largest of the eight countries. Export earnings in Belgium/Luxembourg, Germany and France are about half of the UK figure. Italy and the Netherlands are roughly half the German and France level.

Imports of financial services to Germany are very large at ECU 6.7bn compared to less than one third of that level for the other countries with the exception of Belgium and France. The data on the geographical breakdown of trade in financial services is not sufficiently comprehensive at this level of aggregation to bear comment.

The table also shows that as a percentage of total credits(1) the UK was 2.2 per cent compared to most other countries which ranged between 1.1 and 1.5 per cent. The percentage for Belgium is 3.2 per cent if all the brokerage and Commission items refers to payment for financial services. Spain's credits for financial services were 0.6 per cent of total credits. On the debit side the UK percentage of total debits was lowest at 0.7 per cent while Germany's was highest at 2.6 per cent. Again the Belgium/Luxembourg figure would be highest if all the brokerage and commission items were relevant to financial services.

(1) Credits in trade data are payments received for exported services. Debits are payments made for imported services.

TABLE 3.65: INTERNATIONAL TRADE IN FINANCIAL SERVICES 1985(*)

	Credits		% of Total Credits	Debits		% of Total Debits
	World	EEC10		World	EEC10	
	ECUm			ECUm		
B & L	3,467		3.2	3,750		3.5
D	3,118	n.a.	1.1	6,774	n.a.	2.6
ES	291	25	0.6	849(1)	237	1.7
F	3,291	1,109	1.5	3,115	1,314	1.4
I	1,635	n.a.	1.2	2,052	n.a.	1.4
NL	1,524	n.a.	1.3	2,145	n.a.	2.0
UK	5,803	n.a.	2.2	1,907	n.a.	0.7

(1) Commissions data from 1984

Belgium

Table 3.66 shows that the largest item in Belgian trade was brokerage and commission fees at more than ECU 2bn for both debits and credits, not all of which relates to financial services. Export earnings from this source have grown at a much slower pace than earnings from insurance and banking. Non-merchandise insurance credits doubled between 1979 and 1985 while banking credits rose even faster in the same period. On the debit side the growth rates were similar to that on the credit side and in absolute terms trade was about balanced for these items.

The geographical breakdown shown for Banking and Insurance on Transport indicates that almost one half of earnings abroad are from the EEC10 on these items. More than half of payments abroad on these two items were to the EEC10.

(*) Some of the data in the tables which follow were obtained from the Statistical Office of the EEC in Luxembourg on the basis that it would not be published.

**TABLE 3.66: TRADE IN FINANCIAL SERVICES BY
BELGIUM/LUXEMBOURG, 1979-85**

	1979	1980	1981	1982	1983	1984	1985
	ECUm						
<u>Credits</u>							
Brokerage Fees and Commissions	-	2,029	2,177	1,977	2,310	2,130	2,198
Banking	-	174	222	291	335	374	462
- of which EEC10	-	50	74	73	89	132	132
Nonmerchandise Insurance	373	419	484	514	550	616	741
- of which EEC10	224	246	266	271	308	352	n.a.
Transport Insurance	-	50	49	73	67	66	66
- of which EEC10	-	25	25	24	22	22	22
<u>Debits</u>							
Brokerage Fees and Commissions	-	2,103	2,057	1,974	2,164	2,371	2,633
Banking	-	100	123	170	224	242	286
- of which EEC10	-	25	49	73	89	110	132
Nonmerchandise Insurance	373	419	509	514	550	660	743
- of which EEC10	224	240	291	313	330	396	n.a.
Transport Insurance	-	50	74	73	89	88	88
- of which EEC10	-	50	49	48	45	44	66

Source: IMF: S.O.E.C.

Germany

Earnings abroad on commission fees were almost ECU 1bn in 1985 compared to less than half that level in 1979. Non-merchandise insurance earnings were ECU 1.9bn in the same year and the growth since 1979 was about the same as for commissions. Transport insurance earnings were much smaller at ECU 224m and have not grown so rapidly.

On the debit side, however, commission fees were ECU 3.9bn in 1985, though the growth has not been as rapid since 1979 as the credit side. Non-merchandise insurance payments were more than ECU 2.2 bn and have grown almost 2½ times since 1979. Transport insurance debits, as for the credits have grown less rapidly since 1979 than commissions and non-merchandise insurance.

Overall debits have been larger than credits for these items in Germany's balance of payments.

The geographical breakdown which is available for insurance shows that, in broad terms, about half Germany's trade in insurance is with the EEC10.

TABLE 3.67: TRADE IN FINANCIAL SERVICES BY WEST GERMANY, 1979-85

	1979	1980	1981	1982	1983	1984	1985
	ECUm						
Credits							
Brokerage Fees and Commission	440	494	536	658	786	898	994
Non-Merchandise Insurance	893	923	1,634	1,689	1,586	1,932	1,900
- of which EEC10	432	442	585	697	747	876	860
Transport Insurance	149	156	182	212	211	215	224
- of which EEC10	21	21	25	26	29	33	32
Debits							
Brokerage Fees and Commissions	2,322	2,458	2,934	3,400	3,234	3,448	3,900
Non-merchandise Insurance	914	1,060	1,738	1,782	1,848	2,235	2,279
- of which EEC10	426	542	678	840	919	1,056	1,099
Transport Insurance	350	424	446	479	478	565	595
- of which EEC10	118	126	131	156	144	200	206

Source: IMF, S.O.E.C., Bundesbank, Statistical Supplement Services.

Spain

Earnings overseas from banking amounted to ECU 69m. No data is available from the EEC statistical office for prior years. Insurance earnings at just over ECU 200m in total in 1985, have risen by about 50 per cent since 1979, not a particularly large increase compared with some of the other countries.

Payments abroad for financial services considerably exceeded receipts in 1985 mainly because of commission payments; no disaggregation is available between commissions for financial and other services.

The data available on the geographical breakdown shows that almost half of receipts from abroad for insurance on transport and banking services were from the EEC10. More than half of payments abroad for total insurance and banking were to the EEC10.

TABLE 3.68: TRADE IN FINANCIAL SERVICE BY THE SPAIN 1979-85

	1979	1980	1981	1982	1983	1984	1985
	ECUm						
<u>Credits</u>							
Banking	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	69
- of which EEC10	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	25
Non-merchandise							
Insurance	116	180	167	215	299	148	145
- of which EEC10	-	-	-	-	-	-	101
Transport Insurance	30	23	41	45	54	71	77
- of which EEC10	-	-	-	-	-	-	38
<u>Debits</u>							
Commissions, Brokerage etc.	165	196	316	417	403	450	-
Banking	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	39
- of which EEC10	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	14
Non-merchandise							
Insurance	119	128	182	214	140	177	215
- of which EEC10	-	-	-	-	-	-	147
Transport Insurance	73	94	112	134	142	170	145
- of which EEC10	-	-	-	-	-	-	76

Source: IMF, S.O.E.C.

France

Receipts from banking services accounted to ECU 711m in 1985 compared to less than ECU 200m in 1979. Non-merchandise insurance receipts were less than ECU 500m in 1985 and had not grown very rapidly since 1979. By contrast insurance on transport grew very rapidly over the same period from ECU 650m to ECU 2.1bn.

Payments abroad for banking services reached ECU 700m in 1985 from a level below ECU 200m in 1979. Non-merchandise insurance payments at ECU 400m had not shown such rapid growth since 1979. Transport insurance payments, however, roughly trebled between 1979 and 1985 to reach ECU 1980m.

About one third of receipts from foreign earnings in banking and insurance came from the EEC10 in 1985. About 40% of payments abroad for these services was to the EEC 10.

No data on commission receipts or payments has been identified for France.

TABLE 3.69: TRADE IN FINANCIAL SERVICES BY FRANCE 1979-85

	ECUm						
	1979	1980	1981	1982	1983	1984	1985
<u>Credits</u>							
Banking ECUm	183	258	394	428	445	500	711
- of which EEC10	28	46	54	59	59	71	185
Non-merchandise							
Insurance	308	340	422	469	513	590	469
- of which EEC10	142	151	175	188	180	182	168
Insurance on Transport	652	722	910	1,052	1,223	1,464	2,111
- of which EEC10	253	286	335	365	473	501	756
<u>Debits</u>							
Banking	174	240	433	560	540	556	701
- of which EEC10	47	73	96	164	166	168	236
Non-merchandise							
Insurance	279	348	417	473	528	620	434
- of which EEC10	143	174	203	223	198	232	193
Insurance on Transport							
ECUm	629	764	953	1,106	1,329	1,593	1,980
- of which EEC10	319	385	467	490	600	678	885

Source: IMF, S.O.E.C.

Italy

Earnings abroad from banking in 1985 were in excess of ECU 1bn compared to only half that level in 1979. Non-merchandise insurance earnings at ECU 345m were also much larger in 1985 than 1979. While earnings from insurance in transport doubled, the absolute figure was ECU 97 m in 1985.

Payments abroad by Italy for these services have tended to exceed receipts. The largest element of these payments relating to the banking and non-merchandise insurance sectors.

The geographical breakdown which is available shows that Italian trade in insurance and banking is mostly conducted with countries outside the EEC10.

TABLE 3.70: TRADE IN FINANCIAL SERVICES BY ITALY, 1979-85

	1979	1980	1981	1982	1983	1984	1985
	ECUm						
<u>Credits</u>							
Banking	618	690	820	943	815	895	1,193
- of which EEC10	155	185	211	235	n.a.	n.a.	n.a.
Non-merchandise							
Insurance	136	151	196	229	255	387	345
- of which EEC10	7	10	9	14	n.a.	n.a.	n.a.
Transport Insurance	43	51	55	56	66	83	97
<u>Debits</u>							
Banking	1,083	1,245	1,598	2,050	1,170	1,188	1,388
- of which EEC10	295	348	385	462	n.a.	n.a.	n.a.
Non-merchandise							
Insurance	185	224	241	288	362	491	544
- of which EEC10	16	19	25	32	n.a.	n.a.	n.a.
Transport Insurance	58	63	71	72	82	105	120

Source: IMF, S.O.E.C.

Netherlands

Throughout the 1978 to 1985 periods the Netherlands was in deficit on commissions/brokerage fees and transport insurance.

Earnings from abroad on commissions/brokerage fees and other fees were almost ECU 1.3 bn in 1985 compared to ECU 0.7 bn in 1979. It is not clear how much of this relates to financial services. Earnings abroad from banking were just over ECU 200m in 1985 compared to ECU 80m in 1979.

On the debit side commissions and other fees exceeded ECU 1.6bn in 1985 compared to less than ECU 900m in 1979. Payments for banking and non-merchandise insurance were both just less than ECU 200m in 1985. Payments abroad for transport insurance rose very quickly from ECU 17m in 1979 to ECU 113m in 1985.

No geographical breakdown is available for the data on commissions. About one third of earnings abroad from banking were from the EEC10 and about half of payments abroad on banking services. The data from the EEC statistical office indicate that payments to the EEC10 exceeded those to the World and this is being queried.

TABLE 3.71: TRADE IN FINANCIAL SERVICES BY THE NETHERLANDS 1978-85

	1979	1980	1981	1982	1983	1984	1985
	ECUm						
Credits							
Commissions, brokerage fees etc.	717	824	826	972	1,004	1,107	1,289
Banking	80	75	101	136	138	192	229
- of which EEC10	31	30	33	47	48	70	87
Transport Insurance	8	9	7	6	6	6	6
- of which EEC10	3	4	2	2	3	3	3
Debits							
Commissions, brokerage fees etc.	877	1,090	1,289	1,390	1,397	1,557	1,647
Banking	50	51	76	85	96	134	199
- of which EEC10	28	29	37	44	45	67	91
Non-merchandise Insurance	17	51	0	56	20	111	113
- of which EEC10	37	57	40	51	0	103	130
Transport Insurance	135	143	152	153	150	184	186
- of which EEC10	32	30	28	29	29	35	36

Sources: IMF, S.O.E.C.

United Kingdom

The table below shows that overseas earnings by the UK banking sector were almost ECU 2.7 bn in 1985 compared to ECU 661m in 1979. Earnings from insurance at ECU 1.1bn also showed a considerable increase from the 1979 level of ECU 353m. Receipts both from commodity trading and stock exchange other broking also doubled during this period.

Payments for financial services received from abroad are identified gross only for banks and this includes an element of investment income due to overseas affiliates. This debit item reached almost ECU 2bn in 1985 compared to less than ECU 0.5bn in 1979. Overall the UK has maintained a large surplus on trade in financial services.

No geographical breakdown of this data was available.

TABLE 3.72: TRADE IN FINANCIAL SERVICE BY THE UK 1979-85

	1979	1980	1981	1982	1983	1984	1985
	ECUm						
<u>Credits</u>							
Banking	661	801	1,036	1,283	1,305	1,925	2,676
Insurance	353	405	567	685	717	906	1,127
Net Commodity Trading	440	568	650	801	991	1,131	1,049
Stock Exchange and Other Brokerage	513	559	808	778	779	959	951
<u>Debits</u>							
Banking - Investment Income and Services Charges	464	581	855	1,351	1,166	1,455	1,907

Source: UK Balance of Payments - CSO Pink Book 1986

Integration of the Insurance Markets in the EEC

The table overleaf shows the number of establishments abroad for the insurance industry in 7 of the 8 countries in 1984. The UK industry has the largest number of establishments abroad, (608), and the smallest percentage (44%) of its foreign establishments in the EEC. UK establishments in the EEC were about the same in number in France, Germany, Belgium and the Netherlands.

France and Germany had 166 and 116 foreign establishments respectively of which 75 and 90 respectively were in the EEC. These establishments were mainly in Belgium, Italy and the Netherlands and in the case of France, Germany.

Out of a total of 79 foreign establishments from the Belgian industry 73 were in the EEC. For Italy, 46 of the 70 foreign establishments were in the EEC and 40 of the 63 from the Netherlands.

TABLE 3.73: INTEGRATION OF EC INSURANCE MARKETS

Country of Origin	Country of Activity								World	EC Share as %
	B	D	F	I	L	NL	UK	EC		
B	-	7	24(1)	1	14	22	1	73	79	92
D	21	-	21	10	3	21	5	90	116	78
F	21	16	-	5	6	11	8	75	166	45
I	8	8	11	-	-	6	5	46	70	66
L	1	-	-	-	-	-	-	1	2	50
NL	11	6	9	1	-	-	3	40	63	63
UK	39	42	47	18	-	36	-	276	608	44

(1) Incl. Luxembourg.

Source: Sigma

**SECTION 4: ANALYSIS OF PRESENT STRUCTURE OF FINANCIAL SERVICES
MARKETS**

4.1 INTRODUCTION

The focus of this section is on regulatory barriers and how they are implemented. In particular attention is given to those regulations:

- affecting the establishment of financial service institutions in overseas markets;
- affecting cross border trade directly.

This section represents the first part of Section 1C of the work programme. The second part of Section 1C which considers the scope for a quantitative assessment of the effects of completing the internal market in financial services is presented in Section 5 of this report.

As indicated above a useful dichotomy for assessing the question of regulatory barriers to international integration in services generally, and in financial services in particular, is that between barriers to trade and barriers to investment. Although financial services (such as insurance or stockbrokerage) could be provided across international frontiers by entities which were not established in the member state where the customer is resident, such transactions are often inhibited by exchange controls and other barriers. These are the barriers to trade narrowly defined. Alternatively, foreign financial institutions could establish a branch or subsidiary in a member state from which to provide the service. The inhibition of such establishment is a barrier to investment.

This section has the objective of reviewing the current situation regarding both barriers to trade and barriers to investment in financial services in eight member states of the Community. Following guidance by the Commission on the priority which should be given to this topic, this review represents a summary of available information.

The organisation of this section is explained on the one hand by the pervasive impact of exchange controls across all financial sectors, and on the other hand by the very different treatment of investment (or establishment) issues as between banking, securities and insurance markets. Thus the analysis begins with an account of the situation regarding establishment in banking, where it is found that comparatively few overt barriers to investment exist. There follows a parallel discussion of establishment in the securities sector, banks are very important in this sector, and that alleviates the restrictions on foreign concerns becoming securities brokers in certain member states. The next part of this section reviews the insurance sector, where there are barriers to trade independent of exchange controls, and where licensing practices often inhibit entry. Finally, we present some notes

on the current situation with regard to exchange controls; in the member states which retain strict exchange controls, these have the effect of severely restricting the freedom of trade in all financial services.

It is useful firstly however to categorise the barriers to trade in summary form for banking, securities and insurance. In the table overleaf the barriers to trade in banking, securities and insurance sectors are categorised in relation to barriers to establishment, to operating conditions and to competing for business. In the subsequent analysis details of the barriers or impediments to the integration of financial markets in each of these main sectors are examined.

TABLE 4.1 BARRIERS TO INTEGRATION IN FINANCIAL MARKETS

BARRIERS TO ESTABLISHMENT IN BANKING

- (1) Restrictions on the legal form banks may adopt.
- (2) Limitations on the number of branches that may be established.
- (3) Restrictions on the takeover of domestic banks.
- (4) Restrictions of equity or other control of domestic banks.

BARRIERS TO OPERATING CONDITIONS IN BANKING

- (1) The need to maintain separate capital funds.
- (2) Differences in the definition of "own capital" funds.
- (3) The need to maintain certain capital-asset ratios.
- (4) Exchange controls.

BARRIERS TO COMPETING FOR BUSINESS IN BANKING

- (1) Limitations on services offered.
- (2) Restrictions on local retail banking.
- (3) Restrictions on acquisition of securities and other assets.

BARRIERS TO ESTABLISHMENT IN INSURANCE

- (1) Lack of harmonisation of licensing procedures.
- (2) Lack of harmonisation in the constitution of technical reserves.

BARRIERS TO OPERATING CONDITIONS AND COMPETING FOR BUSINESS IN INSURANCE

- (1) Direct insurance: restrictions on the placement of contracts with non-established insurers.
- (2) Co-insurance: establishment of a permanent presence imposed on lead-insurers.
- (3) Custom and practice in government procurement policies.
- (4) Lack of harmonisation in the supervision of insurance concerns.
- (5) Re-insurance: compulsory or voluntary cessation of a percentage of contracts to a central pool or prescribed establishment.
- (6) Lack of harmonisation in the fiscal treatment of insurance contracts and premiums.

BARRIERS TO ESTABLISHMENT IN SECURITIES

- (1) Membership of some stock exchanges limited to national citizens.
- (2) Constraints on the establishment of offices of solicit and carry out business in secondary markets.
- (3) Restrictions on the takeover of or equity participation in domestic institutions.
- (4) Limitations on the establishment of securities firms in a universal banking system.

BARRIERS TO OPERATING CONDITIONS IN SECURITIES

- (1) Exchange controls and other equivalent measures which prevent or limit the purchase of foreign securities.
- (2) Conflicting national prudential requirements for investors protection.
- (3) Discriminatory taxes on the purchase of foreign securities.

BARRIERS TO COMPETING FOR BUSINESS IN SECURITIES

- (1) Limited access to primary markets in terms of lead management of domestic issues.
- (2) Restricted access to secondary markets because of national stockbroker monopolies on some stock exchanges.
- (3) Restrictions on dealing with investing public.

4.2 REGULATORY BARRIERS TO TRADE AND ESTABLISHMENT IN BANKING

Our analysis of regulatory barriers in banking examines the conditions under which a foreign banking organisation can set up operations in each of the eight member states covered by the study with a view to determining what special barriers exist. Such barriers might derive from legislative and regulatory provisions, the conduct of monetary and credit policy, institutional customs and conventions.

Our focus here has been on the regulations in force in each of the eight member states. It is important to note that a general synopsis such as this cannot hope to uncover concealed barriers which lie in the fine-detail of the regulations and which have not yet revealed themselves in practice. Furthermore the true impact of regulations will usually depend on the margin of discretion with which they are applied.

In reviewing the legal and regulatory barriers to a non-domestic bank setting up in an EC member state, the general position is that there is little by way of overt discrimination against non-domestic entities in the countries under examination. Within the EEC, credit institutions which have their head office in a member state have right of entry and establishment following the First Council Directive of December 1977. In principle, with some exceptions which will be noted, non-national entities must go through the same sort of procedure as domestic entities in order to set up a banking operation. But that does not necessarily mean that successful and profitable entry to banking is always easy. Obtaining authorization for other than a representative office can be time consuming and costly in administrative terms. If the member state employs a regime of credit ceilings for monetary policy purposes, then even after entry there may be practical difficulties in achieving growth, particularly as the acquisition by foreign entities of a domestic bank is subject to control in all member states. The capitalisation requirements which are imposed even for branches of foreign entities may also impose a differential cost on foreign entrants.

For each member state the report begins by identifying the regulatory authorities. There follows an account of the requirements for establishing a banking operation, regulations restricting foreign (1) acquisitions or participation in indigenous banks, and restrictions on the type and range of services and activities.

(1) Unless otherwise indicated foreign refers both to countries within and outside the EEC.

GERMANY

Supervisory Authority

All banks within Germany are subject to the German Federal Banking Supervisory Authority which, in turn, reports to the Federal Minister of Finance.

The Supervisory Authority supervises banks and acts to prevent adverse developments in the banking system or the economy at large. It is the licensing agent for all banks, and to a certain extent can make banking policy by determining the regulations regarding equity and liquidity requirements. It also has detailed rights of information, investigation and intervention.

Establishment of Banking Operations

In terms of entry and establishment, the same general principles apply to both foreign and domestic banks:

- (1) Representative offices: no licence required but their establishment, relocation and closing must be reported to the Federal Banking Supervisory Office and the Deutsche Bundesbank. Without a licence, activities are restricted to providing investment information and recommendations, and acting as a conduit between customers and the parent company. They may not fill investment orders; and any correspondence from a non-licensed office to a client within Germany must be mailed from outside the country to meet the proscriptions against representative offices conducting banking business within the national boundaries.
- (2) Branches: deemed to be banks in their right although branches of the same bank will be considered as one credit institution.
- (3) Wholly-owned subsidiaries and majority-owned subsidiaries: regarded in law as German banks. There are no entry barriers and licensing requirements are the same as for domestic banks.

The licensing procedure is quite exacting in its requirements, although there is no indication that foreign applicants face any special disadvantages relative to domestic applicants. The following conditions need to be satisfied in order to acquire a licence:

- (1) The resources necessary for conducting a business - in particular adequate capital in the Federal Republic of Germany - must be available.
- (2) The managers must be trustworthy and have the necessary professional qualifications.
- (3) The bank must have at least two managers who work for it not merely in an honorary capacity.

- (4) The bank must send a plan about the intended business and its organisation to the Federal Banking Supervisory Office.

There are no provisions on nationality of personnel and management. Managers of branches of foreign banks or of foreign-owned subsidiaries are required to demonstrate sufficient command of the German language as is necessary to direct a banking institution in Germany. In terms of qualifications and experience, the regulations apply equally to domestic and foreign bank managers.

Regulations Restricting Foreign Acquisitions of Participation in Indigenous Banks

There are no restrictions under this head.

Restrictions on Type and Range of Services and Activities

Branches of foreign banks may not act as banks of deposit for mutual funds of German investment companies but this is not seen to be of practical relevance to their activities in Germany.

Since May 1, 1985, German subsidiaries (but not branches) of foreign financial institutions have been permitted to lead-manage foreign DM bond issues (those of non-resident borrowers, issued in Germany).

Whilst relaxing its objection to foreign lead management of foreign DM bonds, the Bundesbank has reserved the right to apply a reciprocity guideline to financial institutions whose home country is not in the EEC and does not permit similar possibilities. In practice this reservation, which is not specified in either statute or regulation, has only been applied to Japanese firms.

UK

Supervisory Authority

The Bank of England has responsibility for the overall control of the monetary and banking system. It exercises its powers in an informal way but the 1987 Banking Act, when it reaches the statute books, will provide the Bank with greater statutory authority, should it need to act in a more formal manner.

Establishment of Banking Operations

Domestic and foreign institutions are required to comply with the same set of conditions, should they wish to develop a banking presence in the UK.

The opening of a representative office by a foreign bank is subject to notification to the Bank of England; documentation may be required from the parent institution.

Branches of foreign banks are perceived very much as being an integral part of the total operation of the bank worldwide and not as separate entities in their own right. Accordingly, it is seen as inappropriate to expect branches to maintain their own capital, although they have to maintain adequate liquidity and keep within agreed foreign currency exposure guidelines. Assurances are sought from the relevant supervisory authority that it will assume full responsibility for its foreign offshoot, and that the management and finances of the institution are sound. Whilst regular contact between the Bank and foreign branches is maintained, reporting requirements are less extensive and prudential meetings normally less frequent than for UK incorporated institutions.

There are no specific restrictions on ownership of a bank but, under Schedule 2 of the Banking Act, the Bank of England must be satisfied that at least two individuals effectively direct the business of an authorised institution.

Whilst there are no provisions relating to nationality, it may be required, under certain circumstances, to have at least one member of senior management who has appropriate experience in the London market; this would be a pre-requisite for any individual appointed as senior foreign currency dealer.

Regulations Restricting Foreign Acquisitions of Participation in Indigenous Banks

There are no formal restrictions on the acquisition of less than 15% of the share capital of a recognised bank or licensed deposit-taker. Where the acquisition is over 15%, both domestic and foreign institutions fall within the ambit of a Bank of England notice. The Bank must be consulted on all such proposals as early as possible and before any formal negotiations are undertaken. A flexible approach is maintained but, in general, approval for the acquisition will be subject to agreement between the parties concerned and to the satisfaction of tests relating to capital, management, reputation and future intentions.

Restrictions on Type and Range of Services and Activities

The Bank of England's notice of 11th November, 1980, states that all capital issues in sterling should be led by a UK-based institution with the capacity of act as an issuing house in the UK. Non-EEC owned institutions with such a capacity will be eligible to lead sterling issues if in the Bank's view there are reciprocal opportunities in their domestic capital markets for equivalent UK-owned institutions. It is expected, however that such issues will be co-led by a UK-owned institution that can act as an issuing house in the UK. Where the reciprocity requirement is not met, foreign-owned institutions may only participate in a co-management position.

The Financial Services Act 1986, Section 183 (1), gives the Treasury or Secretary of State for the Department of Trade and Industry 'carte blanche' to take action against countries that do not have reciprocity arrangements. This applies not only to banking but also to investments and insurance. Whilst it is highly unlikely that the UK would take action against any EC member as this would contravene EC rules and guidelines, it should be noted that the statutory authority is there for use. Any action taken should be through the formal channels of the European courts.

ITALY

Supervisory Authority

The Interministerial Committee for Credit and Savings (CICR) is the highest authority for credit and monetary policy and supervision of financial institutions. The CICR formulates policies and issues guidelines that are implemented by the executive agencies of the Bank of Italy.

The Bank of Italy is empowered to monitor deposit-taking and loan-granting activities so as to maintain the stability of the banking system. Its supervisory powers cover both the structural aspects of the system (opening of new institutions and branches, mergers and acquisitions) and the operative aspects (participations, territorial competence, loan limits). It may request periodic reports from the banks and conduct inspections.

Establishment of Banking Operations

In practice, as from 1966, there is a ban on the authorisation of all new foreign or domestic banks. Exceptions to this rule have been some banks set up with mixed (Italian and foreign) capital. There are no restrictions on the opening of a representative office by a foreign bank, but both domestic and foreign banks have to seek prior approval for the establishment of new branches.

Other conditions which may be seen as restrictions on foreign bank entry are as follows:

- (1) There is a minimum capital requirement for the opening of the first branch of a foreign bank which is determined on a case-by-case basis. The Bank of Italy has never enacted its power to establish formally a uniform minimum capital requirement for all banks.
- (2) Branches of foreign banks are required to provide "comfort letters" from their parent institutions. Such a letter is not compulsory in the case of EEC banks, though failure to produce one results in a branch's operational limits being severely curtailed.
- (3) In some regions with special statues, local legislation gives the region autonomous powers in credit matters with regard to the establishment of new banks and the opening of branches.

No specific qualifications have been prescribed for bank managers, although they must be resident in Italy and of proven respectability. "Respectability" has not been precisely defined and, in practice, reliance is placed on the bank's judgement.

Restrictions on Foreign Acquisitions or Participations in Indigenous Banks

In view of the legal constraints in force and the fact that the majority of banks are in public ownership, the question of acquisition or participation in indigenous banks only really concerns the banks set up as joint-stock companies (i.e. the ordinary credit banks). In their case the sale of all or part of the capital to foreigners is not subject to authorization by the supervisory authorities (except as regards compliance with the foreign currency regulations), the decision falling within the sphere of banks' autonomous powers. With regard to the "banks of national interest" (those established in the form of a joint stock company which have branches in at least 30 provinces), their shares can only be held by Italian citizens and residents of EC countries.

Restrictions on the Type and Range of Services and Activities

There are limitations on individual lending by branches of foreign banks, with the amount related to a percentage of a branch's own funds. Loans in excess of this amount must be authorised by the Bank of Italy, although there is no limit on the amount that may be borrowed.

Lending by the branches of foreign banks is restricted territorially as follows:

- (i) To the regions in whose provincial capitals the branches are established (without any restriction on the nationality of the borrower).
- (ii) To the whole country in the case of lending to firms of foreign origin on subsidiaries of foreign companies.

Foreign branches, like domestic banks, can only operate in the short-term area - up to eighteen months. Nevertheless, they may extend credit beyond the short-term with ceilings that vary for each branch from 10 to 15% of their borrowed funds. In the absence of a "comfort letter", deposits - rather than borrowed funds - are taken as the reference parameter for lending operations beyond the short term.

BELGIUM

Supervisory Authority

The Central Bank is responsible for issuing bank notes and for regulating currency and exchange.

The commercial banks operating in Belgium are under the control of the Bank Commission which issues a consolidated report on the financial position of the banks concerned annually.

Establishment of Banking Operations

The opening of representative offices is subject to authorisation by the Banking Commission which is usually granted, provided the office is not used for carrying on banking business or for soliciting business to be channelled through offices outside Belgium.

The provisions governing the entry and establishment of branches and subsidiaries apply to both Belgium and foreign banks.

The parent institutions of branches of foreign banks must conform to the pre-conditions for banks incorporated in Belgium; namely:

- (1) The parent institution must carry on banking business.
- (2) The parent institution must be a "societe commerciale" (a commercial company) with legal personality.

The same licensing procedures apply to both domestic and foreign institutions. However, the authorisation to extend mortgage credits required from the Ministry of Economic Affairs may be refused if reciprocity is not granted in the parent bank's country of origin.

Each branch of a foreign or domestic bank has to maintain its minimum "own capital" which must not be used to undertake operations outside Belgium and the Banking Commission requires proof that the endowment capital in no way corresponds to a liability of the parent bank to a third partner.

A statement is also required by the Banking Commission to the effect that the opening of the branch or subsidiary has been notified to the competent authorities of the home country and that the transfer of the required funds has been authorised. In the case of branches, the applicant must provide a certified copy of the decision by the parent bank's management to earmark a portion of the bank's capital to the branch set up in Belgium.

Restrictions on Foreign Acquisitions or Participations in Indigenous Banks

There are two general provisions that apply to a foreign investment in Belgium companies:

- (1) Authorisation by the Minister of Finance is required for any takeover bid on public companies by residents of countries outside the EC.
- (2) The Minister of Economic Affairs, the Minister of Finance and the State Secretary to the Regional Economy must receive prior notification of any operations leading to the acquisition of at least one third of the capital of enterprises operating in Belgium and where capital is of at least BF 100 million.

Any merger of majority interest acquisition must be authorised by the Banking Commission. Also, any significant change in the relative share, the ownership or control of shareholders' participations is subject to prior consultation with the Banking Commission. These provisions, however, apply equally to both Belgium and foreign shareholders.

Restrictions on Type and Range of Services and Activities

There are no restrictions under this head.

THE NETHERLANDS

Supervisory Authority

The Central Bank has extensive powers to supervise the banking industry, although certain actions need the approval of the Minister of Finance. It consults extensively with the banking industry's representative bodies in drafting directives concerning ratios, reporting etc.

Establishment of Banking Operations

Use of the word 'bank' is reserved for a limited group of institutions registered under the Act on Supervision of the Credit System (1978). Exemption status may be granted by the Minister.

The prohibition does not apply to institutions from other EEC Member States which operate in the Netherlands and are entitled to use the word 'bank' in their home country; but an explanation of status, activities and financial position may be required.

No regulatory provisions apply to the entry and establishment by foreign banks of representative office.

A licence is required to engage in the business of a credit institution but the requirements are the same as for a domestic institution, namely:

- (1) A prescribed minimum in terms of own resources.
- (2) Confirmation of the competence of the person in charge of day-to-day management.
- (3) Certification of annual accounts.

There are also controls on individuals that hold over a certain percentage of voting rights in a credit institution, or are otherwise able to exercise (or have exercised) a comparable degree of direct or indirect control. A declaration of no-objection has to be obtained from the Central Bank which is normally granted unless the Bank is of the opinion that it would lead to undesirable developments within the credit system or runs contrary to sound banking policy. No distinction is made between foreign and domestic institutions.

An important element of this policy is the countering of the intermingling of banking and insurance activities which could lead to "undue" concentrations of economic power in the Netherlands. Recently, new measures have been introduced to encourage competition between banks and insurance companies.

There are no regulatory and administrative provisions on nationality and language requirements of personnel and management.

Regulations Restricting Foreign Acquisitions or Participations in Indigenous Banks

The approval of the Ministry of Finance is required for acquisition of a banking institution either by a Dutch or foreign purchaser.

Restrictions on Type and Range of Services and Activities

Foreign firms with branches or subsidiaries in the Netherlands may engage in securities-related activities under the same regulations that apply to Dutch banks, subject to a reciprocity requirement that prohibits foreign banks from acting as lead manager of guilder-denominated bond issues in the Netherlands unless Dutch banks are afforded comparable treatment in the parent country of the foreign bank.

FRANCE

Supervisory Authority

French banking is supervised by a number of different regulatory bodies:

- (1) The National Credit Council - determines policy on banking and financing activity and issues general banking regulations.
- (2) The Banking Commission - monitors compliance with legislation and regulations.
- (3) Bank of France - issues bank notes and has supervisory powers over credit distribution and control.
- (4) Commissaries of the Government - represent the State on each central agency established for each sector of credit establishments. It ensures that each central agency and its members respect the applicable banking legislation and regulations.

Establishment of Banking Operations

The opening of representative offices of foreign banks does not require prior authorisation.

Any institution, either French or foreign, carrying on the general business of banking must obtain a licence from the National Credit Council. As with domestic banks there are specific requirements concerning:

- (1) The legal form of the institution.
- (2) Minimum capital holdings.
- (3) General economic needs.
- (4) Reputability of the managers.
- (5) General exchange control provisions applying to foreign direct investment.

There is no general requirement concerning guarantees and "comfort letters" from parent institutions. The Banking Commission may require that a blocked account in French francs be opened by the parent bank with a view to guaranteeing the branch's liabilities. This requirement has, however, been applied very rarely.

Regulations Restricting Foreign Acquisitions or Participations in Indigenous Banks

As with all foreign investments in France, the acquisition of more than 20 per cent of a company's capital requires the authorisation of the Ministry of Economy and the Bank of France. This is currently an issue of considerable contention because of a denationalisation programme being undertaken which includes several banks and bank-holding companies. The French Minister of Economy has the right to reduce the 20 per cent threshold in the "national interest", and a right to reserve a special preferential share, giving the government authority to block any undesired investment (domestic or foreign) which represents over 10 per cent of that company's capital.

Restrictions on Type and Range of Services and Activities

There is no discrimination but it is an established practice that the lead manager of bond issues denominated in French francs should be a member of the "Comite des Emissions" which is restricted to a small number of banks.

Credit ceilings, in practice, may bear more heavily on recently established banks and on those which deal significantly in French francs with residents. This problem applies to both domestic and foreign-controlled banks; the latter may however be granted a temporary derogation to credit ceilings provisions with a view to facilitating establishment in France.

LUXEMBOURG

Supervisory Authority

The 'Institut Monétaire Luxembourgeois' has responsibility for supervising the banking and financial sectors, and the power to regulate the money supply and credit and lending facilities. The 'Institut Belgo-Luxembourgeois de Change' exercises control over foreign exchange operations.

Establishment of Banking Operations

A bank wishing to operate in Luxembourg may incorporate a company as a separate legal entity or establish a branch or representative office.

Banks incorporated in Luxembourg have not taken the form of a 'société à responsabilité limitée' because credit institutions are prohibited by law from taking this form of incorporation.

Branches of foreign banks are allowed to operate in Luxembourg under the same banking and supervisory regulations as incorporated banks. The branch must maintain its assets clearly separated from those of its parent company and other entities within the group.

Regulations Restricting Foreign Acquisitions or Participations in Indigenous Banks

There are no restrictions under this head.

Restrictions on Type and Range of Services and Activities

There are no restrictions under this head.

SPAIN

Supervisory Authority

The Bank of Spain has overall responsibility for the administration, inspection and professional supervision of banks, saving banks and credit institutions.

Establishment of Banking Operations

Spain, as a recently-joined member of the EC, is in a seven-year transition period. Spanish authorities began to admit foreign banks in 1979 in a deliberate effort to increase the competitiveness and efficiency of the domestic banking sector. The Royal Decree 1388 of June 23, 1978, still regulates the presence of foreign banks within Spain.

Foreign banks may establish subsidiaries, branches or representative offices. Subsidiaries must take the form of a "sociedad anonima" (corporation). Subsidiaries are restricted to three branch offices, including the head office, which effectively excludes them from the Spanish retail banking market. Branches must operate under the full responsibility and name of the parent company. Their authorisation to operate is not transferable. Representative offices cannot conduct credit deposit or intermediary operations.

The capital of a foreign bank subsidiary must be entirely subscribed by the foreign bank and may not be less than Ptas 2,000 million plus a 100 per cent issue premium; shares may not be transferred without authorisation.

In the case of a branch, the capital allocation of the parent company may not be less than Ptas 2,000 million.

There are no specific regulations governing management qualifications, but there are limits on the number of positions that one person can hold simultaneously in banks and companies.

At the request of the Bank of Spain and after a report from the Higher Banking Council, the Ministry of Finance authorises a licence for a banking entity. This requirement is applicable to both corporations and branches. There are no formal guidelines for the granting of this authorisation, and it depends on multiple factors and circumstances, both external and internal. The principle of reciprocity is firmly applied in relation to non-EC countries to ease the competitive pressure on Spanish banks.

All restrictions on entry for other EC members should be removed by 1993.

Regulations Restricting Foreign Acquisitions or Participations in Indigenous Banks

Foreign banks may purchase up to 50 per cent of a Spanish bank with any percentage above this requiring the approval of the Ministry of Economy and Finance. Such approval is only granted exceptionally and usually for the acquisition of a distressed bank.

Domestic banks acquired by foreign interests are accorded full national treatment and they enjoy all the rights and obligations of domestic banks.

Restrictions on Type and Range of Services and Activities

The three major restrictions of the Royal Decree 1388 remain. Firstly, the amount of deposits which a foreign bank can obtain from Spanish customers is limited to 40 per cent of its portfolio of investments and loans to public and private Spanish entities. Foreign banks are allowed free access to the interbank market.

This regulation encourages foreign banks to fund themselves from their parent banks or from the Euromarkets, thus limiting competition for domestic deposits. Combined with the branching restriction, foreign banks are effectively prevented from competing in Spain's retail banking market.

The second restriction limits each foreign bank to a maximum of three branches, as mentioned earlier. In practice, few foreign banks have more than two offices. In contrast, domestic banks now operate over 15,000 branches in Spain.

The third limitation prohibits foreign bank equity participation in Spanish non-financial businesses, even though Spanish banks control a significant portion of private industry. Foreign banks may, however, own equity in credit card companies, data processing service companies for banking operations, and other enterprises related to banking.

CAPITAL AND SOLVENCY REQUIREMENTS: GENERAL NOTE

It would seem that a major restriction on EC states wishing to operate in the internal market is the need for branches to maintain their own minimum endowment capital, so that a parent bank's overall resources may not be drawn upon. The only exception to this rule is the UK where there is no minimum capital requirement.

The definition of "endowment capital" appears to vary from state to state, and it is argued that this can give a competitive advantage to banks established within some countries. Particular sources of contention, according to a report produced by the Economists Advisory Group for the European Commission, are the treatment of subordinated debt within the definition of capital and the degree of consolidation of accounts.

Following on from this, some member states specify minimum solvency requirements in the form of prescribed gearing ratios. It is claimed that these also bring about distortions in competition, not only between banks but with other financial institutions such as unit trust and building sections that do not have to comply with the same rules on solvency.

Research indicates that there is a consensus of opinion within the banking world that lack of harmonization of solvency requirements amongst the EC states constitutes a barrier to trade.

CONCLUSIONS

In conclusion, the following points may be made in regard to banking within the EC member states specified:

- (1) All banking establishments must conform to the prescribed legal forms of the country in which business is established. These may vary from state to state.

- (2) With the temporary exception of Spain, the entry and establishment rules for foreign banks are essentially the same as for domestic institutions.
- (3) There are few problems in establishing representative offices; prior authorisation is only required in some countries.
- (4) There are licensing or prior authorisation requirements for all EC banking countries wishing to establish branches within other member states.
- (5) With the exception of the UK, all branches have to maintain their own minimum endowment capital; the definition of which will vary from state to state. This would seem to provide one of the major obstacles to trade.
- (6) Some countries require "comfort" letters. Such letters are essentially guarantees of support from the appropriate supervisory authority or parent institution and are not generally seen to be an onerous obligation. In Italy, however, a branch's operational activities are curtailed if such a letter is not provided.
- (7) There are no specific restrictions on the employment of foreign, EC nationals or special discriminatory rules in terms of professional qualifications or degree of competence and management experience.
- (8) Once certain conditions are met in relation to minimum capital requirements, the competence of personnel etc, there would appear to be no other obstacles to setting up subsidiaries other than in Spain and Italy.
- (9) In Italy, France and Spain there are restrictions on foreign acquisitions or participations in indigenous banks; and in all EC states some prior authorisation is required from the appropriate supervisory authority.
- (10) With the exception of Spain and Italy, it would seem there is little in the way of significant, openly discriminatory rules on the extent and range of services that may be provided. It appears to be the custom, however, that domestic banks lead-manage domestic bond issues in most of these countries.

The general conclusion to be drawn from this overview of banking practices is that the barriers to trade lie not so much in overt, discriminatory rules and regulations, but rather in national practices that apply equally to both domestic and foreign-controlled banks. Differences in licensing, minimum capital and solvency requirements, territorial restrictions may make some EC countries less attractive than other for foreign bankers.

4.3 REGULATORY BARRIERS TO TRADE AND ESTABLISHMENT IN SECURITIES

European stock exchanges are changing at a rapid rate in an effort to maintain and improve their standing in a competitive international environment. The so-called 'Big Bang' in the UK has happened at the same time as there has been rationalisation measures in other EC countries, such as the proposed integration of regional exchanges in Germany and a new computerised dealing system in France. Nevertheless, there still appears to be considerable obstacles to the free trading of securities within Europe.

Our analysis identifies those barriers to establishment and operation by foreign entities in securities markets. As banks dominate these markets, many of the problems of establishment have already been covered in the appropriate section on banking and are only touched upon here. Exchange controls, which are a particularly material factor in relation to securities, are referred to, but dealt with more fully in a separate section. The tax treatment of purchasers of foreign securities in a small number of countries may introduce distortions in these markets.

BELGIUM

Establishment of Securities Operation

Any financial institution, foreign or Belgian, wishing to carry out securities operations must obtain a licence from the Banking Commission. Those wishing to operate in the primary market - the issuing of securities - must also obtain a licence from the Minister of Finance. This requirement does not apply to banks registered under Belgian law; i.e. domestic banks and subsidiaries of foreign banks.

A non-bank securities firm would have an ambiguous status under existing arrangements. A banking licence is necessary in order to engage in underwriting, distribution and other primary market activities, but it is unlikely to be issued to an organisation that does not offer a relatively wide range of banking-related services to the public. In the event, most foreign securities firms choose to be established in the form of representative offices.

The secondary securities market in Belgium is organised in such a way that:

- (a) Instructions to buy or sell securities on the market must be carried out by a stockbroker.
- (b) Instructions to buy or sell listed or unlisted securities on the market may be accepted only by banks (whether Belgian or foreign) or stockbrokers.

A distinction is thus made between the acceptance and execution of orders.

Stockbrokers must be nationals of Belgium or of another EC country and must carry on their business in their own name or that of a company in which their liability is unlimited and joint and several. Sponsorship and training requirements are very specifically geared to Belgian nationals.

Restrictions on Type and Range of Services and Activities

Authorisation to operate in Belgium gives foreign banks exactly the same rights as Belgian ones with regard to providing services to customers, whether on the primary or the secondary market. Nor is there any difference in treatment with regard to access to money market activities or participation in public sector issues.

There are some restraints on the operations of representative offices of foreign securities dealers. Non-bank commercial enterprises (for example, foreign stockbroking firms) are entitled to establish themselves as representative offices in Belgium but, in these circumstances, may not receive market orders from the public. It is forbidden by law to solicit the savings of the public other than within the framework of one of the systems for the protection of savings. Their activities are thus limited to administering portfolios, investment counselling and the receipt of orders from Belgian intermediaries (banks and brokers) to be executed on foreign markets.

Mutual funds (collective investments) are subject to a special system of control. Belgian funds must be administered by companies duly accredited by the Banking Commission; whilst shares in foreign mutual funds may not be made available in Belgium without prior authorisation from the Banking Commission and the Minister of Finance.

FRANCE

Establishment of Securities Operations

Banks occupy a prominent position in the securities markets, but brokers, who are independent of banks, also play an important role. In dealing in the secondary markets the public may place orders with banks or brokers, but the former have a national advantage through their large branch networks. Brokers have the exclusive legal right to trade on the exchanges where all domestic bonds and shares must be traded (money market instruments and Eurobonds may be traded off the exchanges).

A licence is required from the Finance Ministry to act as a broker and the number of licences is fixed; thus, a licence can be obtained only by acquiring one from an existing broker. Only nationals of EC countries may apply to be licensed as brokers, but election to the governing body of the stockbrokers' association is restricted to French nationals and at present only they have succeeded in joining the exchange.

Both foreign banks and foreign securities firms may apply for banking licences and be established as branches or subsidiaries. Foreign branches must maintain an endowment capital of at least the minimum level of companies incorporated under French Law.

Should foreign-owned firms wish to expand their securities activities in France through the purchase of a French institution, there are restrictions. As detailed before, all acquisitions that constitute more than a 20 per cent share require prior approval.

Restrictions on Type and Range of Services and Activities

Because of a recent change in government underwriting practices foreign institutions may actively participate in the primary markets for Government securities which, prior to 1985, were issued exclusively through a syndicate of French banks. Increasingly, short-term Treasury bills and long-term bonds are being issued through public auction which allows foreign-controlled firms with experience in other markets to become major market-makers in French government issues.

Other primary market activities are, in theory, fully open to foreign firms but, as stated previously, custom dictates that French institutions lead manage bond issues on the domestic French franc or Eurofranc markets.

Involvement in the secondary markets is complicated by the fact that practically all transactions take place on recognised security exchanges and thus pass through a Government-licensed stockbroker.

For the most part, foreign institutions are subject to the same regulations as domestic firms in the sale of securities to resident investors. In order to solicit orders for securities from clients at their homes or places of business, securities firms must have a licence and only solicit for stocks listed on a French securities exchange regulatory body. Because of exchange controls foreign securities purchased by French clients must be held by stockbrokers of credit institutions authorised under the French banking law, which includes foreign banks.

The major practical handicaps which foreign firms face in doing retail securities business in France result from the fact that their business is normally geared to the sale of foreign securities, which is limited by the existence of exchange controls. This problem should diminish as exchange controls are phased out.

The management of investment trusts is open to foreign firms. In order to sell shares in an investment trust to French investors, the fund must be registered on a recognised securities exchange, although not necessarily on a French exchange.

GERMANY

Establishment of Securities Operations

In Germany, which has adopted the universal banking system, most securities-related activities are considered to be banking. Therefore, institutions undertaking one or more of these operations are normally designated banks and are required to obtain a banking licence. Holders of a banking licence may engage in the full range of securities market activities open to domestic financial institutions: new securities issues, secondary market activities, collective investment operations, and portfolio management and counselling.

Foreign institutions have complete freedom as to whether to choose to be established as a branch or as a subsidiary. Foreign security firms may also apply for less comprehensive licences limiting them to securities, as opposed to banking activities.

Banks are members of the stock exchanges as are the free and official stock exchange brokers. The role of the official stock exchange brokers is to equilibrate the supply and demand of the other stock exchange members to fix the official quotation. Besides the official market compartment of the stock exchanges, securities trading is carried out in privately organised "semi-official" markets and in "free trade" which is an informal telephone market for quoted securities outside the opening hours of the "official" stock exchange.

Foreign firms seeking membership on one or more of Germany's eight independent regional stock exchanges are free to initiate an application process that is very similar to the banking licence procedure and identical to the practice for domestic applicants.

Restrictions on Type and Range of Services and Activities

As stated within the section on Banking, foreign bank branches or subsidiaries may participate in and lead manage domestic bond issues; but, as far as issues of foreign DM mark bonds are concerned, only subsidiaries may act as lead manager. Moreover, the issues (if public) must be listed on a German stock exchange.

The German Central Bank has also dropped its opposition to the introduction of various non-traditional debt instruments and practices such as DM floating rate notes, multiple currency issues, zero coupon bonds and swap-linked issues. Because non-German firms have relatively more expertise in these non-traditional instruments, the German Central Bank's decision could be advantageous to foreign firms, at least in the near-term. Nevertheless, the preponderance of "new style" issues so far continues to be done by the major German banks.

A tax which ranges from 0.1 to 0.25 per cent is imposed on secondary market purchases and sales of bearer securities by fund investors. (Professional intermediaries are exempt). Bond issues as registered claims, mainly government bonds, are not subject to the tax.

Some observers believe that the marketing of foreign collective investment shares is rather difficult. To protect domestic purchasers, domestic legislation stipulates certain obligations:

- (1) The designation of a resident representative who must be trustworthy and have the necessary professional qualifications.
- (2) The issue of a sales prospectus.
- (3) Specific reporting and disclosure requirements.

Whilst the preconditions themselves may present a problem, it would seem that there are also market-related factors which discriminate against the introduction of foreign collective investments.

For example, the collapse of a major foreign investment funds, which led to substantial losses by many German households foreign funds would still appear to face resistance among German investors. Market penetration difficulties also arise from the fact that as a result of their extensive retail networks, German financial institutions enjoy much greater access to small investors than foreign firms (particularly new entrants) could ever hope to obtain.

It is alleged by some foreign securities dealers that the means of exercising prudential control over securities operations unnecessarily add to the costs of business. Specifically, the Banking Authority requires not only bank books, but also the computer equipment for the bookkeeping, to be physically located in Germany.

ITALY

Establishment of Securities Operations

Commercial banks and their affiliated finance companies dominate the securities business in Italy. However, execution of trades on securities exchanges is restricted to brokers.

Foreign firms, security companies as well as banks, are able to participate in the Italian securities market through branches or subsidiaries and by acquisitions of existing institutions.

Brokers must exercise their profession as individuals. They do not have corporate status or limited liability. In order to be licensed as a broker, candidates must have Italian nationality, possess an Italian degree and have at least two years experience as a representative of an Italian broker.

Restrictions on Type and Range of Services and Activities

Banks have the leading position in dealing in primary and secondary markets for government bonds, in placing private sector securities and in collecting orders from investors for trading in secondary markets.

Foreign securities companies could, in principle, participate in bond issues as a financial company. They may engage in underwriting of securities issues and are eligible to request lead manager status. Custom and practice, however, means that Italian bond and share issues are led by domestic institutions. Foreign banks may participate in the secondary market by trading bonds or accepting orders for bonds or equities from final investors. However, foreign institutions face some limitations operating in the secondary market as brokers have to be Italian citizens. Foreign banks can purchase and have in the past acquired commission dealers who enable them to compete with Italian banks in this respect. Nevertheless, a commission dealer may only solicit orders from the public, so that a stockbroker must still be used to execute actual trades on the exchange floor.

Foreign securities dealers may establish offices to collect orders for execution overseas, but any foreign securities actually purchased must be deposited with an authorised resident bank.

In order to offer collective investments a special company must be formed known as an Investment Fund Management Company; such companies are usually controlled by the banks or insurance companies.

LUXEMBOURG

Luxembourg has adopted the universal banking system, with banks engaged in all securities-related activities. Brokers and securities firms are also active in the securities market, but dealing with the general public is limited to banks and brokers; securities firms which are not admitted as a broker on the floor of the Exchange may only deal with professionals of the financial sector.

The Luxembourg Stock Exchange is an important international financial centre, with many firms seeking to be listed there as a means of improving their financial standing. In practice, any firm or institution admitted to another recognised exchange may be admitted to the Luxembourg Stock Exchange.

Foreign institutions may establish offices to collect and transmit orders for securities to be executed in the country or abroad or to disseminate information and advice. To do so requires a trading authorisation.

Restrictions on Type and range of Services and Activities

There are no restrictions under this head.

NETHERLANDS

Establishment of Securities Operations

Banks in the Netherlands are licensed to engage in essentially all forms of securities-related activities. The primary securities market is dominated by banks, but brokers and other institutions compete with the banks in offering securities, trading and investment services. Both banks and specialised investment companies organise and market collective investment funds.

Foreign banks may establish branches or subsidiaries after being granted a licence by the Netherlands Central bank. As a means of gaining access to securities-related business, a foreign firm may also purchase a domestic establishment, subject to approval by the Ministry of Finance. This is a precondition for domestic firms as well.

Foreign securities companies may also apply for and be granted a banking licence in the Netherlands, subject to fulfilling prudential requirements.

Foreign corporations or persons may become members of the Amsterdam Stock Exchange. In order to do so, it is necessary to have a representative office, branch or subsidiary in Amsterdam and to be incorporated within the EC.

Restrictions on Type and Range of Services and Activities

There are ample opportunities for foreign financial institutions to participate in the Netherlands securities markets. Foreign banks, however, do not act as lead manager of guilder-denominated bond issues in the Netherlands unless Dutch banks are afforded comparable treatment in the bank's parent country. Foreign co-managers of such issues who are not established in the Netherlands are limited to underwriting no more than one third of an issue (this ceiling was recently raised from 20 per cent.)

Government securities are auctioned to members of the Amsterdam Stock Exchange so that the role of foreign financial institutions is largely dependent on their membership of the Exchange.

A stamp tax is imposed upon transactions in securities between authorised resident intermediaries and the investment public. This measure would appear to place non-resident intermediaries at an advantage over residents.

SPAIN

Establishment of Securities Operations

Banks play a dominant role in the securities market in Spain, but actual dealing on the Stock Exchange may only be done by registered stockbrokers who must be of Spanish nationality. Shares or bonds may be traded off the exchange as well but all trades, except those of Treasury bills and mortgage bonds, must be intermediated by an authorised stockbroker. Stockbrokers are, however, highly dependent on banks through whom clients' orders are largely channelled. Because of high fixed commissions and the rising volume of transactions, stockbrokers make substantial sums of money. A government plan to turn them into market-makers and ease entry to their entrenched profession was scrapped in 1986, after it met tough opposition from the brokers themselves.

Foreign banks may acquire an interest in a Spanish bank or establish branches, subsidiaries or representative offices, subject to approval and with certain qualifications (see Banking Section).

There are two kinds of collective investment which are usually, but not always, controlled by banks. Investment funds must have an initial amount of at least one billion pesetas, and be governed by management companies which are subject to special regulations, including a provision that at least one half of the company and one director are Spanish. Securities must be deposited in either a domestic or foreign-owned resident bank or savings bank. Group Investment Companies are regulated like group investment institutions, and have to have a board of directors with a majority of Spaniards.

Restrictions on the Type and Range of Service and Activities

With restrictions on the number of branches which foreign banks may establish a fairly tight set of exchange controls, international securities dealing are severely limited. Foreign issues may not be introduced in the domestic market and sales or purchases of foreign securities are not normally permitted.

UNITED KINGDOM

Establishment of Securities Operations

Conceptually, a distinction is drawn between banking and investment within the UK. This is reflected in the existence of separate statutory (and other) regulatory regimes for "banking" and "investment business" and also in different supervisory authorities for each category. Banks, however, may engage in both activities and are thus covered by both regulatory regimes.

At the end of 1986 the London Stock Exchange introduced sweeping reforms designed to strengthen the competitiveness of London as a financial centre. One of the major effects of these changes is the creation of broadly-based financial groups offering a full range of services and encompassing securities-related activities on a large scale.

The new measures should facilitate the establishment of foreign security firms or the acquisition of existing ones. In fact, the Bank of England may consider applications from foreign securities firms for deposit-taking licences if certain prudential concerns are satisfied. All institutions are eligible, in principle, for membership in the London Stock Exchange, and to deal in other securities and related markets.

In March 1986, the London Stock Exchange allowed corporate membership in the exchanges, abolished the ceiling of 29.9 per cent on non-members' equity holdings in member firms, and lifted the moratorium on admitting to membership firms in which non-members held any capital.

Although these stock exchange restrictions had not been discriminatory, applying to UK and foreign institutions alike, applications by foreigners for membership in the exchange were discouraged. The unfamiliar divided dealing system, which prohibited firms from acting as both broker and market makers - abolished on October 27, 1986 - and the ban on corporate membership may have also discouraged foreign firms. Since March 1986, however, a number of foreign firms have increased their minority shareholdings in domestic members firms to 100 per cent and some have been accepted as members of the exchange.

Restrictions on Type and Range of Securities Activities

Once established in the United Kingdom, foreign financial institutions engaged in the securities business do, with limited exceptions, receive the same treatment as domestic ones. As mentioned previously, the lead management of sterling denominated securities may only be conducted by an institution resident in the UK where there are reciprocal arrangements in the parent country. Moreover, it is expected that such issues will be co-led by a UK owned institution. This requirement was originally imposed by the Bank of England to regulate international access to the sterling market within the context of the Control of Borrowing Act. There has been some relaxation in this area in the sense that indigenous UK firms which have recently become owned or controlled by foreign firms have subsequently served as co-lead managers.

The stamp duty imposed by the UK authorities on the issues of depository receipts in the UK may weigh particularly heavily on foreign financial institutions. The 1.5 per cent levy was necessary to avoid circumvention of the 0.5 per cent stamp tax on the purchase and sale of securities in the UK, since an interest in such securities could effectively be obtained by purchase of depository receipts.

A mention should be made again of the considerable powers introduced by the Financial Services Act 1986 in cases where UK institutions are deemed not to have received equally favourable treatment in the conduct of investment, insurance and banking business in other countries. Because of the liberalisation of the securities markets, it was felt that some means of redress was necessary against countries where there was an imbalance of treatment. Its use may be reserved, however, for non-EC countries like Japan.

CONCLUSIONS

The main conclusions to be drawn are as follows:

- (1) The major obstacle to establishing a presence in a foreign securities market would appear to be regulations banning foreigners from being licensed as brokers. The importance of exchange membership must be assessed, however, in relation to the entire institutional structure of the securities markets. In Italy, for instance, securities may be traded directly between banks off the exchange, i.e. without a broker as intermediary.
- (2) Difficulties are encountered by non-banking firms which wish to establish themselves in a universal banking environment - as exists, for example, in Germany or Belgium - where a full banking licence will not be granted to an institution that does not offer a full range of banking services. Countries are, however, now adapting and beginning to offer more limited licences for trading in securities only.
- (3) There are restrictions on the establishment of offices either to solicit secondary market business from individual or institutional investors, or to disseminate information about possible investments. Also barriers are placed in the way of dealing directly with the public in executing such orders.
- (4) Regarding primary operations, discriminatory restrictions on the lead management of domestic issues exist in some states.
- (5) In addition to exchange controls, there are other measures which, while not directly prohibiting operations in foreign securities, are designed to prevent or limit their purchase. In Spain, for example, banks, insurance companies and collective investment companies are limited in the amount of foreign securities that may be held in their portfolios.
- (6) A small number of countries levy discriminatory taxes on the purchases of foreign securities. Whilst these taxes do not in most cases discriminate against foreign entities, the increased cost of doing business may act as a disincentive for trading securities in a particular market.
- (7) National prudential requirements are deemed to be a problem in relation to collective investments. Thus, in Germany, many foreign applicants report difficulty in meeting local requirements. This is not seen to be discriminatory, but lack of harmonisation of rules on collective investments may make some European markets less attractive than others.

4.4 REGULATORY BARRIERS TO TRADE AND ESTABLISHMENT IN INSURANCE

Insurance is a highly technical, multifaceted service hidebound by many rules and regulations. As with the banking sector, it may be that margin of discretion with which detailed regulations are applied that determines the competitive standing of a foreign insurer in a member state, rather than the regulations per se.

With insurance the question of barriers to establishment is supplemented by the question of freedom of trade. Over and above the barriers imposed by exchange controls a number of legal barriers to trade in insurance have resulted in a situation where, except for major risks, insurance is fragmented into isolated national markets. In contrast, major risks are laid off in what is a truly international reinsurance market.

Recent court cases have altered the position somewhat in Europe, and it should be noted that whilst attempt has been made to update the source material available, it is possible that recent measures adopted by member states have been overlooked.

In line with the distinction between minor and major risks, this section deals first with direct insurance, before looking at co-insurance and reinsurance. The country-by-country approach is accordingly not followed in this section.

DIRECT INSURANCE

Establishment of Insurance Operations

Licensing

Licensing is the most common means of restricting the access of foreign insurers. Licences may be withheld completely or restricted to certain parts of the business. Almost without exception some permanent presence has been required in the importing country, although this may now change in the light of the recent decision of the European Court of Justice in the case of the Commission versus the Federal Republic of Germany, France, Ireland and Denmark - Freedom to Provide Insurance Services.

While it is not necessary for branches to maintain separate solvency margins, EC directives require undertakings to establish at the head office a solvency margin, calculated according to co-ordinated rules, that is sufficient for their entire business, i.e. both the head office and the agencies and branches. One-third of the solvency margin constitutes the guarantee fund which, depending on the various classes of insurance, cannot be less than a certain fixed amount.

Out of the eight countries specified within this report, most countries fully enforce these EC directives. Foreign insurers must satisfy these criteria in addition to domestic requirements governing technical reserves, which are applied uniformly to both domestic and foreign insurers. Each of the member states has its own separate set of rules governing technical reserves and the assets which represent such reserves.

Recruitment of Local Managerial Staff

None of the eight countries requires a foreign insurance company to recruit local staff for managerial work. The General Agent must be a resident in Luxembourg, France, Germany, the Netherlands and the UK, but not in Belgium, Italy or Spain.

Transfer of Funds

Foreign insurance companies have to comply with the general requirements concerning the transfer of funds which are applied in each country; but there is no specific restriction concerning the insurance sector.

Obstacles to Insurance Transactions

Placing of Contracts

The ruling of December 4, 1986, in the European Court means that those countries which prevent or severely limit the placement of insurance contracts outside their territories with non-established insurers must reconsider their rules and regulations. The Court's decision, however, does not remove all restrictions as national authorisation requirements must, in most cases, be adhered to in the interest of consumer protection.

At present, there are numerous obstacles to placing business outside a country with unlicensed insurers that range from restrictions on the use of resident intermediaries to the volume of business that may be conducted. The full ramifications of the EC ruling in terms of relaxing barriers to trade are unlikely to become evident for some time.

Government Procurement Policies

Government purchases of goods and services may not only be substantial, but can often be connected with other parallel economic activities. The insurance associated with these activities forms a broad range of insurance possibilities for which foreign insurers may have restricted chances to compete if there are preferential procurement policies.

None of the eight member states dealt with in the context of this report have legislation limiting the placement of government insurance contracts to domestic insurers. It may, however, be the case that both custom and practice prevent foreign insurers from offering their services in this area on a competitive basis.

Contract Law

Some countries allow the parties to an insurance contract to choose the law which shall apply. This is however, subject to certain limitations with regard to the compulsory provisions of the contract law relating to the whole contract. In Spain, national law must always be adhered to, whilst both France and Luxembourg enforced national law in certain situations; e.g. in France, when the risk covered is in the country itself.

All the eight states specified allow the parties to insurance contracts to take their differences to their courts, even if the contracts have been made under the law of another country. Restrictions only apply in Luxembourg, where it is only allowed in the case of life assurance of persons, and in France, where it is subject to the rider that the contract does not relate to risks situated in France.

Taxation

None of the eight countries have discriminatory tax measures against foreign insurers although some member states have a more favourable fiscal environment than others. The OECD publication on barriers to trade in insurance, published in 1983, identified the following points:

- (1) Taxes levied are no higher for contracts placed with non-established insurers.
- (2) Germany, Belgium, Luxembourg and the United Kingdom grant tax relief to the proposer for certain types of insurance contracts when the contract is placed in the domestic market.

CO-INSURANCE

Co-insurance is the practice whereby insurance groups form syndicates to share big industrial risks. In most countries, international co-insurance is subject to regulations identical or very similar to those applying to other forms of direct insurance. Most of those countries which allow international co-insurance set high thresholds, below which they do not allow international co-insurance in accordance with the 1987 Coinsurance Directive.

To come within the EC directive on co-insurance, the following conditions in particular must be satisfied:

- (1) The risk must be located within the Community and must be covered, without joint liability between them, by several insurance undertakings (the co-insurers), one of which is the leading insurer, by a single contract at an overall premium and for the same period.

- (2) The leading insurer must fully assume the leader's role in co-insurance practice and must determine the terms and conditions of insurance and rating. Moreover, it must determine, according to the rules or practice of the State where it is established, the minimum amount of the reserves for outstanding claims to be established by each co-insurer.

The latest development in the field of co-insurance has been brought about once again by the case recently before the European Court of Justice. In addition to the particular case against Germany relating to direct insurance, the EC also brought action against Germany, Denmark, Ireland and France on the grounds of non-compliance with its directive on co-insurance. The general ruling to emerge was that the leading insurer of a co-insurance syndicate does not have to be established in a country in which the risks are situated, nor does it require authorisation from the appropriate supervisory authority. The latter point is in direct contrast to that made in the case of direct insurance brought against Germany, where it was emphasised that national authorisation procedures must still be complied with, even though the insurer may not have a permanent presence in the country.

RE-INSURANCE

General Freedom from Regulation

In general it may be said that re-insurance stands out within the insurance sector as being an unregulated business. Whilst the direct sector in almost all countries is subject to a battery of regulations aimed at ensuring solvency and stability in insurance services in general, the same level of concern is not shown for the re-insurance sector, to which, of course, much of the risk covered by the direct insurance sector is passed on, although this situation varies from class to class and country to country.

Under an EC directive, all member states were required to remove all restrictions upon freedom of establishment and freedom to provide services in respect of insurance firms' activities relating to re-insurance.

State Operation

In no country is re-insurance provided as a state monopoly. In Italy, concerns writing life assurance are required to cede from 10 to 40 per cent, depending on the case, of their risks to the National Insurance Institute. In some of the member states, the State may re-insure certain risks in competition with private companies; this does not happen in either the Netherlands or the UK or in many other countries.

Licensing and Supervision of Established Concerns

In Italy and the UK, re-insurance companies are required to obtain a licence when re-insurance is undertaken with direct business; in Belgium, France, Germany, the Netherlands and Spain it is also the case through the licence is not specific to re-insurance but covers direct insurance as well.

When re-insurance is carried out by specialised concerns (pure re-insurance), these concerns may establish without a licence in Belgium, France (provided the head office is in an EC country), Germany and the Netherlands. The other countries require pure re-insurance enterprises to be licensed. Countries are consistent in their approach to supervision - either not bothering at all or supervising both foreign and domestic concerns. Germany provides the only exception in that it supervises domestic undertakings to an extent but not foreign re-insurers.

Deposit Requirements

The supervisory regulations in some member states prevent insurers from covering any part of the technical reserves by claims against reinsurers. This means that they are in practice compelled to require very substantial deposits from reinsurers. As a consequence reinsurance is much less used in those countries (for example France) which have such rules than in those countries (for example Germany) which do not.

CONCLUSIONS

Insurance appears to be similar to the banking sector in that established foreign and domestic insurers are treated in a homogeneous manner, with there being little in the way of open discrimination. Lack of harmonisation of national laws and regulations seem to present the major barrier to free trade, as it results in some member states being inherently less financially attractive than others in terms of open competition.

The case recently before the European Court of Justice, concerning the freedom to provide insurance services, highlights the discrimination exercised by some member states against non-established direct and co-insurers. The full ramifications of the Court's judgements will only become evident once countries have amended their own legislation and adjusted their domestic practices accordingly.

4.5 EXCHANGE CONTROLS RESTRICTIONS ON TRADE IN FINANCIAL SERVICES

EXCHANGE CONTROLS

EC Proposals for Removal of Exchange Controls

Exchange controls, particularly on the free movement of capital, constitute a significant barrier to cross-border trading in financial services, as was outlined in Section 2 of this report.

The European Commission has introduced a two-stage process to liberalise all community exchange controls by 1992. The first stage came into effect in February of this year for seven of the member states, including the UK, France, West Germany, Italy and the Benelux countries. Those measures formally liberalise cross-border transactions in unlisted securities, unit trusts and national securities issued on foreign stock exchanges, as well as long-term trade credits and admission of foreign securities to a domestic market if quoted on a stock exchange. Spain, as a recently joined member of the EC, is allowed until 1990 to introduce these measures.

A proposal has now been made to liberalise all EC capital flows. This will allow individuals to have bank accounts, financial loans and money market instruments in any Community Country.

EXCHANGE CONTROL DETAILS

Introduction

The free movement of capital is assured in the UK, West Germany, the Netherlands, Belgium and Luxembourg, France and Italy; there are, however, reporting and authorisation procedures in force for certain transactions. France and Italy are in the process of liberalising its exchange controls, whilst Spain still retain them on an extensive basis.

The following paragraphs highlight some noteworthy features of the exchange regime in various member states.

Belgium/Luxembourg

These countries have a joint two-tier exchange. Operations related to the purchase or sale of securities are normally done on the financial market like all financial transactions in the Belgian-Luxembourg Economic Union. Some relevant operations may, however, at the choice of the investor, be carried out on either the free or official market, the latter being limited to current account transactions. Such operations include repayment of listed bonds denominated in Belgian or Luxembourg currency and belonging to foreign residents for at least 18 months, as well as the liquidation of participation in enterprises in the Economic Union for which a transfer guarantee was obtained at the time the investment was made. All transactions on the free or the official market involving more than BF 25 million require prior presentation of appropriate documentation to the Exchange Control Board.

France

Restrictions are imposed in a number of areas such as lending to non-residents, and the opening of foreign bank accounts.

Loans made to French companies by foreign lenders, in French francs up to 50 Million have no restrictions; but no prior authorisation is required in the case of foreign currency loans.

Germany

In Germany, there appears to be little in the way of exchange restrictions and of reporting requirements. Two points to note are as follows:

- (i) The purchase of certain fixed interest-bearing securities (Treasury Bonds) by non-residents is subject to approval by the federal government.
- (ii) Whilst there are no restrictions currently in force on deposits of non-residents, the Central Bank is in a position to regulate indirectly the inflow of such deposits by requiring banks to maintain minimum reserves at various rates.

Italy

Italy has a number of capital controls and similar measures designed to prevent capital outflow that restrict international securities dealing.

There are restrictions on both borrowings from abroad and loans by residents to non-residents. Authorisation by the Treasury is required unless specific criteria are met in terms of the type of loan, the amount and its duration. Also financial loans in lire are forbidden.

Capital invested in Italy either by foreigners or Italian citizens resident abroad, for the creation of new productive enterprises may be transferred abroad without any restrictions. Dividends and profits earned from the investment, as well as the proceeds of liquidation, may also be transferred abroad without any restriction. If the investment is not made for the purpose of setting up new productive enterprises, the transfer of dividends or profits abroad may not normally exceed 8% per annum of the capital invested, (although it is currently overridden by an administrative regulation), and the capital invested may not be transferred until two years have elapsed from the date of investment.

Under certain conditions, non-residents can have accounts in foreign currencies while residents are only allowed to keep "authorised accounts" or "special accounts" to deal with international transactions in lire. Any transfer from a foreign account to an internal account is subject to exchange control clearance.

The Netherlands

From October 1, 1986 onward, all regulations dealing with the import and export of capital were abolished in the Netherlands.

In general, Dutch residents are obliged to use authorised banks or institutions, or persons designated by the central bank, when paying or receiving money from non-residents, regardless of the currency employed. Certain transactions between residents and non-residents need to be notified to the central bank for the compilation of the balance of payments.

Spain

Spain is in the process of relaxing exchange controls.

Liberalisation measures are expected in the area of securities' dealings but as at the end of 1986, the following type of restriction was still in force:

- (1) Foreign issues in general could not be introduced on the domestic market but some limited issues have been allowed with authorisation.
- (2) Sales or purchases of foreign securities were very limited.
- (3) Purchases abroad of collective investment securities were very limited.
- (4) The purchase abroad by residents of unquoted securities was prohibited unless in the nature of an authorised direct investment.

There are restrictions on borrowing abroad, with loans over 750 million pesetas requiring the prior approval of the Bank of Spain. Branches of foreign entities may not obtain loans from their home office, unless loans takes form of direct investment or is of a participating nature.

In general, operations between residents and non-residents which result in foreign receipts or payments are subject to exchange control. Some transactions are prohibited and others require prior authorisation, verification or communication. Infringements of the law are regarded seriously by the authorities.

United Kingdom

The UK has no exchange controls and there are no points to be particularly noted under this head.

Conclusions

The removal of exchange controls is seen as an important factor in creating a completely free internal market. The link between exchange controls and trade in services was outlined in our methodological note in Appendix 3.

SECTION 5. QUANTIFICATION OF THE EFFECTS OF REGULATIONS

5.1 INTRODUCTION AND REVIEW OF APPROACHES

The objective of this section is to determine the scope for a quantitative assessment of the effects of completing the internal market in financial services. In particular, the purpose of this section is to provide quantitative measures of the effects of regulations, and of the lack of Community wide competition, or market segmentation. It was envisaged in the work programmes that these quantitative measures would be based on a set of financial products or services, considered to be representative of the output of the financial services sector as a whole, and found in each of the separate Community markets included in the study. In particular, it was envisaged that prices of this set of products would be established for each market.

In this section we present a quantification of the impact of regulation on the basis of a set of prices of financial services and products. We believe, however that such an approach on its own is not sufficient and we have, therefore, in addition considered other measures of the effects of regulation. It is, therefore, useful to review a number of potential approaches to estimating the effects of regulations or market segmentation and to consider their rationale and their limitations.

In attempting to quantify the effects of regulation we considered a wide range of approaches including the following:

- (1) Comparative prices of specific products services;
- (2) Value added/output ratios;
- (3) Survey data on net margins;
- (4) Evidence from other countries on economies of scale or on external economies of financial integration;
- (5) Indirect measures of impact of specific regulations; and
- (6) Case Study of Impact of Deregulation.

The rationale and the limitations of each of the above approaches are discussed below.

(1) Comparative Prices of Specific Products/Services

The work programme envisaged the compilation of comparative prices as the measure of the effects of quantification. The rationale for this approach was indirectly referred to in our analysis of the link between liberalising the market for financial services and liberalisation of capital movements as outlined in Appendix 3 of this report. In that analysis, we

noted that the fragmentation of the European market for financial services means that the consumer does not obtain the services for the lowest possible price. The deviations from the lowest possible price can arise from a variety of conceptually distinct sources. These can include:

- (i) differences in comparative advantage;
- (ii) unexploited economies of scale; and
- (iii) monopoly rents resulting in higher costs or profits;
- (iv) differences in the regulatory, fiscal and judicial systems;
- (v) differences in market structure and practices.

The above analysis highlights the importance of reviewing comparative prices as a measure of the effects of regulation or market segmentation. There are, however, both conceptual and technical difficulties with this approach which implies that while it represents one of the best approaches available, it would be a mistake not to consider other complementary approaches.

A conceptual difficulty with using price differences as a measure of the effect of regulation is indicated by the fact that there are significant price differences within national markets although suppliers in these markets are faced with the same regulations. It is, therefore, not certain that the removal of regulatory barriers to trade would result in a single price. It is important to realise that there are market as well as regulatory barriers to trade. An example of a market barrier is information required to gain entry. Price divergence within countries may be due to information barriers. For example, in the Padoa-Schioppa report, it was noted that "when financial resources are traded, since nothing material is being shipped, the cost of information rather than physical costs represents the main national barrier to trade. Often, however, information will flow more easily between geographically separate but economically linked parties than between physical neighbours."

In addition to this conceptual difficulty there are a number of technical difficulties in measuring prices. Firstly, there is the question of comparability of products. For example the price of motor insurance for the same class of insurance etc may differ as a reflection of differences in the underlying risk. A second problem arises due to the problem of cross subsidisation of financial services products. In our analysis, we have selected a range of products/services in such a way as to attempt to minimise these problems. There is also severe practical difficulties in obtaining price comparisons as relative prices often change rapidly and given significant price variations within countries there is a danger that price divergences between countries may reflect sampling errors.

The issue of comparability of price data is particularly important and while every effort has been used to attempt to obtain comparability, price comparisons are very difficult to make in financial services. For example in the case of term life insurance a report(1) which examines the question in detail, concluded that one is practically never comparing like with like. One factor of considerable significance, is that the basis of the application of direct taxation to life insurance companies differs in the United Kingdom from that in the other Member States reviewed, and usually has the effect that no tax is paid upon the profits of term insurance, which may even benefit from a form of tax credit. Such a tax credit can be taken into account in the fixing of tariffs (this is a consequence of the application of the so-called "income less expenditure" method, which pushes the taxation burden on to those classes of life insurance which gives rise to substantial investment income). As to motor insurance, it must be noted that the scope of the so-called comprehensive cover is not the same in all Member States or for all companies. Also of relevance is the fact that the cost of premiums is to a large extent (although of course not totally) related to the costs of claims. This varies between different Member States for reasons which are not related to the efficiency of the insurance companies. The frequency of accidents varies substantially from one country to another. So does the cost of repairing vehicles. Differences in insurance contracts law make it easier for insurers to avoid payment of claims in some countries than in others. Differences in the legal systems mean that claims can be settled with much less legal expenditure in some countries than in others. Where personal injuries are concerned hospital bills which have to be borne by insurers in some countries, and are supported by the social security system in others. Awards made by courts for physical injury, especially permanent disability, vary enormously.

In comparing insurance prices it is important to take note of the differences between the so-called "pure premium" which is the amount of premium theoretically required to cover claims payments without taking any account of expenses of any kind whatever and without taking account either of investment income, on the one hand, and the loading on the pure premium which is necessary to take account of expenses of all kinds which are largely within the control of the insurance company. Pure premium may be determined for certain classes of insurance (e.g. motor) very largely by national conditions (many of which will remain different even in the internal market), while for others (e.g. damage to high-tech factories) the pure premium will depend on standards of engineering and risk prevention of an international character, and therefore much on national standards.

Similar difficulties arise in relation to other financial services. Despite the difficulties estimates of existing price differences are an important guide to future potential price developments. Therefore while the price comparisons presented in this report are used as a guide in estimating inputs for our economic modelling exercise it would be a mistake to consider the price comparisons as representing a comprehensive comparison of the cost to the consumer of financial services. In many cases as will be outlined later the "price" estimates presented do not represent the cost to the consumer.

(1) Carter R.L, Morgan E.V; "Freedom to Offer Life Insurance Across EEC State Boundaries", E.A.G Report, 1986.

(2) Value Added/Output Ratios

In considering value added to output ratios we are attempting to quantify the effects of market segmentation by measuring the resources used in producing a unit output. Value added represents the sum of compensation of employees and profits accruing to the resources employed. In many service industries the ambiguity of the concept of output and the difficulty of measuring it have often led statisticians to use resource inputs themselves as a measure of output. For the purpose of this analysis such an approach would not be appropriate. The measure of output which we use must be conceptually independent of inputs.

In order to explain the rationale and the limitations of such measures it is useful to take the example of the banking sector. The most commonly used measure of banking output is the value of loans outstanding. This has been used particularly in studies of bank concentration and of economies of scale in banking. Though conceptually independent of inputs, this is, however, an imperfect measure. Its deficiencies can be summarised as follows:

- (a) there is no discrimination between loans of differing intrinsic riskiness or of differing maturities.
- (b) the measure does not discriminate between different degrees of maturity transformation. Thus in one bank, loans may be financed primarily by fixed-term deposits with matched maturity while in another bank long term loans are financed mainly by demand deposits. Abstracting from default risk, the first type of bank is acting as little more than a broker, with no deposit withdrawal risk.
- (c) no allowance is made for deposit-related and money transmission services. Implicitly these are assumed to be proportionate to the size of the balance sheet as measured by loans.
- (d) no allowance is made for other services generated fee income including off-balance sheet transactions, merchant banking activities and so on.

These deficiencies are likely to be particularly severe in making comparisons between individual banks, such as is done in measures of concentration and scale economies. Aggregation over banks, and using the figures in a time series of cross country comparison will tend to reduce the importance of problems (c) and (d), in that the share of non-loan service in the aggregate is likely to be less variable than that in individual banks. Nevertheless problems do remain, but we believe they provide a useful aggregate check on the micro data.

In paying for the services provided by banks, the consumer will cover:

- (i) interest paid by the bank to its depositors;
- (ii) the cost of materials used by the bank, i.e. intermediate consumption and consumption of fixed capital.
- (iii) value added by the bank, i.e. compensation of employees and gross operating surplus.

If we make the assumption that the cost of the first two items is largely beyond the control of each bank, then item (iii) measures the contribution of the banking sector to the aggregate costs of bank services.

If the value added of the banking system is not the minimum possible, this may be due, for example, to taxes and regulations, to inefficiencies, for example those arising from scale dis-economies, or to imperfect competition (in banking or in factor markets).

It is also possible to take the view that to an important extent items (i) and (ii) are not beyond the control of individual banks, and that looking at (iii) alone may result in an understatement of cost differentials. However, with regard to interest on deposits, the level of interest rates is strongly affected by inflation and other conjunctural factors. In a cross-country study, the differences in interest attributable to such factors could swamp the elements of cost differential with which we are concerned.

For insurance the same principles apply. In seeking a suitable output measure the difficulties are perhaps greater than for banks. There is no directly comparable stock measure for insurance like bank loans. The main simple candidate for measuring output is premium income. For accident insurance, claims is also a possible measure. The main conceptual drawbacks of premium are:

- (a) there is a timing problem, the risk insured and paid for in the measured premium may cover a shorter or a longer period than one year.
 - (b) the premium may partly represent a pure investment sum to be risklessly managed by the insurer. Just using premium income simpliciter assumes that the true risk pooling or insurance element is the same for all policies.
- (3) Survey Data on Net Margins

An alternative approach to examining prices is to look at differences in the costs or profits obtained by different financial institutions in the different countries. In particular, an examination of margins in the banking sector and in cost to output ratios in such sectors as insurance can be of use in evaluating the effects of regulations. This represents a micro version of the value added to output ratios considered above.

(4) Evidence from other Countries on Economies of Scale or on External Economies of Financial Integration

The existence of economies of scale and their measurement would provide a very useful basis for quantifying effects of market segmentation. As noted in Appendix 3 of this report, there is considerable controversy regarding economies of scale in financial services and existing evidence on both economies of scale and of external economies of financial integration is very limited.

(5) Indirect Measures of Impact of Specific Regulations

The impact of selected specific regulations could provide an input into a quantification of the effects of regulations. This, however, would only measure static effects. In addition, it would only measure the impact on institutions who decided to "pay the cost" of meeting the regulations. Our judgement is, therefore, that such an approach is very unlikely to prove worthwhile. We have however later in this section for illustrative purposes reported on the results of selective research on the impact of specific regulations in the banking and insurance sectors.

(6) Case Studies of Impact of Deregulation within a National Boundary

An additional potential approach to quantify the effects of regulation is to consider on a case study basis the impact of deregulation within a national boundary and to evaluate what impact it has on prices. This could be a useful additional source of input into an evaluation of the effects of removing or reducing regulations in Europe. We have, therefore, taken as a case study the example of deregulation of the UK securities business.

Other Measures

In addition to the six measures which are reviewed above, we considered a number of other measures such as measures of credit rationing and macro measures such as a share of value added (less trade) in GNP. Due to data or methodological problems with these approaches we decided not to pursue them further.

It is also essential that the indirect macroeconomic implications of regulations are evaluated.

In the remainder of this section the quantified data for comparative prices, value added/output ratios, survey data on net margins, indirect measures of impact of specific regulations, and the case study of impact of deregulation, are presented.

5.2 QUANTIFICATION OF COMPARATIVE PRICES

In the following paragraphs we present a quantification of comparative prices for a range of financial services products in the eight countries. We present details of prices in banking and credit sectors, in insurance and in securities and brokerage sectors. In particular, we analyse details of prices for the following services/products:

- . cost of commercial loans;
- . cost of consumer credit;
- . cost of mortgages;
- . cost of credit cards;
- . cost of purchasing foreign exchange drafts and travellers cheques;
- . cost of letters of credit;
- . cost of current bank accounts;
- . cost of term insurance;
- . cost of home and contents insurance;
- . cost of motor insurance;
- . cost of fire and theft insurance;
- . cost of public liability insurance;
- . and cost of stock exchange transactions.

Our selection of products was designed and agreed with the Commission to overcome some of the difficulties referred to earlier in Section 5.1.

Many of the prices have been obtained directly via a sample of financial providers. Others have been obtained from published sources and from producer associations. It is important to treat comparative price data with care. Prices of financial services change frequently and the data presented represents "a snap shot" at a given point in time. Also of critical importance is that for a wide range of financial services there are a wide range of possible prices on offer and in many cases there is cross-subsidisation between different financial services.

Another important issue relates to how representative are the chosen products of the output of the financial services sector as a whole. This is a difficult issue to judge but given the large number of different services chosen which cover both private consumer and commercial services in banking, insurance and securities sectors these services are believed to be as representative as feasible. These services do not include advisory services. The reason for this is a methodological one in that it was not felt possible to obtain prices for standardised advisory services. The sources of the data presented are indicated in this section.

We have attempted to present in a standard manner the same financial services products in different countries. In certain cases regulatory or market practices have made this difficult to achieve. We have also attempted to standardise the presentation for different types of financial services products. In certain cases however we have not presented the material in this manner where we believe it may be misleading.

A key issue in interpreting the price data is that we have attempted to focus on the cost of the service provided by the financial institutional and have adjusted the figures to remove the influence of interest rate differentials. We have however considered the impact of interest rate differentials separately in Section 6. As many of the products represent the margin over wholesale money market rates the prices do not represent the cost to the consumer. This is consistent with our economic modelling requirements. The data therefore would not be suitable as a measure of consumer prices in different countries. The figures also exclude consumer taxes.

In table 5.2.1 overleaf we define the financial services or products examined in our price comparison.

TABLE 5.21

Name of Standard Service	Description of Standard Service
Banking Services	
Commercial Loan	Annual cost to a medium size firm of a commercial loan of 250,000 ECUs. Measured as excess over inter-bank rates.
Consumer Credit	Annual cost of consumer loan of 500 ECUs. Excess interest rate over money market rates.
Credit Cards	Annual cost assuming 500 ECU debit. Excess interest rate over money market rates.
Mortgage	Annual cost of Home loan of 25,000 ECU. Excess interest rate over money market rates.
Commercial Draft	Total cost for a large commercial client of purchasing a commercial draft for 30,000 ECUs.
Travellers Cheques	Total cost for a private consumer of purchasing 100 ECU's worth of Travellers Cheques.
Current Cheque Account	Annual cost assuming 200 cheques P.A., 20 standing orders, 50 cash withdrawals, 20 credit.
Letter of Credit	Cost of letter of credit of 50,000 ECUs for three months.
Insurance Services	
Term Insurance	Average annual cost of term insurance.
Home Insurance	Annual cost of fire and theft cover for house valued at 70,000 ECUs with 28,000 ECUs contents.
Motor Insurance	Annual cost of comprehensive insurance, 1.6 litre car, Driver 10 years experience, no claims bonus.
Commercial Fire and Theft	Annual cover for premises valued at 387,240 ECUs with stock and contents at 232,344 ECUs.
Public Liability Cover	Annual premium for Engineering company with 20 employees and annual turnover of 1.29 million ECUs. Includes employer liability cover.
Brokerage Services	
Private Equity Transactions	Commission costs of cash bargain of 1,440 ECUs.
Private Gilts Transactions	Commission costs of cash bargain of 14,000 ECUs.
Institutional Equity Transactions	Commission costs of cash bargain of 288,000 ECUs
Institutional Gilt Transactions	Commission Costs of cash bargains of 7.2m ECUs.

INTERPRETING 'PRICE' COMPARISONS

Extreme caution must be exercised in interpreting the price comparisons in this section and the analysis in previous sections concerning the problems of comparability and cross subsidisation must be noted. Also as adjustments in many cases have been made for the interest rate the prices do not represent the cost to the consumer. Prices are also exclusive of consumer taxes. It is also important to note that in section 6 of this report some additional points are raised which are relevant to interpreting the 'price' comparisons.

COSTS OF MORTGAGES

Tables 5.2.2 show the cost of mortgages as measured by the amount by which interest rates on mortgages exceed money market rates. The data in the table was derived by subtracting market rates money from estimates of the costs of mortgages. The latter data was obtained from the European Community Mortgage Federation. The results represent the average costs for each quarter. It is likely that prices will have changed since this data was collected.

TABLE 5.2.2: EXCESS OF AVERAGE MORTGAGE LOAN INTEREST RATES OVER MONEY MARKET RATES

	per cent per annum				
	1982	1983	1984	1985	1986
B	3.36	4.69	3.41	3.23	1.92
D	1.43	3.09	2.75	2.61	2.30
ES	2.31	1.59	4.69	6.35	3.20
F	0.11	1.83	1.94	2.09	2.61
I	2.12	2.06	1.68	2.0	1.40
NL	2.97	3.85	2.57	1.50	1.37
UK	1.60	1.53	4.17	2.61	1.16

**Sources: European Community Mortgage Federation
International Monetary Fund "Financial Statistical
Yearbook".**

The excess of average mortgage interest rates over money market rates is shown in Table 5.2.2. In 1986 the differential ranged from just over 1 per cent in the UK to 3.2 per cent in Spain. Between 1982 and 1986 the excess fell in each of the countries except Germany and France. It should also be noted that financial institutions providing mortgage may obtain funds at rates which differ from money market rates. This factor has not been taken into account in the estimates.

COSTS OF CONSUMER CREDIT

Average rates of interest for bank loans to personal customers are shown in Table 5.2.3 in excess of money market rates.. The excess over prevailing money market rates varies considerably from 2-3 per cent in, Belgium and Luxembourg to 8 per cent or over in the UK, France, and Germany. The precise definition used here relates to the annual cost of a loan for a private consumer purchasing a motor vehicle. The costs examined are the excess over money market rates. The high cost in some countries such as Germany reflect the low level of money market rates. Quotes were obtained directly from two of the major banking groups in each of the countries. Very little differences within countries were evident for the particular consumer credit identified within the institutions contacted. There are of course a wide range of institutions offering different types of consumer credit at significantly different rates within countries. This would have to be taken into account in any comprehensive review of consumer credit.

TABLE 5.2.3 AVERAGE COSTS OF CONSUMER CREDIT

Country	Per Cent Per Annum excess over money market rate
B	2.3
D	9.2
ES	5.4
F	8.0
L	2.8
NL	5.1
UK	8.6

Source: Sample survey of banks plus Morgan Guaranty; "World Financial Markets"

COST OF CREDIT CARDS

The table below shows the average cost for three credit cards. One of the cards examined is a charge card rather than a credit card and this influences the estimates. The costs are made up of a joining fee or annual charge together with the interest charge which has been "normalised" by using the excess of the nominal interest rate charged over the representative money market rate. The table shows credit cards to be most expensive in Italy, Belgium, Germany and the Netherlands. France and Luxembourg were the cheapest on the basis of this measure of costs.

TABLE: 5.2.4
COST OF CREDIT CARDS

	ECU	Range
B	94	83 - 100
D	84	63 - 122
ES	66	63 - 68
F	37	20 - 55
I	99	79 - 117
L	46	43 - 49
NL	75	38 - 104
UK	61	53 - 65

Source: Sample Survey of Credit Card Charges

- (1) The data represent the average annual cost (in excess of money market rates) in the first year of acquiring a credit card and availing of ECU500 credit, if available, for the full year. The credit cards used in the example are Visa, Eurocard and American Express. The results were obtained directly from the credit card companies.

COSTS OF PURCHASING FOREIGN EXCHANGE:

The percentage difference between the exchange rate at which banks buy and sell foreign exchange varies depending on the type of instrument (notes, cheques, drafts), involved. For a given currency this reflects differences in handling and administration costs associated with each instrument. Differences in percentages between banks may also reflect differences in perceptions of risk of exchange rate fluctuations and the degree of competition for new business. We have not considered this issue in this report. We have however examined the cost to the consumer in terms of commissions, charges etc. A survey was carried out of the costs to the consumer of purchasing a commercial draft and travellers cheques in the eight countries. The results were obtained from a major bank with branches in different countries. (The results are shown in tables 5.2.5 and 5.2.6).

COMMERCIAL DRAFTS

Information on the total costs of purchasing a commercial draft for 30,000 ECU's for a large commercial client is presented overleaf.

These costs are inclusive of commission and bank charges. The cost of a commercial draft was the lowest in the Netherlands while in Spain the cost was the highest.

TABLE 5.2.5**COST OF PURCHASING A COMMERCIAL DRAFT**

Country	ECU
B	43
D	53
ES	120
F	63
I	50
L	54
NL	22
UK	47

Source: Sample Survey of Banks

The total cost for a private consumer of purchasing 100 ECUs worth of travellers cheques is given in Table 5.2.6. The results show that Germany, Luxembourg and the United Kingdom were the cheapest countries to purchase travellers cheques in, while France was the most expensive country.

TABLE 5.2.6**COST OF PURCHASING TRAVELLERS CHEQUES**

Country	ECU
B	7.3
D	5.0
ES	7.0
F	7.5
I	6.6
L	5.0
NL	7.2
UK	5.0

Source: Sample Survey of Banks

COST OF LETTERS OF CREDIT

In the table below data on the costs of letters of credit is presented. The figures show that costs were highest in Spain and lowest in France and Germany. The results are based on quotes provided by the major banks in each country reviewed. Very little differences within the countries were observed.

TABLE 5.2.7 COSTS OF LETTERS OF CREDIT

The costs compared on those for:

- Opening
- Confirming
- Accepting
- Carrying out 3 transactions

The credit is for 3 months (1)

	Per Cent of Value
B	1.15
D	0.85
ES	1.5
F	0.875
I	1.03
L	1.2
NL	1.10
UK	1.02

(1) The transactions are large enough not to incur any flat rate minimum charges.

Source: Sample Survey of Banks

COSTS OF CHEQUING ACCOUNTS

The table overleaf sets out the costs of maintaining a current account and carrying out the transactions specified. For the example chosen the charges appeared highest in Italy, Germany and the UK. In the other countries minimal or zero charges were levied. Other factors bear on this comparison since banks are competing for deposits in some countries by offering extra services and in some cases a nominal interest payment on current accounts if certain maximum balances are maintained. The costs are based on a survey of the major banks in each country. In view of the above factors we believe data on these costs could be misleading and we do not use them in our subsequent analysis.

TABLE 5.2.8 BANK CHARGES

The costs compared on those for:

- 200 Cheques p.a.
- 20 standing orders
- 50 Automatic Cash Withdrawals
- 20 Credits

Account does not qualify for free banking

	ECU per annum
B	0
D	117
ES(2)	2
F	10
I	240
L	8
NL(3)	0
UK	112

- (1) Assumed that the standing orders are all opened in the year in question.
- (2) Fixed charge only. No charge on cheques or automatic withdrawals.
- (3) Automatic Cash Withdrawal system introduced recently. Some banks charge DG1.50 per transaction.
- (4) The above charges refer to cheques written within the country in question. In Belgium there are no charges for such cheques but a charge of BF 150 is levied on a euro cheque of BF 7,000 written outside Belgium. Postage is also charged on letters to customers.

Source: Sample Survey of Banks

COST OF COMMERCIAL LOANS

The annual cost to a medium sized firm of a commercial loan of 250,000 ECUs (as measured by the margin over inter bank rates) are shown in table 5.2.9. The table shows commercial loans to be the most expensive in the UK and the Netherlands while France and Belgium were the cheapest. The cost of commercial loans depend on the risk associated with the loan. The data presented overleaf does not represent the cost to the firm as it is measured in terms of the margin over inter bank rates. These rates fluctuate significantly and this factor should be noted. Other reservations regarding these figures are considered in Section 6 of this report.

TABLE 5.2.9: ANNUAL COST OF A COMMERCIAL LOAN

	ECU
B	4,500
D	5,000
ES	5,625
F	4,375
I	5,125
L	5,000
NL	6,750
UK	6,875

Source: Sample Survey of Banks

COST OF TERM INSURANCE

A comparison was made of a sample of costs of term insurance in the eight countries. In examining all of the data on insurance prices in this section the difficulties in making insurance comparisons which was stressed earlier must be noted. Pure term insurance represents only a small proportion of the market in the countries surveyed. However, comparisons of savings linked premiums would not prove very easy to make because of the importance of differing levels of interest rates. The tables below set out the results. The cost of term insurance for a sum of 72,500 ECU was obtained for different classes indicated. The results represent quotes from between six and twelve companies in each of the countries. The results were obtained in 1987.

TABLE 5.2.10: TERM INSURANCE PREMIA, 5 YEARS
(Sum Assured = ECU 72,500)

Country	Age	ECU Per Annum					
		25	Male			Female	
		25	35	45	25	35	45
B		193	288	564	193	288	564
D		161	187	307	153	174	274
ES		174	232	508	168	188	338
F		109	210	463	109	210	463
I		209	290	536	209	290	536
LU		162	258	543	162	258	543
NL		126	144	360	108	126	216
UK		83	101	261	83	87	175

Source: Sample Survey

TABLE 5.2.11: TERM INSURANCE, 10 YEARS
(Sum Assured = ECU 72,500)

Country	Age	ECU Per Annum					
		Male			Female		
		25	35	45	25	35	45
B		208	333	694	208	333	694
D		172	210	375	156	195	336
ES		184	285	640	174	213	418
F		133	242	553	133	242	553
I		220	342	697	220	342	697
LU		178	306	682	178	306	682
NL		124	172	454	107	136	264
UK		91	130	362	87	103	242

Source: Sample Survey

The data on term insurance indicates that premia are lowest in the UK. Insurance in Germany appears considerably higher although the percentage gap narrows as the age group increases. The position with regard to German insurance is interesting and is considered below.

The premiums quoted for France, Italy, Belgium and Luxembourg were the same for males and females. In France and Italy premiums are generally higher than in Germany for both five and ten year terms. The Italian premiums quoted were higher than in France, Germany and the UK in all categories. The Spanish quotes are, broadly speaking, similar to France for males aged 35 and 45. They are higher for 25 year old males and females. The rates for 35 and 45 year old females in Spain are lower than for France.

The premiums in the Netherlands are lower than for many other countries. Premiums in Belgium and Luxembourg are in most cases higher than in Spain, France, Germany and the UK.

As indicated above the German comparisons are interesting as they in part reflect a particular regulatory issue. Specifically contracts are standardised and conservative mortality rates must be used.

It is however mandated that at least 90% of any surplus must be returned to policy holders through dividends/bonuses. This may obscure the true cost of purchasing insurance since the outcome on the bonus/dividend may not be clear for many years.

The premiums shown for Germany in the above tables were an average of premiums quoted by companies some of which have deducted instant rebates and some which may have offered increased benefits in other ways such as including a profit share or special bonus payments in cases of accidental death.

The average figures shown above suggest that term insurance in Germany is considerably more expensive than in the UK. The gap narrows as the age group increases. It is possible that the disparity is less than shown, taking both cost and benefits since the Germany firms which quoted rates without immediate rebates offered other benefits not matched by the UK quotes.

The table below shows the lowest rates quoted in the Germany sample, and the range found in the UK.

TABLE 5.2.12: TERM INSURANCE PREMIA
Lowest in Germany Sample compared to the UK range

		Males			Females		
		25	35	45	25	35	45
5 Year Term							
Germany	Lowest	143	172	249	118	140	174
UK	Highest	95	120	292	95	95	202
UK	Average	83	101	261	83	87	175
UK	Lowest	69	69	168	69	69	113
10 Year Term							
Germany	Lowest	147	200	284	121	156	253
UK	Highest	117	196	419	107	138	281
UK	Average	91	130	362	87	103	242
UK	Lowest	65	85	244	65	65	161

The highest quotes in the UK sample were lower than the lowest in Germany with the exception of 45 year old males and females for both five and ten year terms. Finsinger (1) also found in the sample carried out in 1981, that the highest UK rates were lower than the cheapest in Germany but that the gap narrowed with increased age. However, that sample was carried out before rebates were widespread in Germany. The lowest quotations in the present sample in Germany are in all cases more than fifty per cent above the lowest in the UK except for the ten year term for 45 year old males .

(1) The French Automobile and Life Insurance Markets
 - J Finsinger & R Waldmann 1986

HOUSE AND CONTENTS INSURANCE

The comparison of prices for these policies is particularly difficult because of the importance of location, type of construction, level of security and range of cover options available. The premiums for Italy came out highest from the sample and somewhat surprisingly those of the UK second highest. The results represents quotes obtained from between five and twelve companies in each of the countries reviewed. Again the differences in the inherent risk associated with insurance premium is a key factor. This is one of the reasons why in our economic modelling we have assumed that only a proportion of price differences would be removed in an integrated market.

TABLE 5.2.13: INSURANCE PREMIUMS HOUSE AND CONTENTS

- House valued at ECU 70,000
- Contents ECU 28,000
- Fire and Theft Cover
- House located in a medium sized city

	<u>ECU per Annum</u>	<u>Range</u>
B	118	115 - 132
D	144	93 - 159
ES	135	112 - 160
F	195	163 - 211
I	253	240 - 270
LU	220	217 - 238
NL	164	142 - 185
UK	266	225 - 300

Source: Sample Survey of Insurance Companies

COSTS OF MOTOR INSURANCE

A survey was carried out on the costs of obtaining comprehensive insurance cover for a new 1.6 litre car. The main driver was specified as a 35 year old male with 10 years experience, full no claims bonus and who lived in an average sized city. Open driving was cited as a requirement. The results are set out in the table overleaf: The range estimates provided are also indicated and represent quotes from between six and twenty insurance companies in each country.

TABLE 5.2.14: COST OF INSURANCE PREMIUMS - MOTOR

- Opel Ascona 1.6L
- Male aged 35
- 10 years experience
- Lives in average sized city
- Full no claims bonus
- Open driving

	<u>ECU per Annum</u>	<u>Range</u>
B	494	468 - 526
D	436	394 - 505
ES	758	701 - 812
F	413	401 - 427
I	942	716 - 1015
LU	671	652 - 727
NL	354	294 - 471
UK	316	261 - 411

Source: Sample Survey of Insurance Companies

COST OF COMMERCIAL FIRE AND THEFT INSURANCE

A comparison was made of the cost of obtaining commercial fire and theft insurance for an engineering company assembling computer components. As in the case of house and contents insurance, the comparison of prices for these policies is extremely difficult because of the importance of differences in location, construction etc. The premiums for Italy and France came out the highest, while those in Belgium and Luxembourg were the lowest. The result represents quotes from four and six companies in each country. The very large range of prices quoted in France is noteworthy.

TABLE 5.2.15 COST OF COMMERCIAL FIRE AND THEFT INSURANCE PREMIUMS

- Premises Valued at ECU 387,240
- Stock and Contents ECU 232,344
- Fire and Theft Cover
- Premises Located in a Medium Sized Town

	<u>ECU per Annum</u>	<u>Range</u>
B	1296	1109 - 1486
D	2023	1926 - 2119
ES	1765	1465 - 1986
F	3587	1930 - 5834
I	4896	3459 - 5907
LU	1204	899 - 1755
NL	1412	1265 - 1695
UK	1797	1755 - 1839

Source: Sample Survey of Insurance Companies

PUBLIC LIABILITY

A survey was also carried out on the cost of obtaining public liability for the same example of an engineering company. The company was assumed to have 20 employees with a wage bill of ECU 193,620 and a turnover of ECU 1.2 million per annum. The results are presented in Table 5.2.16. The results represent quotes from between four and six companies in each country. Again the very large range indicated for France and Italy is noteworthy. Particular caution should be exercised in interpreting the figures on public liability insurance cover. Many of the companies contacted indicated that a detailed inspection of premiums etc. would be required before authoritative quotations could be supplied. In some countries the practice concerning the precise tripartite maximum limit also varied between companies and in some countries companies were legally obliged to bear responsibility for legal defense expenses. In view of the difference in judicial and technical factors great caution should be exercised in evaluating the public liability cover. These costs however are given only a very small weighting in our estimates of consumer surplus and therefore do not materially affect our estimates.

TABLE 5.2.16: PUBLIC LIABILITY

-	No. of employees	20
-	Wage Bill ECU 193,620	Clerical 45,178 Manual 148,442
-	Turnover ECU 1.29 million per annum	

		Range
B	968	926 - 1010
D	1257	1084 - 1430
ES	1364	1210 - 1464
F	1852	476 - 3227
I	1508	798 - 2662
L	934	618 - 1249
NL	714	614 - 800
UK	798	725 - 870

Source: Sample Survey of Insurance Companies

COST OF STOCK EXCHANGE TRANSACTIONS

Stock exchange commission rates on trading in Government stocks are shown in Table 5.2.17. The results on stock exchanges are primarily based on the findings of the International Federation (FIBV). In the UK large bargains of more than ECU 7.2m are net of commission, while commission costs elsewhere range from ECU 2,590 in the official market in the Netherlands to ECU 21,500 in Belgium. Luxembourg and the Netherlands (official market) have commission costs of less than ECU 4,000 on a bargain of this size; France (maturities of less than 10 years) and the Netherlands parallel market had costs in the range of ECU 5,000 - ECU 5,400 and, Spain, Italy and France (securities) had costs in excess of ECU 8,900.

The rapidly changing position in European stock exchanges implies that quoted rates for stock exchange transactions are out of date very soon after publication. In the UK the commission cost of institutional gilts is no longer available and we have assumed the same price differential as applies to institutional equities. In Germany bank commissions on institutional equities are now negotiable and we have assumed an average of previously quoted rates and some estimates provided by a major bank.

Commission costs on bargains of ECU 14,400 ranged from ECU 14 in the UK and ECU 21 in Italy, to ECU 65-72 in Belgium, France and Luxembourg and to ECU 108-180 in Germany, in the Netherlands and Spain.

**TABLE 5.2.17: STOCK EXCHANGE COMMISSIONS ON TRADING IN
GOVERNMENT STOCKS**

<u>Cash Bargains</u>		
	Bargain Size ECU 7.2m Equivalent Commission Costs	Bargain Size ECU 14,400 Equivalent Commission Costs
ECU		
B	21,583	65
D		
- Fixed Interest Securities	5,395	108
ES	8,993	180
F		
- Indexed	12,365	72
- Non-Indexed - less than 10 yr to maturity	5,323	65
I	10,791	21
L	3,597	72
NL		
- Official Mkt. less than	2,590 (Negotiable)	137
- Parallel Mkt.	6,295	171
- ASAS less than	5,035 (Negotiable)	137
UK	Mostly net of Commission	14 - 140
	(3,600 approx pre-big bang	(56 pre-big bang)

Source: Federation Internationale Des Bourses (FIBV); Survey Results

Stock exchange commissions on equity trades are shown in Table 5.2.18. For a bargain of ECU 288,000 the average commission costs range from ECU 719 in the UK to ECU 3,453 in Spain. France was found to be the second least expensive with costs of ECU 1,292, followed by Belgium and the Netherlands with costs of ECU 1,726, and Italy with costs of ECU 2,014, Germany and Luxembourg were next with average commission costs of ECU 2,302. For small bargains of ECU 1,440 the cheapest country is France (ECU 9.00) and the UK is the most expensive (ECU 23).

**TABLE 5.2.18: STOCK EXCHANGE COMMISSIONS ON TRADING IN
EQUITIES**

	Cash Bargains Commission Costs,	
	Bargain Size ECU 288,000	Bargain Size ECU 1,440
B	1,727	14
D	2,302	11
ES	3,453	17
F	1,292	9
I	2,014	10
L	2,302	11
NL	1,727 (Negotiable)	22
UK	719	23

Source: FIBV; Survey Results.

5.3 VALUE ADDED/OUTPUT RATIOS

In this section we review aggregate value added/output ratios for the insurance sector and for banking. For insurance we examine value added as a percentage of premiums and for banking we review value added as a percentage of loans outstanding.

INSURANCE

Table 5.3.1 shows the value of premiums and value added in each of the countries in 1983 and expresses value added as a percentage of premiums. In 1983 value added in the Netherlands and the UK were in the 23-26 per cent range while Spain, Belgium, Germany and Italy were in the 13-19 per cent range. This calculation is on a national accounts basis which excludes interest receipts and payments which are deemed to be transfers. A significant proportion of profits in insurance is derived from dividend and interest earnings, part of which are imputed to policy holders. Without interest earnings higher premiums would have to be charged. Thus interest and dividend receipts less imputed interest to policy holders has been added to value added to derive a measure of the resources required to provide insurance services. (When reliance on interest is taken into account it is clear that the UK percentage of premiums is lowest at 1.1 per cent.) The percentage ranges from 21 - 32 per cent for the other countries.

TABLE 5.3.1: VALUE ADDED AND PREMIUMS, 1983 (1)

Country	Aggregate value added (ECU m)	Gross premiums (ECU m)	Value Added as % of gross Premium	Value Added + Net Interest as % Premium	Value Added + Net Interest + Dividends as % Premiums
B	605	3,545	17.1	32.2	34.2
D	7,972	42,951	18.6	22.6	22.4
ES	493	3,607	13.7	n.a.	n.a.
F	1,416	23,696	6.0	21.3	23.8
I	1,166	8,899	13.1	24.0	24.2
NL	1,963	8,252	23.8	24.2	30.6
UK	8,338	32,744	25.5	1.1	23.4

Source: Eurostat; Sigma

(1) Data for Luxembourg on value added in insurance is not available

BANKING

A measure of the costs of the banking service is provided by the value added/loans outstanding ratio. Data on value added as a percentage of loans outstanding is presented in table 5.3.2. Value added in banking as a percentage of loans averaged 6.3 per cent in Italy from 1978-84, with an increase up to 7 per cent in 1983. In France and Spain average value added exceeded 4 per cent and both countries had an increase in value added as a proportion of loans from the late 1970's up to 1982 (France) and 1984 (Spain). German value added as proportion of loans averaged 3.6 per cent 1978-82 and fell between 1978-79 and 1981-82. Belgian value added averaged 3.4 per cent compared to 3.2 per cent in 1978-82. The Netherlands and the UK averaged 3 per cent for value added as a proportion of loans, with UK value added falling as a proportion of loans from 1980 to 1984 and Dutch value added increasing from 1981-82.

TABLE 5.3.2: VALUE ADDED IN BANKING AS PERCENTAGE OF LOANS OUTSTANDING, 1978-84

Country	% of loans							Average
	1978	1979	1980	1981	1982	1983	1984	
B	3.2	n.a.	3.2	3.4	3.8	n.a.	n.a.	3.4
D	4.1	3.9	3.4	3.3	3.4	n.a.	n.a.	3.6
ES	3.0	2.8	n.a.	5.0	4.1	4.3	5.4	4.1
F	4.3	4.4	4.9	5.1	4.9	n.a.	n.a.	4.7
I	5.6	5.6	6.6	6.6	6.7	7.0	6.3	6.3
NL	3.3	3.2	3.0	3.0	3.3	3.7	3.5	3.0
UK	3.3	n.a.	3.7	2.9	2.6	2.8	2.8	3.0

5.4 SURVEY DATA ON NET MARGINS/COSTS

In this section we present data on net margins and on ratio of various costs to output. The margins data for the banking sector are based on a major survey completed by Revell and on research by OECD. The data on insurance sector was obtained directly from a sample of accounts of insurance companies in the different countries.

BANKING MARGINS

Table 5.4.1 gives details of average margins in banking in the different types of banks in the countries surveyed. Gross earnings margins vary considerably between and within countries. Large banks had higher gross margins than the other types of banks in Belgium, Germany and the Netherlands, in France commercial banks had the highest margins, and in Italy and the UK the savings banks and trustee banks respectively had the highest gross margins. Net earnings margins also show considerable variation: in five of the countries net margins were highest in the savings or trustee banks, while in France and the Netherlands the commercial banks had the highest margins.

- (1) Revell, J.R.S., COSTS AND MARGINS IN BANKING, AN INTERNATIONAL SURVEY O.E.C.D. 1980.

TABLE 5.4.1: GROSS AND NET MARGINS IN BANKS, 1982

Country/bank	% of average total assets	
	Gross earnings margin	Net earnings margin
B		
: Large banks	3.36	0.78
Commercial banks	3.01	0.77
Savings bank	2.70	1.06
D		
: Large banks	4.35	1.23
Commercial banks	3.30	1.07
Giro banks	0.86	0.38
Savings banks	3.79	1.59
F		
: Large banks	2.94	0.93
Commercial banks	2.98	1.01
I		
: Large banks	2.92	0.86
Commercial banks	3.23	1.36
Savings banks	4.52	1.98
NL (1981)		
: Commercial banks	2.91	1.00
Savings banks	2.75	0.79
UK		
: Large banks	4.72	1.44
Trustee savings banks	5.83	1.75
Building societies	1.78	0.50

Source: O.E.C.D. Costs and Margins in Banking, Statistical Supplement

Belgium

Table 5.4.2 gives details of gross and net margins in the Belgian banking sector between 1978 and 1982. Gross margins in large banks were very stable while net margins changed considerably. Gross margins in commercial and savings banks were lower than in the large banks, but average gross margins were higher.

TABLE 5.4.2: GROSS AND NET MARGINS IN BELGIAN BANKS, 1978-82

	% of average total assets					
	1978	1979	1980	1981	1982	Average
Large banks						
: gross	3.26	3.37	3.06	3.30	3.36	3.27
net	0.54	0.52	0.49	0.63	0.78	0.59
Commercial banks						
: gross	3.33	3.36	3.10	3.00	3.01	3.16
net	0.61	0.61	0.70	0.68	0.77	0.68
Savings banks						
: gross	n.a.	2.96	2.31	2.56	2.70	2.63
net	n.a.	1.43	0.71	0.90	1.06	1.00

Source: OECD

Germany

Table 5.4.3 shows that in Germany the average gross margin in large banks and in savings banks was over one-fifth higher than in the commercial banks and more than four times the margin of the giro banks. Net margins were also the lowest on average in the giro banks and fell over the 1978-82 period - in contrast to net margins in the other banking sectors.

TABLE 5.4.3. GROSS AND NET MARGINS IN GERMAN BANKS, 1978-82

	% of average total assets					
	1978	1979	1980	1981	1982	Average
Large banks						
: gross	3.34	3.19	3.26	3.82	4.35	3.59
net	0.60	0.49	0.46	0.85	1.23	0.73
Commercial banks						
: gross	2.72	2.55	2.58	2.88	3.30	2.81
net	0.62	0.49	0.45	0.70	1.07	0.67
Savings banks						
: gross	3.42	3.25	3.19	3.56	3.79	3.44
net	1.17	1.05	1.00	1.36	1.59	1.23
Giro banks						
: gross	0.99	0.83	0.73	0.62	0.86	0.81
net	0.45	0.30	0.20	0.13	0.38	0.29

Source: OECD

France

Average gross margins were similar in French large banks and savings banks and were fairly stable in both types of banks over the 1978-82 period. Net margins in commercial banks were considerably higher than in large banks, but rose less rapidly.

TABLE 5.4.4: GROSS AND NET MARGINS IN FRENCH BANKS, 1978-82

	% of average total assets					
	1978	1979	1980	1981	1982	Average
Large banks						
: gross	2.99	2.92	3.12	3.04	2.94	3.00
net	0.55	0.57	0.93	0.94	0.93	0.78
Commercial banks						
: gross	2.93	2.90	3.09	3.06	2.98	2.99
net	0.75	0.75	1.02	1.03	1.01	0.91

Source: OECD

Italy

Italian gross and net margins were on average highest in the savings banks, followed by the commercial banks and the "large banks". For each of types of banks there was a rise in margins over the 1978-82 period.

TABLE 5.4.5: GROSS AND NET MARGINS IN ITALIAN BANKS, 1978-82

	% of average total assets					
	1978	1979	1980	1981	1982	Average
Large banks						
: gross	2.64	2.58	3.04	3.29	2.92	2.89
net	0.67	0.56	0.87	1.13	0.86	0.82
Commercial banks						
: gross	3.02	2.81	3.33	3.55	3.23	3.19
net	1.07	0.94	1.31	1.57	1.36	1.25
Savings banks						
: gross	3.89	3.69	4.30	4.65	4.52	4.21
net	1.37	1.39	1.75	2.05	1.98	1.71

Netherlands

Gross margins in the Netherlands were on average higher in commercial banks between 1978 and 1981 than in the savings banks. However, there was only a small difference in net margins between the two types of bank.

TABLE 5.4.6: GROSS AND NET MARGINS IN BANKS IN THE NETHERLANDS 1978-82

	% of average total assets					
	1978	1979	1980	1981	1982	Average
Commercial banks						
: gross	3.28	3.17	3.05	2.91	n.a.	3.10
net	1.01	1.02	1.02	1.00	n.a.	1.01
Savings banks						
: gross	2.77	2.82	2.64	2.75	n.a.	2.74
net	1.13	0.96	0.78	0.79	n.a.	0.92

Source: OECD

UK

In the UK gross margins in the "large banks" averaged 5.06 per cent from 1980 to 1982, compared with 4.72 and 1.69 per cent respectively for the trustee banks and the building societies. However, net margins in the "large banks" and the trustee banks were similar.

TABLE 5.4.7: GROSS AND NET MARGINS IN UK BANKS, 1978-82

	% of average total assets					
	1978	1979	1980	1981	1982	Average
Large banks						
: gross	n.a.	n.a.	5.45	5.02	4.72	5.06
net	n.a.	n.a.	1.83	1.59	1.44	1.62
Trustee Savings						
: gross	3.94	4.13	4.92	4.80	5.83	4.72
net	1.77	1.64	1.64	1.01	1.75	1.56
Building Societies						
: gross	1.40	1.54	1.76	1.99	1.78	1.69
net	0.59	0.49	0.60	0.72	0.50	0.58

Comparative Administration Costs in Insurance

In this section we consider comparative administration costs in insurance for non life and life activities.

Non-Life

The table below shows management costs and commissions for a sample of companies in each country. The percentages showed wide variations. The averages show that these costs were lowest relative to premiums in the UK and highest in Belgium and the Netherlands.

TABLE 5.4.8: COMPARATIVE ADMINISTRATION COSTS IN NON LIFE INSURANCE

Country	Management and Other Expenses and Commissions as % Net Premiums	
	Range	Average
B	18.0% - 71%	39.6%
D	23.1% - 44.2%	28.2%
ES	7.1% - 66.7%	36.1%
F	20.3% - 62.8%	24.5%
I	19.8% - 42%	31.2%
NL	16.0% - 43.1%	34.5%
UK	6.1% - 30.4%	21.2%

Source: Sample Survey of Accounts of Insurance Companies

Management and other expenses, excluding commissions, are shown in the table below.

TABLE 5.4.9: COMPARATIVE ADMINISTRATION COSTS IN NON LIFE INSURANCE

Country	Management and Other Expenses as % Net Premiums	
	Range	Average
Belgium	10.8% - 57.3%	32.4%
ES	7.1% - 56.1%	32.4%
F	7.5% - 33.5%	17.2%
NL	5.9% - 26%	16.2%
UK	5.6% - 17.3%	11.5%

Source: Sample of Accounts of Insurance Companies

- In the German and Italian accounts in the sample, only the total of management, other expenses and commissions were shown.

In this case also the UK sample exhibits the lowest percentage at 11.5 per cent of premiums. In France and the Netherlands the percentages were 16 - 17% and in Belgium and Spain 32%.

Life Insurance

Management expenses and commissions were 20% of premiums in life companies sampled in the UK compared to 24% in France and Italy and 28.7% in Spain. Life expenses associated with life insurers were not separately identified for the accounts examined in the remaining countries.

TABLE 5.4.10: COMPARATIVE ADMINISTRATION COSTS IN LIFE INSURANCE

Country	Management and Other Expenses and Commissions as % Net Premiums	
	Range	Average
ES	20.2% - 39.2%	28.7%
F	8.9% - 31.6%	24.5%
I	15.7% - 27.0%	24.1%
UK	9.6% - 32.2%	20.1%

Source: Sample of Accounts of Insurance Companies

Management and other expenses excluding commissions averaged almost 13% in UK Life companies compared to almost 14% in France and over 15% in Spain.

TABLE 5.4.11: COMPARATIVE ADMINISTRATION COSTS IN LIFE INSURANCE

Country	Management and Other Expenses as % of Net Premiums	
	Range	Average
ES	7.1% - 34.0%	15.2%
F	7.2% - 18.3%	13.6%
UK	7/9% - 19.1%	12.8%

Source: Sample of Accounts of Insurance Companies

5.5 INDIRECT MEASURES OF IMPACT OF SPECIFIC REGULATIONS

It is useful to consider some indirect measures of the impact of specific regulations. For illustrative purposes we consider the impact of prudential regulations in the banking sector and some measures of impact of regulations in the insurance sector. The analysis represents a summary of research undertaken by EAG in the banking sector(1) and by Carter and Morgan(2) for insurance.

BANKING

A study was carried out in 1986 for the Commission on the consequences of different prudential ratios for competition between credit institutions. The study was partly based on interviews with banks in a number of EEC countries. This section summarises the main points of the report.

Banks in different countries may be required to observe some combination of:

- (i) minimum absolute capital requirements
- (ii) gearing ratios
- (iii) own funds/risk assets ratios
- (iv) fixed asset ratios
- (v) large loan ratios

A range of views were expressed about the extent of distortion caused by these different ratio requirements and it was stressed that variations in definitions of own funds was an important source of distortion. All but one of the interviewees believed that differences in solvency requirements were an important source of distortion. A substantial number also said that the requirements in their own countries were not very different from what would be expected if banks were unconstrained. This apparent paradox, the study states, may be partly due to the importance placed on not only the ratios but also the definition of such matters as own funds. It may also have been reflection of a desire by the bankers to appear prudent in their business dealings. However, the view that the imposed ratios were not very different from what they would be if banks were unconstrained may reflect the fact that, given a certain capital base, banks will adjust the riskiness of their portfolio accordingly. Thus in countries with relatively high capital base requirements banks may tend to invest in more risky (higher return) investments than would be the case if the capital base requirements were lower.

- (1) An Evaluation of the Consequences of the Existence of Different Prudential Ratios for Competition Between Credit Institutions in the European Community, EAG Report 1986, Report Prepared for European Commission.
- (2) Carter R.L., Morgan E.V. Freedom to Offer Life Insurance Across EEC State Boundaries, EAG Report 1986.

The EAG study indicates that it may not be possible to provide accurate quantitative comparisons of the effects on competition of different solvency requirements. On the basis of the opinions of those interviewed it was, however, stated that:

Among the three major banking countries the UK, France and Germany, French banks have a significant advantage over banks in both the other countries.

Banks in the UK probably enjoy a slight competitive advantage over those in Germany.

Among the smaller members of the Community, banks in Denmark were severely disadvantaged.

The Impact of Regulation in Insurance

The impact of regulations in insurance was considered in the 1986 Carter and Morgan study op cited.

This study referred to research which showed significant variations in the prices of term insurance between EEC countries. The survey carried out for the present study confirms those findings. Significant variations in prices within countries were also evident as was also the case in our analysis.

The degree of price variations within countries was said to depend on the degree of regulation but significant variations were still present in highly regulated markets such as Germany. The study listed a number of important variations in term insurance products which could account for price differences between countries. The mortality base used in most countries is set down by the supervisory authorities. The tables used are derived from general population mortality and only in the UK, of the countries covered in this report, is mortality based on experience of insured lives.

The report showed that ultimate mortality rates for insured lives in the UK were only about 65 per cent of that shown for the male population for ages 30, 40, 50, and 60.

The use of population mortality tables builds a safety loading into premiums and this yields increased revenue to companies. In Germany the regulatory authority requires that most of this excess profit is returned to policy holders by way of dividends and bonuses. The extent of the safety margin is indicated by the degree to which mortality rates used in continental countries exceed those based on insured lives in the UK. The table below shows that for most ages of males and females the rates in continental countries were 2-4 times the UK rate.

TABLE 5.5.1**MORTALITY RATES USED IN THE CALCULATION OF TERM INSURANCE PREMIUM RATES IN 1978 AS A PERCENTAGE OF THE RATES USED IN THE UK**

		<u>Belgium</u>	<u>France</u>	<u>Germany</u>	<u>Italy</u>	<u>Netherland</u>	<u>United Kingdom</u>
Mortality Table							
Men aged	25	316	320	450	352	352	100
	35	513	471	471	356	327	100
	45	376	368	314	282	270	100
Women	25	239	242	341	212	111	100
	35	641	588	588	445	325	100
	45	578	566	483	434	319	100

Source: Carter and Morgan, Op Cited.

In Belgium, France, Italy, Luxembourg and the Netherlands the same mortality tables are used for the calculation of term insurance premium for both males and females. In the UK further refinement has been introduced since premiums are quoted for smokers and non-smokers, male and female.

The EAG study also refers to interest rates as a source of price differences for term insurance. In France, Germany and Italy the choice of interest rate to be used in calculating premiums is controlled by the authority.

The study calculated the pure premiums for a 20 year term using UK and Belgian mortality tables and 6 and 4 per cent interest rates. The difference in pure premiums was 227 per cent of which one 25th was accounted for by the resulting interest differential.

The method used to load expenses between different types of policy is a further factor which can affect the price of policies. UK loadings, according to the EAG study, were lower than other countries possibly because of allowance for tax relief on expenses but also because expenses appeared to be calculated on a marginal cost basis.

5.6 CASE STUDY EXAMPLE OF IMPACT OF DEREGULATION

We examine below the impact on costs and margins in the securities market following the recent deregulations in the UK. The impact of deregulation on the London stock market can be assessed by considering commission rates, the number of market makers, equity dealing spreads and the depth of markets for the different types of shares.

Commission Rates

Commission rates pre-and post October 27, 1986 are shown in Tables 5.6.1 and 5.6.2 For equity bargains of St£1,000 - £20,000 commission rates rose after deregulation. For bargains of £1,000 and £20,000 there were small rises in actual commissions quoted between July 1986 and the average rates in December 1986. Bargains of £5,000 and £10,000 showed a more marked increase in commissions. On bargains of £50,000 and above there was a fall in actual commission rates, ranging from 32 per cent for £50,000 bargains to about 20 per cent for £0.5m bargains. For £1m bargains, the cost remained the same between July and December 1986.

TABLE 5.6.1 IMPACT OF DEREGULATION ON THE LONDON MARKET

Commission Rates - Equities

Bargain Value £	Pre Deregulation		Post Deregulation	
	Minimum Scale	% Actual Rate July 1986	Average Scale	% December 1986
<u>Private Clients</u>				
1,000	1.65	1.53	1.63	
5,000	1.65	1.26	1.60	
10,000	1.32	1.02	1.25	
20,000	0.67	0.60	0.63	
<u>Institutions</u>				
50,000	.67	.53	.34	
100,000	.58	.39	.28	
500,000	.40	.31	.25	
1,000,000	.34	.22	.22	

Source: The Stock Exchange, Quality of Markets - Second Report

Details of commission rates for gilts are shown in Table 5.6.2. For institutional clients dealing with a bargain of £0.25m +, almost all commissions post October 1986 are net. Before deregulation commissions were 0.04 per cent for medium/long gilts and 0.0006 per cent for short gilts. For private clients there was a slight fall for £1,000 bargains from slightly more than 1 per cent to an average of 1.0 per cent and a slight fall to an average of 0.1 per cent for bargains of £10,000 - £50,000.

TABLE 5.6.2: IMPACT OF THE DEREGULATION IN LONDON MARKET

Commission Rates - Gilts

Bargain Size	Pre Deregulation %	Post Deregulation %
<u>Institutions</u>		
	Medium and Long Gilts	
250,000+	0.04	Almost all net
	Short Gilts	
250,000	0.006	Almost all net
<u>Private Clients</u>		
1,000	Slightly more than 1%	1.0
10,000 - 50,000	Slightly more than post October 1986	0.1

Source: As for Table 5.6.1

Number of Market Makers

The number of equities by SEAQ classification and number of market makers are shown in Table 5.6.3. Between the Spring of 1986 and December 1986 the number of alpha stocks(1) increased from 62 to 90, beta stocks increased from 417 to 722, gamma from 1,121 to 1,430 and there was a fall in the number of delta stocks from 144 to 91. Overall, there was a rise from 1,744 to 2,133 in the number of stocks.

(1) Alpha stocks are defined as those with more than 10 market makers, turnover of £100m per qtr and market value of £625m. Beta stocks are those with six or more market makers (or 4 who will quote firm prices). Gamma stocks are those with two or more market makers willing to quote indicative prices.

The average number of market makers increased strongly for alpha and beta stocks and also rose, to a lesser extent, for gamma stocks. The number of market makers in delta stocks fell.

TABLE 5.6.3: NUMBER OF EQUITIES BY SEAQ CLASSIFICATION AND NUMBER OF MARKET MAKERS

Number of Market Makers	Spring 1986					December 1986				
	Alpha	Beta	Gamma	Delta	Total	Alpha	Beta	Gamma	Delta	Total
18+						13	2			15
16-17						24	4			28
14-15						24	11			35
12-13	12	2			14	18	39			57
10-11	23	8			31	9	65			74
8-9	24	61			85	1	108			109
6-7	2	105	27	1	135	1	227			228
4-5	1	170	361	19	551		66	582		648
2-3	-	71	720	115	906		3	831		834
0-1			13	9	22			17	91	108
	62	417	1,121	144	1,744	90	722	1,430	91	2,133

Source: As for Table 5.6.1.

Table 5.6.4 shows that the amount of total turnover accounted for by alpha stocks increased from 40 to 56 per cent. There was a marked fall in the proportion of total turnover accounted for by gamma and delta stocks, from 20 per cent to 9 per cent and the share of turnover of beta stocks fell from 40 to 34 per cent.

TABLE 5.6.4: DISTRIBUTION OF UK EQUITY SECURITIES AND TURNOVER BY CATEGORIES

	Pre October 1986		Post October 1986	
	Number	% of Turnover Value	Number	% of Turnover Value
Alpha	62	40	90	56
Beta	427	40	522	34
Gamma	1,240	12	1,430	7
Delta	244	8	91	2
	1,973	100	2,133	100

Source: As for Table 5.6.1

Equity Dealing Spreads

Table 5.6.5 shows that the average dealing spread has narrowed post October 1986 for alphas and betas, as well as for the less actively traded gammas. In the case of alpha stocks there was a fall of one-fifth in spreads for both minimum quotations of 1,000 shares and for maximum quotes of 99,000 shares. For beta stocks spreads increased slightly for minimum quotes, but fell 13 per cent for maximum quotes - with the result that spreads for maximum quotes fell as a proportion of spreads for minimum quotes from 153 per cent to 128 per cent. There was no change for spreads in minimum quotes for gamma shares but a fall of 9 per cent in spreads for maximum quotes.

TABLE 5.6.5: EQUITY DEALING SPREADS**AVERAGE OF DIFFERENCE BETWEEN BEST BID AND BEST OFFER PRICES**

	End Oct 1986	End Jan 1987
Alphas		
- 1,000 Shares	.66	.53
- Maximum quote size	.92	.73
Maximum as % of 1,000 shares spread	139	138
Beta		
- 1,000 shares	1.25	1.30
- Maximum quote size	1.91	1.66
Maximum as % of 1,000	153	128
Gamma		
- 1,000 shares	2.55	2.55
- Maximum quote size	3.2	2.91
Maximum as % of 1,000 shares spread	125	114

Source: As for Table 5.6.1, pages 19 and 20

Additional information on spreads is shown in Table 5.6.6. The average difference between best bid and offer price did not fall for normal market size bargains in alpha quotes and there were increases in spreads for beta and gamma shares. However, there was a very large fall in spreads for large deals - defined as being four times the normal market size indicating an improvement in the depth of the market.

TABLE 5.6.6: DEPTH OF MARKET

	%					
	Pre Big Bang			Post Big Bang		
	Alpha	Beta	Gamma	Alpha	Beta	Gamma
Average difference between best bid and offer price at NMS (1)	0.7	1.9	3.1	0.7	1.95	3.5
Average Difference between best bid and offer price at LMS (2)	1.5	5	7.5	0.6	1.8	2.7

(1) NMS is normal market size (i.e. the usual size in which dealers quote).

(2) LMS is large market size (i.e. defined as four times NMS).

Source: As for Table 5.6.1, page 21

Conclusion on Case Study of Impact of Deregulation

The evidence collected by the London Stock Exchange on the impact of deregulation showed that dealing costs for small bargains rose slightly and those for medium to large bargains, which form the largest part of the market, fell. Evidence on the number of market makers and on the depth of the market suggests that the quality of the market improved significantly following deregulation. It is however important to note that there is uncertainty regarding whether these price reductions will remain given the level of capacity in the market.

SECTION 6: ESTIMATING THE GAINS FROM EUROPEAN ECONOMIC INTEGRATION

6.1 INTRODUCTION AND REVIEW OF METHODOLOGY

In this section we present our estimates of the gains from European economic integration. In particular we consider two aspects of this important issue. Firstly, we examine our estimates of the microeconomic economic gains from integration of European financial services markets. Secondly we review the macroeconomic welfare gains from integration of European capital markets. In particular we consider the gains from risk pooling, and equalisation of interest rates.

There are two approaches available in examining the microeconomic economic gains from integration of European financial services markets. The first approach involves the examination of the costs incurred by firms in meeting the regulatory barriers to trade and establishment and the costs incurred by the public sector in operating these regulations. The second approach which we have used in this study involves using more indirect measures of the cost of regulation. It is however worth considering the first approach in some more detail, even though we have not relied on this method in this study.

An important limitation of the first approach is that estimates of the costs of regulations would not be of use unless assumptions were made regarding what would be the cost of regulation in an integrated market. Such assumptions would be exceptionally difficult to make (as unlike the customs area), it is certain that some level of regulation will continue in an integrated Europe. Of greater importance is the fact that such estimates would very significantly underestimate the economic cost of the present obstacles to trade as they would not capture the benefits of increased competition or economies of scale. In terms of the cost of regulation to the public sector similar difficulties arise. For example in Table 6.1 below details of the numbers employed in the insurance supervisory agencies is presented for selected countries. The data indicates that while there are considerable differences it is not possible to estimate the levels which would be required in an integrated market.

TABLE 6.1: NUMBERS EMPLOYED IN THE INSURANCE SUPERVISORY AGENCIES IN SELECTED COUNTRIES

UK	83
Italy	173
Netherlands	120
Belgium	105
France	300
Germany	300
Spain	350

Our estimates of the costs of "Non Europe" are based primarily on making assumptions on the likely movement of prices in an integrated financial market. These price movements in the banking sector do not refer to changes in the price/costs to the consumer as such costs are comprised of two elements as follows: One, the underlying cost of finance and secondly the cost element incurred in providing the service. As these price reductions will be applied to estimates of value added it is only the latter costs which are relevant. In most cases therefore the "prices" which are relate to the element of the price to the consumer which is in excess of money market rates. Earlier in this study data on the existing prices of financial products were presented. The data indicated a wide range of prices both within and between countries and it is clear that while prices for certain financial services were cheaper in one country, the prices of other services were higher than in the other countries examined. Later in this section we consider our assumptions for the likely prices of financial services in an integrated market.

At present in the non-integrated Europe the various barriers to the completion of the internal market in financial services result in different prices being charged in the different countries. The prices are also related to the size and structure of the different markets, corporate taxation and judicial and regulatory barriers. It is as if there were a set of tariffs on financial services in the high price countries.

From this perspective the evaluation of welfare gains (i.e. net economic benefits) from the completion of the internal market involves an exercise similar to the calculation of the gains (in terms of consumer surplus, etc.) from a move to free trade, or the establishment of a customs union.

Until very recently, economists making such calculations typically employed the assumptions of perfect competition and (usually) constant or diminishing returns to scale (1). All of these studies have computed very small gains from reductions in trade barriers (2). But work by Krugman (3) and others suggests that a main cause of trade - and probably the main sources of gains from trade - between industrial countries is the exploitation of economies of scale (or of scope) in the presence of imperfect competition. Taking account of these considerations can dramatically increase the estimated gains from reducing the barriers to trade (4).

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- (1) An example of such work would be Miller and Spencer, "The Static Economic Effects of the UK Joining the EEC: A General Equilibrium Approach. Review of Economic Studies 1977,
 - (2) For example, Miller and Spencer obtained gains for the United Kingdom from trade creation resulting from the 1973 enlargement of the EEC of only one-sixth of one per cent of GNP (and that was before taking account of the losses from trade diversion, or the net transfer to the Common Agricultural Policy).
 - (3) Krugman, "Increasing Returns, Monopolistic Competition, and International Trade, Journal of International Economics, 1979.
 - (4) For instance, Harris "Applied General Equilibrium Analysis of Small Open Economies with Scale Economies and Imperfect Competition", American Economic Review 1984 found that the estimated gains for Canada from the establishment of a free-trade area with the United States rose from 2.4 per cent of GNP to 8.6 per cent when account was taken of the impact of returns to scale and imperfect competition.

Other important work by Smith and Venables⁽¹⁾ indicates that producers may experience internal economies of scale which lead both to inefficiently small scale production when the market is confined within national boundaries, and to an oligopolistic market structure. Accordingly, average costs of production are unnecessarily high in a fragmented Europe and in addition the mark-up of prices over marginal costs is higher than it need be to cover fixed costs.

The consequences of opening up trade in these circumstances is both to lower unit costs, by allowing more use of the economies of scale, and also (probably) lowering the mark-up of prices over marginal costs to the extent that the oligopoly is weakened. While the consumer will gain, there will be reductions in excess profits.

The above analysis suggests that having estimated the likely differentials by which the prices of financial services in the various member states will change, it remains to determine the potential welfare gains from providing sufficient integration in the financial market in Europe. In order to do this it is necessary to decide how much of the assumed price changes will be due to reduced profits and how much to changes in costs.

It is worth setting out how the welfare losses work out in each of these polar cases. For simplicity, we take it that the cost function for the production of financial services is linear, with a fixed cost of K and a per unit variable (marginal) cost of c . We also assume a simple constant elasticity demand function:

$$x = p^{-\epsilon}$$

where x is the quantity of financial services demanded and p is the price. The price elasticity of demand is, of course, $-\epsilon$. Consider a country where the price differential vis a vis the lowest cost country is λ , i.e.

$$(1 - \lambda)p = c^*,$$

where c^* is the per unit cost in the lowest price country. (Here we are assuming that the lowest price country has access to a sufficiently large market to make the contribution of fixed costs negligible, or in other words that it has been able to exploit all available economies of scale).

In general, the welfare change resulting from completion of the market will equal the sum of the change in consumer surplus and aggregate profits. To the extent that the result is a competitive market (as we assume), then these two will tend to move in the opposite direction, with existing profits being eroded.

(1) Smith A, Venables A. "Trade and Industrial Policy Under Imperfect Competition", Economic Policy, 1986.

The demand function which we have assumed leads to a simple expression for consumer surplus:

$$S = px(p) / (\xi - 1)$$

The change in consumer surplus resulting from a fall in price from p to $(1 - \lambda)p$ can be calculated as:

$$S = px(p) (1 - (1 - \lambda)^{1-e} / (1 - \xi)). \quad (1)$$

Case 1: Pure cost differential. Suppose first that the source of price differentials is purely the fact that some countries can produce financial services at lower cost at all levels of output. Then, taking the fixed cost K to be zero in order to abstract from economies of scale, and taking the market to be always competitive, the marginal cost in the country under consideration is clearly:

$$c = c^* (1 - \lambda).$$

Completion of the market in this situation will result in all of the output being produced by more efficient producers. However there will be no loss of producer surplus because of the pre-existing competitive situation. The total welfare change will therefore equal the gain in consumer surplus given by (1).

Case 2: Price differential reflects oligopoly. It may be that, despite the absence of economies of scale or of cost differentials, non-competitive behaviour is maintaining a higher price. In this polar case, price is a pure mark-up over marginal cost with

$$(1 - \lambda)p = c.$$

Pre-existing profits are

$$px - cx = \lambda px.$$

These will, under our supposition, be wiped out by completion of the European market. The loss of profits must be set against the increase in consumer surplus C to obtain a net welfare change.

In the approach outlined above it is clear that the percentage price differential may understate the loss of consumer surplus particularly if the elasticity of demand is high. This is because the higher price discourages consumption of financial services as well as imposing a penalty on the consumption which does occur.

It is clearly of some importance to decide which of these polar cases is nearer to the actual source of the price differentials. Knowledge of the concentration (number of firms or Herfindahl index) can provide an estimate of the pure oligopolistic profits actually prevailing (in contrast to (2) above.) For example, under the assumption of Cournot-Nash non-competitive behaviour it is well known that:

$$\pi + K = (H/e) px$$

where π is pure profits, and H is the Herfindahl index (which might be approximated by the reciprocal of the number of leading firms).

Equation (3) implies that Cournot-Nash oligopoly could not generate profits in excess of a given percentage of total expenditure. This enables one to place an upper limit on the contribution of imperfect competition to the price differential. Use of this framework would allow us to infer a likely range for this welfare gain from eliminating a given price differential.

The above approach represents a methodology for moving from assumptions of likely range of future price changes to economic welfare gains. It should be stressed that it would be possible to make different assumptions than those assumed in the framework presented. For example some results of economies of scale studies are considered in terms of constant scale elasticities. This would require some reinterpretation of the above material. It would also be possible to make alternative assumptions regarding the impact of market structure on profits. An examination of such alternative assumptions may provide a useful area for future research. In view of the fact that concentration may not be the best indicator of competition (as it is plausible that one could have a highly concentrated and competitive market) we do not present our estimates of any potential loss in producer surplus in this report. For illustrative purposes however we indicate in an appendix the estimated loss in producer surplus derived from this methodology.

In terms of calculating estimates of the economic impact of integration using the above approach it is necessary to make assumptions regarding the following issues: (i) likely level of price changes; (ii) value added in financial services; and (iii) elasticity of demand for financial services. It is useful to consider each of these issues in turn.

6.2 Potential Future Price Changes

The level by which prices of financial services will change in an integrated European market is by definition speculative and difficult to predict. Our analysis in this report provides a basis for producing defensible estimates on this issue. In particular our estimates are guided by a number of factors including data on existing price differentials, value added/output ratios, net margins/cost data and the extent of specific regulations. Our future price scenarios are also guided by case study examples of the impact of deregulation within national boundaries.

The study of price reductions resulting from deregulation within a national market summarised earlier, referred to the UK securities market. This case study indicated that while there were small increases in commission for small transactions for institutional transactions commission rates fell by between twenty and thirty six per cent. In this study we have utilised scenarios where prices are assumed to decline by between ten and twenty six per cent in different countries. These assumed "price" reductions do not represent reductions in consumer prices as in the banking sector they are based on prices or costs in excess of money market rates. The implied reduction in consumer prices in these cases would be a fraction of the assumed price reductions used in this study. In view of the difficulties inherent in estimating likely price movements we have also considered the sensitivity of our findings to alternative price assumptions.

It is possible to construct a wide range of possible price scenarios which could emerge in an integrated market. For example one could assume that prices would fall to the level of the lowest existing price observation. Indeed there would be some grounds for assuming that the larger market opportunities presented by an integrated European financial services market would enable prices to fall below existing lowest prices, as economies of scale are exploited. In this study we have taken a more conservative estimation of the potential gains which could be secured.

In order to highlight the reasoning behind our future price scenarios it is useful to consider for each country some of the factors referred to above. This analysis is undertaken on a country by country basis in subsequent paragraphs overleaf. In this analysis we pay particular attention to existing price differentials. The points raised regarding relative prices in Section 5 of the report should be noted in interpreting the analysis in this section. The price comparisons are based on assuming for each category of financial services a weighting for each of the financial services prices presented. While precise data on the percentage of value added incurred in producing the particular services is not available the weights have been derived on the basis of estimates of the relative importance of the particular products/services. The basis for the weighting system is presented as an appendix.

Price Scenario for Belgium

In the table below the data on the price of selected banking services in Belgium compared with other countries is presented. In particular we present calculations on the percentage differences in the prices of banking services in Belgium compared with the average of the four lowest price observations. The costs of current accounts are not presented due to the widespread belief that these are very significantly affected by cross subsidisation. The cost of credit cards and letters of credit used represent the particular examples referred to in Section 5. The results for consumer credit and mortgages are not sensitive to the particular examples chosen.

TABLE 6.2: COMPARATIVE PRICES OF BANKING SERVICES IN BELGIUM

	% Difference from the 4 Lowest Observations
Cost of Consumer Credit	-41.0
Cost of Credit Cards	79.0
Cost of Mortgages	31.3
Cost of Letters of Credit	21.8
Cost of Foreign Exchange Drafts	6.2
Cost of Foreign Exchange Travellers Cheques	35.2
Cost of Commercial Credit	-4.6
Implied Potential Price Fall	16.0
Assumed Potential Price Fall	8.0

The implied price fall estimate represents the level by which prices of banking services would fall if the weighted average of the banking financial services examined declined to the average of the four lowest observations. It should be noted that the implied price fall assumes that where prices are currently below the average of the four lowest that no increase would incur in the integrated market. This important assumption is made for all countries. In this case the data would suggest a price decline of 16.0 per cent. However as indicated previously this would imply a much lower price decrease in terms of the cost to the consumer. While the price of most of the banking services in Belgium reviewed were above the average of the four lowest, the costs of consumer and commercial credit were lower. The prices of banking services in Belgium may reflect the relatively small size of the Belgium market while the cost of credit may in part be related to the relatively large presence of foreign banks in the Belgium market. Foreign banks account for approximately one third of the aggregate assets of banking institutions in Belgium.

We believe however that it would not be prudent to assume that in Belgium banking prices as defined would fall by 16.0 per cent. This is in part due to the fact that in our calculations for consumer surplus we use total figures on value added. This would overestimate the gain in consumer surplus by the extent to which value added was incurred on the supply of services outside of the Community. In addition the banking prices in Belgium probably in part reflect some market characteristics which would not alter in an integrated market. Also given the complexity and rapidly changing nature of the banking market it is likely that our price comparisons may overestimate potential price differences. To take account of the above factors we assume that only fifty per cent of the implied price would incur in an integrated market.

It is also useful to present the results for insurance products in Belgium. Data on the percentage differences from the four lowest observations are outlined in the table below. The particular examples for insurance products used were presented in Section 5. The average prices obtained were used in the calculations below.

TABLE 6.3: COMPARATIVE PRICES OF INSURANCE SERVICES IN BELGIUM

	% Difference from the 4 Lowest Observations
Cost of Contents and House Insurance	-15.9
Cost of Motor Insurance	30.0
Cost of Commercial Fire and Theft Insurance	-8.7
Cost of Public Liability Insurance	13.4
Cost of Term Insurance	77.6
Implied Potential Price Fall	31.0
Assumed Potential Price Fall	16.0

In the case of insurance products the data indicates that prices of house and contents insurance and commercial fire and theft were below the average of the four lowest while prices of other insurance products were higher, particularly for term insurance and motor insurance.

This price configuration probably reflects local conditions such as high vehicle accident rate and the cost of motor vehicle repairs as well as regulatory factors. The implied price fall also reflects the importance given in our weighting system to life insurance as measured by the term estimates.

In view of the problems inherent in insurance price comparisons referred to earlier in this report we have assumed that only fifty per cent of the implied price fall represent potential price declines.

The final category of products for Belgium presented relate to stock exchange transactions and data on this is presented in the table below. The prices relate to the examples used in Section 5 of this study.

**TABLE 6.4: COMPARATIVE PRICES OF STOCK EXCHANGE TRANSACTIONS
IN BELGIUM**

	% Difference from the 4 Lowest Observations
Cost of Private Equity Transactions	35.9
Cost of Private Gilts Transactions	14.4
Cost of Institutional Equity Transactions	26.4
Cost of Institutional Gilts Transactions	284.1
Implied Potential Price Fall	53.0
Assumed Potential Price Fall	26.0

With regard to security transactions the figures show a particularly high cost of institutional gilt transactions compared with the average of the four lowest observations in other countries. This may in part reflect the very low commission on institutional transactions in certain other countries and may also reflect the particular arrangements for financing the public sector in Belgium, although an examination of this latter issue is outside the scope of this study. In view of the rapidly changing nature of security transactions in Europe and the other factors referred to in relation to banking and insurance services we believe it would not be appropriate to assume that any more than fifty per cent of the implied price fall would incur in an integrated market.

Price Scenario for Germany

In the table below the data on the price of selected banking services in Germany compared with other countries is presented. The results show the percentage differences in the prices of banking services in Germany compared with the average of the four lowest observations.

TABLE 6.5: COMPARATIVE PRICES OF BANKING SERVICES IN GERMANY

	% Difference from the 4 Lowest Observations
Cost of Consumer Credit	135.9
Cost of Credit Cards	60.0
Cost of Mortgages	57.3
Cost of Letters of Credit	-10.0
Cost of Foreign Exchange Drafts	30.9
Cost of Foreign Exchange Travellers Cheques	-7.4
Cost of Commercial Credit	6.0
Implied Potential Price Fall	33.0
Assumed Potential Price Fall	13.0

The above price comparisons indicate that if banking prices were to fall to the average of the four lowest observations this would result in a decline of 33.0 per cent. It must be noted however that the way the estimate of consumer credit, commercial credit, credit cards and mortgages were calculated represented the cost in excess of selected money market rates. In many cases the absolute levels of these costs were comparatively low in Germany but because of the low level of wholesale money market rates the costs appear high when defined as above. Also the relatively high cost of consumer credit reflects the feature of the domestic financial services market where the main banking institutions prefer the use of straightforward overdraft facilities. Thus the particular type of consumer credit is not common in the main financial institutions and this is reflected in the data presented above. Also of relevance is the fact that in Germany the use of credit cards is very limited and as a result there is a much smaller market for these cards with resultant consequences for economies of scale. The analysis of value added as a percentage of loans outstanding in the German banking sector indicated a lower percentage than was evident in a number of other countries. In view of the above features and the other factors referred to in the analysis of Belgium banking data we believe that it would be misleading to assume that even fifty per cent of the implied price fall represents the potential price decline. In our analysis we have therefore assumed only forty per cent of the implied price fall in our calculations of consumer surplus and even this may overestimate the position. As stressed previously the assumed price fall to the consumer would be only a fraction of 13 per cent.

In table 6.6 below data on the price of insurance products in Germany is presented.

TABLE 6.6: COMPARATIVE PRICES OF INSURANCE SERVICES IN GERMANY

	% Difference from the 4 Lowest Observations
Cost of Contents and House Insurance	2.7
Cost of Motor Insurance	14.7
Cost of Commercial Fire and Theft Insurance	42.5
Cost of Public Liability Insurance	47.3
Cost of Term Insurance	5.1
Implied Potential Price Fall	10.0
Assumed Potential Price Fall	5.0

With regard to insurance prices the particular features of the German insurance market referred to in Section 5 should be noted. Also of relevance is the regulatory position whereby for the larger commercial risks the law requires such risk to be insured with an authorised German insurer. In our analysis of administration costs in non life insurance companies in Germany these appeared to be below the average in other countries but there are severe difficulties in drawing any conclusions from such comparisons.

In view of the fact that insurance price comparisons are particularly sensitive to differences in regulatory and other differences including the critical issue of underlying risk we believe it would not be prudent to assume that any more than fifty per cent of the implied price fall represents potential price reductions. We have therefore used an assumption of fifty per cent of the implied price fall in our estimates of consumer surplus.

The final category of financial services examined for Germany relates to the costs of private and institutional stock exchange transactions. We present overleaf estimates of the percentage differences of security prices in Germany compared with the four lowest observations.

**TABLE 6.7: COMPARATIVE PRICES OF STOCK EXCHANGE TRANSACTIONS
IN GERMANY**

	% Difference from the 4 Lowest Observations
Cost of Private Equity Transactions	6.8
Cost of Private Gilts Transactions	90.1
Cost of Institutional Equity Transactions	68.5
Cost of Institutional Gilts Transactions	-4.0
Implied Potential Price Fall	11.0
Assumed Potential Price Fall	6.0

The data on the costs of stock exchange transactions implies a price fall of 11.0 per cent in Germany in the event of an integrated financial services market. This is significantly less than the price reductions which emerged in the UK following deregulation. However as indicated earlier the position in the German stock exchange has changed since the figures were published and institutional transactions are now a matter for negotiation. In the light of these developments we believe it is appropriate to assume that fifty per cent of even the relatively modest price fall should be used in our calculations.

Price Scenario for Spain

In table 6.8 the calculations for the percentage difference between Spain's banking prices compared with prices in the eight countries, is presented.

TABLE 6.8: COMPARATIVE PRICES OF BANKING SERVICES IN SPAIN

	% Difference from the 4 Lowest Observations
Cost of Consumer Credit	38.5
Cost of Credit Cards	25.7
Cost of Mortgages	118.8
Cost of Letters of Credit	58.9
Cost of Foreign Exchange Drafts	196.3
Cost of Foreign Exchange Travellers Cheques	29.6
Cost of Commercial Credit	19.2
Implied Potential Price Fall	34.0
Assumed Potential Price Fall	20.0

The data presented in table 6.8 indicates an implied price fall in Spanish banking services of thirty four per cent. It should of course be noted that the implied price fall in terms of the price to the consumer would be significantly less than this amount, for the reasons referred to earlier. The two products which appear particularly high compared with the four lowest countries are mortgages and foreign exchange drafts. Foreign exchange drafts are not that significant in our overall weighting system and the mortgage figures represent the costs in excess of money market rates. The mortgage figure relates to 1986 costs and it is likely that with the recent opening of the banking market these costs would have been moved more in line with the lower priced countries. The latest data on value added in banking as a percentage of loans outstanding in Spain indicated a high percentage compared with other countries although the question of comparability is again relevant.

In our analysis of the economic gains from European integration we believe for the reasons referred to earlier in this chapter it would be a mistake to assume that all of the implied price fall could be realised. In the case of Spain we have therefore assumed that only 60% of the implied price fall represents potential price falls in our modelling assumptions. This price fall represents the position after integration compared with the situation which existed to which the data relates. This figure is therefore likely to be an overestimation of the potential gains compared with the current position. While our results for certain countries may overestimate the gains it is the overall benefit to the community which is the key focus of this study. Overall we believe any overestimate in certain countries is likely to be counteracted by some of the conservative assumptions made in our calculations.

In the table below data on comparative prices of insurance services compared with the average of the four lowest is presented.

TABLE 6.9: COMPARATIVE PRICES OF INSURANCE SERVICES IN SPAIN

	% Difference from the 4 Lowest Observations
Cost of Contents and House Insurance	-3.7
Cost of Motor Insurance	99.5
Cost of Commercial Fire and Theft Insurance	24.4
Cost of Public Liability Insurance	59.9
Cost of Term Insurance	37.4
Implied Potential Price Fall	32.0
Assumed Potential Price Fall	19.0

While the figures show that the cost of motor insurance and public liability insurance were particularly high the particular concerns indicated previously regarding public liability insurance should be noted. The cost of motor insurance may be related to the underlying risks and costs associated with motor insurance in Spain. The cost of contents and house insurance was lower than the average of the four lowest. The above figures would indicate an implied price fall of thirty two per cent. In view of the difficulties with insurance comparisons we believe however that it would be prudent to assume that only 60% of this price fall represents the potential price reductions.

As for other countries we also examined comparative prices for stock exchange transactions in Spain. The relevant calculations are outlined in table 6.10 below.

TABLE 6.10: COMPARATIVE PRICES OF STOCK EXCHANGE TRANSACTIONS IN SPAIN

	% Difference from the 4 Lowest Observations
Cost of Private Equity Transactions	65.0
Cost of Private Gilts Transactions	216.9
Cost of Institutional Equity Transactions	152.7
Cost of Institutional Gilts Transactions	60.0
Implied Potential Price Fall	44.0
Assumed Potential Price Fall	26.0

The above price comparisons for stock exchange transactions would indicate a potential price fall of 44 per cent. Such a price reduction would be very high by the experience of other countries and we therefore believe it overstates the potential price reduction. In our assumptions we have therefore taken 60% of this price fall. While this is less than the price reduction which occurred on large transactions in the UK we believe it represents the maximum potential price fall which is appropriate for our modelling requirements. Given the rapidly changing nature of European stock exchange this position is likely to have been reduced further since the data was collected.

Price Scenarios for France

In the table overleaf data on the comparative prices of banking services is presented for France. The figures show the percentage differences in prices from the average of the four lowest price observations.

TABLE 6.11: COMPARATIVE PRICES OF BANKING SERVICES IN FRANCE

	% Difference from the 4 Lowest Observations
Cost of Consumer Credit	105.1
Cost of Credit Cards	-29.5
Cost of Mortgages	78.5
Cost of Letters of Credit	-7.2
Cost of Foreign Exchange Drafts	55.6
Cost of Foreign Exchange Travellers Cheques	38.9
Cost of Commercial Credit	-7.3
Implied Potential Price Fall	25.0
Assumed Potential Price Fall	13.0

The above figures indicate a very high cost for consumer credit and for mortgages in France compared with the average of the four lowest observations. It is important to note that as for other countries these do not represent the price to the consumer but rather the excess of over money market rates. It is interesting to note that the figures indicate that the cost of commercial credit over inter bank rates are less than the average in the four lowest countries. It is also interesting to note that public ownership is very important in the French banking sector although this is changing due to privatisation. In view of these factors and the fact that our potential price reductions are applied to total value added we believe that assuming all of the implied price fall would overstate the economic benefits arising from economic integration. We have therefore used an assumption in our estimates of fifty per cent of the implied price fall.

Comparative prices of insurance services in France are outlined in table 6.12. The data compares five insurance products which include both private and institutional areas. The very wide variance in insurance quotes indicated in Section 5 should be noted.

TABLE 6.12: COMPARATIVE PRICES OF INSURANCE SERVICES IN FRANCE

	% Difference from the 4 Lowest Observations
Cost of Contents and House Insurance	39.0
Cost of Motor Insurance	8.7
Cost of Commercial Fire and Theft Insurance	152.8
Cost of Public Liability Insurance	117.0
Cost of Term Insurance	33.2
Implied Potential Price Fall	24.0
Assumed Potential Price Fall	12.0

The data on insurance products presented above would indicate an implied price fall of 24 per cent if prices declined to the weighted average of the four lowest observations. The data on value added as a percentage of premium in the insurance sector in France was less than the average of other countries reviewed. In view of the differences in riskiness of insurance between countries and the variance in the quotes referred to above, we believe it would be prudent to only assume that fifty per cent of the implied price fall represents potential price fall in our estimates of consumer surplus.

The figures on comparative prices of equity and gilt transactions are presented below.

TABLE 6.13: COMPARATIVE PRICES OF STOCK EXCHANGE TRANSACTIONS IN FRANCE

	% Difference from the 4 Lowest Observations
Cost of Private Equity Transactions	-12.6
Cost of Private Gilts Transactions	21.5
Cost of Institutional Equity Transactions	-5.4
Cost of Institutional Gilts Transactions	57.4
Implied Potential Price Fall	23.0
Assumed Potential Price Fall	12.0

The data on French security prices indicate that prices of private equity transactions and institutional equity transactions were below the average of the four lowest observations while gilt transactions were more expensive. The implied price fall of 23 per cent is based on the assumption underlying all of the price comparisons that prices which are below the average of the four lowest would not increase in an integrated market. This, because of the issue of cross subsidisation may be unrealistic and is likely to overestimate the potential gains. We have therefore assumed that only 50% of the implied price fall represents potential price reductions in our economic modelling.

Price Scenarios for Italy

Table 6.14 presents estimated prices of banking services in Italy compared with other countries.

TABLE 6.14: COMPARATIVE PRICES OF BANKING SERVICES IN ITALY

	% Difference from the 4 Lowest Observations
Cost of Consumer Credit	121.0
Cost of Credit Cards	88.6
Cost of Mortgages	-4.3
Cost of Letters of Credit	9.1
Cost of Foreign Exchange Drafts	23.5
Cost of Foreign Exchange	
Travellers Cheques	22.2
Cost of Commercial Credit	8.6
Implied Potential Price Fall	18.0
Assumed Potential Price Fall	9.0

The above price data indicate that with the exception of mortgages the prices of all of the banking services examined were more expensive in Italy compared with the average of the four lowest countries. The data on value added in banking as a percentage of loans outstanding for Italy was the highest of the countries examined. The margins data reviewed earlier in this report also indicated relatively higher margins for Italian commercial banks and for savings banks, although such comparisons are influenced primarily by the nature of the institutions.

The price data overleaf would indicate an implied price fall of 18 per cent. It should however be noted that the figures on consumer credit represent an assumed average of selected other countries and because of this and the reasons discussed earlier in this section we believe it would be prudent to use a more conservative figure and in our calculations we assume a price decline of only 9 per cent.

Data on the estimated prices of insurance products in Italy are presented below. The figures show that for the insurance products examined estimated prices were significantly above the average of the four lowest observations.

TABLE 6.15: COMPARATIVE PRICES OF INSURANCE SERVICES IN ITALY

	% Difference from the 4 Lowest Observations
Cost of Contents and House Insurance	80.4
Cost of Motor Insurance	147.9
Cost of Commercial Fire and Theft Insurance	245.0
Cost of Public Liability Insurance	76.8
Cost of Term Insurance	83.2
Implied Potential Price Fall	51.0
Assumed Potential Price Fall	26.0

There are a number of important technical, judicial and market practices which are evident in the Italian insurance market and which are likely to influence the price figures presented above. The figures as for all countries are very sensitive to the risks covered and there are very marked regional and other differences in the levels of risks in the Italian insurance market. For example the cost of contents and house insurance in certain cities are a multiple of those in other regions. It is also common for rebates to be offered on insurance services in the Italian market. In view of the above factors and the reservations noted previously concerning public liability and other insurance prices we believe it would be a mistake to use the implied price fall in our estimates. We have therefore decided to take fifty per cent of the implied price fall as the potential gain in our economic modelling calculations.

In the table overleaf comparative prices of stock exchange transactions in Italy are presented. The figures show that while the prices of private stock exchange transactions are lower than the average for the four lowest, the cost of institutional transactions are above the average in the eight countries. If prices of securities fall to the average of the four lowest observations this would imply a price fall of 33.0 per cent. We believe however that it would be prudent to assume that the potential price fall represents only fifty per cent of this estimate.

**TABLE 6.16: COMPARATIVE PRICES OF STOCK EXCHANGE TRANSACTIONS
IN ITALY**

	% Difference from the 4 Lowest Observations
Cost of Private Equity Transactions	-2.9
Cost of Private Gilts Transactions	-63.0
Cost of Institutional Equity Transactions	47.4
Cost of Institutional Gilts Transactions	92.0
Implied Potential Price Fall	33.0
Assumed Potential Price Fall	17.0

Price Scenarios for Luxembourg

In the table below comparative prices for banking services in Luxembourg are presented. Reliable comparative data on the cost of mortgages in Luxembourg was not obtainable during our study. We have however assumed that the cost of mortgages in Luxembourg is equal to the average costs in the other countries examined.

TABLE 6.17: COMPARATIVE PRICES OF BANKING SERVICES IN LUXEMBOURG

	% Difference from the 4 Lowest Observations
Cost of Consumer Credit	-26.9
Cost of Credit Cards	-12.4
Cost of Mortgages	36.5
Cost of Letters of Credit	27.1
Cost of Foreign Exchange Drafts	33.3
Cost of Foreign Exchange Travellers Cheques	-7.4
Cost of Commercial Credit	6.0
Implied Potential Price Fall	16.0
Assumed Potential Price Fall	8.0

The above figures indicate that a number of banking services in Luxembourg are lower than the average of the four lowest countries. Overall the implied price fall was lower than for most of the countries examined. Our analysis of regulations in the banking sector indicated that Luxembourg was one of the most

international markets in Europe and the sector was more significant in relation to the size of the economy than for any of the other countries reviewed. In view of this factor and the comments on the 'price' comparisons referred to earlier, we believe it is prudent to only assume a price fall of 8.0 per cent for Luxembourg.

The data on the comparative prices of insurance services in Luxembourg are presented below. The results show the price comparison for commercial insurance and for private contents and house insurance and motor insurance.

**TABLE 6.18: COMPARATIVE PRICES OF INSURANCE SERVICES
IN LUXEMBOURG**

	% Difference from the 4 Lowest Observations
Cost of Contents and House Insurance	56.9
Cost of Motor Insurance	76.6
Cost of Commercial Fire and Theft Insurance	-15.2
Cost of Public Liability Insurance	9.5
Cost of Term Insurance	65.9
Implied Potential Price Fall	37.0
Assumed Potential Price Fall	19.0

The data on insurance prices in Luxembourg presented above are higher than the average of the four lowest observations with the exception of commercial fire and theft insurance. The figures indicate an implied price fall of 37.0 per cent. However in view of the difficulties in obtaining comparative insurance figures we have used an assumed price fall of only nineteen per cent. The reservations regarding differences in risk etc. must be noted.

The cost of both private and institutional stock exchange transactions are presented in the table overleaf. The data represents a comparison with the four lowest observations.

**TABLE 6.19: COMPARATIVE PRICES OF STOCK EXCHANGE TRANSACTIONS
IN LUXEMBOURG**

	% Difference from the 4 Lowest Observations
Cost of Private Equity Transactions	6.8
Cost of Private Gilts Transactions	26.8
Cost of Institutional Equity Transactions	68.5
Cost of Institutional Gilts Transactions	- 36.0
Implied Potential Price Fall	9.0
Assumed Potential Price Fall	5.0

The above figures indicate that the cost of institutional gilt transactions was lower in Luxembourg than the average of the four lowest observations. The prices would indicate an implied price fall of 9.0 per cent. In our economic estimates we however assume a price fall of only 5 per cent.

Price Scenario for the Netherlands

In table 6.20 comparative prices of banking services in the Netherlands are outlined.

**TABLE 6.20: COMPARATIVE PRICES OF BANKING SERVICES IN
THE NETHERLANDS**

	% Difference from the 4 Lowest Observations
Cost of Consumer Credit	30.8
Cost of Credit Cards	42.9
Cost of Mortgages	-6.3
Cost of Letters of Credit	16.5
Cost of Foreign Exchange Drafts	-45.7
Cost of Foreign Exchange Travellers Cheques	33.3
Cost of Commercial Credit	43.0
Implied Potential Price Fall	10.0
Assumed Potential Price Fall	5.0

The data on the price of banking services in the Netherlands presented overleaf show that for most of the banking services examined prices were higher than the average in the four lowest countries. The price of the important product of mortgages as defined in terms of the excess over money market rates and the price of foreign exchange drafts were lower than the average of the four lowest observations. This significantly influences the overall implied price fall. The data on 'prices' presented above would indicate a 'price' fall of ten per cent. In view of the points raised previously regarding the price comparisons and the international element in banking we have however taken the more cautious assumption that 'prices' would decline by only five per cent although this may underestimate the potential price fall.

The estimated prices of insurance services in the Netherlands indicate that in general prices for insurance services chosen were less than the average of the four lowest observations.

TABLE 6.21: COMPARATIVE PRICES OF INSURANCE SERVICES IN THE NETHERLANDS

	<u>Unweighted</u> <u>% Difference</u> <u>from the 4</u> <u>Lowest</u> <u>Observations</u>
Cost of Contents and House Insurance	16.9
Cost of Motor Insurance	-6.8
Cost of Commercial Fire and Theft Insurance	-0.5
Cost of Public Liability Insurance	-16.3
Cost of Term Insurance	-8.9
Implied Potential Price Fall	1.0
Assumed Potential Price Fall	0.5

The above figures would indicate an implied price fall of one per cent. While extreme caution must be exercised in interpreting our analysis of costs in the insurance sector considered previously, it is interesting to note that management and other expenses as a percentage of net premiums in non life insurance companies in the Netherlands were very low compared with other countries reviewed. It is unlikely that in an integrated market that the potential price fall would be limited to such a small decrease, however we have used the above assumption in our economic estimates of potential consumer gains. We have also considered for the Netherlands as for other countries the impact of a price range on our base case estimate of plus and minus five per cent.

The estimates of the price of stock exchange transactions in the Netherlands are presented in the table below. The data indicates that differences in comparative prices between private equity and gilt transactions and institutional transactions.

**TABLE 6.22: COMPARATIVE PRICES OF STOCK EXCHANGE TRANSACTIONS
IN THE NETHERLANDS**

	% Difference from the 4 Lowest Observations
Cost of Private Equity Transactions	113.6
Cost of Private Gilts Transactions	160.6
Cost of Institutional Equity Transactions	26.3
Cost of Institutional Gilts Transactions	-17.4
Implied Potential Price Fall	18.0
Assumed Potential Price Fall	9.0

The above data indicates a potential price fall of approximately eighteen per cent. In our estimates of economic welfare gains we have used an assumption of 9.0 per cent.

Price Scenarios for UK

In table 6.23 estimates of comparative prices for banking services in the UK are presented. The figures show that with the exception of consumer and commercial credit the prices of all the financial services examined are similar to the average of the four lowest observations. In the case of consumer and commercial credit this is measured as the cost in excess over money market rates. This may be affected by the high interest rates in the UK. The figures also show that the costs of mortgages and foreign exchange travellers cheques are lower than the average of the four lowest.

TABLE 6.23: COMPARATIVE PRICES OF BANKING SERVICES IN THE UK

	% Difference from the 4 Lowest Observations
Cost of Consumer Credit	121.5
Cost of Credit Cards	16.2
Cost of Mortgages	-20.7
Cost of Letters of Credit	8.1
Cost of Foreign Exchange Drafts	16.1
Cost of Foreign Exchange Travellers Cheques	-7.4
Cost of Commercial Credit	45.7
Implied Potential Price Fall	18.0
Assumed Potential Price Fall	9.0

Overall therefore the prices of banking services in the United Kingdom appears competitive except for loans which may be influenced by money market and inter bank rates. The data indicates an implied price of 18 per cent. We believe however that due to the fact that many of the services examined were competitive as well as the international nature of UK banking sector, this is likely to overestimate the potential price falls. In view of the points discussed above we have assumed that the potential price fall is only 9. per cent. It is important to note that this would indicate a reduction in actual prices to the consumer of much less than this amount for the reasons referred to earlier in this report.

Data on comparative prices of insurances services in the UK is presented below compared with the average of the four lowest observations.

TABLE 6.24: COMPARATIVE PRICES OF INSURANCE SERVICES IN THE UK

	% Difference from the 4 Lowest Observations
Cost of Contents and House Insurance	89.7
Cost of Motor Insurance	-16.8
Cost of Commercial Fire and Theft Insurance	26.6
Cost of Public Liability Insurance	-6.5
Cost of Term Insurance	-29.9
Implied Potential Price Fall	4.0
Assumed Potential Price Fall	2.0

The figures on insurance prices in the UK indicate that three of the five products examined were less expensive than the average of the four lowest price observations. The two products which are above the lowest prices are home and commercial fire and theft. The premiums for these products reflect local conditions concerning risk and it has been reported that these have increased significantly in recent years to take account of increases in risks. It is also noteworthy that the limited data reviewed on administration costs in the UK insurance sector as a percentage of premiums were among the lowest observed. In our economic modelling we have assumed a price fall of two per cent.

In table 6.25 below information on comparative prices of stock exchange transactions in the UK are presented. The results show differences in comparative price levels between private and institutional transactions. Due to the nature of UK institutional gilt market it was not possible to obtain cost of such transactions. We have however assumed that the relatively cost compared with other countries of these transactions are the same as for institutional equity transactions.

TABLE 6.25: COMPARATIVE PRICES OF STOCK EXCHANGE TRANSACTIONS IN THE UK

	% Difference from the 4 Lowest Observations
Cost of Private Equity Transactions	123.3
Cost of Private Gilts Transactions	35.6
Cost of Institutional Equity Transactions	-47.4
Cost of Institutional Gilts Transactions	-47.4
Implied Potential Price Fall	12.0
Assumed Potential Price Fall	6.0

The above figures indicate the relatively high cost of personal transactions and the low cost of institutional business, which confirms the documented post big-bang development. The above figures would indicate an implied price fall of 12.0 per cent. In view of the current situation in the UK Stock Exchange and the reductions in prices which have occurred to date we believe this may overestimate the potential gain and we have assumed a potential price fall of six per cent.

6.3 KEY NON PRICE ASSUMPTIONS

In addition to estimates of potential price changes it is necessary to estimate value added, and the elasticity of demand in order to calculate gains in consumer surplus. These assumptions are reviewed below. In the appendices we also consider assumptions on the Herfindahl index and consider some estimates of gains in economic welfare using this index as an indicator of changes in producer surplus.

Value Added in Financial Services

In order to calculate consumer surplus and welfare gains it is necessary to estimate value added in financial services. Detailed data on value added is available as indicated earlier in our report for the credit and insurance sector. A disaggregation for credit and for insurance is also available for most countries. No data on value added for securities is available but some aspects of securities will be included in the value added figures for credit institutions. Where we use a disaggregated analysis and consider credit and insurance sectors separately we have assumed that the potential price fall for each of these sectors would be the potential price fall assumed for overall financial services sector.

Elasticity of Demand for Financial Services

In order to decide on the appropriate assumptions to make regarding the price elasticity of demand for financial services we reviewed existing literature. There were however very few estimates of the elasticity of demand for financial services available. Some estimates were available however for the interest elasticities of the demand for money (1) but these are unlikely to be representative of the price elasticity for financial services in general. Some research (2) has however been recently completed on the price elasticity of the demand for whole life insurance and the results of this research indicated price elasticities for policies without participation in profits, in the range 0.71-0.92. In our base case assumptions we have used a price elasticity of demand assumption of 0.75.

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- (1) See Hein E.S. and Hafer R.W, "Financial Innovations and the Interest Elasticity of Money Demand: Historical Evidence", Journal of Money, Credit and Banking, Vol. 16 No. 2 May 1984.
- (2) See Babbel, D.F, Price Elasticity of Demand for Whole Life Insurance, Journal of Finance, Vol XI No. 1, March 1985.

6.4 BASE CASE ESTIMATES AND RESULTS OF INTEGRATION

In the table below a summary of our base case estimates used in the calculation of consumer surplus for each of the countries reviewed is presented. In subsequent paragraphs we examine the resultant estimates for gains in consumer surplus of integration of European financial services markets. We also examine the sensitivity of the results to changes in some of the main assumptions used. It should be stressed that consumer surplus represents the net gain to all consumers and does not refer to private consumers versus institutional or commercial consumers.

The assumed price reductions represent the weighted average of the assumed price reductions for banking, insurance and securities referred to earlier. In view of the uncertainty inherent in any such price scenarios we have taken a price range of five per cent above and below the assumed price estimate. As indicated earlier these price reductions do not refer to the price to the consumer which would be significantly less than these estimates.

TABLE 6.26

Assumptions Used in Base Case Estimate of Economic Integration

Country	Value Added In Credit & Insurance		Value Added in Credit in Insurance Institutions		Elasticity of Demand	Assumed Percentage Price Reductions
	(1)	(2)	(2)	(2)		
	ECU	BN	ECUs	BN		
B	5.966		3.979		0.75	6 - 16
D	44.417		33.902		0.75	5 - 15
ES	13.929		8.638		0.75	16 - 26
F	29.277		27.046		0.75	7 - 17
I	26.998		23.861		0.75	9 - 19
LU	.535		-		0.75	3 - 13
N	8.537		6.244		0.75	1 - 9
UK	70.240		21.666		0.75	2 - 12

(1) 1985 data except Luxembourg which is 1982.

(2) 1983 data except Luxembourg which is 1982.

Results of Impact of European Integration

In the table below estimates of the economic impact of European integration of financial services as measured by the change in consumer surplus is presented for each of the countries examined. The estimates indicate that the gain in consumer surplus would be of the order of 11,144m -32,710m ECUs. The lower estimate is based on a lower assumed price reductions while the higher estimate is based on scenario of greater price reductions. It is important to stress the nature of the results. In particular they represent a snap shot of the position before and after integration. The figures also assume a competitive market structure after integration. The realism of this assumption is open to question but is necessary for the analysis. The figures indicate the net gains in consumer surplus on a country by country basis but do not make any assumption about the redistributive effects between producers and different countries. Thus the results indicate the benefits to the consumers in each country and the overall gain in consumer surplus to the Community. They do not indicate the impact on economic activity in the different countries. The results therefore do not represent the change in economic welfare for individual countries. In an integrated competitive market it is likely that there will be new entrants and firms unable to compete. The distribution of the gain in demand between producers in different countries will depend on how the national producers respond to the new trading environment. An examination of this issue which includes the regional policy implications is outside the scope of the analysis in this study.

TABLE 6.27: ESTIMATED GAIN IN CONSUMER SURPLUS RESULTING FROM INTEGRATION OF EUROPEAN CREDIT AND INSURANCE MARKETS

	<u>ECUs M</u>
B	366 - 1,018
D	2,264 - 7,074
ES	2,376 - 4,040
F	2,105 - 5,330
I	2,516 - 5,542
LU	16 - 73
N	86 - 796
UK	<u>1,415 - 8,837</u>
	11,144 -32,710

The extent to which the above estimates represent a gain in economic welfare depends on the assumptions made regarding the extent to which the price reductions used result in a loss in producer surplus. The particular framework which we have adopted would indicate that it would be necessary to subtract from this gain in consumer surplus some estimates of the likely decline in producer surplus. In doing so we recognise that it could be

argued that this results in an underestimation of the gains from European economic integration but consider that a conservative approach is more likely to represent the real situation as barriers are removed. In an appendix we present a methodology using the Herfindahl index as a measure of concentration which we use to estimate potential economic welfare gains. In the event of the consumer surplus gains being used as a measure of economic welfare gains we believe it would be prudent to use the mid point in the price range as the upper estimate of economic welfare gains.

It is also useful to consider the consumer surplus gains for the credit and insurance sector separately. Due to limitations of available data a more detailed sub-sectoral breakdown is not feasible. It is likely however that there may be differences in the determinants of consumer surpluses (such as elasticity differences) for different sub sectors. The sensitivity analysis undertaken later in this section may be of use in considering the impact of changes in different assumptions.

In examining the individual results for credit and insurance sectors separately it should be noted that due to definitional differences these do not equate with aggregate results for 'credit and insurance' sector. For most countries the results are similar but for the UK the aggregate credit and insurance sector include significantly more activities than the sum of the two sub sectors. In presenting the disaggregate results the credit sub sector will be referred to as banking and securities.

Consumer Surplus in Banking Securities Sectors

In the table below the estimates of the impact of integration of European banking sector in terms of gains in consumer surplus is presented.

The table indicates the estimated gains in consumer surplus resulting from integration of the European banking markets. The size of the gain is primarily determined by the size of value added in the sector and the assumed reduction in prices. The figures do not represent a gain in economic welfare in each country. It is important to also note that the figures do not represent the gain or loss to producers in each country.

TABLE 6.28: ESTIMATED GAIN IN CONSUMER SURPLUS RESULTING FROM INTEGRATION OF EUROPEAN BANKING MARKETS

	ECU's M
B	203 - 634
D	2,438 - 6,172
ES	1,474 - 2,505
F	1,945 - 4,924
I	1,216 - 3,800
N	63 - 649
UK	880 - 3,207

Consumer Surplus in Insurance Sector

In the table below the estimates of the impact of integration of European insurance sector in terms of gains in consumer surplus are presented. The very large gains in consumer surplus resulting from integration of European insurance markets accounted for by Germany and the UK reflects the size of the markets in these two countries and not a higher percentage gain. Indeed the percentage gains for the UK and Germany are lower than for number of the other countries reviewed.

TABLE 6.29: ESTIMATED GAIN IN CONSUMER SURPLUS RESULTING FROM INTEGRATION OF EUROPEAN INSURANCE MARKETS

	ECU's M	
B	69	- 138
D	80	- 829
ES	73	- 131
F	102	- 258
I	253	- 398
N	20	- 100
UK	84	- 600

Sensitivity of Results

It is important to stress that there is considerable uncertainty regarding what will be the economic outcome of European integration. Our calculations are designed to attempt to estimate in a quantified manner the likely impact based on certain assumptions regarding future developments. The results therefore represent an estimate based on a set of reasonable assumptions. In view of the uncertainty regarding a number of the key assumptions it is important to examine the sensitivity of the results to changes in the assumptions made. In the following paragraphs we consider the impact on our estimates of consumer surplus for alternative assumptions regarding price changes and elasticity of demand.

For the banking sector the 'prices' in general represent the value added element in prices. It is important to stress that these price assumptions do not represent the price to the consumer. The price reductions to the consumer would be much less than the 'price' assumptions used in our analysis. It was not possible to obtain a similar measure for other sectors but due to the importance of banking in overall financial services this is of key importance.

Sensitivity of Estimates to Alternative Price Assumptions

In the table below we present estimates of the gain in consumer surplus resulting from integration of European credit and insurance markets on the basis of a range of price assumptions. Our estimates presented earlier were also based on a range of price reductions.

TABLE 6.30: ESTIMATED GAIN IN CONSUMER SURPLUS ON THE BASIS OF ALTERNATIVE PRICE ASSUMPTIONS

ECU's M				
Assumed Percentage Price Changes	10	20	30	40
B	620	1,290	2,040	2,868
D	4,620	9,640	15,160	21,300
ES	1,450	3,020	4,750	6,680
F	3,040	6,350	9,990	14,040
I	2,810	5,860	9,210	12,950
LU	60	120	180	260
N	890	1,850	2,910	4,090
UK	7,300	15,240	23,970	33,680

The results indicate that the estimates of consumer surplus are, not surprisingly, sensitive to alternative price assumptions.

Sensitivity of Estimates to Alternative Elasticity of Demand Assumptions

In the table below we present estimates of consumer surplus gains using alternative assumptions of price elasticity of demand. The figures indicate that the estimates are not very sensitive to changes in the price elasticity of demand.

TABLE 6.31: ESTIMATED GAIN IN CONSUMER SURPLUS ON THE BASIS OF ALTERNATIVE ESTIMATES OF PRICE ELASTICITY OF DEMAND

Assumed Price Elasticity of Demand	ECU's m			
	0.2	0.5	0.75	1.5
B	971	996	1,018	1,087
D	6,759	6,933	7,074	7,502
ES	3,727	3,894	4,040	4,526
F	5,068	5,209	5,330	5,717
I	5,235	5,400	5,542	6,000
LU	71	72	73	77
N	776	786	796	824
UK	8,535	8,698	8,837	9,272

6.5 MACROECONOMIC IMPLICATIONS

In addition to our estimates of the microeconomic impact of integration of European financial services sector it is also necessary to consider the macroeconomic welfare gains from integration of European Capital markets. In particular it is important to consider the gains from risk pooling, and equalisation of interest rates. These issues are considered in subsequent paragraphs.

Risk Pooling by Capital Markets

It is well known that holding a diversified portfolio of stocks can result in lower risk for any given return than would be obtainable from any single stock. In effect the risk specific to individual stocks becomes negligible in the average return on the portfolio, with remaining risk attributable only to correlations between the variability of individual stock returns. If an investor is confined to investing in the securities of a particular country, he may be unable to achieve the maximum diversification. Accordingly, an investor restricted in this manner may have to put up either with more risk than necessary for a given (expected) return, or with a lower (expected) return for a given level or risk.

These considerations are more important if the returns obtainable in the stock markets of different countries are not very highly correlated with each other, as lack of correlation between assets points to a potential for gains from diversification.

From the borrower's point of view too there can be benefits from the integration of capital markets, even if the rate of interest on risk-free assets were the same in all countries, to the extent that integration increases the potential for diversifying risk. This is because the typical borrower offers a risky asset to the lender; but the integrated market will require no compensation by way of additional mean return for those parts of the risk that is diversifiable in an international portfolio. This borrower's gain can be described as the gain from integration, as opposed to the gains which lenders can make by diversifying their portfolios as described in the previous paragraph, since the latter gains may exist even if the markets are integrated.

Assessment of the empirical significance of these points requires the answer to two questions. First: are the European capital markets integrated (with each other and with the rest of the world) in the sense that rates of return fully reflect all diversification possibilities? Second: can an investor restricted to the assets of one country achieve as good a trade-off between risk and return as if he was free to choose from foreign assets also in forming his portfolio? These questions are logically separate, as it is possible that integration of capital markets exists in the sense of the first question above while some investors are restricted in their portfolio choice by exchange controls.

Both questions have been addressed by an extensive literature, though a conclusive quantification of the magnitudes involved is not yet available. One of the main reasons for the remaining uncertainty lies in the fact that so much hinges on the degree of correlation between assets in different countries. These correlations can only be estimated from historical patterns, but there is no guarantee that past correlations will provide a reliable guide to the future. A comprehensive review of the conceptual issues involved is presented in a paper by Michael Adler and Bernard Dumas(1).

(1) Adler M. Dumas B. "International Portfolio Choice and Corporation Finance", Journal of Finance 1983.

On the second question, which is the more clearcut of the two, the general conclusion from many studies may be summarised by the view of Adler and Dumas that because of the "fairly small correlations" which exist between stock market values in different countries, "it is possible to reap important gains from international portfolio diversification".

For instance the widely quoted early study by Levy and Sarnat (1) observed that while the mean return from a portfolio of EEC-6 country stocks based on experience in the 1950's and 1960's was about 15.5%, this was achieved at the cost of a risk (standard deviation) of 25.0%. An "all-country" stocks portfolio would yield a mean return of 12.0%, but with much reduced risk at 8.0%. The lowest risk that could be obtained for a mean return of 12.0% using government bonds and only EEC-6 stocks was 16.7%.

In like vein, Solnik (2), calculated that an US investor confined to US securities would suffer a two-thirds increase in risk for the same mean return.

Attempts to answer the question, whether the international capital markets are in fact integrated (so that the gains to borrowers discussed above are already available), have required subtle statistical techniques. Many of these tests, such as those used by Solnik and by Stehle(3), have been inconclusive. However, a recent paper by Cho, Eun and Senbet(4), presents more conclusive results from the analysis of an extensive 11-country data set with over 300 individual stocks. Four EEC countries (UK, Germany, Belgium and Netherlands) are included in the study. As with previous data sets, correlations between stock returns in different countries tend to be low (the mean intra-country correlation is only 0.23, compared with a mean intra-country correlation of 0.52). The authors' strategy is to consider each pair of countries, identifying the factors which explain most of the variation between the returns in the stocks of those countries, and having controlled for those factors, examining whether the required rate of return on individual stocks depends on which country that stock comes from. In the case of most country pairs, there is a dependence on the country, a conclusion which allows the author to reject the hypothesis of full international capital market integration. It should be noted that this rejection comes from the risk-premium component of the required return, rather than any estimated difference in the risk-free return between countries. So far as the EEC countries are concerned, Cho, Eun and Senbet reject full integration for them also; even within the EEC, it seems that

- (1) Levy, Sarnat. "International Diversification of Investment Portfolios" American Economic Review 1970"
- (2) Solnik BH, "The International Pricing of Risk: An Empirical Investigation of the World Capital Market Structure" Journal of Finance 1974.
- (3) Stehle RE, "An Empirical Test of the Alternative Hypothesis of National International Pricing of Risky Assets", Journal of Finance 1977.
- (4) Cho Eun & Senbet, "International Arbitrage Pricing Theory: An Empirical Investigation", Journal of Finance 1986.

full capital market integration does not hold. Only in the case of two out of the six country pairs: Germany-Netherlands, and France-UK, is it possible (with more than 1% probability) to entertain the hypothesis that any two of the four EEC countries are integrated in this sense.

Conclusions Regarding Risk Pooling by Capital Markets

The above analysis indicates that the European capital markets are not integrated in the sense that rates of return do not fully reflect all diversification possibilities. Furthermore investors who are restricted to the assets can not achieve as good a trade-off between risk and return as if there was freedom to choose from foreign assets.

In terms of the quantified importance of potential greater portfolio diversification possibilities some estimates of this can be obtained by computing the expected rate of return on an internationally diversified portfolio with the same risk as the actual risk of the market portfolio in the particular country. The difference between this and the actual market return represents the annual gain in rate of return which could result from integration. For example, using the data of Levy and Sarnat (op. cit.), an appropriately levered international portfolio could generate mean returns almost three-quarters as high as the mean return on the EEC-6 market portfolio, for the same risk. In fact their figures yield a mean levered return, for the same risk of over 11% per annum higher. The more recent Grauer and Hakansson figures, referring to the US rather than EEC-6, also suggests very substantial gains from international diversification.

"Implications of Completing the Internal Market for Certain Capital Movements?"

At present the persistence of exchange control prevents the free flow of capital from moving to the countries with the highest rates of return. Even if there were no differences between the efficiency of the financial services industry in the various members states, the removal of exchange controls could be expected to have beneficial effects through the convergence of real interest rates.

It is useful to attempt to estimate the likely implications of completing the internal market for certain capital movements. It is however important to note the limitations of such an analysis.

The analysis and the estimates presented below are based on a study of the changes in demand for physical investment, by country, as a result of changes in the real cost of capital (largely, though not entirely, determined by changes in real interest rates). Clearly the completion of the internal market, by removing exchange controls, technical barriers, and by liberalising trade in financial services, will almost certainly alter the interest rate configuration from what it would otherwise have been, and stimulate all kinds of capital flows, both short term and long term. However, as noted above, the estimates of welfare gains given relate to certain longer term capital items only, and these do not cover all of the internal market implications for capital flows.

Moreover, given the limited coverage of the analysis it is necessary to keep in mind that, as far as direct investment is concerned, this has been largely liberalised for some time, and so it is possible that the impact of completing the internal market on this item will be very modest indeed. This will be the case if, for example, the marginal efficiency of physical capital has already been largely equalised, as a result of existing arrangements, in most of the countries covered by the report.

Given information on the marginal efficiency of capital and the real interest rates prevailing in the different countries, it is possible to quantify the gains from the move to a common interest rates. A caveat should be recognised in respect of the assumption that the removal of exchange controls would necessarily equalise the real rates of interest across Europe. Until there is a much tighter exchange rate mechanism in the EMS, and one covering all of the countries, convergence of real interest rates will remain imperfect. In order to consider the potential benefits it is however useful to consider the economic impact of an equalisation of interest rates, resulting from the integration of European capital markets.

Where financial markets are segmented by controls which inhibit the free movement of capital, real interest rates may differ between countries. In the extreme case where there is total segmentation and no balance of payments imbalance, each country's investment would be financed from domestic savings. Real interest rates, assuming no other internal distortions, would equal the marginal product of capital in each country. Removal of restrictions on capital flows may not of itself be a sufficient condition for equalisation of real interest rates if there exist other factors which affect differentially the profitability of investment between countries. Differences in the structure and impact of taxation systems between countries are a potentially significant distortion (1)

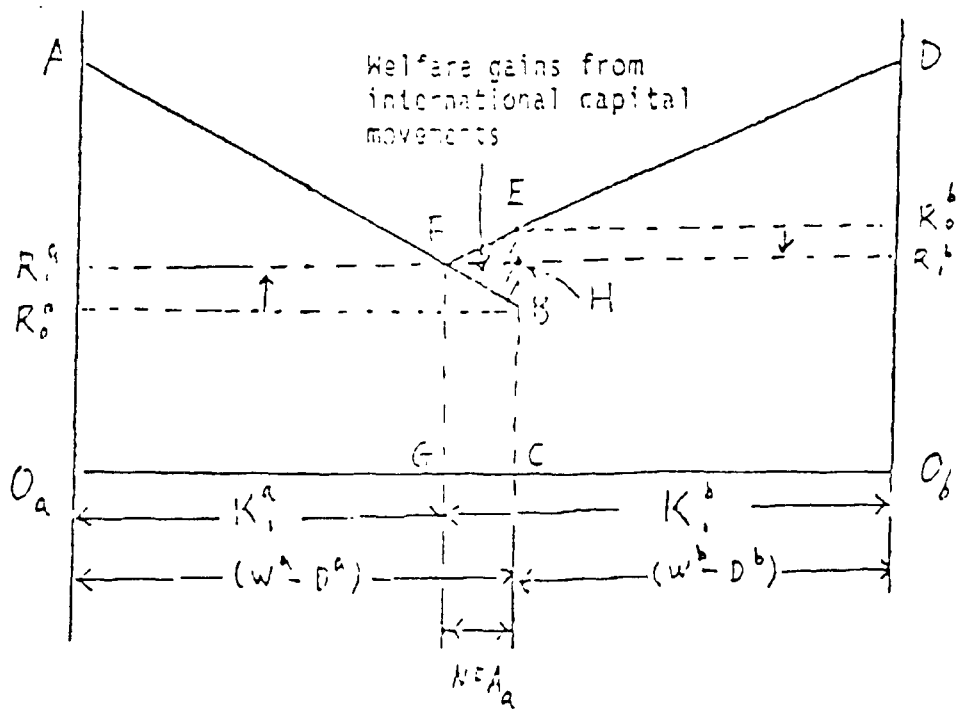
Liberalisation of controls on financial markets would give rise to a capital outflow from a country with low real interest rates to a country with higher real rates. This will tend over time to equalise real interest rates between countries. Investment in projects with the highest returns, irrespective of the country in which they are located, will enable net gains to be achieved. Thus the country experiencing the capital outflow can achieve a larger net national product through receipt of interest on foreign assets in excess of the return which could have been achieved by investing domestically. The country in receipt of the capital inflow can increase its domestic produce by a sufficient amount to pay interest abroad and still achieve a larger net national product.

(1) See "Internationalisation of Financial Markets: Some Implications for Macroeconomic Policy and for the Allocation of Capital", Furao, M. Hanozaki, M; OECD Working Paper, November 1986.

In order to clarify the impact of gains from equalisation of interest rates it is useful to consider the diagram below. The diagram and the exposition which follows draws heavily on the OECD paper by Fukao and Hanozaki referred to earlier.

INTEGRATED FINANCIAL MARKET

Marginal Product of Capital



In the diagram on integrated financial markets the marginal product of capital schedules is presented for two countries A and B in a simplified analysis of how welfare is increased on foot of integration of their capital markets. Before integration real interest rates in A are lower than in B.

After integration, the real interest rates of the two countries will tend to be equalised. The capital stock of country A declines from K_{0a}^a to K_{1a}^a by the amount of its net foreign asset, NFA_a . Corresponding to this, the capital stock of country B increases from K_{0b}^b to K_{1b}^b . The real interest rate of country A increases from R_{0a}^a to R_1^a while that of country B decreases from R_{0b}^b to R_1^b . The net domestic product of country A declines from the area of ABCO to the area of AFGO. The net national product of this country is larger than the net domestic product in the

new equilibrium by the amount of investment income from abroad, which is equal to the area of FHCG. Therefore, the net national product of country A increases by the triangle area of FHB. On the other hand, the net domestic product of country B increases from the area of DO_bCE to the area of DO_bGF, increasing by the area of ECGF. The increase in the net national product is equal to the triangle area of EHF due to interest payments abroad (the area of FHCG). The total increases in the world net national product is equal to the shaded area of EBF, which may be regarded as a welfare gain by the two countries. This welfare gain is created by the improved allocation of capital through the international equalisation of the marginal product of capital.

The calculations underlying the estimates presented in this section on the gains from equalisation of interest rates involve two main steps as follows:

- (i) estimation of the equilibrium interest rate after integration;
- (ii) calculation for the eight countries of the equivalent area of the triangle shown in the diagram earlier.

The calculations are based on classical analysis and the traditional assumptions regarding market flexibility etc. applies.

In the first of these steps the average retail interest rate, r^o is calculated. The equilibrium rate r^* is estimated as r^o plus any adjustment to this unweighted average which would be brought about by the existence of differences in the interest elasticities of demand for capital between countries. The calculations for this first step is as follows: (where X^1 represents the US\$ billion change in the demand for capital which would result from a one percentage point reduction in the real cost of capital.)

The inverted marginal efficiency of capital function for country i is $X_i(r_i)$, with the mean interest rate as r^o and the equilibrium interest rate in the integrated market as r^* . Then if

$$\delta = (r_i - r^o) X'_i(r^o) / X'_i(r^o),$$

then, approximately,

$$r^* = r^o + \delta.$$

The second step in the calculations is accomplished by calculating differences between the estimated equilibrium rate and the actual real interest rate. The precise calculation is as follows:

Writing $\epsilon_i = [r_i - r^*]$, an approximation to the loss is given by:
 $0.5 \sum \epsilon_i^2 X'_i(r^o).$

The framework indicates that the size of the welfare gains to be achieved from equalisation of real interest rates depends both on the size of the differences and on the responsiveness of the demand for capital to interest rate changes in different countries.

Estimates of the increase in the demand for capital as a result of a one percentage point decrease in the real cost of capital were obtained from the OECD working paper referred to above. These estimates were available for Germany, France, the UK and Italy. These are the four largest economies of the eight in this study and we have assumed that the demand for capital in the remaining four countries, in response to a one percentage point decline in the real cost of capital, is equal to the average of that in the larger four.

The table below shows estimates for real interest rates, the responsiveness of the demand for capital to a one percentage point decline in the real cost of capital and deviations from the equilibrium real interest rate. It is important to stress that real interest rate deductions will also affect consumer's income and welfare.

TABLE 6.32: WELFARE GAINS FROM THE EQUALISATION OF REAL INTEREST RATES

	Real Interest Rates Short Term 1986	Real Interest Rates Long Term 1986	Changes in Demand for Capital * ECU BN	Deviations from Equilibrium Short Term Interest Rate	Deviations from Equilibrium Long Term Interest Rate
	Percentage Points				
	1	2	3	4	5
B	9.4	6.9	16	1.3	0.8
D	7.6	6.4	135	-0.4	0.3
ES	5.7	3.6	33	-2.3	-2.5
F	8.6	6.3	80	0.6	0.2
I	8.8	6.2	104	0.7	0.8
L	9.4	6.9	0.6	1.3	0.8
NL	8.2	7.4	28	0.2	1.3
UK	7.9	5.9	96	-0.1	-0.2

* As a result of a 1 percentage point decline in interest rates.

Sources: Real Interest Rates - Central Banks

The potential welfare gains from completing the internal market for certain capital movements can be calculated using the deviations of real interest rates from equilibrium (columns 4 + 5 overleaf) and the estimates of the change in the demand for capital shown (column 3) and using the formula outlined previously for the approximation of the loss of non integration. The results indicate a gain of between 1.4 - 1.6bn ECUs depending on whether long or short term rates are used. The size of these gains reflects the coverage and nature of the analysis and developments to data in liberalising capital movements.

Conclusions

Our research indicates that there is significant potential gains to be secured in terms of increases in consumer surplus and economic welfare, resulting from integration of European financial services markets.

Extreme caution must be exercised in interpreting any quantification of the potential gains as the results will of necessity be speculative. However on the basis of our base case assumptions, we estimate that the gain in consumer surplus would be of the order of 11b - 33b ECUs. The net economic welfare gains using the higher price assumptions are estimated to be of the order of 22bn ECUs. These gains represent the potential microeconomic benefits of integration of main European Community financial services markets. The results for individual countries presented in this study do not represent the potential economic welfare gains for each country as this would involve an examination of the distribution of the potential aggregate gains which is outside the scope of this study.

In addition to the above gains it is also likely that there will be macroeconomic welfare gains from integration of European capital markets. The gains from risk pooling by capital markets could generate mean returns almost three-quarters as high as the return on existing market portfolios. Also of importance is the potential gains from equalisation of interest rates.

The gains from integration will result from the dynamic effect of economic integration and not simply as a result of removing the costs of meeting some of the existing regulations. In all countries consumers will benefit from European integration but some producers will come under pressure to survive in the single market.

In this study the importance of financial services in terms of output and employment was indicated. The critical macroeconomic importance of capital markets was also highlighted. In view of the potential benefits of European integration of financial and capital markets it is essential that steps are taken to rapidly complete the internal market in financial services.

APPENDICES

APPENDIX 1: TERMS OF REFERENCE

APPENDIX 2: NOTE ON EMPLOYMENT AND VALUE ADDED CLASSIFICATION

APPENDIX 3: DETAILED METHODOLOGICAL REVIEW OF LINK BETWEEN
TRADE IN FINANCIAL SERVICES AND CAPITAL MOVEMENTS

APPENDIX 4: TABLES ON OVERVIEW OF AREAS OF COMPETITION BETWEEN
FINANCIAL INSTITUTIONS

APPENDIX 5: BASIS FOR WEIGHTING SYSTEM USED IN PRICE COMPARISONS

APPENDIX 6: MAPPING OF FINANCIAL SERVICE GROUPINGS USED IN
DIFFERENT SECTIONS OF THE REPORT

APPENDIX 7: USE OF HERFINDAHL INDEX TO ESTIMATE ECONOMIC WELFARE GAINS

APPENDIX 1: TERMS OF REFERENCE: SUMMARY WORK PROGRAMME



Summary Work Programme

Geographical coverage of the study: F.R. of Germany, France, Italy, the United Kingdom, the Benelux countries and Spain.

The study is divided into two parts:

The objectives of the first part (Part I) of the study are:

- to assess the importance of financial services to the Community economy, from the point of view of the producer and from the point of view of the user of financial services;
- to analyse the present organisation of the market for financial services;
- to determine the scope for a quantitative assessment of the effects of completing the internal market, both as a whole and in parts.

This information will then be used, in the second part (Part II) of the study;

- to evaluate the cost of the present obstacles to trade in financial services;
- to provide estimates of the benefits of completing the internal market.

The first part of the study is divided into three sections.

Section IA Methodological Issues

The purpose of this section is to resolve three methodological problems. In particular it is;

- to provide a comprehensive but operational definition of financial services;
- to identify the producer and users of financial services;
- to clarify the link between liberalising the market for financial services and liberalisation of capital movements.

The definition of financial services will be based on an analysis of the range of services or products available. It will cover the following:

- international, commercial, and private banking, corporate financial services and offshore banking;
- money market activities, broking, funds management;
- consumer credit;
- assurance, insurance and re-insurance;
- commodities exchange and futures exchange.

The identification of the producers of financial services will proceed country by country because it is unlikely that, in each of the member states of the community, a given service will be provided by the same kind of institution. The identification of users will concentrate on direct users of financial services. Users will include companies, households and General Government.

In examining the link between financial services and capital movements it should be noted that

- the liberalisation of certain financial services can proceed independently of the liberalisation of capital movements particularly if the principal of "home country control", as set out in the White Paper, is accepted. On the other hand the liberalisation of other financial services will not be effective without free capital movements. The study must identify those cases where the liberalisation of the relevant financial services, and those cases where separate action is required.
- the need for, and the right of financial institutions to establish themselves in member states other than those in which they are already based (particularly as regards insurance services) depends upon the outcome of certain cases now before the European Court of Justice.

Section 1B Macro-economic and sectoral Analysis

The purpose of this section is to provide a body of data for financial services, covering, for each of the countries included in the study;

- a) turnover, output, value added, employment and profitability;
- b) the demand for financial services by households, companies and General Government;
- c) external transactions

together with the additional material required to enable comparisons with other sectors and the total economy to be made.

These data will include both detailed cross-sectional analysis as well as time series with greater emphasis being given to more recent years. Some of the data will reflect the institutional structure of the financial service sector (employment etc.) some of the product structure (demand etc.) The body of data must therefore include any appropriate correspondence or transition tables, required to match these two approaches. The definitions and concepts used in assembling the data must be those of the European System of Accounts (ESA).

This body of data will be based upon national or international macro-economic data as well as data of a more micro-economic kind from the following sources:

- data from associations of producers of financial services;
- specialised publications;
- samples of data from individual producers;
- other miscellaneous sources.

In assembling the data the following problems should be considered:

- The difficulty of measuring the output of services.
- The variation of data coverage as between countries.

Section 1C: Analysis of the present structure of the financial service market and quantifications of the effects of regulation

The focus of this section will be on regulatory barriers and how they are implemented.

In particular attention will be given to those regulations:

- affecting the establishment of financial service institutions in overseas markets;
- affecting cross border trade directly.

The purpose of this section will also be to provide quantitative measures of the effects of regulations, and so of the lack of Community wide competition, or market segmentation. These quantitative measures will be based on a set of financial products or services, considered to be the representative of the output of the financial services sector as a whole, and found in each of the separate community markets included in the study. Prices of this set of products will be established for each market.

WORK PROGRAMME FOR PART II OF THE STUDY

Part II of the study will be divided into three sections, the first will be concerned with the cost of the present obstacles to free trade in financial services.

Section 11A Evaluating the Cost of the Present Obstacles to Free Trade in Financial Services and Background Research and Analysis

The purpose of this section is to provide figures for the cost of the obstacles to free trade in financial services and also with the compilation and analysis of background research which will be used in Section IIC.

Most emphasis in Part II of the study will be focused on indirect estimates of costs of non Europe. These estimates will be obtained indirectly from an analysis of price data and from an analysis of the data on the other approaches to the quantification of the effects of regulations.

Section IIB Analysis of Macroeconomic Welfare Gains

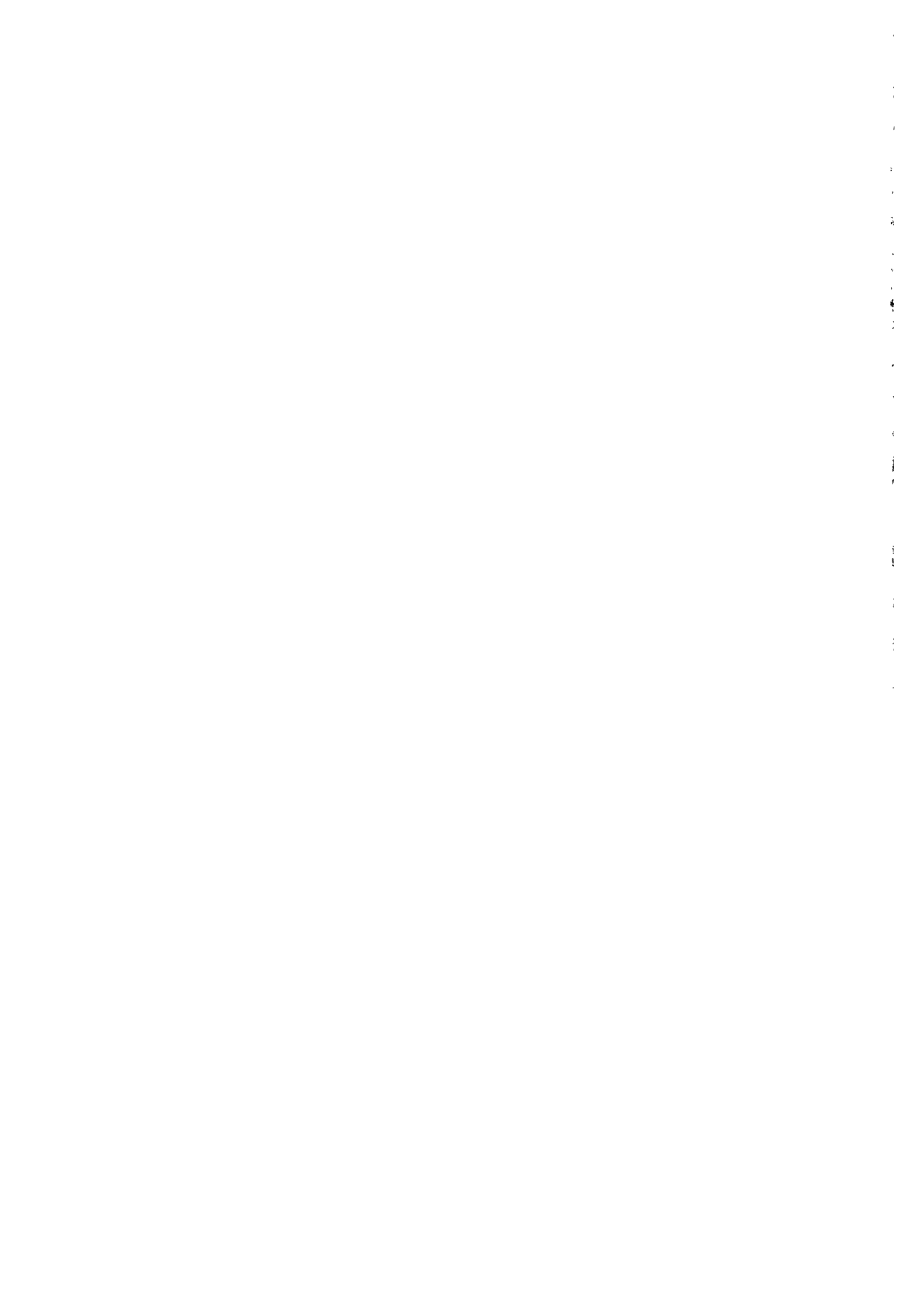
In this section data on the real interest rates prevailing in different countries will be compiled. Assumptions regarding the marginal efficiency of capital will also be made.

An analysis of other external benefits relating to international pooling of capital market risks and credit rationing will also be provided.

Section IIC Estimating the Gains from Completing the Internal Market for Financial Services

The purpose of this section will be to provide figures for the benefits to be made from completing the internal market for financial services. The work of this section must firstly be directed towards measuring the effect of completing the internal market on the net welfare gain for each country. This will be expressed in millions of ECUs or as a percentage of other economic variables.

APPENDIX 2 : NOTE ON EMPLOYMENT AND VALUE ADDED CLASSIFICATION



WORK PROGRAMME FOR PART II OF THE STUDY

Part II of the study will be divided into three sections, the first will be concerned with the cost of the present obstacles to free trade in financial services and with background research and analysis for sections IIC of the study. The second section will be concerned with analysis of macroeconomic welfare gains. The third with the benefits to be gained from completing the market.

Section IIA Evaluating the Cost of the Present Obstacles to Free Trade in Financial Services and Background Research and Analysis

The purpose of this section is to provide figures for the cost of the obstacles to free trade in financial services and also with the compilation and analysis of background research which will be used in Section IIC.

Most emphasis in Part II of the study will be focused on indirect estimates of costs of non Europe. These estimates will be obtained indirectly from an analysis of price data and from an analysis of the data on the other approaches to the quantification of the effects of regulations.

Section IIB Analysis of Macroeconomic Welfare Gains

In this section data on the real interest rates prevailing in different countries will be compiled. Assumptions regarding the marginal efficiency of capital will also be made. Illustrative estimates will be calculated of macroeconomic implications of the impact of equalisation of interest rates on the basis of these assumptions.

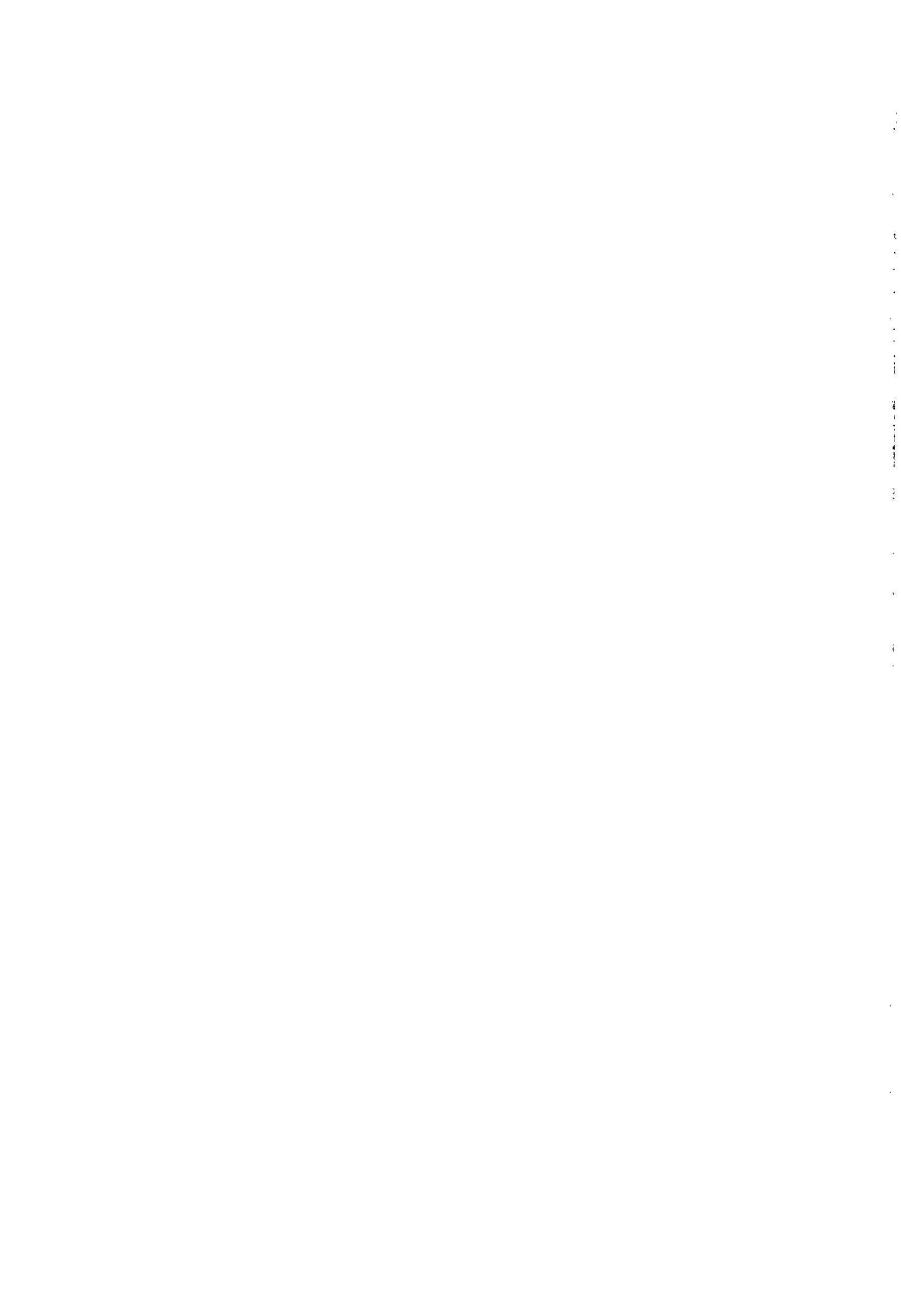
An analysis of other external benefits relating to international pooling of capital market risks and credit rationing will also be provided.

Section IIC Estimating the Gains from Completing the Internal Market for Financial Services

The purpose of this section will be to provide figures for the benefits to be made from completing the internal market for financial services. The work of this section must firstly be directed towards measuring the effect of completing the internal market on the net welfare gain for each country. This will be expressed in millions of ECUs or as a percentage of other economic variables.

The estimation of the gains will be obtained by using an adapted model which takes account of the new imperfect competition approach.

In effect, what the model will provide (together with assumptions regarding the price elasticity of demand) is a formula which, when applied to the price differential for each country (relative to the price in the completed market) and the size of each country's market, will yield estimate for each country of the net welfare gain of completion of the internal market for financial services in Europe.



**APPENDIX 3: DETAILED METHODOLOGICAL REVIEW OF
LINK BETWEEN TRADE IN FINANCIAL
SERVICES AND CAPITAL MOVEMENTS**

Link Between Trade in Financial Services and Capital Movements

In this appendix we consider the important and complex issue of the link between trade in financial services and capital movements.

The main issues which need to be addressed in this connection are analysed and discussed in the following paragraphs.

- (1) The extent to which trade in financial services necessarily involves capital movements.

Generally speaking an international capital movement occurs when a resident of one country acquires a financial claim on a resident of another country. As intermediaries, financial institutions often act as principals with respect both to the ultimate creditors and the ultimate debtors. Thus a deposit placed by a German resident in an United Kingdom bank represents an international capital movement as does a loan made by the UK bank to a German company. The position is less clearcut in the case of the issue of a note of indebtedness by the German company to the German investor, guaranteed by the UK bank; even in this case, for some purposes, the transaction may be treated as involving an international capital movement. If the bank merely places the note, without guarantee then we would not normally say that an international capital movement has happened. Nevertheless a financial service has been performed by the bank in packaging and marketing the note. Another example of an international service transaction without a capital movement could arise with an insurance company. It is clear that for both long-term and accident insurance the sale of a policy establishes a financial claim. But a French insurance company might sell a claim on its Spanish branch to a resident of Spain. In so far as the administration, marketing and other costs were incurred by the French parent, with the Spanish branch being merely a front company, we would regard this transaction as an international sale of services; but there would have been no international capital movement.

Therefore it is possible for some international trade in financial services to take place without capital flows. Nevertheless exchange controls inhibit the ability of residents to obtain financial services from foreign financial institutions not specifically geared up for such indirect arrangements. Furthermore, setting up arrangements for delivering financial services across international borders without effecting capital flows will often be costly for the providers.

(2) A schematic approach.

As discussed in Section 4 of this report exchange controls of varying degrees of severity inhibit the international movement of capital between member states of the Community. (The most severe controls involve Greece, Ireland, Spain and Portugal). The circumstances under which different financial services can legally be provided, or financial products sold, across international frontiers, varies widely both in theory and in practice. The same applies to the degree to which financial institutions can set up branches, or establish subsidiaries, in other member states. Finally a wide variety of different regulations and fiscal regimes applies to financial services in the different member states (and in some cases these discriminate against foreign financial institutions).

In the face of this degree of institutional complexity, and in order to grasp the main issues, we have adopted a schematic approach. Thus we rule out certain configurations and focus only on a small set of archetypical regulations. In particular, we ignore the possibility (which is of practical relevance, for example in insurance) that foreign institutions granted the freedom to trade or to establish will be actively discriminated against in the fiscal or regulatory regime.

(3) Whether partial completion of the internal market can achieve theoretical efficiency?

The fragmentation of the European market for financial services means that the consumer does not obtain the services for the lowest possible price. The deviations from the lowest possible price can arise from a variety of conceptually distinct sources. In the first case there is the question of comparative advantage: a combination of intrinsic characteristics such as factor endowments and access to the appropriate production technology may make some member states relatively more suitable for the production of financial services. A second reason for deviations from the minimum possible price in a fragmented Europe is the possibility of unexploited economies of scale. Even more important is the potential for external competition to eliminate uncompetitive practices and monopoly rents which can persist in protected markets. In what follows, the likely success of various stages of partial liberalisation in achieving these potential gains will be reviewed one by one.

(4) The role of regulations.

Each member state regulates the operation within its jurisdiction of resident financial institutions. The purpose of this regulation is partly prudential, partly macroeconomic, and it may also have other objectives such as channeling of credit to economic sectors which are considered strategic, or protection of the interests of weaker economic agents. As is well known and indeed explicitly recognised by the Commission's White Paper, if foreign financial institutions are allowed to trade without being subject to strict local

regulations, they may gain such a competitive advantage over domestic institutions as to render the regulations unsustainable. It is important to know whether, or to what extent, liberalisation of trade in financial services, or liberalisation of capital movements, can be undertaken without weakening the independence of regulatory authorities. The fact that these regulations may have the effect of raising the price of financial services above the minimum provides an independent reason for inquiring as to their sustainability in the face of liberalisation of trade and capital movements.

(5) Failures of competition.

In a fully unified market, the welfare losses which can be attributed to the present fragmentation would presumably be eliminated. However we must be cautious in concluding that competitive efficiency will prevail with services being provided to the consumer at minimum cost. But there is evidence of non-competitive behaviour in financial markets. Financial services of both the credit and the insurance variety derive their very nature from economies of large numbers; this effectively impels the uncontrolled financial markets to some degree of concentration. Although the practical importance of these economies beyond a certain size may be disputed, there can be no certainty that an unified European financial market will not be a concentrated one, unless a pro-competitive regulatory regime is enforced.

Indeed, while it is true that not all of the member states have competitive financial markets at present, it may nevertheless be remarked that there might on balance be welfare losses in moving from a competitive, but fragmented, market to an unified, but oligopolistic one.

The remainder of the analysis of the above methodological question is organised as follows: firstly we propose a classification of different degrees of freedom of trade in financial services. These classes are then explored with reference to their likely effect on costs of production, on market structure and on the sustainability of a number of types of national regulation in a regime of tight exchange controls. We then examine the effect of liberalising exchange controls while retaining restrictions on trade or establishment. Finally, some conclusions are presented.

Degrees of trade freedom

(1) Freedom to trade or to establish.

Concentrating on the situation where there may be restrictions on capital movements, the degree to which financial institutions can penetrate foreign markets depends firstly on whether they are allowed to

- sell products across international frontiers
- open a branch in the foreign market
- establish a subsidiary in the foreign market.

The present situation in regard to the degree of freedom of sale or establishment is outlined in Section 4 of this report. Where there is the freedom to sell financial products, but branching or establishment of subsidiaries is restricted, and where binding exchange controls exist, the freedom to sell many financial products will typically be nugatory. The sale of a financial service without being able to issue or accept a claim effectively confines the financial institution to pure brokerage or advisory role. Even if the institution could get around this by means of off-balance sheet arrangements, that would reflect a loophole in the exchange controls.

The distinction between branching and the establishment of a subsidiary is not as clear from the perspective of the economic analysis of competitive behaviour, as it is from the point of view of taxation or legal obligations. The establishment of a subsidiary, i.e. a legal entity under the laws of the host country, appears to weaken the integration and control of the parent by comparison with entry on the basis of a branch. But the distinction may be more apparent than real, for example because the directors of the subsidiary may be employees of the parent company. A particular point which is relevant is that branches are generally considered as non-resident for the purpose of exchange controls, and this may offer some advantages to that form of presence over the establishment of a subsidiary where exchange control restrictions are severe. Certainly the differing tax and company law treatment of branches and subsidiaries may result in significant competitive advantages of one form of operation over another, and over domestic institutions, raising the same type of question as arise where foreign financial institutions are permitted to operate abroad under home country financial regulations and supervision, as discussed below.

(2) Home or host country regulations.

For a branch or subsidiary, the degree to which the newcomer is subject to host country regulations and supervision, as opposed to the regulatory and supervisory regime of its home country, will be a decisive factor so far as the competitive position is concerned. In each of the member states of the

Community financial institutions are subject to an important range of regulatory and supervisory controls going beyond the company law requirements imposed on non-financial companies. Differences between the regulatory and tax environment in different member states are also significant.

Though the "concept of mutual recognition and equivalence" proposed by the Commission applies more to prudential than to other aspects of the regulatory and fiscal environment, and the acceptability of local regulations under certain circumstances has been established by the European Court of Justice, it is convenient here to draw the dichotomy between home and host country regulation. The process of harmonization of regulations, which will be accelerated by the process of completing the internal market, will in time make this distinction less important. But for the immediate future it will in many instances be decisive. As we will see, it may be necessary to extend the application of mutual recognition and home country regulation to a wider sphere, including matters often regarded as part of monetary policy if full microeconomic efficiency is to be obtained.

Generally speaking one may expect the role of host Governments to be comparatively less prominent in at least some aspects of the regulation and supervision of branches by comparison with subsidiaries.

- (3) Types of regulation.
Schematically, and with inevitable oversimplification, we can assign regulations to one of the three boxes: prudential, consumer protection, and general monetary and credit policy. The archetypical prudential requirement is a capital adequacy or maximum gearing requirement; interest rate ceilings, rules on loadings for accident insurance and premium calculation rules for life insurance exemplify requirements imposed for consumer protection; while liquidity ratios for banks are typical of monetary policy instruments. Of course any such classification will be subject to objections. Many regulations have multiple purposes, and some may have consequences which are not in line with their stated objectives. Our interest here is not so much in what objectives the regulations achieve as in their cost and competitiveness implications.
- (3) Are the strictest regulations really necessary?
Nevertheless there is a fundamental difficulty for policy analysis in this area: if one assumes the regulations to be well-targetted to their objectives, different regulatory

regimes will tend to result in a different product mix. For instance a regime of tight prudential requirements and detailed consumer protection rules will tend to support a financial sector which is less prone to failures and where the consumer is better served in the dimensions to which regulatory attention has been addressed. The price of financial services may be higher, but it could be argued that the product is, according to the revealed preferences of the regulatory authorities, better. The simplest approach to this difficulty is to accept the objectives of the least regulated country, and to treat, for the purpose of analysis, tighter regulations as being superfluous or distortionary. In the achievement of the unified market in Europe something like this approach will probably have to be adopted in the end, perhaps combined with the adoption of a minimum set of regulatory standards.

(5) The role of exchange controls

It is also necessary to look more closely at the effect of exchange controls on the operation of branches or subsidiaries of foreign financial institutions. To anticipate, a major conclusion of our discussion is that the role of exchange controls is an important one. As noted above, a distinction can usually be drawn between those aspects of an international financial service transaction that involve international capital movements and those that do not. The existence of a local branch can allow a foreign institution to provide a financial service even in the presence of exchange controls that would inhibit the flow of capital which might otherwise be associated with the transaction. However one can imagine that where permission to branch or establish a subsidiary was granted to a foreign financial institution, this might well be accompanied by specific and limited exemptions from exchange controls which could be sufficient to make an appreciable difference to its ability to compete in the host country.

A foreign financial institution may need only the freedom to diversify internationally a small part of the balance sheet of its branch or subsidiary to achieve an optimal diversification of its global portfolio. Therefore even small exemptions from the exchange control rules may be sufficient to make the difference between a segmented and an unified financial market in Europe so far as that institution is concerned. That is one reason why it is interesting to focus on the possibility of special and partial exemptions from exchange controls for financial institutions.

Selected scenarios.

Even confining ourselves to these three aspects leads to an unmanageably complex combination of scenarios. So instead of trying to analyse each possible case, we focus on a small subset of cases which will bring out the main features.

The first cases, denoted A1 and A2 in Table 2.1 below, are intended to represent the goal of the European Commission. There is freedom to trade in financial services across international frontiers, and also freedom to establish subsidiaries and branches. Exchange controls have essentially been eliminated under A1 and A2. The difference between these two scenarios is the degree to which the provision of financial services is subject to home (A1) or host (A2) country regulations. As already mentioned, while the Commission has espoused the principle of mutual recognition with home country licensing and supervision, it is assumed in the Commission's view of the completed internal market that certain matters, such as monetary policy regulations, will remain a matter for the host country. This effectively leaves the Commission's scenario in a half-way house between A1 and A2.

Other rows in Table 2.1 represent, in differing ways and to differing extents, limitations on a free international financial market. Each of the scenarios chosen involve some degree of exchange controls, with a distinction drawn between very tight controls which apply also to financial institutions, and more liberal regimes which have limited specific exemptions allowing financial institutions some leeway to balance their portfolio internationally.

Scenario B is at one artificial pole, where there are many barriers to the establishment of a presence internationally, but where exchange control restrictions are fairly light and there is freedom to trade financial services (for example by telephone) across frontiers. The most restrictive scenario considered is C, where, although trade is permitted, strict exchange controls severely limit the degree to which it can be availed of.

Moving to the opposite pole, where establishment of a commercial presence is permitted, but trade is impeded, we consider four scenarios differing in the severity of exchange controls and between home and host country regulations: D1 and D2 are where there are no exemptions from a severe exchange control regime, and where branch operation, as opposed to the establishment of a subsidiary, is not permitted; scenarios E1 and E2 are more liberal in that subsidiaries of foreign financial institutions are allowed some exemptions from an otherwise strict regime of exchange controls, and where foreign institutions are allowed to operate through branches. D1 and E1 relate to home country regulations, D2 and E2 to host country regulations, a distinction which, as already mentioned will become progressively less important as harmonization of the regulatory and supervisory regime proceeds.

Although the scenarios considered do not exhaust the possible combinations, they are sufficiently representative to illustrate the main considerations involved.

TABLE A 2.1

Scenario:	Freedom to:			Exchange Controls:			
	Trade	Establish Subsidiary	Branch	Whose Regulations Apply?	Tight	Limited Exemptions	None
A1	T	S	B	Home			N
A2	T	S	B	Host			N
B	T			Host			N
C	T			Host			N
D1		S		Host		T	
D2		S		Home	T		
E1		S	B	Home		L	
E2		S	B	Host		L	

(1) The Situation in the Presence of Exchange Controls

In order to throw light on the degree to which maximum efficiency can be achieved in the presence of fairly strict exchange controls, some of the likely consequences of a liberalisation of establishment rules and practices are explored below. Some of the arguments obviously apply to more than one situation, but undue repetition is avoided.

(i) Home country regulations and supervision apply.

(In terms of the scenarios which we have selected, the following paragraphs relate chiefly to D1 and E1.)

In this situation, the general presumption is that tightly regulated financial sectors will not be able to compete abroad, and furthermore domestic institutions could be under threat from foreign competition. Assuming first of all that a good degree of competition prevails in the home market before trade or entry is permitted, we may review the likely impact of the different types of regulation selected earlier. For convenience, we refer more to banks than to other types of intermediary, many of the arguments hold for all types of intermediary with appropriate modifications. To anticipate, we will conclude that, while the differing regulations involve a distortion of competition, this need not in all cases be fatal for domestic institutions. Just as for trade in goods, comparative advantage will generally preserve segments of the market in which domestic institutions remain competitive, though this may result in the emergence of anti-competitive pressures.

To begin with there is the capital adequacy or maximum gearing type of prudential requirement. For a bank this means that lending must be backed partly by issues of equity. A higher capital adequacy requirement for domestic banks does not necessarily mean that they will be placed under a competitive disadvantage, as the cost of equity capital at home may be lower than that abroad because of the existence of exchange controls. In general, capital adequacy requirements are likely to impose only modest burdens; even the most sophisticated of such regulations cannot hope to take full account of the risk structure of the bank's balance sheet, so that in equilibrium a bank which faces a competitive disadvantage because of a higher capital requirement can adjust the riskiness of its balance sheet until its own choice of leverage would correspond to that imposed. In this way the coexistence of banks with different compulsory capital requirements may result in a segmentation of the market by risk rather than in an outright competitive disadvantage.

Turning to interest rate ceilings, imposed at least partially for consumer protection against usurious charges (though the fear of ruinous competition is also a justification), a similar type of argument may apply. Basically the argument would be that, provided the interest rate ceiling was not too far below market clearing levels, the domestic bank, restricted by having to keep low deposit rates, might be able to offer safer deposits by a more rigorous vetting of loan applicants (which they could afford to undertake because of the low cost of deposits). That would leave the foreign competitor with a riskier loan portfolio, but higher deposit rates to justify it. However the resulting riskiness of the liabilities of the foreign bank (or near-bank) would be an unattractive feature of this regime, from the authorities' point of view: in effect the imposition of interest rate ceiling would have increased the riskiness of a sector of the banking system. Note that it is the existence of exchange controls that preserve this distortion.

Maximum loading requirements for insurance premia would also segment the market. Domestic insurers, no longer able to cross-subsidise lines with unduly low maximum loadings would presumably ration their availability if unregulated foreign insurers entered. Likewise the imposition of burdensome calculation rules for life insurance premiums on domestic insurers would be highly visible, and while the failure of the maximum loading rules to achieve their objective might result in a withdrawal of the rules, until that was done inefficiencies would result.

Liquidity ratios for banks imposed for reasons of monetary policy fall into a third category. On the one hand, if the required balances are not remunerated at a market rate then this imposes a cost penalty on the domestic bank which may be hard for it to absorb. Bank deposits are already such a liquid asset that it is hard to see how a bank could offset the imposition by adjusting its business (for example by offering liberal overdraft permissions) to the point where it would call for a substantial voluntary increase in the bank's holdings of non-remunerating liquid assets, especially when one considers the normally ready availability of liquidity at market rates through interbank market. On the other hand, the monetary policy objectives underlying the liquidity ratios are likely to be frustrated by the entry of unregulated foreign banks. So the potentially severe cost penalties suffered by domestic banks would not achieve any policy objective. This anomalous situation would probably induce the authorities to relax the requirements.

This review of the impact of certain regulations reveals that some might tend to segment the market: giving the domestic institutions a comparative advantage in some sectors, while others could impose an outright competitive disadvantage on them. Some of these consequences might be acceptable to home regulatory authorities, but in other cases the tighter

regulations would have ceased to perform any constructive function and would presumably be withdrawn. There would thus be a momentum in the direction of international harmonization of many regulations. To the extent that harmonization was achieved, then greater efficiency could be expected to result; but the fact that authorities might be prepared to live with the sorts of market segmentation and distortion which have been illustrated suggests that this particular half-way house might persist for some time.

To the extent that the regulations remained unharmonized, market segmentation might result in non-competitive practices. For the home institutions, being driven into a small segment would put pressure on profitability and the existence of a common external cause would make cartelisation to preserve revenue a plausible reaction, and one in which the authorities might well find it easy to acquiesce. For the foreign entrant, the absence of competition from the home institutions might make it relatively easy for the first few newcomers to establish a limit price regime that would discourage further competition from abroad.

It should be noted that fiscal preferences, or procurement-type preferences given to domestic institutions, as well as the potential market power of state-owned financial institutions might inhibit the ability of foreign institutions to enter even under a "home regulations" regime. This consideration would be less important, though not entirely without weight, in the absence of exchange controls.

In summary, we may conclude that, because of the effects noted above, the acceptance of home country regulations and supervision will not, in the absence of exchange control liberalisation (as in scenarios D1 and E1), be adequate to ensure full efficiency.

(ii) Host country regulations and supervision apply.

In this case (applying for instance to scenarios D2 and E2) the focus of attention shifts from the distorting effects of differential regulations to the competitive environment. The new entrants, if they have lower costs arising for example out of economies of scale or scope, may scoop the market; driving out inefficient home institutions. On the other hand, especially if the home market is imperfectly competitive to begin with, new entrants may find it advantageous to benefit from the non-competitive environment with larger profits from a smaller share of the market.

The likelihood of foreign entrants quickly sweeping up a large share of financial markets is questionable. The ability of an institution to trade effectively in financial markets depends on its creditworthiness. Even a major international bank or insurance company, though easily established in the money markets, will have to make an investment of time and resources

in establishing the requisite degree of confidence among non-financial corporate and household customers. This barrier to entry may not deter foreign competition if the newcomer's other costs are low, but the process will be a prolonged one and the benefits of trade will be slow in coming. Furthermore, especially if the market is already imperfectly competitive, the barriers may prevent the price of financial services from falling as much as they might in a fully integrated competitive equilibrium. For when the first newcomers are established they may be able to inhibit further foreign entrants by pricing just too low to make further entry across the barrier worthwhile.

It should be borne in mind that the application of host regulations already involves a barrier to entry, as foreign institutions will generally find it costly to effect the establishment of a subsidiary which complies with the regulations, quite apart from the risk of covert discriminatory administration of the regulations.

Are financial markets prone to imperfect competition? One reason for expecting some financial markets to exhibit imperfect competition is the possible existence of economies of scale and scope. Another is the very impact of certain regulations. In particular, quantitative restrictions on credit expansion, however desirable their objectives may be, are often thought to inhibit competition. Limitations on opening new branch offices can have a similar effect. Under such arrangements it could be the case that even the most inefficient institution preserves its market share, thereby allowing the others to make excess profits. If freedom of establishment simply admits a new member to such a comfortable arrangement, it is clear that little consumer gain may result.

While there may be some non-competitive pricing by financial institutions, little research has been done on the nature of this imperfect competition. Should we think of them as behaving cooperatively, as a cartel, or non-cooperatively with strategic but uncoordinated interactions? In short we are left with the ambiguity of a variety of possible results without knowing which one is empirically applicable.

The recent revisionist theory of contestable markets invites us to consider closely whether supposed barriers to entry arising from sunk costs of entry are real. It has been argued that in many non-financial cases investments are reversible; capital can be sold. However in the case of investments designed to build creditworthiness as discussed here, it seems clear that this critique is not applicable. The existence or importance of economies of scale or scope is hotly disputed. For many years researchers failed to find economies in banks except for very small firms; now these findings are being disputed on technical grounds and it seems likely that further

research using refined methodology will be better equipped to detect economies. Here we maintain the working assumption that such economies are potentially important. A detailed review of existing evidence on economies of scale will be undertaken in Part II of this study.

Our tentative conclusion is that freedom of establishment under host country regulations will not guarantee a fully competitive outcome with prices of financial services falling to the lowest possible. Bound by exchange controls the home customer cannot bypass the domestic market and seek the lowest price worldwide. Persistence of, or conceivably the introduction of, imperfectly competitive financial markets at home may well limit the welfare gains from freedom of establishment.

While quantification is difficult, we would deduce that the outcome of scenario D2 is likely to be less satisfactory than with the corresponding home country regime D1, and likewise E2 would prove preferable to E1.

Specific exemptions from exchange controls for financial institutions.

If rigid exchange controls are in effect and fully applicable to establishing financial institutions, the potential for these institutions to diversify their portfolio internationally is compromised. The result is that the institutions cannot fully achieve economies of diversification, of scale and of scope. The potential losses are not only the financial losses of having a less than optimally diversified portfolio, but also result from the additional resource costs of managing a separate portfolio, and indeed what will probably have to be substantially a separate operation altogether, as considerable decentralisation of decision making and control to the foreign branch or subsidiary under these circumstances is likely to occur. This cost penalty incurred by new entrants will obviously mean fewer threats to home institutions from low cost foreign operations, and correspondingly smaller consumer gains.

But exchange controls are often imposed to protect the official foreign exchange reserves from speculative raids, and the monetary authorities might be willing, without compromising this objective, to allow a foreign financial institution enough by way of exemptions from the controls to allow the institution to manage its portfolio on a global basis. For example, provided the aggregate net inflow or outflow of funds attributable to the institution was not a large fraction of its balance sheet, the official reserves would be secure, but the financial institution would not be constrained in its portfolio decisions (except, of course if it wished to undertake exchange rate speculation).

Quite apart from the efficiencies imparted to a bank or insurance company from being able to diversify its portfolio

sufficiently is the potential for stock-market related intermediaries to function in such a way as to provide, even in the presence of exchange controls, the international pooling of stock-market risks that is sought from an unified European stock-market. Already stocks are held across international borders through the medium of depository receipts which effectively give the stocks some of the characteristics of home securities. It is conceivable that de facto freedom of establishment of unit-trust type intermediaries with limited exchange control exemptions could generate, through somewhat analogous instruments, a major widening of investing opportunities for wealth holders, and cheaper sources of finance for corporate borrowers in several member countries even while the general regime of exchange controls persisted.

This discussion clearly favours the scenarios which are more liberal on the exchange control front, such as the E scenarios.

Ranking the possibilities

In terms of which set of circumstances, among the four scenarios permitting establishment, but hampered by exchange controls, is likely to yield the greatest consumer benefits, we may infer from the above discussion, tentative though it is, that a "host regulations" environment is less favourable than "home regulations", largely because it seems more likely to preserve non-competitive markets. The "home regulations" regime could also encourage non-competitive practices, but, as it would put pressure on many of the most distorting regulations, the outcome would probably be better.

Specific exemptions from exchange controls could offer cost savings to intermediaries, as well as widening the market, and are likely to offer advantages to the domestic consumer.

The proposed ranking of the four combinations is therefore:
E1 > D1 > E2 > D2.

Free Movement of Capital

To contrast the situation of exchange controls with freedom of establishment, this section briefly reviews some aspects of trade in financial services with freedom of capital movements, but restrictions on establishment, as in Scenarios B and C. The Commission's goal, as represented by scenarios A1 and A2 are also placed in context.

Sustainability of regulations.

It has already been argued that freedom of trade without freedom of establishment and in the presence of exchange controls (Scenario C) is unlikely to lead to any significant inroads being made by foreign producers of financial products.

On the other hand, with a regime of free movement of capital as in B, the presumption must be that business will flow to the lowest cost producer.

By definition of such freedom, it will no longer be possible to, maintain a "host country regulations" regime, as the producers of financial services will not have any particular dealings with the authorities of the countries in which they are not established. Accordingly the pressure on the authorities to dismantle controls which segment the market or impose cost penalties on home banks will be severe. Some regulations which might survive under exchange controls even with "home country regulations" will have more serious consequences if maintained under freedom of capital movements. For instance, it has been pointed out above that the existence of exchange controls can result in the required rate of return on equity capital differing from country to country, so that higher capital requirements might place a burden on shareholders without necessarily preventing the home financial institution from competing with a foreign institution. But with freedom of capital movements, equity will migrate to where it is better rewarded, and a home bank faced with high capital adequacy requirements might find it impossible to raise capital on terms which allow it to compete, even if the remainder of its cost structure is as low as the foreign bank.

This perspective suggests that scenario A2 will place considerable pressure on regulations that are more severe than the international norm, leading to a fairly rapid convergence of regulation and ultimately to the equivalence of A1 and A2.

However, it must be borne in mind that certain types of fiscal preference may be used very effectively to inhibit trade. For example, the import demand for life assurance is at present very weak in countries where only those premiums that are paid to an established domestic insurer are tax-deductible.

Cost reductions

Returning to Scenario B, the question to be asked is whether limitations on establishment might restrict the degree to which cost savings might be expected from a liberalisation of exchange controls. Basically, the costs imposed derive from the need to operate at a distance. Undoubtedly, this would compound the problem of establishing creditworthiness which, as already discussed, would grace a new entrant. Mail order financial services may not be attractive for many customers, corporate and household alike. On the other side of the confidence and creditworthiness equation, financial institutions themselves will be somewhat reluctant to extend credit or undertake insurance for customers about which they can know comparatively little, as will be the case if it is difficult for firms to a physical presence in a country in which they are neither established with a subsidiary nor have a branch. In practice therefore, cost savings might be

restricted to wholesale type business, or to standard products, where individual verification is not required, or is very easy. The practical relevance of this proposition is illustrated by the situation with what may be called the retail insurance market, in which there is practically no international trade in the community, with twelve separate national markets instead.

Impact on competitive structure

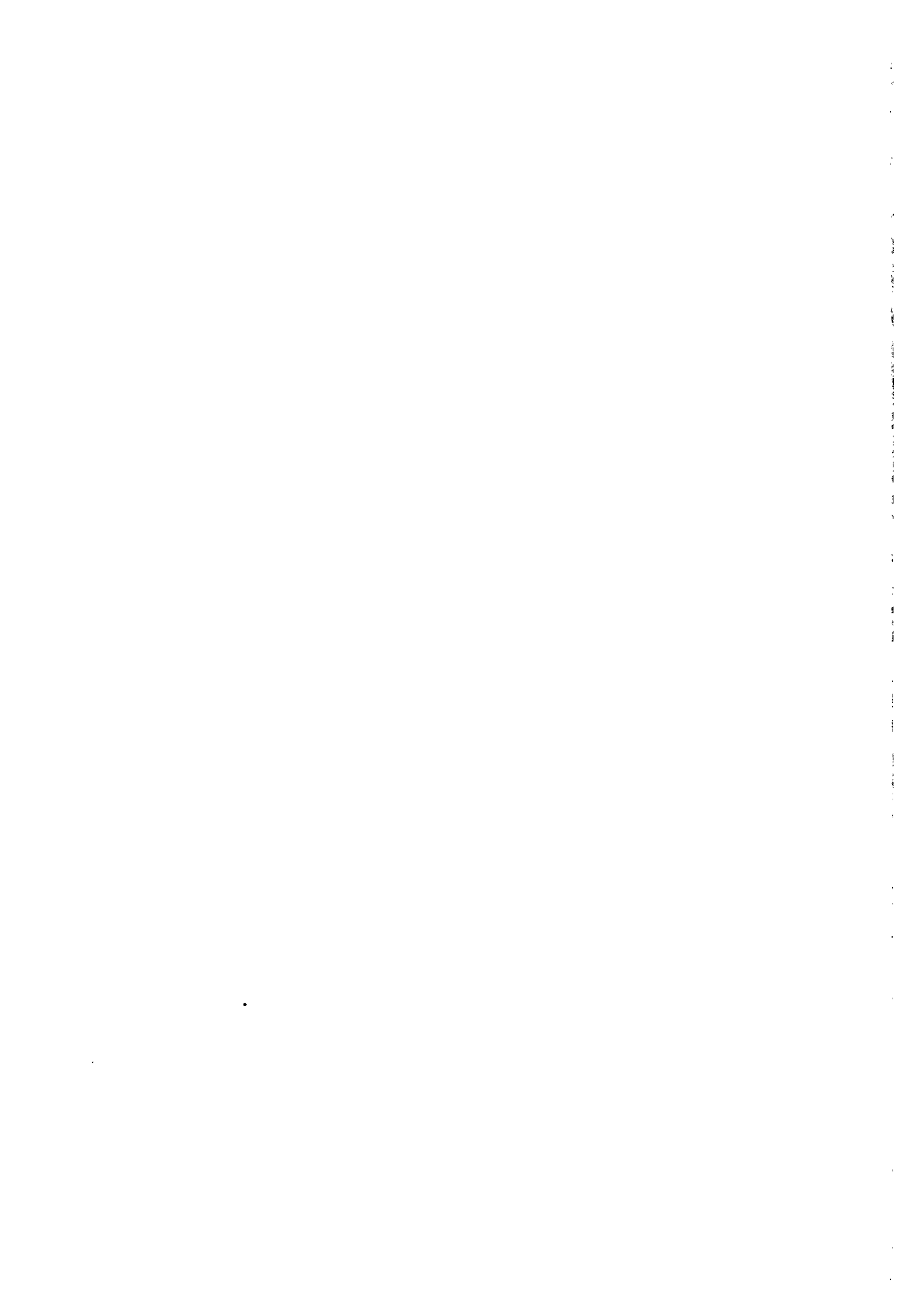
With the important exception of retail and face to face types of financial services, one would expect a general move towards competitive conditions in the financial marketplace following a move to freedom of capital flows. Indeed this is probably an accurate description of much of international banking and reinsurance today. It is not easy to see what forces could allow local pockets of financial market imperfection to exist. Nor is it likely that an extension of the market in Europe would create a concentration of market power that might ultimately work against the consumer. The large size of the existing global free financial markets is so large as to reduce fears that the addition of the parts of the European financial market which are now protected could have such a result.

Conclusion

The discussion in this section has necessarily been qualitative and somewhat speculative, reflecting the scarcity of relevant research findings. Furthermore, to avoid undue pedantry, only a selection of issues has been touched upon. The general conclusion however seems clear. Maintenance of strict exchange controls may well inhibit the full consumer benefits from freedom of trade and freedom of establishment for financial services in Europe. This is partly because financial institutions will not be able to avail of the economies of a wider market. Although an attempt to maintain a regime of strict regulations will run into difficulties under home country regulations, it is not certain that all of these regulations will create impossible competitive disadvantages for home financial institutions. Market segmentation rather than global loss of competitiveness may often be the consequence.

Under host country regulations, the result of freedom of establishment may be very little improvement where uncompetitive market structures exist or may result. In contrast, the prospect for welfare gains from a liberalisation of exchange controls does not seem to depend so heavily on freedom of establishment, at least for financial services of a wholesale or standard type. In terms of the scenarios outlined in the analysis, the three with freedom of capital movements, A1, A2 and B, dominate the rest in welfare terms.

**APPENDIX 4: DETAILED TABLES ON OVERVIEW OF AREAS OF
COMPETITION BETWEEN FINANCIAL INSTITUTIONS**



COMPARATIVE OVERVIEW OF AREAS OF COMPETITION BETWEEN FINANCIAL INSTITUTIONS IN 1986

The key below applies to the columns (institutions) in all the following tables:

- 1 Clearing/commercial banks
- 2 Merchant banks
- 3 Savings banks
- 4 Postal and giro banks
- 5 Credit unions
- 6 Mortgage credit institutions/building societies
- 7 HP finance companies
- 8 Leasing companies
- 9 Factors
- 10 Life assurance companies
- 11 General assurance companies
- 12 Reinsurance companies
- 13 Investment funds
- 14 Unit trusts
- 15 Pension funds
- 16 Stockbrokers
- 17 Commodities brokers
- 18 Money brokers

In the following Table 1 series, the following key applies to the cell entries:

- a very significant
- b significant
- c minor significance

In the following Table 2 series, the following key applies to the cell entries:

- a large
- b medium
- c small

Country: West Germany

Table 1 Extent to which different institutions are significant in different service areas

Services	Institutions																	
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1 Current (checking) account	b	a	b	a	c													
2 Retail deposits	b	a	b	a	b	c												
3 Money market deposits/loans	a	c																
4 Eurocurrency deposits	a	c																
5 Offshore banking	a																	
6 Foreign exchange	a	c																
7 Travellers cheques	a	a		c	c													
8 Hire purchase/consumer finance	a	a		a	c	b			b	b								
9 Credit cards	b	a	c	a	c													
10 House mortgages	b	a		b	a				c	b	c							
11 Factories, export credit	a	c		c	c			a										
12 Leasing	a							a										
13 Venture capital	a						a											
14 Business loans	a	c		c	c	c	c	c										
15 International lending	a	c																
16 Investment in stock market assets	a	a		c	c		c	c					b	b	b			
17 Loan guarantees	a	c		c														
18 Investment and corporate finance advice	a	c						c	c				c	c				
19 Life assurance	c	c							a									
20 Accident insurance (direct)																		
- motor	c	c								a								
21 - employer's liability	c	c								b								
22 - other										c								
23 Reinsurance												a						
24 Investment fund management	a	b		b									a					
25 Unit trust management	a													a				
26 Pension services	c	c													a			
27 Securities: underwriting, new issues and placement	a	c																
28 Securities broking	a	a		a												a		
29 Money broking	a																	a
30 Bullion and other commodities trading	a																	a

Note: Germany operates a universal banking system

Country: France

Table 1 Extent to which different institutions are significant in different service areas

Services	Institutions																	
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1 Current (checking) account	a		b	c	a	c												
2 Retail deposits	a		b	b	a	c	c											
3 Money market deposits/loans	a	a	c		c													
4 Eurocurrency deposits	a	a																
5 Offshore banking	a																	
6 Foreign exchange	a		c															
7 Travellers cheques	a		c		c													
8 Hire purchase/consumer finance	b				b	c	a											
9 Credit cards	a		c		a													
10 House mortgages	a		c		a	c												
11 Factories, export credit	a				c			a										
12 Leasing	a							a										
13 Venture capital	a				c													
14 Business loans	a		c		b													
15 International lending	a		c															
15 Investment in stock market assets	b		a		c								a	a	b			
17 Loan guarantees	a		c		c													
18 Investment and corporate finance advice	a	a																
19 Life assurance	c								a									
20 Accident insurance (direct)																		
- motor											a							
21 - employer's liability											b							
22 - other	c																	
23 Reinsurance												a						
24 Investment fund management	b	b											a					
25 Unit trust management		b												a				
26 Pension services															a			
27 Securities: underwriting, new issues and placement	a	a																
28 Securities broking																a		
29 Money broking																		a
30 Bullion and other commodities trading		a																a

Note: Most large banks undertake merchant banking activities

Country: Italy

Table 2 Proportion of total business of financial institutions accounted for by different service areas

Services	Institutions																	
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1 Current (checking) account	c	b	a	b	c													
2 Retail deposits	a	a	a	a	a	c												
3 Money market deposits/loans	b	a	c	c														
4 Eurocurrency deposits	a																	
5 Offshore banking	c																	
6 Foreign exchange	c	c																
7 Travellers cheques	c	c	c															
8 Hire purchase/consumer finance	c	a	a	a	a			b	b	b								
9 Credit cards	c	c																
10 House mortgages	c					b												
11 Factories, export credit	c			c				a										
12 Leasing	c						a											
13 Venture capital	c			c														
14 Business loans	a	c		b														
15 International lending	c	c	c															
16 Investment in stock market assets	a	c										a	a	a				
17 Loan guarantees	c			c														
18 Investment and corporate finance advice	c	a		c														
19 Life assurance								a										
20 Accident insurance (direct)																		
- motor										a								
- employer's liability										b								
- other																		
23 Reinsurance											a							
24 Investment fund management	b											a						
25 Unit trust management	b												a					
26 Pension services														a				
27 Securities: underwriting, new issues and placement		a																
28 Securities broking															a			
29 Money broking																	a	
30 Bullion and other commodities trading																a		

Country: United Kingdom

Table 1 Extent to which different institutions are significant in different service areas

Services	Institutions																	
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1 Current (checking) account	a	b	c	c														
2 Retail deposits	a	b	b	a														
3 Money market deposits/loans	a	a	c	c	c													
4 Eurocurrency deposits	a	a																
5 Offshore banking	a																	
6 Foreign exchange	a	c	c	c														
7 Travellers cheques	a	c	c															
8 Hire purchase/consumer finance	a	b	c	c	a													
9 Credit cards	a	c	c	c														
10 House mortgages	b	c	c	a					c									
11 Factories, export credit	a	c	c					a										
12 Leasing	a	c	c				a											
13 Venture capital	a																	
14 Business loans	a	c	c															
15 International lending	a																	
16 Investment in stock market assets	b	c		c									a	a	a			
17 Loan guarantees	a																	
13 Investment and corporate finance advice	a	a															a	
19 Life assurance	c	c						a										
20 Accident insurance (direct)																		
- motor	c	c							a									
21 - employer's liability																		
22 - other	c	c																
23 Reinsurance					c						a							
24 Investment fund management	b	b										a						
25 Unit trust management	b	b											a					
25 Pension services														a				
27 Securities: underwriting, new issues and placement	a	a																
23 Securities broking		b													a			
29 Money broking																		a
30 Bullion and other commodities trading																		a

Note: Most large banks undertake merchant banking activities

Country: Belgium

Table 1 Extent to which different institutions are significant in different service areas

Services	Institutions																	
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1 Current (checking) account	a		b	c	c	c												
2 Retail deposits	a		a	c	a	c												
3 Money market deposits/loans	a	a	c		c													
4 Eurocurrency deposits	a																	
5 Offshore banking	a																	
6 Foreign exchange	a		c															
7 Travellers cheques	a																	
8 Hire purchase/consumer finance	a		c		c		a											
9 Credit cards	a		b															
10 House mortgages	b		b		c	b	c											
11 Factories, export credit	a		c		c			a										
12 Leasing	a				c			a										
13 Venture capital	a				a													
14 Business loans	a		c		b													
15 International lending	a		c															
16 Investment in stock market assets	a	a	c		c								a	a	a			
17 Loan guarantees	a																	
18 Investment and corporate finance advice	a	a	c		c												a	
19 Life assurance	c							a										
20 Accident insurance (direct)																		
- motor											a							
21 - employer's liability											b							
22 - other																		
23 Reinsurance												a						
24 Investment fund management	a	b											a					
25 Unit trust management	a	b												a				
26 Pension services															a			
27 Securities: underwriting, new issues and placement	a	a																
28 Securities broking	a															a		
29 Money broking																		a
30 Bullion and other commodities trading			a															a

Note: Most large banks undertake merchant banking activities

Country: Luxembourg

Table 1 Extent to which different institutions are significant in different service areas

Services	Institutions																	
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1 Current (checking) account	a	a		c														
2 Retail deposits	a	a		c	c	c												
3 Money market deposits/loans	a	a				c												
4 Eurocurrency deposits	a	b																
5 Offshore banking	a																	
6 Foreign exchange	a	c		c														
7 Travellers cheques	a	b		c														
8 Hire purchase/consumer finance	a	c		a		a												
9 Credit cards	a	c																
10 House mortgages	c	a		c	c													
11 Factories, export credit	a	a		c				a										
12 Leasing	a	a					a											
13 Venture capital	a																	
14 Business loans	a	a		c														
15 International lending	a																	
16 Investment in stock market assets	a	a																
17 Loan guarantees	a	c		c														
18 Investment and corporate finance advice	a	c																
19 Life assurance	c									a								
20 Accident insurance (direct)																		
- motor	c										a							
21 - employer's liability																		
22 - other	c																	
23 Reinsurance												a						
24 Investment fund management	a	c											a					
25 Unit trust management	a	c												a				
26 Pension services	a														a			
27 Securities: underwriting, new issues and placement	a															a		
28 Securities broking	a																	
29 Money broking	a																	
30 Bullion and other commodities trading	a																	

Note: Luxembourg operates a universal banking system

Country: Netherland

Table 1 Extent to which different institutions are significant in different service areas

Services	Institutions																	
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1 Current (checking) account		b	b	a	b	c												
2 Retail deposits		b	b	b	a	c	c											
3 Money market deposits/loans	a		c															
4 Eurocurrency deposits	a		c															
5 Offshore banking	a																	
6 Foreign exchange	a		c															
7 Travellers cheques	a		c		c													
8 Hire purchase/consumer finance		b	b		b	c	a											
9 Credit cards		a	c		c													
10 House mortgages		a	b	b	a	c				b								
11 Factories, export credit		a			c	c		a										
12 Leasing		a					a	a										
13 Venture capital		b																
14 Business loans		a	c		b	c	c	c	c									
15 International lending		a	c															
16 Investment in stock market assets	a	a	b		b	c		c	c									
17 Loan guarantees		a	c		c													
18 Investment and corporate finance advice	a	a	b		b			c	c				c	c				
19 Life assurance		b	c						a									
20 Accident insurance (direct)																		
- motor		b	c							a								
21 - employer's liability										a								
22 - other		c	c							c								
23 Reinsurance												a						
24 Investment fund management	a	a			b								a					
25 Unit trust management		a			b									a				
26 Pension services		c	c												a			
27 Securities: underwriting, new issues and placement	a	a	b	b														
28 Securities broking																a		
29 Money broking	a																	a
30 Bullion and other commodities trading		a																a

Note: Netherlands operates a universal banking system

Country: Spain

Table 1 Extent to which different institutions are significant in different service areas

Services	Institutions																	
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1 Current (checking) account	a		c															
2 Retail deposits	a	a	a	a	a	c	c											
3 Money market deposits/loans	a	a																
4 Eurocurrency deposits	a	c																
5 Offshore banking	a																	
6 Foreign exchange	a	c																
7 Travellers cheques	a	c		c														
8 Hire purchase/consumer finance	a	a		b	a	a												
9 Credit cards	a	c		c														
10 House mortgages	a			c	c													
11 Factories, export credit	a	a						c										
12 Leasing	a						a											
13 Venture capital	b			c														
14 Business loans	a	c		b														
15 International lending	a																	
15 Investment in stock market assets	a	a										a	a	a				
17 Loan guarantees	a	c		c														
18 Investment and corporate finance advice	a	c		c			c	c										
19 Life assurance	a	c							a									
20 Accident insurance (direct)																		
- motor	a	c								a								
21 - employer's liability										b								
22 - other	a	c																
23 Reinsurance												a						
24 Investment fund management	a	a											a					
25 Unit trust management	a													a				
26 Pension services	c														a			
27 Securities: underwriting, new issues and placement	a																	
28 Securities broking																a		
29 Money broking																		a
30 Bullion and other commodities trading																	a	

Note: Most large banks undertake merchant banking activities

APPENDIX 5: BASIS FOR WEIGHTING SYSTEM USED IN PRICE COMPARISONS

BELGIUM

<u>Product</u>	<u>Basis</u>
Commercial loans	Weighted by bank loans, discount credits and acceptances to manufacturing industry, multiplied by the interest charged on commercial loans in excess of the interbank rate.
Mortgages	Weighted by mortgages outstanding multiplied by the excess of the average mortgage rate over money market rates in 1986.
Consumer Credit	Weighted by 25% of the claims of Commercial Banks on the Private Sector, multiplied by the interest charged on consumer credit in excess of the money market interest rate.
Credit Cards	Weighted by figures on credit outstanding on credit cards multiplied by the margin on credit cards. Based on UK data on credit outstanding on credit cards adjusted by number of credit cards used in Belgium.
Travellers Cheques	Weighted by 25% of tourism receipts and expenditures multiplied by the percentage cost of purchasing travellers cheques.
Foreign Exchange Drafts	Assumed to have the same weight as letters of credit.
Letters of Credit	Weighted by 20% of bank loans to the manufacturing sector multiplied by margins on letters of credit.

GERMANY

<u>Product</u>	<u>Basis</u>
Commercial Loans	Weighted by lending to domestic enterprises and self employed in manufacturing multiplied by the interest charged on commercial borrowing in excess of the interbank rate.
Mortgages	Weighted by mortgages outstanding multiplied by the excess of the average mortgage rate over money market rates in 1986.
Consumer Credit	Weighted by lending to individuals excluding housing multiplied by the interest charge on consumer credit in excess of the money market rate.
Credit Cards	Weighted by figures on credit outstanding on credit cards multiplied by the margin on credit cards. Based on UK data on credit outstanding on credit cards adjusted by number of credit cards used in Germany.
Travellers Cheques	Weighted by 25% of tourism receipts and expenditures multiplied by the percentage cost of purchasing travellers cheques.
Foreign Exchange Drafts	Assumed to have the same weight as letters of credit.
Letters of Credit	Weighted by 20% of bank loans to the manufacturing sector multiplied by margins on letters of credit.

SPAIN

<u>Product</u>	<u>Basis</u>
Commercial Loans	Weighted by credit to the private manufacturing sector for productive activity multiplied by the excess of interest rate charges on commercial loans over the interbank rate.
Mortgages	Weighted by mortgages outstanding multiplied by the excess of the average mortgage rate over money market rates in 1986.
Consumer Credit	Weighted by 25% of bank lending to enterprises and families multiplied by the excess interest charge on consumer credit over money market rates.
Credit Cards	Weighted by figures on credit outstanding on credit cards multiplied by the margin on credit cards. Based on UK data on credit outstanding on credit cards adjusted by number of credit cards used in Spain.
Travellers Cheques	Weighted by 25% of tourism receipts and expenditures multiplied by the percentage cost of purchasing travellers cheques.
Foreign Exchange Drafts	Assumed to have the same weight as letters of credit.
Letters of Credit	Weighted by 20% of bank loans to the manufacturing sector multiplied by margins on letters of credit.

FRANCE

<u>Product</u>	<u>Basis</u>
Commercial Loans	Weighted by credit to manufacturing multiplied by excess of commercial interest rate charges over the interbank rate.
Mortgages	Weighted by mortgages outstanding multiplied by the excess of the average mortgage rate over money market rates in 1986.
Consumer Credit	Weighted by 25% of estimated personal credit multiplied by the interest charge on consumer credit in excess of the money market rate.
Credit Cards	Weighted by figures on credit outstanding on credit cards multiplied by the margin on credit cards. Based on UK data on credit outstanding on credit cards adjusted by number of credit cards used in France.
Travellers Cheques	Weighted by 25% of tourism receipts and expenditures multiplied by the percentage cost of purchasing travellers cheques.
Foreign Exchange Drafts	Assumed to have the same weight as letters of credit.
Letters of Credit	Weighted by 20% of bank loans to the manufacturing sector multiplied by margins on letters of credit.

ITALY

<u>Product</u>	<u>Basis</u>
Commercial Loans	Weighted by bank loans to manufacturing multiplied by the excess of commercial interest rate charges over the interbank rate.
Mortgages	Weighted by mortgages outstanding multiplied by the excess of the average mortgage rate over money market rates in 1986.
Consumer Credit	Weighted by 25% of estimated personal credit multiplied by the interest charge on consumer credit in excess of money market rates.
Credit Cards	Weighted by figures on credit outstanding on credit cards multiplied by the margin on credit cards. Based on UK data on credit outstanding on credit cards adjusted by number of credit cards used in Italy.
Travellers Cheques	Weighted by 25% of tourism receipts and expenditures multiplied by the percentage cost of purchasing travellers cheques.
Foreign Exchange Drafts	Assumed to have the same weight as letters of credit.
Letters of Credit	Weighted by 20% of bank loans to the manufacturing sector multiplied by margins on letters of credit.

NETHERLANDS

Product

Basis

Commercial Loans	Weighted by universal banks credits and loans to manufacturing multiplied by the interest charge on commercial loans in excess of the interbank rate.
Mortgages	Weighted by mortgages outstanding multiplied by the excess of the average mortgage rate over money market rates in 1986.
Consumer Credit	Weighted by 25% of credit to individuals multiplied by the interest charge on consumer credit in excess of the money market rate.
Credit Cards	Weighted by figures on credit outstanding on credit cards multiplied by the margin on credit cards. Based on UK data on credit outstanding on credit cards adjusted by number of credit cards used in the Netherlands.
Travellers Cheques	Weighted by 25% of tourism receipts and expenditures multiplied by the percentage cost of purchasing travellers cheques.
Foreign Exchange Drafts	Assumed to have the same weight as letters of credit.
Letters of Credit	Weighted by 20% of bank loans to the manufacturing sector multiplied by margins on letters of credit.

UK

Product

Basis

Commercial Loans	Weighted by loans and advances outstanding from the UK monetary sector to resident manufacturing companies multiplied by the interest charge on commercial loans in excess of the interbank rate.
Mortgages	Weighted by mortgages outstanding multiplied by the excess of the average mortgage rate over money market rates in 1986.
Consumer Credit	Weighted by 25% of consumer credit to the private sector multiplied by the interest charge on consumer credit in excess of money market rates.
Credit Cards	Weighted by figures on credit outstanding on credit cards multiplied by the margin on credit cards.
Travellers Cheques	Weighted by 25% of tourism receipts and expenditures multiplied by the percentage cost of purchasing travellers cheques.
Foreign Exchange Drafts	Assumed to have the same weight as letters of credit.
Letters of Credit	Weighted by 20% of bank loans to the manufacturing sector multiplied by margins on letters of credit.

LUXEMBOURG

Product

Basis

Commercial Loans	Weighted by estimated bank loans to manufacturing multiplied by margin on commercial loans.
Mortgages	Weighted by estimated mortgages outstanding multiplied by the excess of rates over money market rates. Estimates based on Belgium data on the basis of the ratio of Luxembourg/Belgium population.
Consumer Credit	Weighted by 25% of estimated consumer credit multiplied by interest rate in excess of money market rates. Estimated data based on Belgium data on the basis of the ratios of populations.
Credit Cards	Weighted by figures on credit outstanding on credit cards multiplied by the margin on credit cards. Based on UK data on credit outstanding on credit cards adjusted by number of credit cards used in Luxembourg.
Travellers Cheques	Weighted by 25% of estimated tourism receipts and expenditures multiplied by the percentage cost of purchasing travellers cheques. Estimates based on Belgium data on the basis of the ratio of bednights spent by foreign tourists in Luxembourg in all means of accommodation to that in Belgium.
Foreign Exchange Drafts	Assumed to have the same weight as letters of credit.
Letters of Credit	Weighted by 20% of estimated bank loans to the manufacturing sector multiplied by margins on letters of credit.

**APPENDIX 6: MAPPING OF FINANCIAL SERVICE GROUPINGS USED
IN DIFFERENT SECTIONS OF THE REPORT**

Appendix 5 lists eighteen institutions and thirty services which they provide in various combinations across different countries.

Appendix 4 describes ten main service activities in the financial sector. The table overleaf lists the eighteen institutions and shows how the thirty services in Appendix 5 are linked to the 10 main service activities of Appendix 4.

LINKS BETWEEN GROUPS OF FINANCIAL SERVICES

Eighteen Institutions	Thirty Services	Ten Main Service Activities
I1 Clearing Banks	S1 Current Checking A/c's	MSA1 International and Domestic Commercial Banking -S4, S6, S11 S14, S15, S17
I2 Merchant Banks	S2 Retail Deposits	
I3 Savings Banks	S3 Money Market Deposits/Loans	
I4 Postal/Giro Banks	S4 Eurocurrency Deposits	MSA2 International and Domestic Private Banking - S1, S2, S4 S7, S12, S13, S15, S17
I5 Credit Unions	S5 Offshore Banking	
I6 Mortgage Institutions	S6 Foreign Exchange	
I7 Financial Companies	S7 Travellers Cheques	MSA3 Corporate Finance S18, S27
I8 Leasing Companies	S8 Hire Purchase/Consumer Finance	
I9 Factors	S9 Credit Cards	
I10 Life AssuranceCos	S10 House Mortgages	MSA4 Offshore Banking- S5
I11 General Assurance Cos	S11 Factories, export credit	MSA5 Money Market
I12 Reinsurance Cos	S12 Leasing	Activities-S3, S29
I13 Investment Funds	S13 Venture Capital	MSA6 Broking-S16, S18, S28
I14 Unit Trusts	S14 Business Loans	MSA7 Fund Management - S24, S25, S26
I15 Pension Funds	S15 International Lending	MSA8 Consumer Credit - S8, S9, S10
I16 Stockbrokers	S16 Investment in Stock Mkt.	
I17 Commodity Brokers	S17 Loan Guarantees	MSA9 Assurance, Insurance & Reinsurance -S19, S20, S21, S22, S23
I18 Money Brokers.	S18 Investment and Corporate Finance Advice	
	S19 Life Assurance	MSA10 Commodities Exchange Business -S30
	S20 Accident Insurance - Motor	
	S21 Employers liability	
	S22 Other	
	S23 Reinsurance	
	S24 Investment Fund Management	
	S25 Unit Trust Management	
	S26 Pension Services	
	S27 Securities - underwriting etc.	
	S28 Securities Broking	
	S29 Money Broking	
	S30 Bullion and Commodity Trading.	

In Section 3 the data on employment are taken from Eurostat for most countries. The classifications are:

- 81 Banking and Finance
- 82 Insurance
- 81 + 82 Total Banking, Finance and Insurance

These correspond to NACE categories 81, 82 and 81+82 respectively in Eurostat publications. Under the heading "Banking and Finance" is included the first nine (I1-I9) of the eighteen institutions listed above together with I13, I14, I15 and some parts of I16 to I18 and central banks. Those parts of I16 to I18 which are excluded are brokers acting only as agents in transactions. Financial Brokers acting only as agents would be included in NACE 83, Business Services to Enterprises. In practice the degree of adherence to these principles varies between countries.

The data on value added in Section 3 are taken from Eurostat National Accounts, branch 69, Credit and Insurance. In the European System of Accounts branches are units of homogeneous production and are intended to highlight technico-economic relationships in the economy. Branch 69 corresponds to NACE 81 + 82 as defined above.

In Section 5 of the report national accounts data on net interest and dividends were drawn from Eurostat sectoral accounts. In contrast to the branch analysis, referred to above, the sectoral analysis is based on an institutional breakdown of economic activity intended to highlight income flows and the behavioural relationships among economic agents. Institutions are defined generally as units which keep a complete set of accounts. The sectors used in this part of the study were:

Credit Institutions	S40
Insurance Enterprises	S50
Credit and Insurance Enterprises	S40 + S50

The degree of correspondence between S40 and S50 and branch 69 is reasonably close for most countries. Brokers not acting in principals are not included in these sectors.

**APPENDIX 7: USE OF HERFINDAHL INDEX TO ESTIMATE ECONOMIC
WELFARE GAINS**

As indicated in the report the estimates of consumer surplus may overestimate economic welfare gains by the extent to which there is any loss in producer surplus. One approach to considering this issue is to assume that in a concentrated sector the potential for realising oligopoly profits is greater. It is of course plausible that intense competition could exist in a concentrated industry. It is however useful to consider the impact on net economic welfare gain of assuming that a reduction in producer surplus would result in an integrated financial services market. In this appendix it is further assumed that the Herfindahl index can be used as a measure of concentration.

Before we present the results of this analysis it is useful to consider in more detail the possible link from the Herfindahl index to industrial concentration to oligopoly profits and the loss of producer surplus. The basic concept is that the Herfindahl index is a measure of concentration and the more concentrated the sector the greater will be its ability to earn oligopoly profits. To the extent to which profits in excess of competitive profits exist it is assumed that this implies that part of the price reductions in an integrated market would result from a reduction in profits. The extent to which this incurs represents a loss in producer surplus.

The Herfindahl index is a measure of concentration that is based on the sum of squares of the percentage market shares of the companies in a country. For illustrative purposes consider an example of the banking sector in two countries A and B. Let us assume that for simplicity that there are five banks in each country but in country A, each holds 20 per cent of the market while in B three banks each have 30 per cent of the market while the remaining two hold five per cent. In the example the Herfindahl index would be calculated as:

$$\text{Country A } [0.2^2] \times 5 = 0.2$$

$$\text{Country B } ([0.3^2] \times 3) + [(0.5^2) \times 2] = 0.275$$

The higher level of concentration in country B is reflected in the higher value of the Herfindahl index.

High levels of concentration may be taken as an indication of the potential degree of monopoly or oligopoly power. In such markets firms may be able to affect market prices.

Herfindahl Index

Estimates of the Herfindahl Index for European countries were available for 1973 (1) while data was not available to us to directly update the Herfindahl Index, information on the concentration ratio for the three largest banks was available for 1983. (2) Research by Honohan and Kinsella (1) indicated that the three bank concentration ratios were highly correlated with estimates for Herfindahl Index. Our estimates of the Herfindahl Index used in our base case are based on updating the 1973 estimates by the percentage changes in the combined concentration ratios for commercial banks and all banking institutions, compared with the 1973 estimates. Given the nature of these calculations caution should be exercised in comparing these estimates and it would be useful to estimate an update of the Herfindahl Index when data becomes available. This is however unlikely to significantly alter the estimates of economic welfare gains.

In the table below estimates of the Herfindahl Index for different countries are presented.

<u>Country</u>	<u>Herfindahl Index</u>
B	0.119
D	0.046
ES	0.086
F	0.086
I	0.050
LU	0.086
N	0.177
UK	0.036

(1) Honohan, P. Kinsella R.P., "Company Bank Concentration Ratios Across Countries ", Journal of Banking and Finance, (6) 1982.

(2) Revell, J, "Margins and the Role of Large Banks", Institute of European Finance, Research Monograph, No. 2 1982.

Base Case Estimates

In the table below we estimate the impact of subtracting the estimates of producer surplus using the methodology outlined above. The results indicate that the economic welfare gains would be of the order of 18,137m ECUs.

**Estimated Gain in Economic Welfare Resulting from Integration of
European Credit and Insurance Markets**

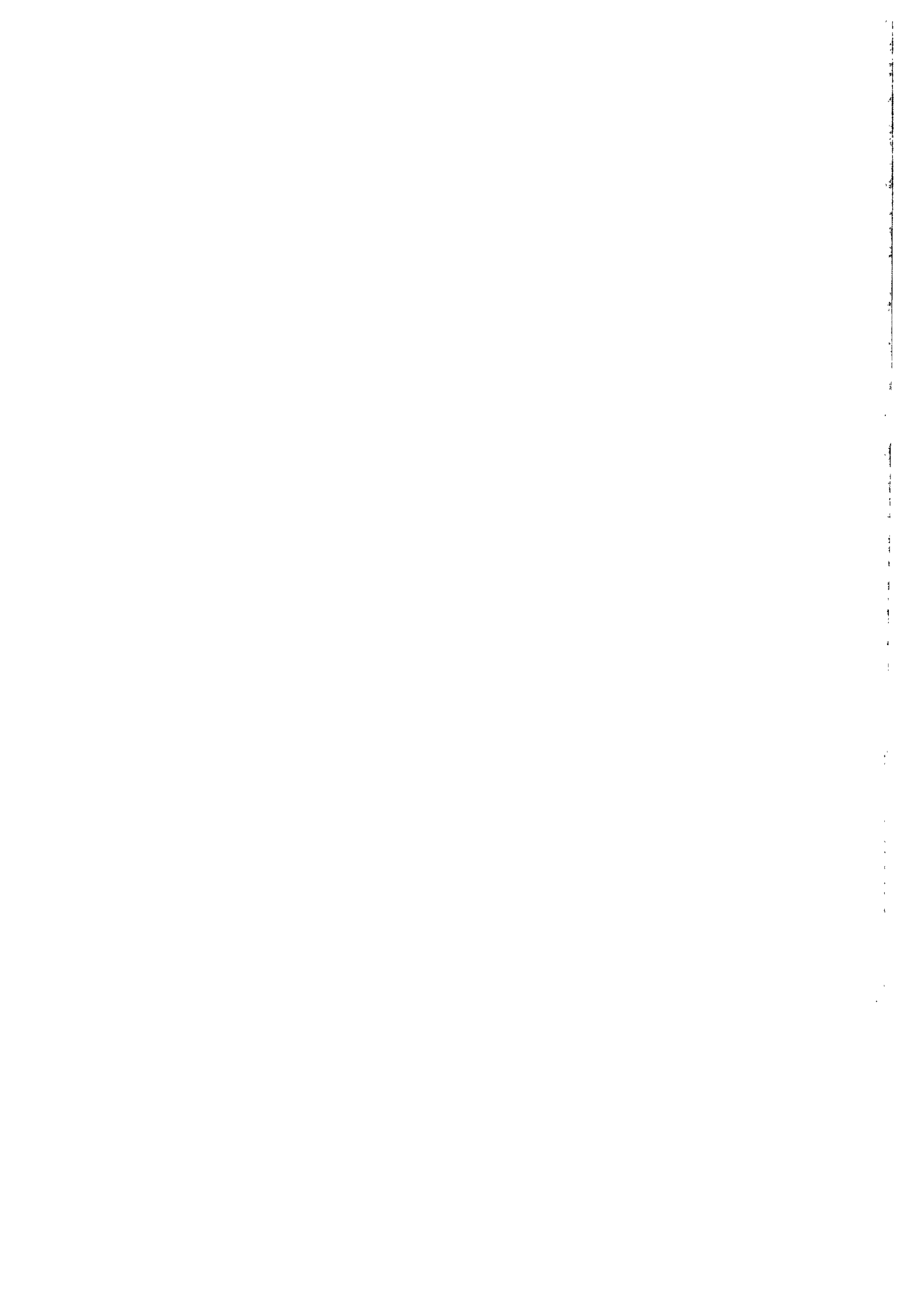
	<u>ECUs M</u>
Total for Eight Countries	18,137

In view of the methodological difficulties of using the above approach to estimate net economic welfare gains we have not presented the above results in the text of the report. The results may however be useful in providing some guidance on the potential loss in producer surplus. Alternative approaches to this important issue may be a useful area for further research.

STATISTICAL ANNEX

TO THE "COST OF NON-EUROPE" IN FINANCIAL SERVICES

Providing a detailed sectoral analysis
of financial services



1. INTRODUCTION

This statistical annex, was presented by Price Waterhouse as background material in connection with a study of the costs of "Non Europe", which was undertaken for the European Commission.

In this document we present a detailed sectoral analysis of financial services in the eight countries examined. While every effort has been made to obtain consistent data for each of the countries examined, the absence of consistent detailed sectoral data from either international or national sources, dictated the need to utilise a wide range of data sources. This has enabled a much more comprehensive sectoral analysis to be undertaken. We have converted all of the data for each of the national countries to ECUs in order to facilitate comparisons.



CONTENTS

1	INTRODUCTION	Page
2.	BANKING AND CREDIT	1
2.1	Germany	1
2.2	France	13
2.3	Italy	22
2.4	United Kingdom	34
2.5	Belgium	47
2.6	Luxembourg	58
2.7	Netherlands	67
2.8	Spain	78
3.	INSURANCE	89
3.1	Germany	89
3.2	France	100
3.3	Italy	108
3.4	United Kingdom	112
3.5	Belgium	118
3.6	Luxembourg	125
3.7	Netherlands	128
3.8	Spain	134
4.	BROKERAGE AND SECURITIES	140
4.1	Germany	140
4.2	France	148
4.3	Italy	155
4.4	United Kingdom	161
4.5	Belgium	168
4.6	Luxembourg	174
4.7	Netherlands	178
4.8	Spain	187

2 BANKING AND CREDIT

2.1 Germany

Statistical Overview

- Table 1 Balance sheet totals of German banking institutions
- Table 2 Number of monthly reporting banks and their classification by size
- Table 3 Asset and liability breakdown of all universal banks as a percentage of year-end total 1980-84
- Table 4 Asset and liability breakdown for commercial banks, savings banks, central giro institutions, regional giro institutions, regional institutions of credit co-operatives and credit co-operatives as a percentage of year-end total 1984
- Table 5 Foreign bank representation in Germany
- Table 6 Balance sheet structure of foreign banks and other categories of banks in Germany

Table 1 Balance sheet totals of German banking institutions

	ECU million		Number of banks in	
	Oct 1986	Jan 1986	Oct 1986	Jan 1986
A Multi-purpose banks				
1 Commercial Banks				
Big banks	142,803	127,894	6	6
Regional banks and other commercial banks	166,169	151,808	99	98
Branches of foreign banks	34,432	37,345	64	63
Private banks	21,237	17,128	70	69
Total	364,640	334,175	239	236
2 Savings Banks	358,399	325,995	590	590
3 Central Giro Institutions	259,399	235,741	12	12
4 Regional Institutions of Credit Companies	71,665	63,225	8	8
5 Co-operative Banks	206,783	190,149	3,604	3,654
Total Multi-purpose Banks	1,260,662	1,149,285	4,453	4,500
B Specialist Banks				
1 Mortgage Banks				
Private	150,096	136,612	25	25
Public	86,265	79,893	12	12
Total	236,321	216,505	37	37
2 Instalment Credit Institutions	19,984	16,850	85	89
3 Banks with Special Functions	113,343	103,115	16	16
4 Postal Giro and Postal Savings Banks	23,851	22,544	15	15
5 Foreign Banks	68,958	-	112	-
Total Specialist Banks	462,456	360,391	265	157
C Total All Categories of Banks	1,654,161	1,509,677	4,606	4,657
D Building Societies	75,128	72,992	30	31
Private	50,926	49,511	17	18
Public	24,201	23,481	13	13

Table 2 Number of monthly reporting banks and their classification by size (December 1985)

Category of banks	A	B	C	D	E	F	G	H	I	J
Commercial banks	236	10	13	8	31	35	24	27	67	21
Big banks(2)	6	-	-	-	-	-	-	-	-	6
Regional banks and other commercial banks(5)	98	3	3	3	11	12	9	11	34	12
Branches of foreign banks	63	-	2	2	9	11	6	8	22	3
Private bankers(6)	69	7	8	3	11	12	9	8	11	-
Regional giro institutions (inc Deutsche Girozentrale)	12	-	-	-	-	-	-	-	-	12
Savings banks	590	-	-	3	6	76	134	171	181	19
Regional institutions of credit co-operatives (inc Deutsche										
Genossenschaftsbank)	9	-	-	-	-	-	-	-	3	6
Credit co-operatives (3)	3,655	59	547	998	984	729	228	75	34	1
Mortgage banks	37	-	-	-	1	2	2	1	5	26
Private	25	-	-	-	1	1	-	1	4	18
Public	12	-	-	-	-	1	2	-	1	8
Instalment sales financing institutions	89	15	9	10	12	12	12	11	7	1
Banks with special functions	16	-	-	1	-	-	2	2	1	10
Postal giro and postal savings bank offices	15	-	-	-	-	1	3	6	13	8
Building and loan associations	31	-	-	-	-	1	3	3	7	4
Private	18	-	-	-	-	1	3	3	7	4
Public	13	-	-	-	-	-	-	3	6	4
Total(4)										
excluding building and loan associations	4,659	(84)	(569)	(1,020)	(1,034)	(854)	(402)	(287)	(298)	(96)
including building and loan associations	4,690	(84)	(569)	(1,020)	(1,034)	(855)	(405)	(293)	(311)	(104)

Key:

- A Total number of monthly reporting banks(1)
- B Less than ECU 4.56 million
- C ECU 4.56 million to less than ECU 11.39 million
- D ECU 11.39 million to less than ECU 22.79 million
- E ECU 22.79 million to less than ECU 45.58 million
- F ECU 45.58 million to less than ECU 113.95 million
- G ECU 113.95 million to less than ECU 227.89 million
- H ECU 227.89 million to less than ECU 455.79 million
- I ECU 455.79 million to less than ECU 2278.9 million
- J ECU 2278.9 million and over

Source: Monthly Report of the Deutsche Bundesbank, vol 38, no 4, April 1987

Notes:

- 1 Including banks in liquidation
- 2 Deutsche Bank AG, Dresdner Bank AG, Commerzbank AG, and their Berlin subsidiaries
- 3 Including other banks not organised in the form of a co-operative but affiliated to the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken eV. Up to December 1971 the figures for credit co-operatives (Schulze-Delitzsch) and credit co-operatives (Raiffeisen) were recorded and published separately
- 4 Figures in brackets do not contain postal giro and postal savings bank offices
- 5 Including private bankers whose business is not organised in the form of a sole proprietorship or partnership
- 6 Only banks organised in the form of a sole proprietorship or partnership, see footnote 5

Table 3 Assets and liability breakdown for all universal banks 1980-84

	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
Balance Sheet										
Assets										
Cash and balance with central bank	25233	24127	25750	27584	30112	3.44	3.05	2.89	2.77	2.78
Interbank deposits	155070	166854	182077	196490	222704	21.13	21.06	20.44	19.77	20.53
Loans	443275	482353	535589	598001	642877	60.39	60.88	60.12	60.16	59.27
Securities	90665	98300	123495	144669	159207	12.35	12.41	13.86	14.55	14.68
Other assets	19760	20699	23961	27285	29698	2.69	2.61	2.69	2.74	2.74
Liabilities										
Capital and reserves	24017	25918	29717	33384	36747	3.27	3.27	3.34	3.36	3.39
Borrowing from central bank	28274	22306	26436	31019	35448	2.56	2.82	2.97	3.12	3.27
Interbank deposits	179736	186859	206236	222718	245203	24.49	23.58	23.15	22.41	22.61
Non-bank deposits	397359	424407	477633	529656	578570	54.14	53.56	53.61	53.28	53.34
Bonds	93189	108011	121717	142739	151474	12.70	13.63	13.66	14.36	13.97
Other liabilities	20941	24832	29133	34513	37157	2.85	3.13	3.27	3.47	3.43
Balance sheet total	734001	792333	890873	994030	1084598					
End-year	691525	752350	851625	948627	1019257					
Average total										
Number of institutions	3087	3072	3061	3039	3025					

Source: OECD, 1987

Table 4 Asset and liability breakdown for universal banks, including commercial banks, savings banks, central giro institutions, regional giro institutions, regional institutions of credit co-operatives and credit co-operatives as a percent of year-end total 1984

	Commercial banks	Large banks	Regional giro institutions	Savings banks	Regional institutions of co-operatives	Credit co-operatives	All universal banks
Assets							
Cash and balance with central bank	3.77	4.27	0.82	3.19	2.52	2.99	2.78
Interbank deposits	24.52	26.52	26.52	8.15	54.65	13.97	20.53
Loans	57.16	53.94	60.49	65.83	20.09	64.34	59.27
Securities	12.53	13.07	10.43	19.00	21.14	14.67	14.68
Other assets	2.02	2.20	1.74	3.84	1.61	4.03	2.74
			percentages				
Liabilities							
Capital and reserves	3.93	3.98	2.21	3.58	3.33	3.69	3.39
Borrowing from central bank	4.39	3.90	1.82	2.92	4.88	3.20	3.27
Interbank deposits	28.47	26.66	26.81	9.41	71.84	10.62	22.61
Non-bank deposits	49.28	57.00	19.50	79.61	9.49	78.94	53.34
Bonds	9.87	3.44	47.11	0.45	8.53	0.67	13.97
Other liabilities	4.05	5.03	2.55	4.03	1.94	2.89	3.43
End of year total (%)	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Total (ECU million)	324112	149122	238203	304090	61402	159692	1087499

Source: OECD, 1987. Adapted from time series data on pp 29-35

Notes: The same table provides data from 1980-84 in both percentages and DM millions

Table 5 Foreign bank representation in Germany

(ECU billion)

Item	Branches of foreign banks		Credit institutions majority-owned by foreign banks		Foreign banks, total	
	Number(1)	Business volume	Number(1)	Business volume	Number(1)	Business volume
Total representation	64	34.42	48	34.52	112	68.94
Compare:						
December 1971	29	4.22	12	0.85	41	5.07
Parent country						
United States	12	9.55	8	11.52	20	21.07
Japan	10	14.98	3	1.78	13	16.75
France	5	3.17	10	4.75	15	7.92
United Kingdom	3	0.86	4	4.66	7	5.52
Switzerland	-	-	5	4.94	5	4.94
Italy	3	2.83	-	-	3	2.83
Other countries	31	3.02	18	6.87	49	9.89
Banking centre						
Frankfurt	39	16.80	32	23.96	71	40.76
Dusseldorf	6	10.66	5	6.48	11	17.14
Hamburg	16	5.33	7	2.59	23	7.92
Other banking centres	3	1.63	4	1.49	7	3.12

Source: Bundesbank, 1987

Notes: (1) Main branch or registered office in Germany, excluding other branches

Table 6 Balance sheet structure of foreign banks and other categories of banks in Germany

(% volume of business, end of October 1986)

Item	Branches foreign banks	Credit institutions majority-owned by foreign banks(1)	Foreign banks, total	All categories of banks
Assets				
Claims on banks(2)(3) of which foreign banks	57.1	34.2	45.6	21.9
Claims on non-banks(2)(3) of which domestic non-banks	40.8 29.5	19.8 43.7	30.2 36.6	6.1 60.3
Securities	22.4 11.2	35.9 17.9	29.2 14.6	57.4 12.5
Liabilities				
Liabilities to banks(2) of which foreign banks	84.8	62.4	73.6	23.0
Liabilities to non-banks(2) of which domestic non-banks	54.9 8.4	29.0 27.7	41.9 18.0	4.1 49.1
Bearer bonds outstanding	4.9	23.0	13.9	47.6
Capital and published reserves(4)	- 5.4	0.2 6.0	0.1 5.7	19.9 3.7

Source: Bundesbank, 1987

- Notes: 1 Extraction of the foreign-owned subsidiaries (of independent legal status) included in the categories 'Regional banks and other commercial banks', 'Private banks', 'Mortgage banks' and 'Instalment sales financing institutions'
- 2 Including loans on a trust basis and registered bonds
- 3 Including bill-based lending
- 4 Pursuant to section 10 of the Banking Act

Market Overview

A Multi-purpose banks

- 1 Commercial banks
- 2 Savings banks
- 3 Central giro institutions
- 4 Regional institutions of credit co-operatives
- 5 Co-operative banks

B Specialist banks

- 1 Mortgage banks
- 2 Instalment credit institutions
- 3 Banks with special functions
- 4 Postal giro and postal savings banks
- 5 Foreign banks

C Other institutions

- 1 Building societies
- 2 Investment companies
- 3 Insurance companies

Structure and Organisation of Markets

Introduction

Banking institutions in the Federal Republic of Germany can be classified into two main categories; multi-purpose banks and specialist banks. Multi-purpose banks 'are full service enterprises, providing all kinds of commercial banking activities and all sorts of business typical of investment dealers, brokerage houses, investment funds, and trust companies' (Boreham, 1985, p20). Although the multi-purpose or 'universal' banks dominate the German financial system, there are also numerous specialist banks which provide various specific functions.

Table 1 gives a breakdown of balance sheet totals for different bank categories and illustrates how the multi-purpose banks dominate the market. Over two-thirds of the banking system's assets are owned by the multi-purpose banks of which the commercial banks have the largest share, ECU 358,399 million slightly more than the savings banks. Table 2 shows the respective sizes of the reporting banks according to each category. Table 3 illustrates the balance sheet structure for all universal banks indicating that loans account for over 60 per cent of total asset and non-bank deposits account for the lions share of liabilities. It must be noted that this only provides us with a highly aggregated view of universal banking business. In addition, the recent rapid growth of off balance sheet items (which may account for a large proportion of business) such as foreign exchange dealings and options and futures trading is impossible to trace. The final table provides us with a breakdown per sector.

A Multi-purpose banks

1 Commercial banks (Geschäftsbanken)

This group represents Germany's three big banks; Deutsche Bank AG, Dresdner Bank AG and Commerzbank AG, together with their Berlin subsidiaries, 99 regional banks, private banks and subsidiaries or branches of various foreign banks. Typically the commercial banks provide a universal banking service. 'In principle, the 'universal banks' in the Federal Republic of Germany are permitted to carry out banking business with domestic and foreign customers, ie with other banks as well as with enterprises, individuals and public authorities' (OECD, 1987, p 110). The commercial banks operate over the whole range of banking business offering their products and services to a wide range of customers. Their activities range from traditional deposit-taking and lending business, foreign trade financing, syndicated loans, to all types of securities business.

2 Savings banks

These are mainly municipal or district banks. Special savings laws still exist legislating the main objectives of these institutions to encourage 'savings and giro transactions, to provide credit for low-earners and the middle classes, and to fulfil the finance requirements of their local communities' (Hendrie, 1985, p 5). Savings banks hold the lions share of non-bank deposits in the German financial system. 'They usually specialise in the long-term and hold a substantial part of their assets and liabilities in the form of mortgage credit and savings deposits' (OECD, 1987, p 110). Although the savings banks still maintain their traditional activities, in recent years they have diversified and have now virtually become universal banks. Savings banks participate in many forms of commercial banking activities although emphasis is on long term loans to their municipal owners, mortgage loans and medium to long-term commercial credits. They are not allowed to undertake certain types of investment, for example, holding company securities. Funds are predominantly obtained from savings and time deposits. The central giro institutions act as the central organisations of the savings banks.

3 Central giro institutions (Landesbanken girozentralen)

The 12 Girozentralen hold the liquid reserves of the savings banks, that is they serve as their clearing houses. In addition, they act as the state banks for the respective federal states. They are involved in all commercial banking activities and compete with the larger commercial banks. Funds are mainly obtained through bond issues and to a lesser extent from the money markets.

4 Regional institutions of credit co-operatives (Zentralbanken)

The Zentralbanken act as clearing houses to the credit associations enabling them to provide a universal banking service to their customers. They offer investment and credit facilities as well as securities and foreign exchange services. The regional Zentralbanken and their central organisation, the Deutsche Genossenschaftsbank compete with the commercial banks and central giro institutions for universal banking business.

5 Co-operative banks

The co-operative banks or credit associations, as they are sometimes known, were originally funded to provide banking facilities to their members. They now provide a universal banking service primarily, but not exclusively, to their members. Some operate in specific areas of the economy, for example, 'industry, handicraft, agriculture and civil service' (OECD, 1987, p 110).

B Specialist Banks

1 Mortgage banks (Realkreditinstitute and Hypothekenbanken)

These provide long-term housing finance and offer credit to public authorities (communal loans). Funds are mainly raised through mortgage and 'communal' bond issues. Their main competitors for housing finance are universal banks.

2 Instalment credit institutions (Teilzahlungsbanken)

These offer a range of instalment credit facilities to individuals and businesses. Some of these institutions are owned by domestic or foreign banks or by major retailers.

3 Banks with special functions

These are either private or public banks that operate in clearly defined areas such as export finance or bill discounting.

4 Postal giro and postal savings banks

These are institutions of the Federal Post Office. They only accept deposits but offer no loans, apart from small overdrafts which can be arranged. The deposits are used for the internal financing of the Post Office. These institutions compete vigorously with the banks for sight and savings deposits.

5 Foreign banks

These provide services similar to the commercial banks. Tables 5 and 6 illustrate their importance. By October 1986, 37.5 per cent of all foreign bank assets and 46 per cent of all liabilities were accounted for by mainly short term transactions with foreign business

partners. Business is dominated by foreign business and interbank transactions. Subsidiaries of foreign banks do participate in more domestic related business than foreign branches.

C Other Financial Institutions which Accept Deposits and/or Extend Credit

1 Building societies/Building and loan associations/Building loan saving banks (Bausparkassen)

These institutions provide credit to their depositors after they have completed some form of contractual savings plan. All credit is granted exclusively for buildings - purchase, renovation, etc. Building and Loan associations play an important role in financing private housing.

2 Investment companies

These operate on a trust basis, investing the funds deposited.

3 Insurance companies

As well as offering traditional insurance services, these grant mortgages for private house financing.

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2.2 France

Statistical Overview

- Table 1 Balance sheet of large banks 1980-84
- Table 2 Balance sheet of all commercial banks and credit co-operatives 1980-84
- Table 3 Banks' balance sheet (Banques d'affaires, banques de dépôts and banques de crédit) at the end of 1983
- Table 4 Breakdown by subgroup of the banque de dépôts sector
- Table 5 Mutual and co-operative banks - total assets 1983
- Table 6 Treasury and PTT - main assets and liabilities 1983
- Table 7 The top French banks (1985)

Table 1 Balance sheet of large banks 1980-84

(ECU million)

Balance sheet	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
											% of year-end total				
Assets															
Cash and balance with central bank	8425	8379	10835	10491	12227	2.48	2.15	2.44	2.17	2.18					
Interbank deposits	138755	158578	177068	198915	232630	40.92	40.65	39.87	41.11	41.46					
Loans	150147	175781	199871	218838	242011	44.28	45.07	45.00	45.22	43.13					
Securities	4941	6512	8594	11497	13163	1.46	1.67	1.93	2.38	2.35					
Other assets	36786	40811	47791	44155	61069	10.85	10.46	10.76	9.12	10.88					
Liabilities															
Capital and reserves	7917	8619	8830	9024	9634	2.33	2.21	1.99	1.86	1.72					
Borrowing from central bank															
Interbank deposits	136519	162995	196272	218255	251187	40.26	41.79	44.19	45.10	44.77					
Non-bank deposits	146277	163474	172219	187122	207386	43.14	41.91	38.77	38.67	36.96					
Bonds	12149	15067	20642	25049	33787	3.58	3.86	4.65	5.18	6.02					
Other liabilities	36191	39906	46195	44445	59105	10.67	10.23	10.40	9.18	10.53					
Balance sheet total															
End-year total	339045	390061	444158	483895	561099										
Average total	305175	359758	405252	452875	518941										
Number of institutions	8	8	8	8	8										

Source: OCED, 1987

Notes: 1 Eight large banks are Banque Nationale de Paris, Crédit Lyonnais, Banque Paribas, Banque Indosuez, Crédit Commercial de France, Crédit du Nord and the Crédit Agricole, Société Générale

Table 2 Balance sheet of all commercial banks and credit co-operatives 1980-84

Balance sheet	(ECU millions)						% of year-end total			
	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
Assets										
Cash and balance with central bank	13730	14620	16174	16669	18919	2.50	2.32	2.28	2.14	2.13
Interbank deposits	231174	260652	289652	327339	381756	42.10	41.33	40.89	42.09	43.04
Loans	235200	276031	309027	335235	367625	42.83	43.76	43.62	43.11	41.45
Securities	11944	14311	17480	23202	28617	2.18	2.27	2.47	2.98	3.23
Other assets	57061	65114	76098	75234	90100	10.39	10.32	10.74	9.67	10.16
Liabilities										
Capital and reserves	15846	17179	17850	18593	20845	2.89	2.72	2.52	2.39	2.35
Borrowing from central bank										
Interbank deposits	247696	289209	337757	379826	430347	45.11	45.85	47.68	48.84	48.52
Non-bank deposits	214270	238833	250797	271200	295904	39.02	37.87	35.40	34.87	33.36
Bonds	18428	25295	33137	40606	56515	3.36	4.01	4.68	5.22	6.37
Other liabilities	52869	60213	68890	67456	83406	9.63	9.55	9.72	8.67	9.40
Balance sheet total										
End-year total	549109	630729	708432	777680	887017					
Average total	498308	582146	650406	725269	826634					
Number of institutions	408	421	427	429	435					

Source: OCED, 1987

Table 3 Banks' balance sheet (Banques d'affaires, banques de dépôts and banques de crédit) at the end of 1983

	Billions of ECUs
Assets	468.925
Credits to treasury	8.347
Credits to enterprises, households and local authorities	218.218
Credits to credit institutions	113.029
Fixed assets	10.902
Other assets	118.385
Liabilities	468.925
Demand deposits	61.973
Savings deposits	24.853
Short-term deposits and certificates	49.445
Borrowing from credit institutions	137.432
Bonds issued	27.016
Capital	16.390
Other liabilities	151.818

Source: Hendrie, 1985

Table 4 Breakdown by subgroup of the banque de dépôts sector

		At end of 1983	
		No of banks	No of branches
National banks	3	5,587	217
Rediscount houses	7	9	14
Other banks with head office in Paris	75	1,069	101
Regional banks	19	2,154	39
Local banks ¹	66	321	51
Banks under foreign control	119	464	74
Total	289	9,604	497

Source: Hendrie, 1985

Notes: 1 Local banks, banks in French overseas territories and in Monaco

2 Total assets are in ECU billion

Table 5 Mutual and co-operative banks - total assets 1983

	ECU billion
Crédit Agricole	106.6
Crédit Mutuel	21.6
Banques Populaires	24.8
Crédit Co-opératif	1.9

Source: Hendrie, 1985

Table 6 Treasury and PTT - main assets and liabilities 1983

	ECU billion
Assets	18.71
Credits to Treasury	18.71
Liabilities	
Notes and coin	1.54
Demand deposits	17.18

Source: Hendrie, 1985

Table 7 The top French banks (1985)

French ranking (by assets)	World ranking	Bank	Assets ECUm	Capital ECUm
1	6	BNP	161,312	3,198
2	8	Crédit Agricole	161,063	6,856
3	10	Crédit Lyonnais	146,079	1,801
4	13	Société Générale	127,952	2,596
5	29	Paribas	95,548	3,467
6	74	CIC Group	46,231	848
7	78	Indosuez	43,336	917
8	84	Banques Populaires	39,666	1,307
9	98	BFCE	31,488	401
10	110	Crédit Commercial de France	28,199	769
11	147	Compagnie Bancaire	20,788	1,397
12	181	UBAF	15,140	557
13	291	Fédérative du Crédit Mutuel	8,710	606
14	343	Eurobank	7,021	159
15	354	Banque Worms	6,819	164
16	423	Sovac	5,586	404
17	480	L'Afrique Occidentale	4,463	51
18	493	Banque Sudameris	4,148	239
Total			953,548	25,737

Source: The Banker

Market Overview

- 1 Traditional banks
- 2 Foreign banks
- 3 Mutual and co-operative banks
- 4 Savings institutions
- 5 Finance houses
- 6 Non-bank institutions
- 7 PTT and the Treasury
- 8 Securities and property investment companies

The banking law that came into force on 25th July 1984 extended supervisory control of the Commission Bancaire to all banking institutions operating in France: commercial banks, mutual or co-operative banks, savings banks, finance companies and specialised financial institutions. Banks perform the whole range of banking operations and related financial services. Some of the larger banks own subsidiaries which specialise in various activities such as factoring, consumer credit and so on. These subsidiaries are usually finance houses. Nevertheless, banks can offer these services in their own right.

1 Traditional banks (Banques inscrites)

A 1945 law distinguished three types of banks: banques de dépôts, banques d'affaires and banques de crédit à long et moyen terme. The above 1984 legislation abolished this distinction and subsequently any institution granted banking status is now allowed to undertake all banking activities: accepting deposits from the public, lending, fund management and related financial operations. The traditional banks include all the major commercial banks. They play an important role in securities trading and actively participate in the international wholesale markets. As well as offering short-term and medium to long-term credit to commerce and industry, commercial banks have developed personal loan and mortgage schemes for private individuals. Hire purchase financing, venture capital and other specialised methods of extending credit are generally offered through subsidiaries. Traditional banks account for approximately 50 per cent of all corporate lending. These banks dominate the securities issuing business where they act either as intermediaries or as sponsors and underwriters. Private individuals are offered a whole range of securities services, from enacting specific orders, registration, investment management, etc. This group's main banks are Banque Nationale de Paris, Crédit Lyonnais and Société Générale.

2 Foreign banks

A subset of the 'traditional' banks, France had 142 foreign or foreign-controlled banks in 1984. These institutions do business either as branches, subsidiaries or representative offices. They account for

almost 15 per cent of total assets, 12 per cent of new lendings and 8 per cent of deposits' (Lebegue, 1985). With the current trend towards deregulation of financial markets and innovation, especially in the capital markets, this has encouraged more foreign banks to enter France (see section on brokerage and securities).

3 Mutual and co-operative banks

Mutual banks have special legal status in France but they are permitted to undertake a similar range of operations as are the traditional banks. Their business has traditionally been more orientated towards the retail sector, personal lending accounts for 35 per cent of the whole market compared with 25 per cent for the traditional banks. However, this group only accounts for 9 per cent of total corporate clients. The agricultural credit banks, Credit Agricole network, are by far the most important mutual and co-operative institutions. Their business has traditionally focused on loans to individuals and organisations involved in the agricultural sector. Resources are obtained mainly by customer deposits and bond issues (see Table 5).

4 Savings institutions

Their main business is deposit taking. They have recently expanded their business to offer chequing facilities and personal loans. They lend mainly for house finance purposes and are also allowed to grant loans to local communities. Ordinary savings banks (caisses d'épargne et de prévoyance) are controlled by the Centre National de Caisses d'Epargne et de prevoyance and compete vigorously with the national savings bank which provides services to savers through the post office network.

5 Finance houses

The business of these organisations is mainly geared towards lending and securities trading. Legislation does not allow them to collect short-term deposits. They control the dominant share of personal consumer credit in France, approximately 70 per cent compared with 30 per cent for the banks.

6 Non-bank financial institutions

They usually fulfil specific objectives to stimulate economic development in various economic sectors. Funds are usually obtained on the financial markets and credit is of a long term nature.

7 PTT and Treasury

They collect deposits through the Post Office. Lending business is very small. The Post Office also collects savings for the national savings bank through its offices.

8 Securities and property investment companies

Special 'financial entities' such as SICAVs (open-ended investment companies) collect funds which they invest in securities. Their services are sold through banks to private investors or directly to institutions. Most of these companies are owned by the banks. Property investment associations are mainly managed by banks and/or bank holding companies, they offer their shares for sale through the banks.

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2.3 Italy

Statistical Overview

- Table 1 Legal categories and size classes of Italian banks 31st December 1983
- Table 2 Balance sheet of all Italian commercial banks 1980-84
- Table 3 Balance sheet of large commercial banks 1980-84
- Table 4 Balance sheet of Italian savings banks 1980-84
- Table 5 Banks and central banking institutions - combined balance sheet at 30th June 1984
- Table 6 Italy's top ten banks 1985
- Table 7 Domestic and foreign deposits and investments by category of bank, December 1983

Table 1 Legal categories and size classes of Italian banks 31st December 1983

(numbers)

Institutions	Major	Large	Medium-sized	Small	Minor	Banks in sample	Total
Banks	8	6	9	31	151	205	314
Public law	4	1	1			6	6
of national interest	3					3	3
ordinary credit		4	7	19	62	92	157
co-operative	1	1	1	12	89	104	148
Savings banks	1	1	7	30	46	85	87
Total	9	7	16	61	197	290	401
Rural banks							686
Central credit institutions						5	5
Total						295	1092

Source: OECD, 1987

Table 2 Balance sheet of all Italian commercial banks 1980-84

(ECU billion)

Balance sheet	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
Assets															
Cash and balance with central bank	2.900	2.950	2.053	2.273	2.806	1.06	0.96	0.59	0.58	0.64					
Interbank deposits	34.596	42.005	46.999	53.588	52.567	12.59	13.65	13.44	13.67	11.90					
Loans	77.654	82.517	85.596	98.564	116.220	28.27	26.82	24.48	25.14	26.31					
Securities	62.735	63.581	77.408	86.894	88.030	22.84	20.67	22.14	22.17	19.93					
Other assets	96.807	116.576	137.571	150.690	182.037	35.24	37.90	39.35	38.44	41.22					
Liabilities															
Capital and reserves	7.512	9.892	12.035	16.629	19.990	2.73	3.22	3.44	4.24	4.53					
Borrowing from central bank	1.259	1.672	1.607	4.116	1.441	0.46	0.54	0.46	1.05	0.33					
Interbank deposits	31.456	36.886	41.924	48.964	49.388	11.45	11.99	11.99	12.49	11.18					
Non-bank deposits	150.628	155.481	175.662	196.703	214.879	54.84	50.54	50.24	50.18	48.65					
Bonds	0	0	0	0	0	0.00	0.00	0.00	0.00	0.00					
Other liabilities	83.837	103.697	118.399	125.595	155.961	30.52	33.71	33.86	32.04	35.31					
Balance sheet total															
End-year total	274.691	307.629	349.628	392.008	441.660										
Average total	235.156	263.261	295.498	341.960	372.099										
Number of institutions	214	213	210	205	204										

Source: OCED, 1987

Table 3 Balance sheet of large commercial banks 1980-84

(ECU billion)

Balance sheet	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
Assets															
Cash and balance with central bank	0.842	0.820	0.524	0.879	1.228	1.12	1.01	0.58	0.44	0.54					
Interbank deposits	4.230	5.949	6.170	21.811	20.017	5.64	7.35	6.78	11.04	8.87					
Loans	17.396	18.208	19.156	44.078	52.607	23.20	22.49	21.06	22.32	23.32					
Securities	16.862	14.730	19.197	40.399	39.966	22.49	18.19	21.11	20.46	17.71					
Other assets	35.640	41.250	45.894	90.327	111.805	47.54	50.95	50.47	45.74	49.55					
Liabilities															
Capital and reserves	1.520	2.027	2.139	6.240	7.306	2.03	2.50	2.35	3.16	3.24					
Borrowing from central bank	0.346	0.342	0.341	1.397	0.652	0.46	0.42	0.38	0.71	0.29					
Interbank deposits	7.634	7.389	9.530	25.048	27.437	10.18	9.13	10.48	12.68	12.16					
Non-bank deposits	31.100	30.807	35.306	84.489	90.712	41.48	38.05	38.82	42.78	40.21					
Bonds	0	0	0	0	0	0.00	0.00	0.00	0.00	0.00					
Other liabilities	34.368	40.392	43.625	80.319	99.515	45.84	49.89	47.97	40.67	44.11					
Balance sheet total															
End-year total	74.969	80.957	90.942	197.493	222.622										
Average total	63.591	69.518	74.710	175.549	184.252										
Number of institutions	3	3	3	8	8										

Source: OCED, 1987

Note: Large banks 1980-83, Banca Nazionale del Lavoro, Banca Commerciale Italiana and Credito Italiano
 From 1984-85 five other banks have been included; Banco di Napoli, Istituto Bancario San Paolo di
 Torino, Monti dei Paschi di Siena, Banco di Roma, Banca Popolare di Novara

Table 4 Balance sheet of Italian savings banks 1980-84

(ECU billion)

Balance sheet	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
Assets															
Cash and balance with central bank	0.796	0.757	0.657	0.739	0.914	0.95	0.86	0.66	0.63	0.69	0.66	0.86	0.66	0.63	0.69
Interbank deposits	10.401	10.719	11.850	12.695	15.324	12.47	12.21	11.88	10.77	11.60	11.88	12.21	11.88	10.77	11.60
Loans	23.946	25.448	27.055	30.769	36.888	28.70	28.98	27.13	26.11	27.93	28.70	28.98	27.13	26.11	27.93
Securities	25.747	25.266	29.976	35.943	36.058	30.86	28.78	30.06	30.50	27.30	30.86	28.78	30.06	30.50	27.30
Other assets	22.546	25.612	30.187	37.717	42.880	27.02	29.17	30.27	32.00	32.47	27.02	29.17	30.27	32.00	32.47
Liabilities															
Capital and reserves	2.159	2.495	2.958	4.577	5.973	2.59	2.84	2.97	3.88	4.52	2.59	2.84	2.97	3.88	4.52
Borrowing from central bank	0.415	0.334	0.289	0.287	0.338	0.50	0.38	0.29	0.24	0.26	0.50	0.38	0.29	0.24	0.26
Interbank deposits	3.115	3.467	3.844	5.649	5.770	3.73	3.95	3.85	4.79	4.37	3.73	3.95	3.85	4.79	4.37
Non-bank deposits	60.416	61.534	70.438	78.859	85.728	72.41	70.08	70.63	66.91	64.91	72.41	70.08	70.63	66.91	64.91
Bonds	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other liabilities	17.331	19.972	22.195	28.491	34.255	20.77	22.75	22.26	24.17	25.94	20.77	22.75	22.26	24.17	25.94
Balance sheet total															
End-year total	83.436	87.803	99.725	117.863	132.064										
Average total	75.537	82.453	89.594	105.692	120.346										
Number of institutions	86	85	85	85	85										

Source: OCED, 1987

Table 5 Banks and central banking institutions - combined balance sheet at 30th June 1984

	billion ECU	%
Assets		
Lire liquidity	2.612	11.6
Obligatory reserves and compulsory deposits	42.131	
Loans		
short term	116.203	
medium term	24.722	36.7
Bank acceptances	.082	
Treasury bills	23.245	30.0
Bond and debentures	92.081	
Shares and participations	5.327	1.4
Interbank accounts	44.208	12.7
Accounts with special credit institutions	4.695	
Foreign assets	29.402	76.0
	<hr/>	<hr/>
	386.890	100.0
Liabilities		
Capital and reserves	26.221	6.8
Savings deposits	115.522	
Certificates of deposit	4.431	67.7
Customers' current accounts	137.358	
Other deposits	3.097	
Due to Bank of Italy and Italian Foreign Exchange Office	6.131	1.6
Interbank accounts	39.627	11.1
Accounts with special credit institutions	2.992	
Foreign liabilities	47.242	12.3
Balance other liabilities/other assets	2.088	0.5
	<hr/>	<hr/>
	386.890	100.0

Source: Hendrie, 1985

Table 6 Italy's top ten banks 1985

(billion ECU)

Bank	Total assets *	Net profit *	Return on assets (%)
Banca Nazionale del Lavoro	66.230	0.167	0.25
Banca Commerciale Italian	47.920	0.070	0.15
Banco di Roma	41.612	0.032	0.08
Istituto San Paolo di Tornio	39.067	0.303	0.78
Credito Italiano	38.239	0.065	0.17
Cariplo	35.760	0.084	0.24
Banco di Napoli	34.812	0.012	0.03
Monte dei Paschi di Siena	30.201	0.124	0.41
Banco di Sicilia	21.627	0.015	0.07
Banca Nazionale Agricoltura	14.126	0.030	0.15

Source: Financial Times, 22nd December 1986

Note: * All figures refer to main bank operating company and associates

Table 7 Domestic and foreign deposits and investments by category of bank, December 1983

(billion ECU)

Category of bank	Foreign deposits		Domestic deposits		Domestic lending foreign currency		Domestic lending in lire	
	Amount (a)	Market share	Amount (b)	Market share	Amount (c)	Market share	Amount (d)	Market share
					a/b (%)	c/a (%)	c/d (%)	
Public-law banks	15.051	28.4	52.177	19.2	28.8	24.6	21.048	18.4
Banks of national interest	20.305	38.3	31.597	11.6	64.3	18.9	15.449	13.5
Ordinary commercial banks	10.041	18.9	65.649	24.2	15.3	39.7	30.144	26.3
Co-operative banks	4.204	7.9	44.454	16.4	9.5	44.8	17.260	15.1
Savings banks	3.346	6.3	77.266	28.5	4.3	70.0	27.990	24.4
Central credit institutions	0.113	0.2	0.192	0.1	58.8	0.1	2.603	2.3
Total	53.060	100.0	271.335	100.0	19.6	29.7	114.494	100.0
								13.8

Source: Bank of Italy, Annual Report, 1983

Market Overview

- 1 Public charter banks
- 2 National interest banks
- 3 Ordinary credit banks
- 4 Co-operative banks
- 5 Savings banks and first category pledge banks*
- 6 Agricultural and craft industry banks
- 7 Foreign banks
- 8 Other financial institutions
 - special credit institutions
 - leasing and factoring companies

By the end of 1985 90 per cent of Italy's banking system was state-controlled. Italy had 1,096 separate banking institutions ranging from the smallest rural banks (casse rurali) to the big three national interest banks. The major trend over the last two years has been the growing significance of the securities markets in the corporate, federal and retail savings sector which has reduced the proportion of funds being deposited with the banks.

'The most important development which has begun to change the behaviour of banks has been a series of deregulation measures ... the lifting by the Bank of Italy in two stages between June 1983 and January 1984 of individual credit restrictions on banks has been the key measure which has increased competition' (Friedman, 1985).

In addition, foreign banks have also been given greater access to the Italian market, although by late 1985 there were only 34 foreign institutions in the country. Italian banks have also been given permission to open more branches overseas. 'Only 14 Italian banks have substantial operations' overseas. On a more esoteric note, one unusual feature of the Italian banking system is that the central authorities dictate where and when banks both domestic and foreign can establish branches. This procedure will change when Italy has to fulfil the criteria laid out by the European Community directive on bank establishment. This will come into being in 1989. Another important point is that banks are not allowed to establish merchant banking companies (Mediobanca is the only true investment bank in Italy). On the other hand, banks have recently placed a lot of emphasis on selling mutual funds and government debt to the general public.

1 Public charter banks (Istituti di Diritto Pubblico)

These six banks operate in Italy through over 1,700 branches. They are: Banca Nazionale del Lavoro, Banco di Sardegna, Istituto Bancario San Paolo di Torino, Monte dei Paschi di Siena, Banco di Napoli and Banco di Sicilia. They are owned by the government and executive staff appointments are made by the state. At the end of 1984 they held over 19 per cent of total domestic deposits, and undertook 18 per cent of

domestic lending. The largest public charter bank, Banca Nazionale del Lavoro, is also Italy's largest bank. All of these banks offer a full range of banking services: deposit taking, lending - secured and unsecured, guarantee business, acceptance and/or encashment of bills of exchange, credit cards, treasury services, security transactions and so on.

2 National interest banks (Banche di Interesse Nazionale)

The three banks in this group are Banca Commerciale Italiana, Banco di Roma and Credito Italiano. They are state-owned but have a minority private sector shareholdings. Their business is similar to the public charter groups.

3 Ordinary credit banks

There are approximately 120 of these 'private' banks which have over 2,900 branches. Most of the branch networks are localised and few have national coverage. At the end of 1983 they held 24.2 per cent of market share in domestic deposits and were the largest lire lending group, having nearly 25 per cent of the market. They offer a full range of banking services - see above.

4 Co-operative banks (Banche Popolari)

These banks are co-operative joint stock companies. There are 145 co-operative banks which have nearly 2,400 branches. Although they operate a full range of banking services, the co-operative banks business is localised with emphasis being placed on small business loans.

5 Savings banks and first category pledge banks (Casse di Risparmio)

The savings banks (and first category pledge banks) are non-profit making organisations. There are 89 savings banks which have 3,510 branches. Traditionally their business concentrated on the acceptance of retail savings deposits but they now offer chequing facilities and all other services that commercial banks are allowed to undertake.

6 Agricultural and craft industry banks (Casse Rurali ed Artigiani)

These are 691 small co-operative banks. They perform most banking operations but their business is very localised. Most of their lending is to their members.

7 Foreign banks

By late 1985 there were only 34 foreign banks established in Italy. They are mainly involved in corporate and wholesale money market business. Their funds are predominantly from the interbank market, but some deposits are made by large industrial companies and public institutions. They lend mainly to subsidiaries of foreign firms based in Italy and large scale corporations. They can offer Italian customers the services provided by their parent companies, namely foreign currency loans and other financial and capital market facilities. 'Between 1970 and 1980 foreign banks increased their share of the Italian market and their balance sheet assets rose from 0.8 per cent to 1.5 per cent of the national total' (Flenda, 1984). With the continued deregulation of financial and capital markets within Italy this trend will undoubtedly continue.

8 Other financial institutions

Special credit institutions (Istituto di Credito Speciale) - There are some 90 of these institutions that are authorised to offer medium and long-term credit. The Italian banking system distinguishes between institutions that are authorised to offer short, medium and long-term credit. 'Ordinary' or short term credit (up to 18 months) has traditionally been the preserve of the banks. 'Special' or medium and long-term credit operations are classified according to the final users of this credit, for example:

Mobiliare credit	medium and long term credit to industry, mining, shipbuilding, public utilities
Immobiliare credit	medium and long-term credit to real estate companies and the hotel and tourist industry

'Public work' credit and 'credit for agriculture and fisheries' are other categories. Specific institutions or departments within banks provide these different credit facilities. These institutions raise funds by issuing bonds, borrowing on the euromarkets and from term deposits. Most of the lending is secured. Commercial banks have recently entered the medium-term loan market and so pose a competitive threat to these organisations.

Leasing and factoring companies - a large number of firms undertake leasing activities, 41 of them accounted for 85 per cent of the market in 1983. The total value of contracts was less than 10,000 billion lire. Factoring business is already well-established in Italy. 'In 1983 the turnover of the companies operating in the factoring field was 6,500 billion lire (ECU 4,815.2 million); more than five times the turnover of 1980' (Hendrie, 1985). The major leasing and factoring companies are owned by banks.

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2.4 United Kingdom

Statistical Overview

- Table 1 Reporting banks balance sheet totals at 31st December 1986
- Table 2 Monetary sector institutions 1984-86
- Table 3 Comparative statistics. Total liabilities/assets. Main financial groups 1975-85
- Table 4 Clearing banks and UK merchant banks post big bang
- Table 5 Top 20 UK building societies - profile of services (excluding mortgages)
- Table 6 Total balance sheet of London clearing banks 1980-84

Table 1 Reporting banks balance sheet totals at 31st December 1986

(ECU million)

	Balance sheet total	%
Retail banks	300,309	24.1
Accepting houses	44,223	3.5
Other British banks	102,017	8.2
US banks	136,671	11.0
Japanese banks	332,347	26.6
Other overseas banks	307,516	24.6
Consortium banks	24,535	2.0
Total	1247,620	100.0

Source: Bank of England Quarterly Bulletin, 1987

- Notes:
- 1 Retail banks are those banks which have extensive branch networks in the UK or participate directly in a UK clearing system - 19 in total.
 - 2 Accepting houses are members of the Accepting Houses Committee and certain Isle of Man and Channel Island subsidiaries.
 - 3 Other British banks are all other UK registered institutions.
 - 4 Consortium banks are UK registered institutions owned by banks or financial institutions, but in which no one institution has a shareholding of more than 50 per cent, and in which at least one shareholder is based overseas.

Table 2 Monetary sector institutions 1984-86

	1984	Mid-February 1985	1986
Number of institutions(a)	663	673	661
of which:			
Recognised banks	290	290	291
Licensed deposit-takers	308	315	304
Channel Island and Isle of Man institutions(b)	66	66	66
London and Scottish banks and their monetary sector subsidiaries	41	40	47
Accepting houses	16	16	16
Discount houses	10	10	9
Foreign banks	301	330	332
of which:			
Licensed deposit-takers	81	124	118

Source: Abstract of Banking Statistics, 1986

- Notes:
- (a) Not including Trustee Savings Banks and the Banking Department of the Bank of England which are also part of the monetary sector
 - (b) Those institutions (including branches of some UK banks) which have opted to join the UK monetary sector.

Table 3 Comparative statistics. Total liabilities/assets. Main financial groups 1975-85

(ECU million)

	1975	1976	1977	1978	1979	
London and Scottish Banks Group						
Bank of Scotland	2,234	2,281	2,562	2,982	3,705	
Barclays	33,136	31,018	33,684	35,845	46,767	
Lloyds	17,606	18,911	20,665	22,221	26,990	
Midland	18,508	19,053	20,473	23,428	31,244	
National Westminster	26,177	27,462	29,357	33,434	44,782	
The Royal Bank of Scotland	5,973	5,917	5,940	6,695	8,006	
Standard Chartered						
Co-operative Bank Group	591	589	636	691	925	
Girobank	282	328	335	443	698	
Trustee Savings Banks Group	na	7,170	7,323	8,064	8,996	
Yorkshire Bank Group	614	626	662	795	1,016	
Building Societies	43,219	45,372	52,452	59,553	70,838	
	1980	1981	1982	1983	1984	1985
London and Scottish Banks Groups						
Bank of Scotland	4,613	6,451	7,773	9,104	10,401	12,253
Barclays	61,983	80,007	95,486	98,859	113,361	110,684
Lloyds	33,175	49,986	61,436	65,472	74,516	74,377
Midland	42,316	74,146	85,630	89,630	104,102	98,598
National Westminster	57,759	78,293	97,211	102,244	120,864	123,036
The Royal Bank of Scotland	10,271	14,035	16,578	18,871	22,665	25,520
Standard Chartered		35,838	43,367	81,410	48,088	48,952
Co-operative Bank Group	1,148	1,515	1,745	1,813	2,040	2,083
Girobank	926	1,238	4,515	1,540	1,847	2,192
Trustee Savings Banks Group	10,556	12,097	15,500	16,383	18,290	20,839
Yorkshire Bank Group	1,287	1,551	1,905	2,266	2,594	2,866
Building Societies	89,880	111,760	130,300	146,283	173,872	205,314

Source: CSLB Abstract of Banking Statistics, 1986

Table 4 Clearing banks and UK merchant banks post big bang

Banks/group	Stockmarket capitalisation	Main purchases or partners in London	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R	S	T	U	V	W	X	Y	Z
UK clearing banks																												
Barclays	3,570	de Zoete & Bevan (S) Wedd Durlacher Mordaunt (J) Barclays Merchant Bank (M)	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Lloyds	2,236	Black Horse Agencies (E) Lloyds Merchant Bank (M)		X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Midland	1,291	Samuel Montagu (M) W Greenwell (S)	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
National Westminster	3,737	Fielding, Newson-Smith (S) County Bank (M) Bisgood Bishop (J)	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
UK merchant banks																												
Barings	NA	Wilson & Watford (J)	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Hambros	381	Strauss Turnbull (S) Mann & Co (E)	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Hill Samuel	332	Bairstow Eves (S)	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Kleinwort Benson	479	Wood Mackenzie (S) Grievson Grant (S)	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Mercantile House	233	Charlesworth & Co (J) Laing & Cruickshank (S)	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Morgan Grenfell	664	Alexanders Discount (D) Pember & Boyle (S)	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
N M Rothschild	NA	Pinchin Denny (J)	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Schroders	160	Smith Bros (J) Helbert Wagg, Anderson, Bryce Villiers (S)	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
S G Warburg (Mercury International)	399	Akroyd & Smithers (J) Rowe & Pitman (S) Mullens (S)	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X

Source: Economist (1986)

Key

A	UK equities market making
B	International equities market making
C	Gilts primary dealing
D	Futures, options and swaps
E	Eurobond market making
F	Eurobond underwriting
G	Eurocommercial paper
H	Sterling commercial paper
I	US treasuries market making
J	Equity issues
K	Retail stockbroking
L	Retail banking
M	Wholesale banking
N	Foreign exchange
O	Mergers and acquisitions
P	Commodities
Q	Bullion
R	Consumer finance
S	Unit trusts
T	Fund management
U	Private client investment
V	Estate agents
W	Mortgages (£)
X	Commercial property
Y	Venture capital
Z	Insurance

Notes:

(C)	commercial bank
(D)	discount house
(E)	estate agent
(J)	jobber
(M)	merchant bank
(S)	stockbroker

Table 5 Top 20 UK building societies - profile of services (excluding mortgages)

Services (excluding mortgages)	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Halifax	X			X	X	X	X			X					X	X
Abbey National	X			X	X	X	X	X				X	V			X
Nationwide	X	X		X	X		X	X	X	X	X	X	A	X	X	X
Alliance & Leicester				X	X	X	X	X	X		X	X	X			X
Leeds Permanent				X	X	X	X	X	X					X	X	X
Woolwich Equitable	X			X	X	X	X	X						X	X	X
Anglia*	X	X	X		X	X	X	X			X	X	X	X		X
National & Provincial	X	X	X	X	X	X	X	X	X	X	X		X	X		X
Bradford & Bingley	X			X		X		X	X		X	X				X
Britannia	X	X	X	X	X	X	X	X	X	X	X		V			X
Cheltenham & Gloucester							X						V			X
Bristol & West				X	X		X	X							X	X
Yorkshire*				X				X	X							X
Gateway*				X				X								X
Northern Rock		X				X						X			X	X
Town & Country				X	X	X		X	X				V	X	X	X
Midshires	X	X		X	X	X	X			X		X				X
Coventry				X	X	X	X	X			X				X	X
Guardian*																
Skipton		X				X									X	X

Source: Retail Banker International, 1987

Notes: Several societies are expected to announce new services during 1987

- * to be announced
- V Visa
- A Access

- Key:
- 1 PEPs (Personal Equity Plans)
 - 2 Unit trusts
 - 3 Share dealing
 - 4 ATMs
 - 5 Cheque book
 - 6 Personal loans
 - 7 Travellers cheques
 - 8 Direct pay of wages
 - 9 Standing orders
 - 10 Foreign exchange
 - 11 Direct debit
 - 12 Personal pensions
 - 13 Credit card
 - 14 Overdraft
 - 15 Estate agency
 - 16 Insurance

Table 6 Total balance sheet of London clearing banks 1980-84

(ECU million)

Balance sheet	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984	% of year-end total				
											1981	1982	1983	1984	
Assets															
Cash and balance with central bank	4959	5723	6910	7620	7738	2.48	1.93	1.93	2.02	1.78					
Interbank deposits	52984	82741	93085	92274	102408	26.54	27.85	26.05	24.50	23.58					
Loans	108065	159837	203522	221792	261905	54.13	53.80	56.96	58.88	60.30					
Securities	13840	16814	17550	18658	21461	6.93	5.66	4.91	4.95	4.94					
Other assets	19803	31974	36234	36334	40809	9.92	10.76	10.14	9.65	9.40					
Liabilities															
Capital and reserves	11293	14274	16318	17542	15740	5.66	4.80	4.57	4.66	3.62					
Borrowing from central bank															
Interbank deposits															
Non-bank deposits	182687	273632	330111	346603	398036	91.50	92.10	92.39	92.02	91.65					
Bonds	2374	4091	5233	7337	12076	1.19	1.38	1.46	1.95	2.78					
Other liabilities	3297	5091	5640	5196	8469	1.65	1.71	1.58	1.38	1.95					
Balance sheet total															
End-year total	199651	297089	357301	376678	434321										
Average total	182660	256565	325235	358925	404352										

Source: OCED, 1987

Market Overview

1 Statistical banks

- clearing banks
- accepting houses
- other merchant banks
- foreign banks
- consortium banks

2 Other deposit-taking institutions

- finance houses and leasing companies
- building societies
- trustee savings banks
- government savings institutions
- special financial agencies

Over 650 institutions provide data for the Bank of England statistics. The main types of financial institutions 'not listed as statistical banks are the discount houses ..., the building societies, the finance houses and the special financial agencies' (Hendrie, 1985). Both the foreign and retail banks dominate the banking sector accounting for approximately 90 per cent of total assets. In 1986 there were 19 retail banks and over 300 foreign banks operating in the UK. The recent liberalisation of the UK securities market has heralded a new era for British banks. Banks, money brokers and foreign institutions can participate relatively freely in the financial markets. UK and overseas banks have acquired wholly-owned broking and jobbing firms to enact securities business for their clients and on their own account. 'The result is that London is becoming one of the most liberalised and broadly based financial markets of the world' (Arthur Andersen, 1986).

There are many ways to classify the UK banking and credit sectors as can be seen from the breakdowns in the statistical overview. This paper will adopt the classification according to Hendrie (1985).

1 Reporting banks

This group includes the clearing banks, accepting houses, 'other British banks', the foreign banks and the consortium banks.

Clearing banks - this group is so-called because they have traditionally dealt with the majority of the country's cheque and credit clearing. Six London and Scottish clearing bank groups dominate this sector; Barclays, Lloyds, Midland, National Westminster, The Royal Bank of Scotland and the Bank of Scotland. The first four have extensive branch networks throughout England and Wales (they are known as the 'Big Four' London clearing banks) whereas the latter's branch network is predominantly based in Scotland. The London clearing banks accounted for '65 per cent of sterling advances to UK residents in 1983 compared with the Scottish clearing banks' seven per cent' (Hendrie, 1985).

They also have much larger branch networks, approximately 10,500 in 1985 compared with the Scottish clearing 1,785. The National Girobank, the state-owned organisation established in 1968 to offer money transmission services through post offices as well as the Trustee Savings Bank and the Co-operative banks are also members of the Bankers Clearing House in London.

The 'Big Four' London clearing banks offer the whole range of banking products and services to the general public and dominate the money transmission facilities within the UK.

'Their subsidiary companies, many of which are themselves recognised banks or licensed deposit takers, concentrate on offering specialised services and facilities many with a bias towards the requirements of their parents' larger corporate domestic and overseas customers. Some foreign subsidiaries, however, provide a wide range of banking services through branch networks in the territories in which they operate akin to the operations of their parents in the United Kingdom' (OECD, 1987).

Clearing banks offer traditional current and deposit account facilities and in recent years have introduced interest-bearing chequing accounts. The clearing banks also play a large role in the market for wholesale deposits. The majority of their funding comes from these two sources. These banks also dominate the retail and corporate lending markets in the UK. Retail customers have access to overdraft and short-term unsecured lending. Since 1980, the banks have also made major inroads in the longer-term mortgage finance market accounting for approximately one-sixth of building society and bank mortgage lending at the end of 1984. Corporate banking facilities have been traditionally provided by the banks' merchant banking subsidiaries. These subsidiaries allow the clearers to 'offer a wide range of services, including corporate advice, mergers, new issues and equity participation' (Hendrie, 1985). Up to three years ago, commercial banks dominated the bank-loan market, merchant banks 'were the prima donnas of corporate finance, stockbrokers acted as agents for debt and equity investors, and jobbers had a monopoly on market making in securities' (Economist, 30th August 1986). Since the liberalisation of the UK financial markets on the 27th October 1986, the four big clearing banks have expanded their brokerage and securities business. Through their merchant banks arms, together with the purchasing of jobbing and broking firms, banks now undertake business ranging from equities markets making and primary dealing in gilts to more traditional lines of business (see Table 4).

Accepting houses - members of the Accepting Houses Committee form the 'top échelon' of the merchant banking sector. By the end of 1984 there were 16 members. These banks have a special relationship with the central banking authorities in that their sterling acceptances are eligible for rediscount at the Bank of England. 'Their businesses include acceptance credits and other banking services, as well as corporate finance and investment management ...' (Hendrie, 1985). They are heavily involved in the new issues of securities and mergers and

acquisitions business. The accepting houses also have investment subsidiaries that manage mutual funds (unit trusts), investment trusts and large securities portfolios for private as well as institutional investors. 'Other services provided by accepting houses and related companies include leasing, export finance, insurance broking, bullion dealing and the provision of venture capital' (Hendrie, 1985).

Other merchant banks - this group is dominated by the subsidiaries of other banks, for example, County Bank (National Westminster) and Barclays Merchant Bank, as well as British overseas banks and merchant banks that are not members of the Accepting Houses Committee. Some perform the same functions as the accepting houses but do not have the 'special' relationship with the central banks.

Foreign banks - at 31st December 1986 foreign banks held over sixty per cent of the UK banking systems's total assets. There are approximately 400 foreign owned banks now operating in London. 'These banks have tended to concentrate on commercial lending, trade finance and trading on the money markets' (Arthur Andersen, 1986). Both the American and Japanese as well as the European banks are very active in the UK capital markets and offer the range of services similar to the merchant banks. Many purchased stockbrokers and jobbers prior to the reorganisation of the UK securities market on 27th October 1986. Typically the foreign banks have been involved primarily with wholesale and corporate banking services, although they do provide rather limited retail facilities. 'In addition a number of US banks own finance houses subsidiaries and savings institutions ...' (Arthur Andersen, 1986).

Consortium banks - these are banks owned by other banks, 'where no one institution has a shareholding of more than 50 per cent, and in which at least one shareholder is based overseas' (Bank of England, 1983). 'The major activity of consortium banks is the provision of term lending in foreign currency, mostly to overseas borrowers. They are also active in syndicated loans and international bond issues' (Hendrie, 1985).

2 Other deposit taking institutions

Finance houses and leasing companies - at the end of 1984 approximately 80 to 90 per cent of total finance house business was undertaken by the 42 members of the Finance Houses Association. A few of the largest finance houses are subsidiaries of the main clearing banks, eg Forward Trust (Midland Bank). Their main business includes medium-term instalment credit which includes hire purchase, leasing and lending to household and companies. It is noted (Hendrie, 1985) that the clearing banks had over 50 per cent of the UK leasing market through their subsidiaries.

Building societies - at the end of 1985 the UK had 167 building societies with total assets exceeding ECU 205,314 million. Traditionally this group has obtained funds from consumers through share and deposit balances and used these mainly for financing home purchases. 'The two largest UK building societies would rank by total deposits among the world's largest 100 banks' (Arthur Andersen, 1986). The 1986

Building Societies Act extended the traditional role of the building societies and now they are able to offer a whole range of banking, investment, insurance and non-financial products. Out of the top 20 UK building societies, 19 offer insurance products through their extensive branch networks. Most of the larger groups offer cheque books and personal loans. Securities transactions can be carried out through the Anglia, National and Provincial, Britannia and Bristol and West building societies.

Trustee Savings Bank (TSB) - the TSB Group had assets amounting to ECU 20,839 million by the end of 1984. It is one of the largest personal banking groups in the UK. Since the 1976 Trustee Savings Bank Act the TSB has developed as a broad retail banking organisation. Prior to 1976 the TSB raised funds through ordinary and investment retail accounts through its substantial regional network. 'They have expanded their savings, investment and current account facilities, and now offer personal loans introduced in 1977, mortgage loans (1979) and corporate finance (1980)' (Hendrie, 1985). As well as these services, they also offer other retail services like insurance, travellers cheques and unit trusts. The TSB owns an insurance subsidiary as well as one of the main finance houses.

Government savings institutions - this group includes the National Savings Bank and the National Girobank which offer their services through the Post Office. The National Savings Bank offers deposit and cash withdrawal facilities mainly for retail customers. It is involved with the issuing of National Savings Certificates. Funds raised by the government through the National Savings Bank are usually invested in government securities. The National Girobank offers a broader range of banking facilities through the Post Office network. It is a member of the London Bankers' Clearing House, and offers a broad range of banking services ranging from traditional retail services to credit facilities for companies, international money transmission, money market deposits and specialist investment services.

Special financial agencies - Like the 3 'i's (Investors In Industry), these institutions specialise in providing finance to companies at less onerous rates than the banks. They mainly provide venture capital and/or development finance to commercial companies. Funding is through the domestic and international money markets. Investors in industry offers loans and equity finance.

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2.5 Belgium

Statistical Overview

Table 1 Main financial intermediaries in Belgium 1970-85

Table 2 Percentage share of the different intermediaries in the whole financial sector at 31st December 1985

Table 3 Balance sheet structure of Belgian banks 1980-84

Table 4 Balance sheet structure of private savings banks 1980-84

Table 5 Belgian banks, disaggregated balance sheet, 31st December 1983

Table 6 General savings and pension banks, disaggregated balance sheet, 31st December 1983

Table 1 Main financial intermediaries in Belgium 1970-85

Year	Banks	Private savings banks	Public credit institutions	Societies de Credit	Total
Number (units)					
1970	78	36	6	44	164
1980	83	31	6	25	145
1985	84	29	6	16	135
Balance sheet total (ECU million)					
1970	15.188	2.888	11.154	.460	296.899
1980	101.133	14.690	45.833	1.815	163.470
1985	197.214	25.057	65.515	1.294	289.080
Deposits					
1970	7.613	2.567	9.908	0.215	20.303
1980	36.333	12.980	40.665	1.165	91.143
1985	58.078	20.011	55.242	0.659	133.990

Source: Association Belge des Banques, Annual Report, 1986, p 100

Table 2 Percentage share of the different intermediaries in the whole financial sector at 31st December 1985

Year	Banks	Private savings banks	Public credit institutions	Total
Balance sheet total				
1970	51.9	9.9	38.2	100
1980	62.6	9.1	28.3	100
1985	68.5	8.7	22.8	100
Total deposits				
1970	37.9	12.8	49.3	100
1980	40.4	14.4	45.2	100
1985	43.6	15.0	41.4	100
Credit to private sector				
1970	35.8	13.4	50.8	100
1980	42.9	13.8	43.3	100
1985	44.2	13.8	42.0	100

Source: Association Belge des Banques, Annual Report, 1986, p 100 - various tables

Table 3 Balance sheet structure of Belgian banks 1980-84

(million ECU)

Balance sheet	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
Assets															
Cash and balance with central bank	347	330	314	312	406	0.34	0.26	0.23	0.20	0.22					
Interbank deposits	40211	55006	59249	69527	82349	39.76	42.92	43.58	44.18	45.04					
Loans	36565	44191	45063	48373	54049	36.16	34.48	33.15	30.73	29.56					
Securities	20014	23482	25937	33544	38263	19.79	18.32	19.08	21.31	20.98					
Other assets	3996	5144	5393	5636	7684	3.95	4.01	3.97	3.58	4.20					
Liabilities															
Capital and reserves	2692	3130	3243	3955	4602	2.66	2.44	2.39	2.51	2.52					
Borrowing from central bank				Included in interbank deposits											
Interbank deposits	57274	77565	83377	98432	117358	56.63	60.52	61.33	62.54	64.18					
Non-bank deposits	31562	35169	36256	40614	44363	31.21	27.44	26.66	25.81	24.26					
Bonds	4772	5774	6574	7752	8601	4.72	4.51	4.84	4.93	4.70					
Other liabilities	4834	6516	6511	6636	7927	4.78	5.08	4.79	4.22	4.34					
Number of institutions	83	84	84	84	84										

Source: OECD, 1987

Table 4 Balance sheet structure of private savings banks 1980-84
(million ECU)

Balance sheet	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
Assets															
Cash and balance with central bank	84	72	64	55	66	0.57	0.45	0.38	0.28	0.30	0.57	0.45	0.38	0.28	0.30
Interbank deposits	380	608	730	850	1061	2.58	3.78	4.33	4.29	4.80	2.58	3.78	4.33	4.29	4.80
Loans	7822	7872	7459	7947	8166	53.25	48.93	44.17	40.13	36.93	53.25	48.93	44.17	40.13	36.93
Securities	5587	6643	7620	9745	11407	38.03	41.29	45.13	49.21	51.58	38.03	41.29	45.13	49.21	51.58
Other assets	816	894	1012	1205	1414	5.56	5.56	5.99	6.08	6.40	5.56	5.56	5.99	6.08	6.40
Liabilities															
Capital and reserves	602	627	664	765	914	4.10	3.89	3.93	3.86	4.14	4.10	3.89	3.93	3.86	4.14
Borrowing from central bank	2	2	3	3	0	0.01	0.01	0.02	0.01	0.00	0.01	0.01	0.02	0.01	0.00
Interbank deposits	98	57	65	92	97	0.67	0.35	0.38	0.47	0.44	0.67	0.35	0.38	0.47	0.44
Non-bank deposits	9794	10822	11368	13081	14943	66.67	67.26	67.32	66.06	67.57	66.67	67.26	67.32	66.06	67.57
Bonds	3492	3765	3904	4772	5036	23.77	23.40	23.12	24.10	22.77	23.77	23.40	23.12	24.10	22.77
Other liabilities	701	817	881	1089	1126	4.77	5.08	5.22	5.50	5.09	4.77	5.08	5.22	5.50	5.09
Number of institutions	31	30	30	31	28										

Source: OCED, 1987

Table 5 Belgian banks, disaggregated balance sheet, 31st December 1983

	ECU billion	%
Assets		
Due from banks	66.780	42.9
Credit to the private sector (residents) ¹	25.422	16.3
Foreign credit	21.762	14.0
Credit to the Belgian public sector		
short-term bills	12.249	7.9
long-term bills	16.079	10.3
Securities and participations	4.842	3.1
Fixed assets	0.757	0.5
Total	155.624	100.0
Liabilities		
Bankers' deposits	93.505	60.1
Customers' deposits		
demand deposits	10.686	6.9
term deposits	20.185	13.0
savings deposits	9.287	6.0
bonds	7.666	4.9
Capital and reserves ²	3.562	2.3
Total	155.624	100.0

Source: Hendrie, 1985

Notes: 1 including rediscounted bills
2 including subordinated loans

Table 6 General Savings and Pension Banks¹, disaggregated balance sheet, 31st December 1983

	ECU billion	%
Assets		
Housing credit	6.752	36.3
Credit to undertakings	2.785	15.0
Credit to public sector	4.648	25.0
Total	18.594	100.0
Liabilities		
Deposits by private persons	15.939	85.7
ordinary savings books	7.871	42.3
savings bonds	4.602	24.8
Institutional deposits	-	-
Total	18.594	100.0

Source: Hendrie, 1985

Notes: 1 Savings banks only; the consolidated balance sheet (savings bank, life assurance and industrial accidents fund) totalled BF 933.5 billion at the same date

Market Overview

- 1 Banks
 - Money market banks
 - Customer banks
 - Diversified banks
- 2 Private Savings Banks
- 3 Public Credit Institutions
 - General Savings and Pension Bank
 - National Industrial Credit Corporation
 - Communal Credit of Belgium
 - Other public credit institutions
- 4 Post Office Giro
- 5 Other financial institutions

1 Banks

Belgian banks can be divided into three main categories:

- 1 Money market banks
- 2 Customer banks
- 3 Diversified banks

Money market banks are quantitatively the largest category and consist of organisations that typically have only one or a few branches. Funds come mainly from bankers' deposits. The majority of their business is concerned with international activity, namely overseas transactions and foreign exchange business. They are mainly branches or subsidiaries of foreign banks. This group can be subdivided between those banks that provide a broad range of credit activities and others involved mainly in investing on the interbank market, ie eurocurrency business.

Customer banks are small and medium-sized banks that focus their operations at households and foreign exchange business. These institutions can also be split up into two categories - those that focus deposit collection on households and those that concentrate in the business sector. Most of the organisations concentrating on retail deposit-taking have local or regional branch networks. They lend primarily to small and medium-sized commercial organisations and to consumers.

Diversified banks are mainly large institutions that carry out a whole range of banking services. This category includes Belgium's three largest banks, Société Générale de Banque, Banque Bruxelles Lambert and Kredietbank. Their business covers both the retail and corporate sector including most types of eurobusiness. These institutions have large branch networks and substantial deposit bases. They undertake substantial international and foreign exchange business as well. Finally, this third category includes a few medium sized 'wholesale banks' that have very small branch networks and deal almost exclusively with the commercial sector.

'... banks may not hold shares or participations in commercial or commercial-type companies nor in partnerships, except in the following cases: if they are shares or participations in credit institutions, banks or savings banks; if the banks have acquired these securities with a view to offering them for sale ...' (Hendrie, 1985).

2 Private savings banks

The main function of private savings banks is to receive and manage funds taken mainly from private individuals. The majority of their lending is focused on mortgage lending although some savings banks, especially the larger ones, have begun to reduce their specialisation and are focusing more on a wider range of commercial banking activities. Assets are principally mortgages and government securities. Typically, savings banks do not participate as much as the banks in international business and their clientele is mainly retail.

3 Public credit institutions

The main public credit institutions; the General Savings and Pensions Bank, the National Industrial Credit Corporation and the Communal Credit of Belgium, provide specific financial services throughout the Belgium financial system.

The General Savings and Pensions Bank is one of the world's largest savings banks, it raises its funds mainly from savings deposits, a huge pool of which enables it to undertake various banking business (see Table 6). On the assets side, it lends mainly for residential housing finance and provides credit to the public sector mainly by purchasing government securities. Commercial credit usually takes the form of medium to long-term loans as well as purchasing National Industrial Credit Corporation notes and bonds. This organisation also undertakes export finance through its participation in the Creditexport pool. In 1980 the General Savings and Pension Fund became a public bank (on the savings collection side of its business) and this has encouraged it to diversify even further. It now caters for pensions, life insurance and mortgage business.

National Industrial Credit Corporation was originally established to provide medium or long-term loans to domestic, industrial, commercial and agricultural companies. The Belgian government holds approximately half of its capital. The main line of business is in long and medium term investment credits to the aforementioned groups. The main source of funding is the issue of bonds.

Communal Credit of Belgium acts as banker for the provinces and municipalities. Long term loans constitute the major portion of its assets. These are funded predominantly by the issue of medium-term notes. It has virtually become a full bank providing chequing and various credit facilities for its customers.

Other public credit institutions

National Fund of Professional Credit - this institution specialises in medium and long-term loans to small and medium-sized firms and various self-employed craftsmen.

National Institute of Agricultural Credit - specialises in medium and long-term credit to the agricultural sector.

Central Mortgage Credit Board - the main business is granting mortgage credits.

4 Post Office Giro

The Post Office does not lend and only accepts non-interest bearing deposits in current accounts. Its main function is funds transfer. This organisation is usually perceived as being the banks' main competitor for funds transfer.

5 Other Financial Institutions

Mortgage companies)	are all specialised
Finance companies)	and of relatively
Leasing and factoring companies)	small size

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2.6 Luxembourg

Statistical Overview

- Table 1 Total balance sheets and number of banks and savings institutions in Luxembourg, 1960-85
- Table 2 Geographic origin of banking and savings institutions established in Luxembourg, 1980-85
- Table 3 Luxembourg banks - assets and liabilities at 31st December 1984
- Table 4 Luxembourg euromarket liabilities by currency and eurocurrency assets by country of borrower - third quarter 1985
- Table 5 Luxembourg banks' balance sheet totals 1980-85

Table 1 Total balance sheets and number of banks and savings institutions in Luxembourg, 1960-85

Situation at year-end	Number of banks	Sum total of banks' balance-sheets (billion ECU)
1970	37	4.617
1975	76	32.434
1976	78	39.592
1977	90	51.734
1978	97	62.629
1979	108	80.991
1980	111	96.478
1981	115	123.056
1982	115	133.907
1983	114	145.070
1984	115	161.334
1985	119	-

Source: Treasury, 1986 (adapted)

Table 2 Geographic origin of banking and savings institutions established in Luxembourg, 1980-85

	A	B	C	D	E	F	G	H	I	J	K
December 1980	111	12	29	6	5	7	14	11	4	12	11
December 1981	115	13	29	7	6	7	14	11	4	12	12
December 1982	115	13	30	8	7	8	14	10	4	12	9
December 1983	114	12	31	8	7	7	14	11	4	13	7
December 1984	115	12	28	8	8	7	15	10	5	15	7
December 1985	119	12	29	8	7	6	16	12	5	16	7

Source: Treasury, 1986 (adapted)

Key:

- A Number of institutions
- B Luxembourg-Belgium
- C Germany (FR)
- D France
- E Italy
- F Switzerland
- G Scandinavia
- H USA
- I Japan
- J Other countries
- K Multinational joint ventures

Table 3 Luxembourg banks - assets and liabilities at 31st December 1984

(billion ECU)

Assets	
deposits with banks	82.932
loans	59.785
bills and bonds	15.788
other assets	4.973
Total ¹	163.477
Liabilities	
deposits from banks	112.947
other deposits	35.255
capital, subordinated loans, reserves	8.674
other liabilities	6.601
Total ¹	163.477

Source: Luxembourg Monetary Institute

Note: 1 Proportion of balance sheets denominated in foreign currencies: about 89 per cent of total assets

Table 4 Luxembourg euromarket liabilities by currency and eurocurrency assets by country of borrower - third quarter 1985

(% of total: third quarter 1985)

	Banks in BIS reporting area ¹	Luxembourg
US\$	68.7	47.2
DM	12.1	30.2
Swfr	6.0	9.4
Western Europe	46.6	68.1
Eastern Europe	3.5	5.6
North America	14.0	5.1
Latin America and Caribbean	12.7	11.2
Middle East	3.1	1.3
Far East, etc ²	12.5	3.1
Other	7.6	5.6

Source: Blanden, 1986

Notes: 1 Germany, Belgium, France, Italy, Luxembourg, the Netherlands, UK, Sweden, Switzerland, Austria, Denmark, Ireland, Spain, Finland, Norway

2 Japan, Singapore, Australia, New Zealand, South Africa

Table 5 Luxembourg banks' balance sheet totals 1980-85

	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
	ECU million					% of average total assets									
Balance Sheet															
Assets															
Cash and balance with central bank	134	144	187	170	273	0.14	0.12	0.14	0.12	0.14	0.14	0.12	0.14	0.12	0.17
Interbank deposits	50219	61866	68252	73190	82385	52.05	50.28	50.97	50.45	50.45	52.05	50.28	50.97	50.45	51.07
Loans	33848	47293	50742	54012	59000	35.08	38.43	37.89	37.23	37.23	35.08	38.43	37.89	37.23	36.57
Securities	4607	4864	5657	7510	8986	4.77	3.95	4.22	5.18	5.18	4.77	3.95	4.22	5.18	5.57
Other assets	7679	8883	9072	10181	10682	7.96	7.22	6.77	7.02	7.02	7.96	7.22	6.77	7.02	6.62
Liabilities															
Capital and reserves	2956	3617	4045	4635	5305	3.06	2.94	3.02	3.20	3.20	3.06	2.94	3.02	3.20	3.29
Borrowing from central bank	0	0	0	0	0	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Interbank deposits	70896	88323	96077	102464	11146	73.48	71.78	71.75	70.63	70.63	73.48	71.78	71.75	70.63	69.09
Non-bank deposits	17944	24412	26286	29364	34792	18.60	19.84	19.63	20.24	20.24	18.60	19.84	19.63	20.24	21.57
Bonds	868	1187	1420	2134	2767	0.90	0.96	1.06	1.47	1.47	0.90	0.96	1.06	1.47	1.72
Other liabilities	3823	5510	6082	6465	7007	3.96	4.48	4.54	4.46	4.46	3.96	4.48	4.54	4.46	4.34
Balance sheet total	96487	123050	133910	145062	161327										
End-year	89229	113337	130490	137413	150329										
Average total															
Number of institutions	111	115	115	114	115										

Source: OECD, 1987

Market Overview

- 1 Main domestic banks
- 2 Specialised banks
- 3 Foreign banks
- 4 Financial institutions of the EEC

On 31st December 1985 there was a total of 203 credit institutions of which 119 enjoyed full bank status. In addition, 22 non-bank financial institutions, which mainly perform specialised operations such as leasing and factoring or granting farm credits to the agricultural sector, were also resident in the Luxembourg market. Up until the mid-1960s, the majority of banks in Luxembourg 'existed principally to serve the needs of the local community' (Hendrie, 1985), but over the last twenty years developments in European financial and capital markets have helped Luxembourg to become one of the major centres for eurobanking. The Grand Duchy's share of euromarket business was approximately 9 to 9.5 per cent in 1986 (see Financial Times, 1986). This helps to explain why nearly 90 per cent of banks and savings institutions operating in Luxembourg are foreigners. In addition:

'A special characteristic of the Luxembourg banking business is that ... Luxembourg banks are incorporated as 'banques mixtes'. No distinction is made between clearing banks, merchant banks and investment banks. No legal provision prevents them from exercising the activities of all of them, but for obvious reasons each operates on a selective basis' (Hendrie, 1985).

Approximately two thirds of the domestic commercial business is undertaken by a relatively small number of banks, mostly the agricultural co-operatives as well as branches of French banks that have been established in Luxembourg for a long time. As Luxembourg was one of the forerunners in developing the eurobond market and the 'holding company status was found to be perfectly suited as a vehicle of raising capital in the international market' (Arthur Andersen, 1986), this encouraged foreign banks to enter the market, primarily undertaking international banking business in the euromarkets. As would be expected, most local business is undertaken by the domestic banks whereas international business is dominated by foreign financial institutions. Typically, a universal banking system prevails.

1 Main domestic banks

Domestic banks only accounted for just over ten per cent of total banking assets in 1985. The largest domestic institution is the state-owned savings bank 'Caisse d'Epargne de l'Etat. Three other Luxembourg banks also play an important role in domestic banking business: Banque

Générale du Luxembourg (BGL), Banque Internationale à Luxembourg (BIL) and Kredietbank SA (Luxembourgeoise (KBL). All these are affiliated to the three main banking groups in Belgium. These three banks offer a broad range of retail products through their branch networks within the Duchy. Their main source of funds is from retail deposits and substantial deposit accounts registered in the name of Belgian residents. They compete mainly with the state savings bank, the Caisse d'Epargne de l'Etat, which held over 60 per cent of the total savings of Luxembourg banks by the end of 1984. These institutions' traditional business has been to obtain savings deposits from residents and to channel these funds back into medium and long-term lending to the public and private sector, especially for housing finance. As the Caisse d'Epargne is the only institution which is governed by public law, it undertakes certain central bank functions, for example, it acts as a clearing centre for other banks. Recently it has begun to develop its international business, although most of its business is with the non-bank resident sector. The three large private banks offer a fuller variety of services ranging from traditional retail businesses to international/eurobanks facilities and bullion transactions.

2 Specialised banks

This group includes consumer credit institutions, Central Agricultural Co-operative Bank (Caisse Centrale Raiffeisen) and the National Credit and Investment Company. The consumer credit institutions offer hire purchase facilities for consumers, a type of business that is not usually offered by the banks. Nevertheless, banks either own or have a controlling interest in these organisations. The Central Agricultural Co-operative whose members are predominantly individuals involved in the agricultural industry offers preferential lending facilities to its clients. Finally the National Credit and Investment Company (a public group) concentrates on medium to long-term lending to industry, export credits, guarantees and equity participation.

3 Foreign banks (mainly Eurobanks)

Foreign banks account for approximately 90 per cent of the banking systems' total assets in 1985. The majority of these banks 'hold their capital in currencies other than the Luxembourg franc' (OECD, 1987). Their operations concentrate almost exclusively on eurobanking business. They operate in all areas of international banking and in 1986 had over nine per cent of total euromarket business. All Luxembourg banks are governed by the same legal system, which enables them 'to undertake all the usual banking transactions' (OECD, 1987). This has encouraged domestic banks to offer private banking services (mainly portfolio management services for private customers). An important point to note is that the classification for the Luxembourg financial system varies considerably. Arthur Andersen breaks the group into three; commercial banks, eurobanks and Cedel (an international clearing house for eurobonds), whereas Hendrie (1985) and OECD (1987) have quite different categories. The above classification is our own.

4 Financial institutions of the EEC

Two main financial institutions of the EEC are based in Luxembourg; the European Investment Bank and the Directorate General of Credit and Finance. These add, '... a further dimension to the financial centre, in both the eurobond and eurocurrency markets, they play a significant role' (Arthur Andersen, 1986).

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2.7 Netherlands

Statistical Overview

Table 1 Netherlands banking system: balance sheet totals of registered credit institutions and mortgage banks, 30th December 1985

Table 2 Number of financial institutions registered with the Central Supervisory Authority

Table 3 Balance sheet of banks in the Netherlands 1980-84

Table 4 The top ten banks in the Netherlands

Table 5 Savings banks in the Netherlands

Table 1 Netherlands banking system: balance sheet totals of registered credit institutions and mortgage banks, 30th December 1985

(million ECU)

	Total	%
Universal banks, banks organised on a co-operative basis and their central credit institution (Rabobanks)	209,020	90.7
Security credit institutions	459	0.2
Savings banks	13,847	6.0
Mortgage banks	7,089	3.0
Total	229,606	100.0

Source: De Nederlandsche Bank NV Quarterly Bulletin, 1986

Note: The Quarterly Bulletin does not provide an institution breakdown for the largest category

Table 2 Number of financial institutions registered with the Central Supervisory Authority

Description	End-1984	End-1985
Universal banks	85	83
Banks organised on a co-operative basis:		
- banks organised on a co-operative basis	949	938
- affiliated savings banks	950	939
Total	1,899	1,877
Security credit institutions	17	18
Associated savings banks	54	53
Non-member savings banks	13	13
Total	67	66
Central credit institutions	1	1
Mortgage banks	8	8
Other capital market institutions	2	2
Total	10	10
Grand Total	2,079	2,055

Source: De Nederlandsche Bank NV, Annual Report, 1985

Table 3 Balance sheet of banks in the Netherlands 1980-84

(ECU million)

Balance sheet	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
Assets															
Cash and balance with central bank	1908	2184	1823	1669	1823	1.42	1.44	1.08	0.92	0.92	1.42	1.44	1.08	0.92	0.92
Interbank deposits	39428	48218	50676	52835	63029	29.36	31.71	30.14	29.02	31.86	29.36	31.71	30.14	29.02	31.86
Loans	80519	86294	96563	102734	107151	59.96	56.76	57.43	56.44	54.16	59.96	56.76	57.43	56.44	54.16
Securities	7672	9323	11908	14415	16541	5.71	6.13	7.08	7.92	8.36	5.71	6.13	7.08	7.92	8.36
Other assets	4761	6018	7160	10383	9296	3.54	3.96	4.26	5.70	4.70	3.54	3.96	4.26	5.70	4.70
Liabilities															
Capital and reserves	4169	4795	5573	6191	6875	3.10	3.15	3.31	3.40	3.47	3.10	3.15	3.31	3.40	3.47
Borrowing from central bank	2156	3132	1933	2631	2191	1.61	2.06	1.15	1.45	1.11	1.61	2.06	1.15	1.45	1.11
Interbank deposits	44741	52502	55573	58211	61258	33.32	34.53	33.05	31.98	30.96	33.32	34.53	33.05	31.98	30.96
Non-bank deposits	62299	69490	79275	84010	94293	46.39	45.71	47.15	46.15	47.66	46.39	45.71	47.15	46.15	47.66
Bonds	12037	11976	13118	14764	15720	8.96	7.88	7.80	8.11	7.95	8.96	7.88	7.80	8.11	7.95
Other liabilities	8887	10143	12657	16230	17503	6.62	6.67	7.53	8.92	8.85	6.62	6.67	7.53	8.92	8.85
Balance sheet total	134288	152038	168130	182036	197839										
End-year total	125197	142800	164767	177635	190443										
Average total															
Number of institutions	86	90	91	92	86	1.18	4.65	1.11	1.10	-6.52	1.18	4.65	1.11	1.10	-6.52

Source: OCED, 1987

Note: Banks include 'universal banks' and banks organised on a co-operative basis

Table 4 The top six banks in the Netherlands

	Balance sheet totals						Net income									
	1976/80		1983		1984		1985		1976/80		1983		1984		1985	
	(% increase)		(% increase)		(% increase)		Amount 1985 (ECU b1)		Amount 1985 (ECU b1)		(% increase)		Amount 1985 (ECU b1)		Amount 1985 (ECU b1)	
Amro	17.1	9.6	1.9	7.2	53.286	10.0	28.4	19.1	34.9	135.404						
ABN	18.1	7.0	10.9	-3.2	56.671	10.8	7.1	4.5	19.2	190.362						
Nederlandsche Middenstandsbank	21.1	6.6	7.7	2.7	27.957	22.3	14.1	8.9	22.1	67.304						
Nederlandsche Credietbank	19.2	1.5	1.4	-13.9	5.257	11.7	21.6	-21.1	9.9	3.106						
Credit Lyonnais Nederland	16.4	-4.2	24.3	17.6	6.412	-16.0*	-	-	-	-						
Rabobank	17.7	7.4	7.7	3.4	52.449	24.8	15.6	9.4	8.1	266.029						

Source: Financial Times, 16th July 1986

Note: * After tax profits have been allocated to the general contingency provisions since 1983 when Slavenburg's Bank was wholly acquired by Credit Lyonnais

Table 5 Savings banks in the Netherlands

	Total assets end-1985 (ECU million)
1 Verenigde Spaarbank, UTRECHT	3785
2 Nutsspaarbank te's Gravenhage, the Hague and Bondsspaarbank NOORDWIJK (merger announced)	1479
3 Bondsspaarbank Midden Noord en Oost Nederland AMERSFOORT	1379
4 Gelders-Utrechtse Spaarbank, WAGENINGEN and Spaarbank Limburg, MAASTRICHT (merger announced)	1268
5 Centrale Volksbank/Algemene Spaarbank voor Nederland, UTRECHT	1049
6 Cooperatieve Vereniging van Bondsspaarbanken WA UTRECHT	902
7 Nutsspaarbank West Nederland, HAARLEM	820
8 Bondsspaarbank Centraal en Osstelijk Nederland, APELDOORN	539
9 Other savings banks (20)	1108
	<hr/>
Total	12330
	<hr/>

.... / cont

Joint Balance Sheet

(ECU million)

Liabilities	1985	Assets	1985
Due to depositors	10,870	Cash on hand, PO, cheques and transfer accounts, Bankers	8,395
Various liabilities	358	Loans to individuals	197
Reserve	1,101	Securities	2,978
		Mortgages	4,618
		Long term loans	3,076
		Various assets	622
	<hr/> 12,330		<hr/> 12,330

Joint Profit and Loss Account

(ECU million)

Expenditure	1985	Income	1985
Salaries, social taxes etc	137	Interest earned	404
General costs	129	Commission	17
Depreciation	21		
Provisions and extraordinary losses	13	Extraordinary profits	19
Company tax	15		
Net profit	124		
	<hr/> 439		<hr/> 439

Source: Euromoney, 1986

Market Overview

- 1 Universal retail banks
- 2 Merchant/investment banks
- 3 Co-operative banks
- 4 Savings banks
- 5 Government savings institutions
- 6 Mortgage banks
- 7 Finance houses
- 8 PPMs
- 9 Security credit institutions
- 10 Foreign banks
- 11 Other capital market institutions

Under Dutch law, credit institutions and capital market organisations are classified into six main groups:

- universal banks
- banks organised on a co-operative basis
- security credit institutions
- savings banks
- mortgage banks
- other capital market institutions

The large universal banks operate in a similar fashion to their West German counterparts and offer a whole range of financial services. Banks organised on a co-operative basis (sometimes called agricultural credit banks) also offer a wide range of services. The other groups are more specialised and concentrate on specific aspects of financial service provision. Classification of the Dutch financial system appears to differ considerably (see Hendrie, 1985; Arthur Andersen, 1986 and OECD, 1987). This paper will adopt the Arthur Andersen (1986) classification. The Netherlands has approximately 90 banks, of which half are foreign owned or are branches of foreign banks.

1 Universal retail banks

As has already been mentioned, this group provides a whole range of financial services from commercial banking, investment banking, stockbroking to insurance business. Traditionally, these institutions have had a markedly different business focus, recently the distinctions have become less clear and they now offer comparable services. These institutions are Algemene Bank Nederlandsche NV (ABN Bank), Amsterdam Rotterdam Bank NV (Amro Bank), Nederlandsche Bank, Co-operative Raiffeisen Boerenleenbank (Rabobank). (The Rabobank is sometimes classified with the co-operative bank category.) The three major banks in this category are Amro, ABN and the Rabobank. Amro concentrates its business mainly on the Dutch market whereas ABN has substantial overseas interests. These banks offer all the usual credit facilities to the business sector; overdrafts, short-term and medium-term loans (up to 10 years), leasing and factoring. They also provide cheap credits to small

businesses, especially to firms operating in the retail sector. The banks' consumer lending ranges from overdraft facilities to house finance loans. Funding comes mainly from time and savings deposits as well as resources raised on the public and private capital markets. It is important to note that this group is the main subset of commercial banks in the Netherlands. Although there are some 90 commercial banks in the Netherlands, the 'universal' banks dominate this section.

2 Merchant/Investment banks

Arthur Andersen (1986) is the only source of information that specifically classifies this group. The most important firms being, Pierson, Holding and Pierson NV (AMRO), Bank Mees and Hope NV (ABN) and F van Lanschat Bankiers NV (RABO-Nat West). 'Although these banks do not differ much other than in size from the retail banks, their business emphasis is directed to corporate and portfolio management clientele' (Arthur Andersen, 1986).

3 Co-operative banks (Agricultural credit banks)

The co-operative banks were initially set up in order to provide savings and credit facilities for the agricultural community. They are organised on a co-operative basis and are centralised in the RABO bank. At the end of 1983 there were 964 banks of this type in the Netherlands. Traditionally their business has been retail (consumer) orientated but in recent years they have increasingly directed their services towards large corporate clientele. Overall, the activities they are permitted to undertake are the same as for the commercial banks.

4 Savings banks

After several amalgamations by mid-1986 there were less than 30 independent savings banks in the Netherlands and they are now all members of the Netherlands Association of Savings Banks (Nederlandse Spaarsbankbond). Nine savings banks have total assets of more than Dfl 1 billion. Savings deposits form the main proportion of total assets. In mid-1984 savings banks had 17 per cent of the savings markets. Because of the 'social character' of these institutions they have always been limited in their business operations. Over the last decade they have concentrated on providing a wider range of retail financial services. On the lending side, savings banks have concentrated on mortgage business. Seven of the largest savings banks have recently obtained permission from the Dutch central bank to offer commercial loans. 'Smaller savings banks can grant such loans on an indirect way through co-operation with the universal bank owned by the joint savings bank' (Euromoney, 1986).

5 Government savings institutions (Rijkspostspaarbank-Postgiro)

Up to 1st January 1986 this group included the Postal Giro Service and the Post Office Savings Bank. The latter traditionally offered savings facilities for retail customers but in recent years it has widened its scope and is now quite active in the mortgage lending and consumer credit markets. On 1st January 1986 the two organisations merged to form the Postbank. Prior to the merger these two institutes were operating as a single commercial unit under the name Postgiro/RPS. Although essentially a retail bank, the new Postbank has received limited powers to enter the commercial market.

6 Mortgage banks

These banks' activities 'concentrate on the financing and, to a minor extent, on the developing of real estate projects' (OECD, 1987). There are 40 mortgage banks registered in the Netherlands, 'However, the number ... is realistically less than ten. None of these banks are really independent since all have large banks or insurance companies as major shareholders' (Arthur Andersen, 1986).

7 Finance houses

Finance houses offer mainly consumer credit services, numbering about 100 in total, they are mostly owned by banks or insurance companies.

8 PPMs (Particuliere Participatie Maatschappij)

These are venture capital institutions. As banks in the Netherlands are not allowed to hold direct stocks in companies (holdings greater than 5 per cent need central bank authorisation), the government introduced PPMs to fill the gap for venture capital funding.

'The Government guarantees the return of 50 per cent of the losses incurred by these institutions (most of which are owned by the general banks) or special projects in which they invest. Currently there are over 20 PPMs operating' (Arthur Andersen, 1986).

Other Institutions not covered in Arthur Andersen classification:

9 Security credit institutions

These are stockbrokers operating in the Dutch market. Their business is mainly to act as intermediaries for securities transactions on the stock exchange. They attract funds, usually on current accounts and lend against securities. There were 17 security credit institutions at the end of 1983 all under the supervision of the central bank.

10 Foreign banks

Over fifty per cent of the commercial banks in the Netherlands are foreign. By the end of 1983 they represented nearly 19 per cent of the commercial banks' balance sheet total. The majority of their business is directed towards corporate clientele. Recent deregulation in the Dutch capital market has enabled foreign banks to lead-manage guilder bonds and note issues (see French, 1986). This, however, has not led to a large influx of foreign banks into the Dutch market. Corporate finance is still dominated by the four major universal banks.

11 Other capital market institutions

These 'consist of two companies: one is directed at financing the activities of municipalities, while the activities of the others consist for a significant part of being an executive institution for the Government in lending money to companies for economic development' (OECD, 1987).

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2.8 Spain

Table 1 Concentration of the commercial banking system 1972-82

Table 2 Total balance sheet for the Spanish banking system 1980-84

Table 3 Total balance sheet for all private banks 1980-84

Table 4 Total balance sheet for the 'Big Seven' banks 1980-84

Table 5 Total balance sheet for savings banks 1980-84

Table 6 Total balance sheet for credit co-operatives 1980-84

Table 1 Concentration of the commercial banking system 1972-82

(percentages of total resources)

	1978	1979	1980	1981	1982
Seven large groups					
Parent banks	60.98	60.29	59.46	58.52	58.88
Subsidiaries	11.86	12.03	12.59	13.61	17.32
Group total	72.84	72.32	72.05	72.13	76.21
Other banks	27.16	27.68	27.95	27.87	23.79
Total	100.00	100.00	100.00	100.00	100.00

Source: Revell, 1984

Note: Total resources = total deposits + cash certificates in hands of public + endorsed bills

Table 2 Total balance sheet for the Spanish banking system 1980-84

(ECU million)

Balance sheet	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
Assets															
Cash balance with central bank	11,404	15,612	20,900	28,094	28,617	6.50	7.65	9.09	12.43	10.68					
Interbank deposits	14,914	16,995	24,098	23,035	31,066	8.50	8.33	10.48	10.19	11.59					
Loans	100,219	115,850	127,585	120,792	122,731	57.14	56.81	55.49	53.45	45.79					
Securities	26,298	28,527	30,755	29,522	56,996	14.99	13.99	13.37	13.06	21.26					
Other assets	22,547	26,949	26,599	24,557	28,601	12.86	13.22	11.57	10.86	10.67					
Liabilities															
Capital and reserves	12,598	15,329	16,595	18,745	21,537	7.18	7.52	7.22	8.29	8.04					
Borrowing from central bank	3,841	4,490	5,169	6,071	8,351	2.19	2.20	2.25	2.58	3.12					
Interbank deposits	12,407	14,249	21,978	20,909	27,890	7.07	6.98	9.56	9.25	10.41					
Non-bank deposits	134,521	157,067	172,192	165,631	192,068	76.70	77.02	74.89	73.29	71.67					
Bonds	3,199	3,535	4,853	5,953	8,106	1.82	1.73	2.11	2.63	3.03					
Other liabilities	8,816	9,282	9,139	8,925	10,058	5.03	4.55	3.97	3.95	3.75					
Balance sheet total															
End-year total	175,383	203,933	229,937	225,992	268,010										
Average total	160,629	187,123	212,300	209,984	247,831										
Number of institutions	353	357	362	369	363										

Source: OCED, 1987

Note: The defined banking system includes all private banks, savings banks and credit co-operatives

Table 3 Total balance sheet for all private banks 1980-84

(ECU million)

Balance sheet	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
Assets															
Cash and balance with central bank	7,542	8,999	13,211	16,878	17,224	6.14	6.26	8.24	10.90	9.44					
Interbank deposits	8,856	10,392	15,619	15,859	22,304	7.21	7.22	9.74	10.25	12.23					
Loans	76,819	88,755	95,212	87,788	87,770	62.55	61.72	59.37	56.71	48.11					
Securities	12,588	14,103	15,712	15,498	33,009	10.25	9.81	9.80	10.01	18.09					
Other assets	17,021	21,553	20,621	18,769	22,122	13.86	14.99	12.86	12.13	12.13					
Liabilities															
Capital and reserves	9,087	10,996	11,705	12,902	14,601	7.40	7.65	7.30	8.34	8.01					
Borrowing from central bank	3,400	4,091	5,048	5,733	8,138	2.77	2.84	3.15	3.70	4.46					
Interbank deposits	10,040	11,493	18,027	16,408	21,893	8.18	8.00	11.24	10.60	12.00					
Non-bank deposits	90,249	105,828	113,676	107,827	124,208	73.48	73.60	70.88	69.65	68.08					
Bonds	3,200	3,535	4,119	4,133	4,756	2.61	2.46	2.57	2.67	2.61					
Other liabilities	6,840	7,850	7,800	7,804	8,833	5.57	5.46	4.86	5.04	4.84					
Balance sheet total	122,806	143,792	160,366	154,800	182,429										
End-year total	111,844	131,521	148,810	145,043	169,187										
Average total															
Number of institutions	125	128	130	135	135										

Source: OCED, 1987

Table 4 Total balance sheet for the 'Big Seven' banks 1980-84
(ECU million)

Balance sheet	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
Assets															
Cash and balance with central bank	4,313	5,026	8,498	10,839	10,405	6.90	7.11	10.37	13.97	11.55	6.90	7.11	10.37	13.97	11.55
Interbank deposits	3,591	4,178	5,299	4,753	6,305	5.74	5.91	6.47	6.13	7.00	5.74	5.91	6.47	6.13	7.00
Loans	40,571	44,967	46,021	40,596	39,441	64.90	63.63	56.16	52.31	43.79	64.90	63.63	56.16	52.31	43.79
Securities	7,512	8,522	10,162	10,329	21,316	12.02	12.06	12.40	13.31	23.66	12.02	12.06	12.40	13.31	23.66
Other assets	6,529	7,977	11,965	11,090	12,618	10.44	11.29	14.60	14.29	14.00	10.44	11.29	14.60	14.29	14.00
Liabilities															
Capital and reserves	5,837	6,827	6,015	6,831	7,766	9.34	9.66	7.34	8.80	8.62	9.34	9.66	7.34	8.80	8.62
Borrowing from central bank	522	195	214	486	1,620	0.83	0.28	0.26	0.62	1.80	0.83	0.28	0.26	0.62	1.80
Interbank deposits	3,220	2,659	5,978	4,541	7,237	5.15	3.76	7.30	5.85	8.03	5.15	3.76	7.30	5.85	8.03
Non-bank deposits	49,367	56,420	67,339	63,522	70,846	78.97	79.91	82.18	81.84	78.65	78.97	79.91	82.18	81.84	78.65
Bonds	150	107	93	322	427	0.24	0.15	0.11	0.42	0.47	0.24	0.15	0.11	0.42	0.47
Other liabilities	3,420	4,412	2,306	1,914	2,181	5.47	6.24	2.81	2.47	2.42	5.47	6.24	2.81	2.47	2.42
Balance sheet total															
End-year total	62,516	70,669	81,945	77,608	90,077										
Average total	58,174	65,692	74,702	73,373	84,127										
Number of institutions	7	7	7	7	7										

Source: OCED, 1987

Note: The 'Big Seven' banks are: Banco Español de Credito, Banco de Bilbao, Banco Central, Banco Hispano Americano, Banco Popular Español, Banco de Santander and Banco de Vizcaya

Table 5 Total balance sheet for savings banks 1980-84

(ECU million)

Balance sheet	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
							% of year-end total								
Assets															
Cash and balance with central bank	3,761	6,409	7,289	10,376	10,753	7.98	11.99	11.79	16.29	13.85					
Interbank deposits	4,273	4,383	6,173	4,941	6,581	9.06	8.19	9.99	7.76	8.48					
Loans	20,591	23,686	28,384	29,427	31,161	43.64	44.29	45.92	46.21	40.13					
Securities	13,340	13,976	14,531	13,482	23,189	28.27	26.13	23.51	21.17	29.87					
Other assets	5,216	5,035	5,439	5,467	5,957	11.06	9.42	8.79	8.58	7.67					
Liabilities															
Capital and reserves	3,089	3,759	4,174	4,980	6,044	6.55	7.03	6.75	7.82	7.78					
Borrowing from central bank	431	399	121	94	213	0.92	0.74	0.20	0.15	0.27					
Interbank deposits	1,665	1,802	2,659	3,365	5,420	3.53	3.36	4.29	5.28	6.98					
Non-bank deposits	40,150	46,282	52,882	52,220	61,247	85.10	86.53	85.56	81.99	78.88					
Bonds	0	0	744	1,827	3,334	0.00	0.00	1.20	2.86	4.30					
Other liabilities	1,835	1,247	1,237	1,216	1,383	3.90	2.34	2.00	1.90	1.78					
Balance sheet total															
End-year total	47,181	53,489	61,807	63,686	77,649										
Average total	43,931	49,651	56,434	57,914	70,901										
Number of institutions	73	82	82	82	80										

Source: OCED, 1987

Table 6 Total balance sheet for credit co-operatives 1980-84

(ECU million)

Balance sheet	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
Assets															
Cash and balance with central bank	100	214	409	839	640	1.93	3.15	5.25	11.16	8.07					
Interbank deposits	1,785	2,230	2,306	2,227	2,181	33.04	33.47	29.73	29.71	27.44					
Loans	2,818	3,409	3,998	3,576	3,800	52.27	51.19	51.47	47.64	47.89					
Securities	381	448	511	541	790	6.97	6.77	6.53	7.26	9.99					
Other assets	311	360	549	322	521	5.80	5.43	7.02	4.24	6.60					
Liabilities															
Capital and reserves	421	565	716	863	893	7.87	8.44	9.24	11.50	11.23					
Borrowing from central bank	10	10	9	0	0	0.09	0.07	0.06	0.04	0.01					
Interbank deposits	702	954	1,302	1,137	577	12.98	14.28	16.78	15.15	7.24					
Non-bank deposits	4,132	4,948	5,643	5,592	6,613	76.55	74.33	72.68	74.53	83.39					
Bonds	0	0	0	0	16	0.00	0.00	0.00	0.00	0.00					
Other liabilities	140	195	102	-94	-166	2.53	2.87	1.26	-1.21	-2.06					
Balance sheet total	5,396	6,652	7,763	7,498	7,932										
End-year total	4,854	5,951	7,057	7,020	7,743										
Average total															
Number of institutions	155	147	150	152	148										

Source: OCED, 1987

Market Overview

- 1 Private banks
 - National banks
 - Regional and local banks
 - Commercial or mixed banks
 - Industrial banks
 - Foreign banks
- 2 Savings banks
- 3 Credit co-operatives
- 4 Public banks
- 5 Other financial institutions

On 1st January 1986 Spain entered the EEC and subsequently is allowed a seven year 'transition' period when all restrictions on foreign banks entering the domestic market will be lifted. By 1986, 37 foreign banks had already established in Spain, including 19 from other EEC countries. Of these new entrants, only those that have been permitted to buy up troubled Spanish banks have been allowed full access to the retail banking market. Only six of the foreign banks have adopted this approach and the Spanish authorities have not allowed foreign banks to take over healthy Spanish concerns. The majority of foreign banks concentrate on wholesale banking business which in fact has proved to be more profitable than those that have undertaken substantial retail activities (see Euromoney, 1986). The largest Spanish banks are relatively small compared with their foreign competitors. By 1986, Spain had only two banks in the world's top 100 and only five among the top fifty in Europe. A survey commissioned by the Banco di Bilbao in 1985 (see Situación, 1985) indicated that the main Spanish banks are smaller than their European counterparts and less geared to international business. A major feature of the Spanish banking system is that private and savings banks have to maintain compulsory investments and deposits which the government imposes on banking. These 'coefficients' as they are known reached 50 per cent of bank assets in early 1980.

1 Private banks

National banks - There are five official types of private banks operating in Spain; national banks, regional banks, local banks, industrial and foreign banks. The national banks are those banking groups with a countrywide branch network. This group is dominated by the 'Big Seven' - Banco Español de Crédito (Banesto), Banco de Bilbao, Banco Central, Banco Hispano Americano, Banco Popular Español, Banco de Santander and Banco de Vizcaya. This group together with the state-controlled Banco Exterior controlled nearly 90 per cent of total bank

deposits by the end of 1984. These banks produce a broad range of banking services from payments facilities, deposit taking, issuing of savings instruments, money market business, lending to the private and commercial sector, insurance business, securities business and portfolio management (securities transactions have to be carried out before a public notary); to foreign exchange trading and the renting of computer and other equipment.

Regional banks and local banks both perform the same types of business as their national counterparts but their activities have traditionally been restricted by geographical coverage. Regional banks are predominant in a region and local banks are restricted to one specific area. Arthur Andersen (1986) noted that this classification has 'lost much of its meaning' in recent years and it is probably easier to categorise national, regional and local banks merely by size.

Commercial or mixed banks 'offer a wide range of banking services including current accounts, deposit accounts, loans and overdrafts, bill discounting and international business' (Peat, Marwick, Mitchell, 1980). Certain restrictions that were introduced in 1962 stipulate that their investment portfolios must be made up predominantly of government securities. Banks that have concentrated their business mainly on short-term transactions are known as the commercial banks whereas those that have held stakes in industrial companies are known as mixed banks. Revell (1984) notes that in 1981 the seven large national banks 'have not far short of three-quarters of the assets of all commercial and mixed banks'.

Industrial banks were traditionally established to provide long term finance to industry. They obtained most of their funds from term deposits and from the issue of CDs and cash certificates. These distinctions have become blurred over the last two decades and industrial banks participate in many lines of business similar to the commercial and national banks. The Arthur Andersen (1986) study refers to this category as industrial/merchant banks.

Foreign banks - as has already been stated, at the end of 1985, 37 foreign banks had already been established in Spain of which six had full access to the retail banking market. This group has 'captured over 15 per cent of the loan market since 1978' (Euromoney, 1986). Spanish banks have responded by placing more emphasis on developing their corporate banking business as well as introducing new technologies into their retail branch networks.

2 Savings banks (Cajas de ahorro)

Like savings institutions in other European countries these are non-profit organisations 'administered by boards whose members receive no remuneration for their services' (OECD, 1987). The main function has been to collect retail savings deposits and grant loans to the consumer market, in addition 'they are required to purchase fixed-income securities of large enterprises' (OECD, 1987). Legislation passed on 27th August 1977 permitted savings banks to perform the same services as private banks. In 1984 80 savings banks held approximately 25 per cent

of all bank deposits. Their assets accounted for more than one third of the whole banking system. Recently savings banks have begun to expand their business offering a wider range of banking services similar to the private banks.

3 Credit co-operatives

In 1984 the 148 credit co-operatives constituted approximately three per cent of the banking systems' assets. Their funds mainly came from retail deposits and their business is concentrated in the consumer market. They are represented mainly by rural savings banks. A 'recent agreement between Banco de Crédito Agrícola and a large number of rural savings banks will foster the strengthening of these institutions' (Arthur Andersen, 1986).

4 Public banks

This category comprises the state-owned banks and the Post Office Savings Banks. The state-owned banks obtain their funds mainly from the Institute of Official Credit and this is supplemented by borrowing on the national and eurocurrency markets. They lend at preferential rates to certain industrial sectors, public authorities and to a lesser degree to individuals. State-owned banks include:

- Bank of Industrial Credit (BIC)
- Bank of Construction Credit (BCC)
- Bank of Agricultural Credit (BCA)
- Bank of Local Credit (BCL)
- Spanish Mortgage Bank (BHE)
- Spanish Export Bank

The Post Office Savings Bank offers consumer products similar to the savings banks but has the advantage of having a large national branch network.

4 Other financial institutions

Other financial institutions include money market brokerage, companies, finance companies, group investment companies, leasing companies, factoring companies and so on. These groups operate in 'very specific market segments, many of them are linked to banks and they have yet to develop a demand for their products and services in the Spanish market' (Arthur Andersen, 1986).

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3 INSURANCE

3.1 Germany

Statistical Overview

Table 1(a)	Key figures of private insurance
Table 1(b)	Key figures of private insurance (continued)
Table 2	Number of insurance companies by class of business
Table 3	Number of insurance companies under federal supervision by legal form
Table 4	Gross premium income by class of business
Table 5	Breakdown of gross premiums by legal form
Table 6	Market share of foreign insurance companies in the Federal Republic of Germany by class of business
Table 7	Number of branches of foreign insurance companies in the Federal Republic of Germany by class of business and country of origin
Table 8	Market shares of foreign insurance companies in the Federal Republic of Germany by country of origin and by form of undertaking

Table 1(a) Key figures of private insurance

	1970	1980	1984	1985
Gross premium income				
Direct business (ECU million)	7403.2	31268.9	45783.2	48607.4
of which (as %)				
Life assurance	36.4	38.9	37.1	36.5
Health insurance	14.6	12.5	12.8	12.5
Non-life insurance*	45.1	44.9	46.1	47.0
Employment(2)				
Number of employed (in 1000)	189.5	202.3	198.1	197.3
Field service of which			app 300	
Independent full-time agents			app 45	
Part-time agents			app 250	
Insurance companies(2)				
Under federal supervision				
Total number	494	536	526	535
of which				
Life assurance companies	107	108	109	110
Health insurance companies	67	51	52	54
Non-life insurance companies*	289	344	333	389
Reinsurance companies	31	33	32	32
For information				
Establishments of foreign insurance companies	50	114	112	
Investments (million ECU)				
Investment portfolio	23548.2	110431.5	190821.4	212910.6
Net new investments	2268.8	10872.0	17267.3	21344.1
Investment income		8240.4	15152.6	

Source: Statistical Yearbook of German Insurance, 1986

Notes: * all insurance classes except life and health
 1 estimated from operating results of GDV member companies
 2 without 237 pension and funeral expenses funds accounting
 for premium income of 1809.1 million ECU (1984)
 3 provisional result, BAV (Federal Supervisory Office),
 Quarterly Reports 4/86

Table 1(b) Key figures of private insurance (continued)

	1970	1980	1984	1985
Payments(2)(4)				
for the benefit of policy holders				
Total (million ECU)		26644.9	42386.7	
of which				
Life assurance		11743.9	20018.8	21952.7
Health insurance	805.6	3557.7	5661.2	5867.0
Non-life insurance*	2652.4	11343.4	16706.7	
Profit position(2)				
Profit for the year (after tax)		1.4	1.6	
as % of premiums				
Dividends paid to shareholders (million ECU)		148.6	245.3	
Economic reference figures				
Premium incomes as % of the gross national product	4.1	5.3	5.8	5.9
Monthly expenditure as an employee's household(6) on private insurance and social security (ECU)	57.90	236.74	343.92	369.1
of which				
Expenditure on private insurance cover	10.15	48.07	74.20	80.2
Expenditure on social security	47.74	188.67	269.72	288.9
Premium income of the German insurance industry as % of the world premium income(7)	6.6	9.3	6.5	

Source: Gesamtverband der Deutsche Versicherungswirtschaft eV (German Insurance Association), 1986, Cologne

Notes: 4 expenditure in respect of claims, expenditure in respect of bonuses (ie partial refund of premiums and profit allocation to policyholders), allocation to provisions
 5 estimated from the operating results of PKV (Private Health Insurance Association) member companies
 6 4 persons employee's households with an average income
 7 calculated from dollar amounts

Table 2 Number of insurance companies by class of business

End of year	companies under federal supervision						
	A	B	C	D	E*	F	G
1954 ¹	864	95	340	100	295	34	8284
1960	939	102	352	101	350	34	9853
1970	810	107	316	67	289	31	7390
1975	765	113	298	53	274	27	6299
1976	737	111	284	52	260	30	6290
1977	777	108	282	53	302	32	4778
1978	791	107	277	51	323	33	4031
1979	810	107	273	51	346	33	3688
1980	809	108	273	51	344	33	3343
1981	817	109	274	55	347	32	3230
1982	764	109	240	53	330	32	3090
1983	763	107	241	52	328	32	3021
1984	763	109	237	52	333	32	2979
1985	770	110	235	54	339	32	-

Source: Federal Supervisory office for Insurance Companies (BAV), Annual Reports, tables 010 and 020 from 1975 (previously tables 1 and 5)

Notes: * see Table 1
 1 including marine insurance companies
 2 as per 31.3.1954

Key:

- A total number of insurance companies
- B life assurance companies
- C pension funds and funeral expenses insurance
- D health insurance companies
- E non-life insurance companies
- F reinsurance companies
- G total of insurance companies under federal and Länder supervision

Table 3 Number of insurance companies under federal supervision by legal form

(number)

End of year	Joint stock companies A	Mutual insurance associations B(1)	Insurance institutions under public law C	Total number (2)	Foreign insurance companies
1954	135	675	24	838	26
1960	153	707	25	891	48
1970	170	564	23	760	50
1975	198	494	23	717	48
1976	208	455	23	688	49
1977	222	455	23	703	74
1978	228	441	22	694	97
1979	230	437	22	692	118
1980	233	438	22	695	114
1981	240	437	23	701	116
1982	242	381	25	649	115
1983	239	385	25	650	110
1984	245	380	26	651	112

Source: Federal Supervisory Office (BAV), Annual Report, Tables 011 and 010

Notes: 1 including small mutual associations registered under para 53 Insurance Supervisory Law (VAG)
 2 including other legal forms such as GmbH (limited liability company) and eGmbH (registered co-operative society with limited liability)

Table 4 Gross premium income by class of business

(ECU million)

Year	Total	Life	Health	Non-life insurance		For information
		assurance companies ²	insurance companies	companies** Total ³	Motor	reinsurance companies ¹
1970	7403.2	2692.3	1079.9	3335.2	1547.0	1509.3
1975	16113.5	5874.2	2114.8	7499.9	3346.4	3517.5
1976	18937.9	6963.1	2542.2	8725.7	3844.2	4207.7
1977	22336.4	8311.0	2964.3	10246.7	4581.6	5012.9
1978	25310.7	9521.1	3328.2	11501.9	5064.2	5790.9
1979	28540.3	10804.0	3576.8	13135.3	6017.4	6646.5
1980	31268.9	12157.5	3896.6	14044.2	6124.5	7727.1
1981	34389.3	12934.7	4327.8	15552.1	6609.6	8710.1
1982	38859.3	14483.5	5017.5	17732.4	7101.3	9525.8
1983	42960.6	16433.2	5575.4	19183.9	7788.5	
1984	45783.2	16968.9	5883.0	21122.2	8332.2	
1985 ⁴	48607.4	17758.3	6019.6	22848.2	9204.9	

Source: Federal Supervisory office (BAV), Annual Reports, tables 040, 45205 and 5501 from 1975 (previously 7.57, 124, motor insurance until 1982 table 4530) statistics of Insurance Association

- Notes:
- * direct business of insurance companies under federal and Lander supervision
 - ** see Table 1
 - 1 gross premiums including additional charges for total insurance business, accounting period different from calendar year
 - 2 life assurance including non-life classes (property and accident) written by a restricted number of life assurance companies
 - 3 without life assurance companies writing property and accident insurance classes as secondary classes
 - 4 estimated on the basis of operating results of member companies

Table 5 Breakdown of gross premiums by legal form

Year	Total of insurance companies ECU million ³	Joint stock companies	Mutual insurance associations ¹	Insurance institutions under pub law market shares ⁴ as %	Foreign insurance companies ²
under federal supervision					
1970	7005.2	64.0	28.0	4.2	3.8
1975	15131.5	63.7	28.0	4.5	3.8
under federal and Länder supervision					
1975	16113.5	59.6	26.6	10.2	3.6
1978	25310.7	59.6	26.5	10.3	3.6
1981	34387.9	59.3	26.3	10.7	3.7
1982	38859.3	59.0	26.8	10.5	3.7
1983	42960.6	59.3	26.3	10.7	3.7
1984	45783.2	59.5	26.0	10.8	3.7
under Länder supervision					
1975	984.7			97.8	
1978	1500.4			98.7	
1981	2079.6			98.9	
1982	2133.6			98.4	
1983	2166.4			98.6	
1984	2397.6			98.0	

Source: Federal Supervisory Office (BAV) Annual Reports, tables 040, 150, 151, 251, 350, 451 from 1975 (previously table 9), own calculations

Notes: 1 including small mutual associations registered under para 53 Insurance Supervisory Law (VAG)
 2 domestic business of insurance companies having their head office abroad
 3 premium income (total direct business)
 4 percentages of gross premium income derived from direct business in all classes

Table 6 Market share of foreign insurance companies* in the Federal Republic of Germany by class of business

Country of origin	Life assurance			Health insurance		
	1975	1980	1984	1975	1980	1984
	market shares as %					
Switzerland	4.88	5.02	5.45	13.58	14.83	15.20
United Kingdom	0.87	0.83	0.90	1.25	1.27	1.56
Italy	2.15	1.78	1.58			
USA	0.13	0.15	0.08	0.70	0.63	
Austria	0.08	0.09	0.10			
France	0.03		0.11	0.32	0.25	0.23
Netherlands	0.22	0.19				
Sweden						
Total of foreign companies	8.36	8.06	8.22	15.87	16.99	16.99

Country of origin	non-life insurance**			total of all insurance classes ¹		
	1975	1980	1984	1975	1980	1984
	market shares as %					
Switzerland	7.32	7.25	6.92	7.30	7.36	7.46
United Kingdom	2.94	2.63	2.62	1.95	1.75	1.81
Italy	1.55	1.58	1.68	1.55	1.46	1.41
USA	1.02	0.83	1.05	0.65	0.54	0.53
Austria	0.43	0.36	0.34	0.24	0.21	0.20
France	0.13	0.10	0.30	0.12	0.08	0.22
Netherlands			0.06	0.08	0.07	0.03
Sweden	0.07	0.12	0.10	0.04	0.06	0.05
Total of foreign companies	13.46	12.88	13.07	11.94	11.53	11.71

Source: Versicherungsreport, Federal Supervisory Office (BAV) Annual Reports. Taken from Farny, D, 'Die deutsche Versicherungswirtschaft', Karlsruhe, 1985, own calculations

Notes: * branches of foreign insurance companies and German insurance companies in which foreign insurance undertakings hold a majority market. Market shares in terms of gross premiums (direct business and business reinsured)
 ** see Table 1
 1 Total of life assurance, health insurance, non-life insurance

Table 7 Number of branches of foreign insurance companies in the Federal Republic of Germany by class of business and country of origin

	1975		1980		1984	
	Number	% ¹	Number	% ¹	Number	% ¹
Life assurance pension/funeral expense funds	12	9.1	9	7.1	8	6.3
Health insurers	1	3.4	1	3.4	1	3.1
Non-life insurers*	35 ²	16.3 ²	104	33.7	103	32.7
All insurers	48 ²	11.9 ²	114	23.0	112	22.1

numbers by country of origin

United Kingdom	12	46	42
France	7	16	16
Switzerland	11	13	14
Italy	3	7	8
USA	5	7	6
Belgium	2	7	7
Netherlands	3	6	6
Austria	3	4	4
Sweden	1	3	3

Source: Federal Supervisory Office (BAV), Annual reports, Tables 010, 011, 010, own calculations

Notes: * see Table 6

- 1 share in the number of all insurance companies subject to supervision including reinsurance companies (whether small mutual associations registered under para 53 Insurance Supervision Law (VAG) and other legal forms whose activity is restricted to a specified business sector, territory or to specified persons
- 2 without companies underwriting marine insurance only, which in 1975 were exempted from the supervision and in respect of which no precise figures are available

Table 8 Market shares of foreign insurance companies in the Federal Republic of Germany by country of origin and by form of undertaking

(%)

Country of origin	Total of market share 1984 for insurance companies in terms of gross premium	German insurance companies in which foreign insurance companies hold a majority interest	Branches of foreign insurance companies
Switzerland	7.46	4.91	2.55
United Kingdom	1.81	1.68	0.13
Italy	1.41	1.34	0.07
USA	0.53	0.29	0.24
Austria	0.20	0.01	0.19
France	0.22	0.18	0.04
Netherlands	0.03		0.03
Sweden	0.05		0.05
Total of foreign companies	11.71	8.41	3.30

Market Overview

Every organisation wishing to undertake insurance activities in Germany must be incorporated and have an establishment except unsupervised insurers writing unsupervised classes, i.e. reinsurance' (International Insurance Report, February 1985). Insurers are supervised and are not allowed to conduct any types of business other than insurance,

'...nor can they write simultaneously: property insurance and sickness insurance, life insurance and sickness insurance, sickness insurance and accident insurance, credit insurance and any other class whatsoever' (International Insurance Report, February 1985).

Foreign insurers are only allowed to conduct business in Germany through a locally authorised organisation.

In 1986 there were 2941 insurers writing direct insurance business. Of these, 2216 are small organisations which account for only 5.2 per cent of the total premium income. The 385 members of the German Insurance Association (Gesamtverband der deutschen Versicherungswirtschaft (GDV) dominate the market with 94.3 per cent of premiums.

The German market is the largest in the EEC accounting for over 33 per cent of premium income. Foreign insurers share of the German market was approximately 12 per cent in 1986. Foreign companies have a larger market share in the health insurance sector: 17 per cent, compared with 8 per cent of the life assurance and 13 per cent of the non-life assurance market.

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3.2 France

Statistical Overview

- Table 1 The French insurance share in world's and EEC's direct premium income 1960-82
- Table 2 French insurance in 1985
- Table 3 French average propensity to insure 1951-82
- Table 4 Number of companies in the French insurance market 1968 and 1982
- Table 5 French insurance companies' market share according to legal classification
- Table 6 Course of average costs in 1985

Table 1 The French insurance share in world's and EEC's direct premium income 1960-82

percentages

	1960	1970	1975	1979	1980	1981	1982
World	1.15	3.92	5.25	5.62	5.20	4.62	4.49
EEC	16.9	18.3	-	-	20.3	-	19.6

Source: International Insurance Report, April 1985

Table 2 French insurance in 1985

Lines	1984	1985 (tentative) USD 000,000	Non-life %	Change in 85/84 %
	(definitive) ECU 000,000			
Non-Life Insurance				
Motor vehicle	7,868	7,258	40.95	+1.49
public liability	(4,548)	(4,129)	(23.29)	(-0.13)
physical damage	(3,320)	(3,129)	(17.66)	(+3.71)
Fire	2,735	2,714	15.31	+9.17
Sickness and health	1,636	1,653	9.33	+11.20
Accidental bodily injury	1,375	1,450	8.18	+16
Other casualty	990	1,009	5.69	+12.15
(except construction)				
Public liability (except motor vehicle and construction)	1,119	1,075	6.07	+5.76
Cargo	786	698	3.94	-2.18
Construction	503	459	2.59	+0.29
Theft	489	566	3.20	+27.30
Other	834	840	4.74	+10.92
Non-Life Total	18,334	17,722	100	+6.35
Life and Sinking Fund Insurance	8,053	9,406	-	+28.51
Grand Total	26,388	27,128	-	+13.12

Source: French Insurance Newsletter, 1986

Table 3 French average propensity to insure 1951-82

direct premiums as % of GDP

1951	1960	1970	1980	1981	1982
1.53	2.42	3.18	3.70	3.85	3.96

Source: International Insurance Report, April 1985

Table 4 Number of companies in the French insurance market 1968 and 1982

No of domestic companies		No of foreign companies		Totals	
1968	1982	1968	1982	1968	1982
335	308	206	168	541	476

Source: International Insurance Report, April 1985

Table 5 French insurance companies' market share according to legal classification

percentages

	1984	1985	Earned premiums 1985/1984
National companies	21.34	21.13	+2.4
Limited companies	28.30	27.60	+0.9
For-profit federal mutual insurance companies	10.20	10.24	+3.8
Foreign companies	4.71	4.10	-9.9
Total of for-profit companies	65.55	63.07	+1.0
Not-for-profit federal mutual insurance companies	27.77	28.76	+7.1
Local and professional mutuals	1.49	1.48	+2.9
Farming mutuals	6.19	6.69	+11.8
Total of not-for-profit	35.45	36.93	+7.8
Total of companies	100.0	100.0	+3.4
Price growth (yearly average)			+5.8

Source: Insurance Research Letter, 1987

Table 6 Course of average costs in 1985

percentages

	Total cars	Bodily pub liab	Of which: Property pub liab	Total pub liab
National companies	+9.5	+6.4	+12.4	+6.7
Limited companies	+30.3	+30.6	+23.6	+28.9
Federal mutual insurance companies with middlemen	+13.4	+11.6	+12.2	+12.5
Foreign companies	+10.6	+9.7	+5.9	+6.3
Federal mutual insurance companies without middlemen	+27.3	+6.7	-3.3	-0.7
Local and professional mutuals	+12.3	+7.3	+19.2	+14.6
Farming mutuals	+10.2	-20.4	+63.7	-4.5
Total of companies	+20.8	+9.2	+10.9	+8.7

Source: Insurance Research Letter, 1987

Market Overview

Direct insurance companies in France are supervised by the 'Direction d'Assurances' (part of the Ministry of Finance), reinsurers are supervised by the Ministry of Commerce. Up to 1978, the domestic insurance industry was heavily regulated mainly due to an onerous tariff system which required prior approval of insurance premium rates. Since this has disappeared, increased competition in the insurance industry has heralded a decline in the overall financial performance of the insurance sector.

There are many compulsory insurances under state control, for example, transport insurance, professional liability, agricultural risks and the like. These are more common in France than in any other EEC country. Limited insurance companies have the largest share of the for-profit direct business, over 27 per cent in 1985, with the nationalised companies following close behind with 21 per cent of the market. Market share has been reversed since 1980 when the nationalised companies had the lions share. For-profit companies earn over 60 per cent of premiums in the domestic market, the remaining business being undertaken by the not-for-profit mutual organisations. Typically the life insurance business is dominated by the nationalised insurance companies.

In the world league of insurers, France ranks fifth behind the US, Japan, Germany and the United Kingdom. 'In general insurance France is fourth; in life business sixth, as state pensions and social security schemes are highly developed in the republic' (Saltie, 1987). Total market turnover in 1986 was ECU 33.82 billion. There are 420 general insurers and 100 life companies in the French market.

Viewing the main sector, the larger mutual organisations traditionally directed their business towards specific market segments such as civil servants, teachers, farmers, etc. They are at present expanding their motor insurance business. By 1985 they had insured over fifty per cent of the private cars in France. Foreign insurance companies account for approximately 5 per cent of market share, motor premiums account for half of their total business.

Throughout the 1980s there has been considerable growth in life business, mainly brought about by poor expectations about state pension schemes. New products such as savings bonds and personal pension plans are being aggressively marketed by the larger French companies. 'In 1985, for the first time ever in France, life premiums totalled more than motor premiums' (Saltie, 1987). In addition, the denationalisation of the insurance sector is presently on the current government agenda (Assurances Generales de France will return to the private sector in 1987), and this should help boost the market premium share on life business.

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3.3 Italy

Statistical Overview

- Table 1 The Italian share in the world's and EEC's total direct premiums 1960-82
- Table 2 Average propensity to insure in Italy 1950-82
- Table 3 Direct premiums of Italian insurers 1950-83
- Table 4 Breakdown of Italian premium income 1984 by business class
- Table 5 Number of insurance companies, domestic and foreign 1968-82

Table 1 The Italian share in the world's and EEC's total direct premiums 1060-82

	percentages					
	1960	1970	1975	1980	1981	1982
World	1.1	1.6	1.9	1.7	1.6	1.6
EEC	na	9.0	7.7	6.1	6.3	6.7

Source: International Insurance Report, 1985

Table 2 Average propensity to insure in Italy 1950-82

(direct premiums as % of GNP)

	1950	1960	1970	1971	1982
EEC total	2.67	3.27	-	4.09	4.65
Italy	0.9	1.4	1.9	2.3	1.9

Source: International Insurance Report, 1985

Table 3 Direct premiums of Italian insurers 1950-83

(billion ECU)

1970	1975	1980	1981	1982	1983
1831.13	3450.09	5673.81	6661.12	7593.63	8833.99

Source: International Insurance Report, 1985

Table 4 Breakdown of Italian premium income 1984 by business class

	Market premium income 1984 (estimated) (ECU million)	Growth %	Market share %
Motor liability	4,135.66	17.8	40.3
Motor hull	907.05	16.6	8.9
Credit	94.83	35.9	0.9
Bonding	197.63	20.8	1.9
Fire	892.57	13.2	8.7
Theft	337.34	12.7	3.3
Pecuniary loss	8.69	6.7	0.1
Hail	152.02	14.6	1.5
General liability	487.19	18.5	4.7
Legal expenses	10.50	10.9	0.1
PA & Sickness	1,027.94	18.0	10.0
Marine/Transport	474.16	18.5	4.6
Aviation	56.46	21.9	0.6
Miscellaneous	78.54	10.3	0.8
Life & Annuity	8,860.58	17.2	86.4
	1,397.13	28.6	13.6
Total	10,257.71	18.6	100.0

Source: ROA Bulletin, 1986

Table 5 Number of insurance companies, domestic and foreign 1968-82

	1968		1982	
	Domestic companies	Foreign companies	Domestic companies	Foreign companies
Italy	119	48	159	49
Rest of Europe	3831	1532	3351	1204

Source: International Insurance Report, 1985

Market Overview

The Italian insurance market contains: state corporations, large international companies and small companies focusing on specific lines of business, for example, automobile insurance. The market is fairly concentrated, in 1981 the ten largest companies had over fifty per cent of the direct market and 'the home 50 companies were grouped into nine large concerns' (International Insurance Report, 1985). Nevertheless, the market is reasonably open and the number of firms, both foreign and domestic, expanded between 1968 and 1982. The opposite trend has taken place in most other European countries. Viewing the composition of business written in the Italian market, motor business dominates, accounting for 40.3 per cent of premium income in 1984. Life and annuity business was the second largest category accounting for only 13.6 per cent of the market. Total market premium income was estimated to be over ECU 10.13 billion in 1984. One of the most significant features of insurance business over the last two decades is the remarkable decline in market share of the life business. In 1970 it accounted for 23.1 per cent of total premiums, whereas by 1984 market share had fallen to a meagre 13.6 per cent. Inflationary pressures experienced throughout the 1970s together with Italy's extensive social security system are the reasons usually put forward to explain the decline of private life insurance.

'The Italian insurance industry is still relying on its domestic market and showing only a limited interest in Europe, with Latin America and the US being its focal points.'

On the reinsurance side, Italy has one of the world's main companies, Unione Italiana di Riassicurazione. Nevertheless, the majority of Italian reinsurance business is undertaken by German, Swiss and UK concerns.

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3.4 United Kingdom

Statistical Overview

- Table 1 Worldwide premium income of the members of the Association of British Insurers 1984-85
- Table 2 Worldwide premiums of British companies in 1983
- Table 3 Proportion of all company premiums controlled by larger companies
- Table 4 Structure of industry. British-controlled companies, foreign-controlled UK companies and the UK branches of foreign-based companies
- Table 5 The Big Four clearing banks in insurance broking

Table 1 Worldwide premium income of the members of the Association of British Insurers 1984-85

(ECU million)

	UK	Overseas	1985	1984
Worldwide premium income				
Ordinary life	23,278	3,975	27,253	24,741
Industrial life	2,034	-	2,034	2,012
Total life	25,312	3,975	29,287	26,752
Motor	3,735	4,110	7,845	7,682
Fire and accident	7,896	8,922	16,818	14,661
Marine, Aviation and Transport	1,593	560	2,153	1,895
Total General	13,224	13,593	26,817	24,238
Total invested assets				
Life			242,098	199,758
General			48,905	45,130
Total			291,003	244,888
Invisible earnings				
Insurance			5,633	3,718

Table 2 Worldwide premiums of British companies in 1983

	All business ECUm	% to all companies	General ECUm	Long-term ECUm
Commercial Union	3,892.7	9.2	3,209.9	682.8
Prudential	3,804.3	8.9	1,176.0	2,628.3
Royal	3,711.6	8.7	3,254.0	457.6
General Accident	2,620.1	6.2	2,376.5	243.6
Guardian Royal Exchange	2,327.4	5.5	1,774.9	552.5
Sun Alliance	2,008.7	4.7	1,507.3	501.4
Legal & General	1,685.9	4.0	325.6	1,360.3
Eagle Star	1,509.4	3.5	973.9	535.5
Norwich Union	1,429.0	3.4	444.1	984.9
Phoenix	1,156.7	2.7	861.5	295.2

Source: Carter and Godden (1984)

Note: Long term business refers to life, annuity, pension fund management. General is non-life

Table 3 Proportion of all company premiums controlled by larger companies

	percentages				
	1974	1980	1981	1982	1983
5 largest companies	44.9	40.7	41.3	40.4	38.5
Next 5 companies	19.6	20.5	19.7	18.9	18.3
10 largest companies	64.5	61.2	61.0	59.3	56.8

Source: Carter and Godden, 1984

Table 4 Structure of industry. British-controlled companies, foreign-controlled UK companies and the UK branches of foreign-based companies

number of companies

	Total	Composites	General business only	Long-term business only
British-controlled companies	172	27	94	51
Foreign-controlled companies	161	15	121	25
Foreign companies' UK branches	113	5	89	19
Total	446	47	304	95

Source: Carter and Godden, 1984

Table 5 The Big Four clearing banks in insurance broking

(ECU 000)

	Turnover 1983	Profit 1983	Average annual growth in turnover % (2 years to 1983)
Barclays	34,547	18,325	70
National Westminster	24,126	13,405	39
Lloyds	20,859	15,204	53
Midland	21,250	8,697	57

Source: Retail Banker International, 1985

Market Overview

In 1985 the British Insurance Association reported that its members earned total worldwide premium income of ECU 26,817 million. The Association has over 340 members (including UK members with head offices overseas) and their reported figures account for approximately 95 per cent of the domestic and international business of the British insurance company market. The UK insurance market is relatively concentrated. In 1983 the five largest companies wrote 38.5 per cent of total premiums whereas the ten largest had a 56.8 per cent share of the market. Nearly two-thirds of the insurance companies operating in the UK are either foreign-controlled or foreign companies' UK branches. The majority of these foreign companies' business is concentrated in the general (non-life) business category. Viewing the British-controlled companies, out of a total of 172 only 27 transact composite business (both general and life). Table 2 illustrates that the top ten companies in the UK insurance market are all composites.

The breakdown of premium income in the UK insurance market is markedly different from certain other EEC countries. Domestic life premiums account for the lion's share of total worldwide life premium income (86.4 per cent), whereas overseas companies' general premiums have an equal share with their domestic counterparts (see Table 1). That is, non-life insurance is far more dependent on foreign markets than life insurance. Viewing total worldwide premium income, ordinary life has the largest share (48.5 per cent), followed by fire and accident (30 per cent) and motor (14 per cent). Overseas premium income accounts for over 30 per cent of total worldwide premium income. (Zajdlic (1985) notes that Lloyds' contribution to the total of worldwide premium income on top of BIA members would account for 12 per cent of the market in 1983. The BIA figures quoted do not correspond with those in Association of British Insurers (1986)).

Over the last two years the barriers between banking and insurance business have been significantly eroded. In early 1985:

'An informed understanding between the Bank of England and the Department of Trade prohibiting inter-locking ownership between major insurance companies and banks has been scrapped. The Bank of England's readiness to allow the Scottish mutual insurer Standard Life to buy Barclays Bank's 35 per cent stake in the Bank of Scotland is an indication of the new liberal climate' (Retail Banker International, 1985).

On the 19th November 1984 the Bank of Scotland became the first major clearing banks to offer comprehensive motor insurance. Building societies were originally restricted to selling insurance related to their mortgage business, but since the 1986 Building Society Act they can offer a much broader range of services. Most of the major clearers presently sell the full range of insurance products. A recent survey undertaken by Arthur Andersen (1986) stated that UK banks view the insurance business as 'a principal area of diversification ... which is believed to hold sound prospects for growth and profitability'. Respondents to this survey also concluded that the insurance broking

operations of clearing banks will grow very rapidly, as greater use is made of their large branch networks as sales outlets. As early as 1985 the TSB had an insurance sales force of 280 assigned to various branches throughout the country.

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3.5 Belgium

Statistical Overview

Table 1 Belgium's share in the world's and EEC's direct total premiums

Table 2 Belgium's total insurance premiums 1955-83

Table 3 Belgium's average propensity to insure

Table 4 Life premiums as a percentage of total premiums

Table 5 Number of domestic and foreign insurance companies

Table 6 Domestic premium income 1984-85

Table 7 Structure of Belgian portfolio 1970-78

Table 8 Total OECD portfolio in 1981

Table 1 Belgium's share in the world's and EEC's direct total premiums percentages

	1960	1970	1975	1980	1983
World's share	0.8	0.8	1.1	1.1	0.7
EEC's share	na	4.3	4.4	4.1	3.2

Source: International Insurance Report, December 1985

Table 2 Belgium's total insurance premiums 1955-83 (million ECUs)

1970	1975	1980	1981	1982	1983
868.296	1905.023	3517.423	3631.225	3599.521	3663.953

Source: International Insurance Report, 1985

Table 3 Belgium's average propensity to insure direct premiums as % of GDP

1955	1960	1970	1975	1980	1981	1982	1983
2.5	3.0	3.3	3.6	3.9	3.9	3.9	3.8

Source: International Insurance Report, 1985

Table 4 Life premiums as a percentage of total premiums

	1980-83 annual average
Belgium	27.6
Rest of EEC	38.0

Source: International Insurance Report, 1985

Table 5 Number of domestic and foreign insurance companies

	1982	1968	% change
Domestic companies	167	222	-25
Foreign companies	147	304	-52

Source: International Insurance Report, 1985

Table 6 Domestic premium income 1984-85

(ECU million)

Class	Premium Income 1984	Premium Income 1985	Increase %	1985 Market Share %
Life	1,053	1,135	6.6	27.8
Workmen's comp	284	303	5.6	7.4
Motor	1,309	1,408	6.4	34.6
Other liability	177	198	10.8	4.9
Bodily injury	146	155	4.9	3.8
Legal assistance	9	9	(2.9)	0.2
Fire	631	670	4.8	16.4
Transport	67	62	(9.8)	1.5
Credit	50	53	5.1	1.3
Health	71	86	19.3	2.1
Total	3,797	4,079	6.2	100.0

Source: Insurance in Belgium 1985-86
Report of the Belgian Insurance Association

Notes: Rate of inflation in 1985 was 4.87%

Table 7 Structure of Belgian portfolio 1970-78

percentages

	Life	Motor	Accident/liability	Fire	Marine	Rest
1970	28.5	35.1	18.9	12.8	1.5	3.2
1978	26.0	34.6	19.8	13.1	1.3	5.2

Source: International Insurance Report, 1985

Table 8 Total OECD portfolio in 1981

percentages

	Life	Motor	Accident/liability	Fire	Marine	Rest
1981	42	20	17	8	2	11

Market Overview

Insurance companies in Belgium are regulated by the Insurance Control Office in the Central Ministry of Economic Affairs. Regulations have been introduced for life and non-life business since 1979. These regulations correspond to EEC Freedom of Establishment Directives of 1973. A major feature of the Belgian market is the considerable number of compulsory insurances, for example, 'of employers of conscientious objectors, carriage of school children, cycle races, etc' (International Insurance Report, December 1985, p 18).

Between 1968 and 1982 Belgium saw a drastic decline in the number of domestic and especially foreign insurance companies undertaking business in their country. The number of domestic companies fell by 25 per cent, whereas the number of foreign companies declined by over 50 per cent. This is generally explained by the decline in demand for insurance products in Belgium over this period, especially in the late 1970s and early 1980s. Although this trend is more marked for Belgium than any other EC member countries, only the UK (170), France (168) and Holland (157) had more foreign companies writing insurance business in their domestic markets.

Belgian insurers can be classified into four types:

	Market share (%) 1982
1 Stock companies	78.5
2 Co-operatives	4.7
3 Mutuels	14.5
4 Miscellaneous	2.3

If we view the foreign insurance companies, over 80 per cent originate from within the EEC. Overall, market concentration is high, the ten main insurance groups in 1980 accounted for approximately 55 per cent of total premiums (60 per cent in the reinsurance market).

Comparing the types of business within the Belgian insurance market (see Tables 7 and 8) with that within the whole of the OECD countries, it can be seen that life business is constantly lower and motor business is higher within the Belgian markets. The former is partly offset by the high levels of social insurance in the country.

Viewing more recent premium income figures (Table 6) life assurance and motor insurance business still dominate market share, with substantial growth in health and other liability insurance between 1984 and 1985. Nevertheless, these two latter groups only account for a small (approximately 7 per cent) of the overall market.

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3.6 Luxembourg

Statistical Overview

Table 1 Total premiums, European Economic Community, 1983 and 1984

Table 1 Total premiums, European Economic Community, 1983 and 1984
(thousand million)

Country	Currency	1983		1984	
		Local Currency	ECUs	Local Currency	ECUs
Germany	Mark	92,123	41,31	94,940	42,57
Belgium	Francs	161,032	3,49	164,252	3,67
Denmark	Kroner	19,178	2,34	21,000	2,63
France	Francs	159,960	23,18	179,000	26,20
Greece	Drachma	30,921	0,37	37,106	0,40
Holland	Guilder	23,000	9,05	23,200	9,20
Ireland	£ (Eire)	1,265	1,73	1,500	2,09
Italy	Lire	11.945,511	8,69	14.170,000	10,35
Luxembourg	Francs	5,462	0.12	5,570	0.13
United Kingdom	£ Sterling	19,050	33,42	21,550	35,32
Total		-	123,70	-	132,56
Spain	Peseta	438,687	3,37	516,649	4,19
Portugal	Escudo	61,980	0.56	75,021	0,62
Total		-	127,63	-	137,37

Source: International Insurance Monitor, 1986

Market Overview

At the end of 1983 there were 42 insurance companies operating in Luxembourg of which 11 were domestically based. During the year these companies earned over ECU 121 million premium income. A new law went into effect on 1st March 1984 which aimed to boost insurance business in the Duchy, mainly by trying to attract insurance companies writing non-life business. The life market in Luxembourg is relatively small due to the population size; 365,000 in 1984. The new law specifically aimed to attract, 'insurance undertakings which operate directly out of Luxembourg; the so-called 'captive' insurance undertakings; reinsurance undertakings; insurance undertakings specialising in coverage of transportation risks and insurance brokers' (Captive Insurance Company Review, 1985). Unfortunately, the only data we were able to obtain on the Luxembourg insurance market was for 1983 and 1984 (International Insurance Monitor, 1986) so we cannot tell if the legislation has had its desired effect.

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3.7 Netherlands

Statistical Overview

Table 1 Gross premium income of domestic companies 1983

Table 2 Insurance groups

Table 3 Gross premium income per class of business 1983

Table 4 Domestic life insurance companies

Table 1 Gross premium income of domestic companies 1983

(million ECUs)

Year	Gross premiums			Development gross premiums (%)	Development GNP (market prices in %)
	Life	Non-life	Total		
1970	685.3	860.2	1545.2	14.8	11.9
1971	819.1	1004.0	1823.1	16.6	12.5
1972	937.8	1215.6	2153.4	16.3	13.2
1973	1037.8	1459.5	2497.3	10.4	14.4
1974	1281.6	1759.7	3041.3	13.7	13.5
1975	1943.6	2017.9	3961.5	27.5	9.1
1976	1793.1	2393.8	4186.9	-0.4	14.8
1977	2022.4	2809.5	4831.9	9.4	9.2
1978	2140.4	3369.2	5509.6	12.2	7.7
1979	2397.5	3751.3	6148.8	11.4	6.4
1980	2639.6	4146.3	6785.9	10.8	6.4
1981	2834.9	4351.2	7186.1	6.5	4.7
1982	3355.1	4636.0	7991.1	4.7	4.2
1983	3722.9	4919.2	8642.1	5.0	2.7

Source: Informatica Statistica, 1985

Table 2 Insurance groups (1983)

(million ECUs)

	Premiums		Income from other activities	Income from investments	Revenue
	Life	Non-life			
Nationale Nederlanden	2,408	1,985	399	1,739	6,531
AEGON	1,250	999		1,730	3,979
AMEV	749	803	191	534	2,277
Delta-Lloyd	364	318	-	345	1,026

	Capital and surplus	Staff employed (numbers)		
		Netherlands	Other countries	Total
Nationale Nederlanden	1,998	9,593	11,503	21,096
AEGON	939	4,776	2,518	7,294
AMEV	704	3,381	5,189	8,570
Delta-Lloyd	532	3,105	-	3,105

Source: Informatica Statistica, 1985

Table 3 Gross premium income per class of business 1983

(million ECUs)

Year	Life		Non-life			
	Individual	Group	Fire	Sickness and Personal accident	Miscellaneous	Transport and Aviation
1970	-	-	154.0	311.6	321.3	73.2
1971	422.7	396.4	180.2	369.6	371.0	82.8
1972	459.7	478.1	205.0	467.2	459.7	83.6
1973	506.0	531.4	240.9	595.3	534.0	89.3
1974	626.1	655.5	289.8	722.6	647.0	100.2
1975	1174.5	769.4	348.7	807.0	756.6	105.6
1976	861.5	931.6	405.4	954.6	905.9	127.9
1977	904.6	1118.2	472.1	1083.9	1107.1	146.4
1978	1012.3	1127.8	584.9	1241.8	1383.3	159.0
1979	1131.8	1265.7	654.5	1370.1	1556.4	170.3
1980	1238.6	1400.9	738.7	1531.2	1675.2	201.4
1981	1349.5	1485.4	806.5	1619.4	1687.1	238.2
1982	1627.8	1726.9	897.9	1837.1	1617.5	283.5
1983	1827.7	1895.2	967.3	1962.9	1683.5	305.9

Source: Informatica Statistica, 1985

Table 4 Domestic life insurance companies 1983

(thousand ECUs)

	Net premium income	Market share (%)*	Net premium reserve	Capital and surplus	Capital and surplus in % of net premium reserve
Nationale-Nederlanden	1023055	29.20	8052074	760817	9.45
AGEON	675821	19.29	6074450	450383	7.41
Delta-Lloyd	355484	10.14	2963039	181685	6.13
AMEV	330248	9.42	2872221	280810	9.78
Centraal Beheer	286574	8.18	2654280	95796	3.61
Amfas	206183	5.88	1567368	162575	10.37
Interpolis	98450	2.81	751309	57948	7.71
Stad Rotterdam	96252	2.75	640260	54421	8.50

Source: Informatica Statistica, 1985

Note: * Market share defined as: net premiums of domestic companies belonging to an insurance group, divided by total net premiums of all domestic companies

Market Overview

Insurance companies in the Netherlands are under the supervision of the Insurance Chamber, the national supervisory authority. In 1983 there were 74 life assurance companies, of which 62 were domestic concerns and the remainder foreign. Total domestic life premiums amounted to ECU 3,727 million in 1983. In addition, there were 363 supervised non-life insurers writing ECU 4,923 million premium business. Another 412 non-life insurers, not subject to supervision, were also present in the Dutch market. Unsupervised companies either have low premium income or only participate in specific lines of business. The official statistics deal with the supervised insurers.

In the early 1980s the Dutch insurance market was characterised by merger activities between major insurers. By 1983 the largest Dutch company, Nationale-Nederlanden earned over 50 per cent of gross domestic premium income. Four major companies dominate the market, Nationale Nederlanden, AEGON, AMEV and Delta-Lloyd. Nationale-Nederlanden and AEGON control over 50 per cent of the domestic life insurance market.

The total gross premium income for Dutch domestic companies amounted to ECU 9,003 million in 1984. 'In addition, foreign companies wrote a gross premium of ECU 730 million of which 27.9 per cent were in respect of life business and 72.9 per cent non-life business' (ROA Bulletin, 1986). It is expected that insurance companies will soon be able to offer specific banking facilities within the Netherlands.

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3.8 Spain

Statistical Overview

- Table 1 Spanish insurance groups, ownership and premium income 1984
- Table 2 Market structure of Spanish insurance industry 1978-84
- Table 3 The Spanish percentage share in the world's and EEC's direct total premiums 1960-83
- Table 4 Total direct insurance premiums and the average propensity to insure
- Table 5 Portfolio structure of Spain and 14 main countries

Table 1 Spanish insurance groups, ownership and premium income 1984

(ECU million)

Mapfre	Mutual 65%	198.609
La Unión y El Fenxi Español	Linked to Banesto	193.237
Corporación General Aseguradora	40% Banco de Bilbao	177.807
Mutual Madrileña Automovilística	Mutual	132.994
Vitalicio	Linked to Banco Central	132.851
CASER	Linked to Cajas de Ahorros	128.466
Omnia/Mare Nostrum	Partly French owned DRUOT/AGF	100.672
Santa Lucía	Independent joint stock	96.618
Zurich	Swiss owned	91.720
MUSINI	Mutual for state companies	86.980
Ocaso	Independent joint stock	84.451
Mutua General	Mutual	84.349
Winterthur	Swiss owned	76.076
Sanitas	Independent joint stock	75.160
Asisa	Independent joint stock	70.704
Plus Ultra	Linked to Banco de Vizcaya	70.017
RAS	Owned by Italian subsidiary of Germany firm	68.966
Estrella	Linked to Banco Hispano Americano	66.374
Generali	Italian owned	60.970
Bilbao	Some Dutch participation	59.706
L'UAP	French owned	57.383
Crédito y Caución	Some public ownership	56.933
Mutua Nacional Automovilística	Mutual	48.337
El Hercules Hispano	Linked to Banco Exterior	45.659
Royal	British owned	45.469

Source: Asher, 1986

Table 2 Market structure of Spanish insurance industry 1978-84

Year	Total number of insurers	Number of foreign insurers	Foreign insurers % of market premiums	Top 5 groups % of market premiums
1978	687	40	9.2	17.29
1979	680	39	9.0	17.05
1980	640	33	8.6	17.40
1981	631	33	8.5	17.80
1982	625	33	8.7	17.87
1983	618	33	9.1	18.04
1984	(*)	(*)	(*)	(*)

Year	Total market premiums ECUs	% Growth	% growth of consumer prices	Market premiums as % of GNP
1978	187,546	22.0	16.6	1.63
1979	238,435	20.0	15.6	1.67
1980	268,215	22.0	15.2	1.76
1981	304,118	16.8	14.4	1.80
1982	329,348	13.4	14.0	1.78
1983	314,877	13.3	12.2	1.77
1984	375,110	18.3	9.0	1.84

Source: Doubell, 1985

Table 3 The Spanish percentage share in the world's and EEC's direct total premiums 1960-83

	percentages				
	1960	1970	1975	1980	1983
World's share	0.3	0.6	1.0	0.08	0.05
EEC's share	na	3.6	4.1	2.9	2.5

Source: International Insurance Report, 1985

Table 4 Total direct insurance premiums and the average propensity to insure

1970	1975	1980	1981	1982	1983
Total direct insurance premium (in Pesetas billion)					
725	1845	2683	3041	3339	3146
Spanish average propensity to insure (total premiums as % of GNP)					
2.0	2.2	1.8	1.8	1.8	1.8

Table 5 Portfolio structure of Spain and 14 main countries

percentages

	Life 1970	1978	Motor 1970	1978	Acc/Liab 1970	1978	Fire 1979	1978	Marine 1970	1978	Rest 1970	1978
Spain	11.0	13.1	40.8	35.3	8.4	9.7	10.6	11.2	9.6	7.5	19.6	23.2
14 other major countries	35.5	35.8	27.2	25.5	12.1	12.6	9.4	10.2	5.4	4.1	9.8	12.0

Source: International Insurance Report, 1985

Market Overview

'Banks have dominated the market in the past. Though Spain's insurers are not all owned by banks, almost all banks own or have a strong interest in an insurer' (International Insurance Report, 1985). Of the top five Spanish insurance groups in 1984, two were linked with major banks and the third was 40 per cent owned by Banco de Bilbao (Corporación General Aseguradora). One can see from Table 1 that the type of ownership varies considerably between different insurance companies. By the beginning of 1984 there were 618 insurance companies in Spain of which 33 were foreign. Although this seems a rather large amount, relatively few insurance companies play a major role. Nearly two thirds of all business is undertaken by the top forty groups. The main five companies transacted business in 1984 which only accounted for 18 per cent of the total market, compared with a 'norm' of 50 per cent for market concentration in other EEC countries. The market does not have any companies with global general insurance operations and there is no 'significant market to write international reinsurance'.

One major feature of the Spanish insurance industry is the 'relatively small percentage occupied by the life business in the Spanish portfolio' (International Insurance Report, 1985). Conversely, motor insurance appears to dominate the scene, taking 35 per cent of market share in 1978, well above the EEC average. On the reinsurance side, which took approximately 28 per cent of total market premiums, in 1983 (see Doubell, 1985) most of the business is written by foreign reinsurers. Spanish reinsurers only play a very small role in the reinsurance market and a large percentage of domestic life insurance is reinsured overseas.

The current trend appears to be that banks are reducing their shareholding in domestic insurance companies, 'to allow foreign investors to take an interest and introduce the technical expertise necessary to make profit from underwriting' (Doubell, 1985). Nevertheless, there are still only a few foreign insurance companies with small market penetration.

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4 BROKERAGE AND SECURITIES

4.1 Germany

Statistical Overview

- Table 1 The capital market 1983 to 1985
- Table 2 Stock exchange transactions 1974 to 1986
- Table 3 Number of public limited companies and market value of listed shares 1981-85
- Table 4 Number of listed shares and debentures 1980-84
- Table 5 The largest listed companies on the Frankfurt Stock Exchange, end-December 1985
- Table 6 Share and bond turnover for domestic and foreign companies on the German exchanges, 1980-86
- Table 7 Number of shares traded and new capital raised on the semi-official market 1981-85

Table 1 The capital market 1983 to 1985

ECU billion

	1983	1984	1985
Fixed securities			
Gross sales of domestic bonds+	99.8	101.7	117.3
of foreign DM bonds	7.5	8.5	14.0
Net sales of domestic bonds+	38.6	32.2	35.7
Outstanding at year end	381.1	422.8	470.2
including DM foreign bonds	38.6	43.0	52.7
Yield at year end*	8.3%	7.0%	6.6%
Officially quoted shares			
Total market value at year-end	39.4	110.2	197.1
Dividend yield++	3.3%	3.6%	2.5%
Commerzbank index (changes)	+36.5%	+6.4%	+76.1%
Capital increases (cash proceeds)**	1.2	1.1	3.0
Stock exchange trading	37.0	37.8	94.7
Investment funds for small investors			
Net sales	1.68	1.86	3.72
including: bond funds	0.76	2.03	3.81
equity funds	0.25	-0.50	-0.43
real estate funds	0.67	0.34	0.34
Total assets at year end	17.52	20.73	26.40

Source: Financial Times, 7 July 1986

Notes: + nominal
 ++ including tax credit
 * domestic securities outstanding
 ** according to Commerzbank statistics

Table 2 Stock exchange transactions 1974 to 1986

Year	Securities issued by residents				Securities issued by non-residents			
	Total ECU million	ECU million	Bonds %	Shares %	ECU million	Bonds %	ECU million	Shares %
1974	9,179	3,673	40.0	46.7	916	10.0	305	3.3
1975	21,360	10,099	47.3	42.2	1,513	7.1	740	3.5
1976	21,734	9,863	45.4	40.7	2,043	9.4	976	4.5
1977	28,145	13,412	47.7	37.0	3,326	11.8	980	3.5
1978	34,060	14,692	43.1	39.2	4,300	12.6	1,717	5.0
1979	27,215	11,946	43.9	37.6	3,385	12.4	1,662	6.1
1980	32,952	16,058	48.7	33.3	3,870	11.7	2,044	6.2
1981	34,509	16,723	48.5	35.6	3,794	11.0	1,705	4.9
1982	54,202	31,230	57.6	27.3	6,005	11.1	2,168	4.0
1983	81,720	30,340	37.1	45.3	7,668	9.4	6,668	8.2
1984	104,713	49,321	47.1	36.1	10,027	9.6	7,519	7.2
1985	195,868	75,477	38.5	48.3	13,971	7.1	11,764	6.0
1986	283,151	111,660	39.4	48.9	17,495	6.2	15,523	5.5

Source: Statistische Beihefte zu den Monatsberichten der Deutschen Bundesbank, Reihe Wertpapier-statistik
February 1987, no 2

Table 3 Number of public limited companies and market value of listed shares 1981-85

Year-end	Number	Market value (ECU billion)
1981	456	56.1
1982	450	69.0
1983	442	99.4
1984	449	110.2
1985	451	197.1
1986	467	225.7

Source: Deutsche Bundesbank

Table 4 Number of listed shares and debentures 1980-84

Year-end	Shares			Fixed-interest securities		
	Total	Domestic	Foreign	Total	Domestic	Foreign
1980	406	224	182	4929	4439	490
1981	416	229	187	5203	4690	513
1982	405	223	182	5375	4809	566
1983	408	227	181	5445	4847	598
1984	420	240	180	5604	4969	635

Source: Frankfurt Stock Exchange

Table 5 The largest listed companies on the Frankfurt Stock Exchange, end-December 1985

Ranking	Company	Market value (ECU million)
1	Daimler-Henz	18,964.8
2	Siemens	15,898.1
3	Deutsche-Bank	13,563.7
4	Allianz	11,212.8
5	Allianz-Lebensversicherung	9,460.9
6	Hoechst	7,462.1
7	BASF	6,814.6
8	Münchener Rückversicherung	6,599.5
9	Bayer	6,273.3
10	Volkswagen	5,304.6
11	VEBA	4,397.0
12	Dresdner Bank	4,006.7
13	RWE (Pref)	3,838.0
14	Bayerische Motoren-Werke	3,070.1
15	Mannesmann	3,013.0
16	Commerzbank	2,930.0
17	Bayerische Hypo-u Wechsel-Bank	2,809.5
18	Thyssen	2,398.8
19	Mercedes-Automobil-Holding	2,164.1
20	Bayerische Vereinsbank	2,153.1
21	Lufthansa (Pref)	1,843.8
22	Schering	1,610.6
23	AEG	1,474.3
24	Hochtief	1,437.6
25	Linde	1,234.0

Source: Frankfurt Stock Exchange

Table 6 Share and bond turnover for domestic and foreign companies on the German exchanges, 1980-86

(ECU million)

Year	Total	Domestic issuers		Foreign issuers	
		Bonds	Shares	Bonds	Shares
1980	32,952	16,058	10,980	3,870	2,041
1981	34,509	16,723	12,289	3,794	1,705
1982	54,202	31,230	14,798	6,005	2,168
1983	81,720	30,340	37,044	7,668	6,668
1984	104,713	49,321	37,849	10,027	7,519
1985	195,868	75,477	94,658	13,971	11,764
1986	283,151	111,660	138,474	17,495	15,523

Source: Deutsche Bundesbank

Table 7 Number of shares traded and new capital raised on the semi-official market, 1981-85

Year	Shares traded (million)	New issues (ECU million nominal value)
1981	20	3.3
1982	23	0.7
1983	24	1.7
1984	33	41.0
1985	-	34.7

Source: Frankfurt Stock Exchange

Market Overview

In the Federal Republic there are eight stock exchanges: Frankfurt, Dusseldorf, Hanover, Munich, Stuttgart, Berlin, Hamburg and Bremen. The Frankfurt stock exchange accounts for 70 per cent of total turnover. German banks play a dominating role in the country's financial markets and own a large share of German industry. In general, the banks hold between 15 and 20 per cent of the equity share holdings in listed German companies (see Euromoney, June 1986). In addition, all stock market transactions in fixed interest securities and equity securities must be arranged through a commercial bank. 'Banks serve as the customers' agents on the stock market, purchasing and selling securities in their own names for the accounts of the customer' (Hildeburn, 1986, p91). Overall, only banks may be members of the stock exchanges and because of the 'universal' nature of German banking business they undertake a whole range of securities business.

'In Germany about 50 per cent of the total volume of business is done through public corporations (savings banks and their clearing houses), 30 per cent through private commercial banks and 20 per cent through co-operative credit institutions' (Hildeburn, 1986, p91).

It must be noted that private individuals, companies or insurance companies must use the services of commercial banks and/or savings banks if they want to undertake stockmarket transactions. There are over 100 private and public banks which belong to the Frankfurt Exchange, the three largest of which are the big banks, Deutsche Bank, Dresdner Bank and Commerzbank. There are no direct foreign members. Nevertheless, an Arthur Andersen (1986) study suggests that 'Stockbrokers (mostly subsidiaries of foreign brokers) are competing with banks in the market for the broking of and dealing with securities' (p106).

The main investors in equities in the German market are as follows:

Approximate holdings of equities (1984)

Foreign investors	20
Domestic companies	26
Domestic private individuals	20
German and foreign banks	15
Insurance companies	6
Public sector	5
Investment companies (mutual funds)	5.5

Source: Hildeburn, 1986, p91

Insurance companies do not play a major role in the equity market, their major investments are in fixed income bonds.

In the marketplace, the arrival of American and Swiss banks with their experience of worldwide securities business 'is unlikely to impinge on the activities of the larger German banks. However, for the private banks, the future could be less secure' (Euromoney, 1986). American Express has eight branches in Germany offering a range of banking services, it aims to introduce Shearson Lehman's securities activities into the German market. Domestic commentators believe foreign banks and brokers will make major inroads in secondary market activities over the next few years, but the primary market will be dominated by domestic players.

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4.2 France

Statistical Overview

Table 1 Market structure - French official and second market 1985

Table 2 Share turnover on the Paris Stock Exchange, official, second and over-the-counter markets 1981-85

Table 3 The most actively traded shares, Paris Stock Exchange 1985.

Table 4 Number of listed companies, Paris Stock Exchange official market 1981-85

Table 5 Market capitalisation of French securities, Paris Stock Exchange, official and second markets, 1981-85

Table 1 Market structure - French official and second market 1985

ECU

	1985	Change 1985/1984
Number of issues	1,047	+6%
Number of issues listed	3,113	+7%
Market capitalisation (1)	318,264.3	+31%
French shares	95,601.3	+57%
French bonds	222,663.0	+23%
Trade volume * (1)	129,585.0	+75%
Shares	23,969.7	+76%
Bonds	105,515.3	+75%
New issues (1)	56,572.9	+30%
French shares	10,065.8	+52%
French bonds	46,507.1	+26%
Change in price		
French shares	-	+46%
French bonds	-	+5%
Foreign shares	-	+2%
Yield (2)		
French shares	3.70%	-
French government bonds	10.50%	-

Source: Paris Bourse, 1985

Notes: (1) Millions of ECU
 (2) P/E at year end
 * All transactions figures take only sales into account

Table 2 Share turnover on the Paris Stock Exchange, official, second and over-the-counter markets 1981-85

(ECU million)

Year	Share trading value	Domestic companies	Foreign companies
1981	10,516	7,561	2,954
1982	9,771	7,178	2,593
1983	14,106	9,393	4,713
1984	13,435	10,254	3,181
1985	24,431	21,191	3,240

Source: FIBV, Paris Stock Exchange

Table 3 The most actively traded shares, Paris Stock Exchange 1985

Ranking	Company	Average daily volume (ECU 000)
1	Michelin	2,205
2	Thomson CSF	2,101
3	BSN	2,038
4	Peugeot	1,941
5	Ciel du Midi	1,927
6	Moët-Hennessy	1,856
7	Lafarge Coppée	1,677
8	Carrefour	1,486
9	Air Liquide	1,383
10	Elf-Aquitaine	1,341
11	Total	1,214
12	Club Méditerranée	1,130
13	Gie des Eaux	1,064
14	Pernod-Ricard	1,015
15	Source Perrier	1,002
16	L'Oréal	971
17	Chargeurs	830
18	Navigation Mixte	797
19	Sanofi	781
20	Accor	766
21	Télémeccanique Electrique	756
22	Essilor	735
23	Parisienne de Réescompte	683
24	Bouygues	664
25	Merlin Gerin	652

Source: Paris Stock Exchange

Table 4 Number of listed companies, Paris Stock Exchange official market 1981-85

Company	1981	1982	1983	1984	1985
French	568	535	518	504	489
Foreign	162	164	165	166	177
Franc Zone	13	12	14	13	12
Total	743	711	697	683	678

Source: FIBB, Paris Stock Exchange

Table 5 Market capitalisation of French securities, Paris Stock Exchange, official and second markets, 1981-85

(ECU billion)

	1981	1982	1983	1984	1985
Shares	36.3	31.0	48.4	60.2	95.6
Bonds	96.1	121.1	144.4	179.2	222.7
Total	132.4	152.1	192.9	239.4	318.3

Source: Crédit Commercial de France, Paris Stock Exchange

Market Overview

The Paris Stock Exchange accounts for well over 95 per cent of business volume in all the seven French stock exchanges. There are three markets within the French stock exchange system; the official list, the second market (Second Marché), and the over-the-counter market. Total market capitalisation of both domestic and overseas securities listed on the official and second markets exceeded Ffr 2 trillion, by the end of 1980; approximately 30 per cent of which accounted for equities. Share turnover is still dominated by domestic companies 86 per cent of total turnover in 1985).

Up until 1st September 1986 brokers (agents de change) had a legal monopoly to trade in securities on and off the exchanges. A broker could not under any circumstances trade on his own account but was allowed to hold accounts in favour of clients; therefore they were allowed to manage portfolios and provide safekeeping of securities. Since September, this long protected monopoly has been broken. Banks as well as brokers are now 'allowed to deal in the most active contract on the futures exchange (the MATIF). Banks are also allowed to make bond prices within 50 basis points of the Bourse's daily fixing' (Shirreff, 1986). Agents de change are 'being forced to become more investment bank like'.

Nearly 80 per cent of stock exchange orders are processed through banking institutions. Banks play the major role as intermediaries between clients and brokers in France through their large branch networks. The other major type of stock exchange intermediaries are known as 'Remisiers'. Usually they just give advice to investors but they can also execute discretionary orders through brokers. They are licensed by the Professional Association of Brokers.

In 1985 about 50 per cent of trading is undertaken by institutions, 20 per cent by foreign investors and 30 per cent by French individuals. The majority of personal investors own shares directly although significant trade takes place through SICAVs (SICAV's are open-ended funds managed on behalf of companies which allow employees to partake in profit-sharing schemes). They are mainly managed by banks and other financial institutions.

Various capital market reforms since 1984 have encouraged large foreign financial institutions to consider establishment in Paris. Shearson Lehman Brothers has set up an investment bank within its parent American Express in Paris. Credit Suisse First Boston is looking for a 'French vehicle to buy' (Shirreff, 1986) and Morgan Stanley and Goldman Sachs, securities houses, 'strong in international equities are poised to move into France'. These institutions wish to undertake business in three main areas:

- 1 Mandates to place newly privatised issues overseas
- 2 Capital and money market business
- 3 Domestic and cross-border investment banking

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4.3 Italy

Statistical Overview

Table 1 Number of listed companies and shares, and market value, Milan Stock Exchange 1981-85

Table 2 Market value, Milan Stock Exchange, by sector 1984 and 1985

Table 3 Share turnover, Milan Stock Exchange 1981-85

Table 4 Percentage of total trading volume, by sector

Table 5 Italian mutual funds by investment objectives 1984-85

Table 1 Number of listed companies and shares, and market value, Milan Stock Exchange 1981-85

(ECU)

	1981	1982	1983	1984	1985
Shares:					
Number of companies listed (excluding suspended shares)	132	138	139	143	147
Number of shares (excluding suspended shares)	169	180	191	199	211
Market value (ECU million)	22,758	20,622	25,704	36,045	67,814

Source: Milan Stock Exchange

Table 2 Market value, Milan Stock Exchange, by sector 1984 and 1985

(ECU million)

Sector	31st December 1984	7th August 1985
Food and groceries	608.65	968.67
Insurance	6,285.43	9,571.29
Banking	4,935.83	5,917.23
Paper and printing	154.46	306.74
Cement, ceramics etc	693.59	1,199.85
Chemicals	2,548.46	4,309.81
Silos and stores	523.74	903.18
Communications	2,963.21	3,799.65
Electrical engineering	702.09	1,084.12
Investments	9,402.90	9,906.93
Building and property	550.85	719.16
Engineering and motors	5,700.93	8,485.98
Mining and metals	428.91	574.41
Textiles	228.96	302.09
Miscellaneous	317.64	453.91
Total	36,045.43	48,503.02

Source: Milan Stock Exchange

Table 3 Share turnover, Milan Stock Exchange 1981-85

(ECU million)

Year	Trading value
1981	9,764
1982	2,848
1983	4,356
1984	5,171
1985	18,173

Source: Milan Stock Exchange

Table 4 Percentage of total trading volume, by sector

Investor	Percentage
Mutual funds	35
Banks, money managers	20
Private individuals	15
Insurance companies	15
Foreign institutions	10
Mediobanca	5
Total	100%

Source: Hildeburn, 1986

Table 5 Italian mutual funds by investment objectives 1984-85

(net assets in ECU million)

	December 1984	March 1985	June 1985	September 1985
Income	506.73	1,818.37	3,104.28	3,821.82
Balanced	162.88	884.67	1,785.91	3,029.01
Equity	173.01	776.24	1,375.69	2,412.29
Total	842.62	3,479.28	6,265.88	9,263.12

Source: Buchan, 1985 (adapted)

Market Overview

Italy has nine stock exchanges the most important being Milan which accounts for 90 per cent of total equity volume and approximately 80 per cent of the turnover in fixed interest securities. The Milan bourse, however, is 'relatively the smallest of any industrialised country' (Hindle, 1985). Turnover amounted to lire ECU 18,173 million in 1985. Total market capitalisation at the end of 1985 was ECU 67,814 million, of which over fifty per cent was provided by the banking, insurance and finance sectors. Nearly 75 per cent of the market is accounted for by only 20 quoted companies (Friedman, 1986). Foreign holdings of shares account for approximately 4 per cent of market capitalisation.

Stockbrokers (Agenti di Cambio) have an exclusive monopoly over fixing daily prices in bonds and shares on the Stock Exchange floor. Banks are not permitted to deal on the Exchange but they have to deal through stockbrokers. It is permitted, however, to let banks and other financial institutions, as well as the brokers, to match clients' orders. An interesting feature of the Italian market is that a large part of trading in listed and unlisted equities takes place off the floor of the exchange. Given the present regulatory structure, '... around 98 per cent of bond trading and 52 per cent of share trading (at present running officially at around Lire 100 billion (ECU 68.4 million) a day) goes on well away from the official stockmarket; (Friedman, 1987). On 29th January Banca Nazionale del Lavoro began round-the-clock electronic trading, this swiftly led to a reaction from CONSOB the Italian stock market regulatory authority who proposed full day share trading open to brokers, groupings of brokerage firms and new brokerage house subsidiaries of banks. This would be ratified by legislation in the future.

Trade has been boosted over the last five years by the increased interest of foreign and domestic institutional investors as well as the introduction of new mutual funds (unit trusts). As there are virtually no private pension funds in Italy and the insurance companies invest their funds mainly in government stock, the mutual funds have brought institutional investors back into the equity market. Legislation passed in 1983 gave preferential tax treatment to this form of investment and the first one was launched in June 1984. By December 1984 ECU 723.9 million had been invested in mutual funds and by February 1986 they had attracted one million savers. By 30th November 1986 the total funds held by 58 Italian unit trusts was ECU 44,643 million, holding 12.3 per cent of the total capitalisation of the Milan bourse. One of the major reasons for the rapid growth of these types of investment was that since 1985 Italian banks have aggressively marketed them through their branch networks. Most of the major banks in Italy are selling funds managed by themselves, or, in a few cases, other institutions' funds. The two largest insurance companies in Italy are also selling these funds. The main types of Italian equity investors are 'private individuals, insurance companies, investment funds, investment companies, overseas investors, one merchant bank (Mediobanca, which is mainly a medium to long term merchant bank), one pension fund and banks which, by law, are not allowed to hold securities on their own behalf but only on behalf of private and/or institutional investors'.

Total market capitalisation has risen from 12.5 per cent of GDP in 1983 to approximately 24.5 per cent in 1986. The Italian securities and brokerage business is no longer considered to be something of a 'sideshow'. Nomura and Daiwa, Japan's largest securities houses have just opened offices in Milan.

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4.4 United Kingdom

Statistical Overview

Table 1 Nominal and market value of all listed securities at 31st December 1986

Table 2 New issues for cash 1984-85

Table 3 Turnover in UK fixed interest and equities, January to December 1986

Table 4 Share ownership by investor type

Table 1 Nominal and market value of all listed securities at 31st December 1986

	Valuation		
	No of Securities	Nominal ECum	Market ECum
Total public sector (bonds and gilts)	617	209,709.3	202,395.4
Eurobonds			
UK companies	109	9,529.7	8,281.6
Overseas companies	1,092	136,533.6	161,871.7
Irish companies	5	428.3	409.3
Sub-total eurobonds	1,206	146,491.6	170,562.6
Company securities			
Banks and discount houses	111	15,124.4	110,333.9
Breweries and distilleries	194	3,009.5	32,213.5
Building societies	16	454.2	452.4
Commercial, industrial	2,665	64,394.3	907,272.1
Financial trusts, land	473	3,116.0	66,263.7
Insurance	57	2,140.5	64,593.4
Investment and unit trusts	474	5,541.2	37,867.1
Mines	133	1,604.1	37,746.1
Oil	70	9,378.2	195,010.5
Plantations	47	533.6	2,207.5
Property	276	3,789.6	16,873.2
Railways	16	228.3	8,150.3
Shipping	28	667.2	3,639.7
Utilities	43	5,085.6	135,333.7
Waterworks	318	587.5	509.2
Sub-total company securities	4,921	115,654.1	1,618,480.0
Overall total	6,744	471,855.1	1,991,328.1

Source: Stock Exchange Quarterly, 1986

Table 2 New issues for cash 1984-85

(ECU million)

	1984	1985
British government	23,867.4	29,285.2
Irish government	2,624.1	3,059.2
Local authorities and public boards	1,317.3	593.7
British companies		
fixed interest	2,679.3	15,402.0
equity	12,208.9	8,105.3
Total UK and Irish issues	42,697.1	56,445.5
Total overseas companies	39,936.3	41,197.5
Grand total	82,633.4	97,643.0

Source: Hildeburn, 1986

Table 3 Turnover in UK fixed interest and equities, January to December 1986

	No of Bargains	Value ECUm
Company fixed interest		
Debentures and loans	120,627	5,355.6
Convertibles	132,003	4,375.1
Preference and preferred ordinary	49,489	411.0
Total company fixed interest	302,119	10,141.8
Equities		
Building materials	169,693	7,785.7
Contracting and construction	157,997	4,625.3
Electricals	91,554	2,135.4
Electronics	565,772	15,773.9
Mechanical and engineering	358,251	10,599.7
Metals and metal forming	81,869	1,741.9
Motors	197,025	6,794.2
Other industrial materials	139,330	5,172.3
Capital goods total	1,761,491	54,628.4
Beers, wines, spirits and tobacco	326,862	22,708.4
Food manufacturing	224,995	10,324.9
Food retailing	136,847	6,001.5
Health and household products	209,196	12,007.3
Leisure	258,534	7,225.5
Publishing and printing	53,747	3,291.9
Packaging and paper	63,956	2,302.8
Stores	399,433	15,593.1
Textiles	181,844	4,665.8
Consumer group total	1,855,414	84,121.4
Chemicals	188,061	6,776.0
Office equipment	36,896	1,530.5
Shipping and transport	76,040	2,889.4
Miscellaneous	397,534	16,387.6
Other groups total	698,531	27,583.5
Total commercial and industrial	4,315,436	166,333.3
Oils and gas	511,568	14,962.2
Banks, discount and merchant banks	702,663	13,724.8
Insurance	165,422	10,027.3
Property	180,694	6,451.2
Other financial	143,012	5,531.0
Financial group total	1,191,791	35,734.3
Investment trusts	183,560	7,574.2
Mining finance	53,797	2,737.3
Overseas traders	81,727	2,830.2
Grand total ordinary shares	6,337,879	230,171.4

Source: Stock Exchange Quarterly, 1986

Table 4 Share ownership by investor type

percentages

	1963	1984
Pension funds/insurance/unit trusts/investment trusts	27.8	60.0
Charities/industrial/commercial government/overseas	13.5	18.0
Individuals	58.7	22.0

Source: Hildeburn, 1986

Market Overview

The United Kingdom's stock exchange is the third largest in the world. Most of the transactions are carried out on the London exchange although there are a few relatively small regional exchanges. During 1986 the market for securities in the UK was considerably reorganised involving new investor protection legislation, a dramatic change in the ownership and operations of the London exchange, plus developments in the over-the-counter (OTC) market. An investigation of the exchange's activities during the 1970s (under the aegis of the Restrictive Trade Practices Act of 1956) was called off when the exchange agreed to abolish fixed commissions on securities transactions. In addition, traditional methods of trading whereby only jobbers were allowed to take positions in securities and only brokers were allowed to buy and sell securities, from the jobbers for the clients, was abolished. Single capacity, where jobbing and brokerage business was clearly separated was replaced by dual capacity. From 27th October 1986, financial companies could undertake both broking and jobbing functions. 'Big Bang' also blew away restrictive practices in the gilts markets where two jobbers previously dominated the markets. In late 1986 there were 27 firms listed as official primary dealers, making markets in gilts. Prior to the 'Big Bang' 'Financial groups seeking to acquire British securities firms on the stock exchange were allowed to take full control on 1st March 1986' (Hildeburn, 1986). This led to a flood of purchases by both domestic and foreign banks for firms operating on the exchange. The market is now dominated by 33 leading players including the largest American banks and Japanese securities houses (see Economist, 1986a). For the majority of institutions operating in this market, their business is truly global, ranging from UK and international equities market-making, through the whole gamut of investment banking products right down to traditional retail banking business. 'Today, fewer than 20 British institutions of any size are still there ... The leviathans are six British firms that will take on the larger American and Japanese investment banks in providing the full range of global financial services' (Economist, 1986b). They are Barclays de Zoete Wedd, NatWest Investment Bank, Midland Montagu, Morgan Grenfell, Kleinwort Benson and Mercury International. The Economist (1986b) identifies two other groups, the second-leaguers (specialists) and the spectators (those that are sticking to traditional lines of business).

The total market capitalisation of the UK market stood at ECU 477.6 billion at the end of 1986. Turnover in the equity market rose from ECU 179.3 billion during 1985 to ECU 269.8 billion during 1986. Gilt market turnover increased by about one-third from ECU 444 billion in 1985 to ECU 519 billion in 1986. Considering the types of investor, the number of private shareholders has markedly increased over the last three years mainly as a result of the government's privatisation programme. Nevertheless, share ownership is dominated by institutional investors; pension funds, insurance companies, unit and investment trusts. They account for sixty per cent of total turnover in 1984. Although this proportion of market share has probably diminished since then, because of the privatisation programme, they undoubtedly still are the main investors. 'A breakdown of stock exchange turnover in 1983 by value showed that institutions accounted for 68.5 per cent of the turnover, individuals 14.4 per cent, agents (mostly on behalf of individuals) 14.6

per cent, and member firms 2.5 per cent' (Hildeburn, 1986). The figure for member firms is probably much higher now.

As has already been mentioned, 'commercial, merchant and foreign banks now own broker-dealers and many members of overseas stock exchanges have established broker-dealers in the UK' (ISSA, 1986). This, however, does not explain the strength of the foreign banks and overseas securities houses in the London market. The main reason why London has attracted over 550 foreign banks is because it is the capital of the Euromarkets. The Euromarket refers to a variety of markets 'ranging from bonds to swaps and deposits - where financial instruments are bought and sold with eurocurrencies' (Economist, 1986c). The market includes trade in a whole range of financial instruments from bonds to swaps and deposits. In 1985 eurobond 'turnover was \$2.25 trillion ... (ECU 2.95 trillion) against £367 billion (ECU 623 billion) for equities and gilts on the London exchange' (Economist, 1986b). The eurocurrency deposit market is even larger, 1985 turnover totalled \$2.75 trillion. Other markets include the eurocommercial paper and euro-equity market. Most of the activity in the markets is wholesale and subsequently the players are typically large organisations, whether they be banks, securities houses, institutional investors or commercial companies.

Given the new regulatory climate and the importance of the euromarkets in London, most large domestic and foreign banks offer a broad range of financial services from international and eurobusiness to retail broking services. Clearing banks as well as some building societies can now sell shares through their branches as well as offer integrated investment management services. The four main clearers all offer private client investment and retail stockbroking facilities. All but Midland offer unit trust business through their branch networks. In general, because of the above developments, demarcation between commercial banks, savings banks, building societies, insurance companies and other financial institutions will continue to break down. It is expected that a whole range of financial institutions will offer comprehensive securities and brokerage business in the not too distant future.

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4.5 Belgium

Statistical Overview

Table 1 Number of listed shares and market value, Brussels Stock Exchange 1981-85

Table 2 Total equity turnover, Brussels Stock Exchange 1981-85

Table 3 Public issues in Belgium 1982-86

Table 4 The most actively traded shares, Brussels Stock Exchange 1985

Table 1 Number of listed shares and market value, Brussels Stock Exchange 1981-85

(ECU)

Year	Number of listed shares			Domestic market value (ECU million)
	Total	Domestic	Foreign	
1981	368	218	150	7,795.2
1982	351	212	139	8,988.7
1983	342	204	138	13,197.6
1984	337	197	140	17,077.5
1985	336	192	144	23,997.7

Source: FIBV, Brussels Stock Exchange

Table 2 Total equity turnover, Brussels Stock Exchange 1981-85

(ECU million)

Year	Domestic companies	Foreign companies	Total
1981	578.57	827.18	1,405.75
1982	1,085.47	869.15	1,954.62
1983	1,610.87	1,373.83	2,984.70
1984	2,002.66	1,492.50	3,495.16
1985	2,539.84	1,709.41	4,249.25

Source: FIBV, Brussels Stock Exchange

Table 3 Public issues in Belgium 1982-86

(ECU million)

	1982	1983	1984	1985	1986
Shares	485.56	1285.65	368.18	403.25	897.03
Convertible loan stock	-	-	19.81(1)	2.89	65.53
Real estate certificates	-	-	-	26.05	17.12
Private sector bonds	-	209.07	-	-	-
Belgian central government bonds	3936.35	7097.27	6448.06	9541.13(2)	6563.93(3)
Other public sector	2460.22	3670.77	2112.68	4008.02	2630.14
Bonds issued by international institutions	67.10	66.02	209.07	300.60	205.48
Total	6949.22	12328.78	9157.79	14282.12	10379.22

Source: BBL Bulletin, 1987

- Notes:
- (1) Including an ECU-denominated issue by Côte d'Or
 - (2) Including ECU 1.044.31 million converted into bonds from treasury certificates
 - (3) Including ECU 596.8 million converted into bonds from treasury certificates

Table 4 The most actively traded shares, Brussels Stock Exchange 1985

Ranking	Company	Trading value (ECU million)
1	Petrofina	349.31
2	Générale de Belgique	239.78
3	GBL	205.67
4	Intercom	203.84
5	Ebes	152.63
6	Solvay	149.88
7	Générale de Banque	74.50
8	Philips	73.80
9	Arbed	70.99
10	Unerg	70.77
11	Inco	62.41
12	Royal Dutch	62.40
13	Volkswagen	59.04
14	Delhaize	58.33
15	TDK	54.28
16	Ville Montagne	54.13
17	Electrobel	52.75
18	IBM	51.98
19	Bakaert	51.94
20	Sony	51.54
21	Unifonds	46.86
22	GB Inno BM	45.77
23	UCB	43.92
24	Stilfontein	40.53
25	Tractionel	39.98

Source: Brussels Stock Exchange

Market Overview

Up until 1982 the Belgium stock market had been one of the EEC's less active markets. In 1982 the De Clerq law was passed which provided the 'Monory-Bis' incentive, geared to promote equity investment. The provision allowed for income tax deductions for investments by company personnel in their company's own shares. Although the law of 1982 expired on 31st December 1985, the aforementioned provision is still applicable. This helped revitalise the market in the early 1980s. It is estimated that Bfr ECU 1,559 million came into equities from over half a million households. In 1985, three new markets were brought into being on the Brussels Stock Exchange; a futures market, options market and second market for smaller companies not requiring a full listing. Further legislation that came into being at the end of 1986 provides the preferential treatment for designated savings-pension schemes.

There are four stock exchanges in Belgium, Brussels handles approximately 90 per cent of transactions. At the end of 1985 there were 192 domestic and 144 foreign companies listed on the Brussels exchange. Share turnover in 1986 approached BFr ECU 6,849 million of which approximately two-thirds accounted for domestic shares. Total stock market capitalisation exceeded BFr 1,500 billion. Banks, financial companies and trust companies comprise over 30 per cent of market value.

Stockbrokers (agents de change) monopolise trading in the exchange. Brokers are allowed to act individually or in partnership but are not allowed to be organised as joint stock companies. Banks are permitted to receive orders for securities business but they must do their business through stockbrokers. No breakdown of the scale of this type of business is available.

Virtually all shares issued in the Belgium market are in bearer form; it is very difficult to estimate who the main investors in the market are. Commercial banks transact most of their business in the bond market, intervention on the stock market is very small. Banks are subject to legislation which prevents them building up shareholdings in non-bank companies. Banks are allowed to have shareholdings in other banks, savings banks and in certain credit institutions. Various other criteria exist (see Abraham, 1985).

Insurance companies also play an important role in the bond market. They are not allowed to invest more than 25 per cent of their assets in equities, in fact the estimated figure for 1983 was below half this ceiling. Pension funds like insurance companies are more involved in the bond markets, but they are quite a small group, as the lion's share of pensions are paid out by the government. In general, private domestic individuals and foreign investors dominate transactions in the equity markets.

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4.6 Luxembourg

Statistical Overview

Table 1 Listings on the Luxembourg Stock Exchange 1981-85

Table 2 Market value, end-1985

Table 3 Market value of new equity shares, 1985

Table 4 Securities turnover, 1984-85

Table 1 Listings on the Luxembourg Stock Exchange 1981-85

	numbers				
	1981	1982	1983	1984	1985
Listed shares	139	154	162	173	187
domestic companies	29	32	34	37	41
foreign companies	110	122	128	136	146
Investment funds listed	82	94	117	149	178
domestic	54	60	73	102	142
foreign	28	34	44	47	36
New share listings	35	20	10	14	19
domestic shares	4	4	2	4	5
foreign shares	31	16	8	10	14
New investment funds listed	6	14	26	36	42
domestic funds	3	6	16	30	42
foreign funds	3	8	10	6	-

Source: Hildeburn, 1986

Table 2 Market value, end-1985

	(ECU million)
Domestic shares	3,139.90
Foreign shares	83,242.89
Share certificates	60.63
Domestic investment funds	11,098.91
Foreign investment funds	27,926.30
Total	117,007.30

Source: Hildeburn, 1986

Table 3 Market value of new equity shares, 1985

	(ECU million)
Domestic shares	94.23
Foreign shares	157.89
Domestic investment funds	4,096.97
Total market value	4,349.14

Source: Hildeburn, 1986

Table 4 Securities turnover, 1984-85

	(ECU million)	
	1984	1985
Bonds	291.45	351.07
Shares	51.07	57.36
Investment	24.60	31.01
Total	367.11	439.44

Source: Luxembourg Stock Exchange

Market Overview

As with the banking sector, the Luxembourg Stock Exchange is 'characterised by a strong international orientation ... foreign securities represent 90 per cent of all quotations and a staggering 96 per cent of bonds' (Hendrie, 1985). In addition, the Luxembourg exchange has one of the largest trading lists in the world, by the end of 1985 nearly 3,500 stocks and bonds were quoted. 'Bonds predominate, accounting for more than 3,000 listed counters with the remainder of the market made up of 187 stocks and shares and 178 investment funds' (Hildeburn, 1986). Bond turnover accounted for nearly 80 per cent of total turnover during 1985, whereas shares only accounted for 13 per cent. The reason for the predominance of bond business is because Luxembourg undertakes a substantial proportion of official eurobond dealing. Bonds denominated in foreign currencies ranging from the dollar and yen to the ECU (European Currency Unit) are widely traded on the exchange.

The majority of the Luxembourg exchange's members are domestic and foreign banks although there are a few stockbroking firms. As a universal banking system exists in Luxembourg, banks offer a whole range of domestic and international broking and securities services. These include: brokerage in securities, settlement of securities, custodian business, investment advising and trust business, portfolio management, underwriting of new securities issues and the financial servicing of securities. A very important point to note is that **'Members do not have to trade securities on the exchange floor and over 95 per cent of trading occurs off the floor. This explains the small reported turnover for exchange transactions'** (Hildeburn, 1986). Hence it is very difficult to get a 'true' picture of business in the Luxembourg market place. In addition to the official market trading is allowed in unlisted securities but volume is not very large. Over-the-counter business in foreign stocks and bonds is widely undertaken by many banks.

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4.7 Netherlands

Statistical Overview

- Table 1 Number of listed companies, Amsterdam Stock Exchange 1981-85
- Table 2 Securities officially listed, number of issues 1984-85
- Table 3 Trading volume on the Dutch capital market in 1985
- Table 4 Supply and demand in the Dutch capital market 1981-85
- Table 5 The stock exchange in the Dutch capital market 1981-85
- Table 6 Issues on the Dutch capital market 1985
- Table 7 Balance of foreign transactions on the Amsterdam Stock Exchange, 1981-85

Table 1 Number of listed companies, Amsterdam Stock Exchange 1981-85

	1981	1982	1983	1984	1985
Domestic	202	216	215	213	232
Foreign	286	260	256	255	242
Total	488	476	471	468	474

Source: FIBV

Table 2 Securities officially listed, number of issues 1984-85

	Official market		Parallel market	
	End-1984	End-1985	End-1984	End-1985
Dutch bonds	1,312	1,308	3	1
Foreign bonds	151	156		2
Dutch shares	204	278	26	32
Foreign shares	283	335	1	2
Total	1,950	2,077	30	37

Source: Amsterdam Stock Exchange

Table 3 Trading volume on the Dutch capital market in 1985

(ECU million)

	1984	1985	% change
Dutch bonds	23,652.4	30,321.8	+27.5
Dutch convertible bonds	304.7	798.3	+160.7
Dutch mortgage bonds	1,975.2	1,984.1	-
Dutch savings certificates	1,302.9	1,355.5	+3.5
Foreign bonds	1,801.0	1,992.0	+10.1
Total bonds	29,036.2	36,451.7	+24.9
Dutch shares	30,299.6	43,591.9	+43.2
Foreign shares	287.1	285.0	-1.2
ASAS shares	293.9	211.5	+28.4
Claims and warrants	919.5	1,020.0	+10.6
Total shares	31,800.0	45,110.4	+41.2
Parallel Market	239.4	752.1	+313.2
Total volume	61,075.5	82,314.3	+34.1

Source: Amsterdam Stock Exchange

Table 4 Supply and demand in the Dutch capital market 1981-85

percentages

	1981	1982	1983	1984	1985
Net supply					
Institutional investors	59	57	56	60	54
(Private placements)	65	55	46	45	41
Savings banks	7	11	6	3	4
Mortgage banks	-3	-7	-3	-2	0
General banks	24	23	26	29	30
Households and companies	8	11	12	8	4
Total domestic	95	95	97	98	92
Total foreign	5	5	3	2	8
Total	100	100	100	100	100
Net demand					
Public sector	60	66	68	68	52
Mortgage banks	-2	-5	-2	-2	-1
General banks	-	-	4	2	5
Households and companies	40	31	21	23	28
Total domestic	98	92	91	91	84
Total foreign	2	8	9	9	16
Total	100	100	100	100	100
Scope:					
Total supply/demand (billion guilders)	41.6	48.5	50.2	46.3	58.2
In % of Net National Income	31.1	14.8	14.9	13.1	15.7

Source: Amsterdam Stock Exchange

Table 5 The stock exchange in the Dutch capital market 1981-85¹

percentages

	1981	1982	1983	1984	1985 ²
Stock market, of which	24	38	48	54	46
shares	-1	-	2	-2	5
bonds	25	38	46	56	41
Private loans	51	50	38	31	37
Mortgage bonds	16	4	10	9	14
Real estate	9	8	4	6	3
Total supply/demand ³	100	100	100	100	100

Source: Amsterdam Stock Exchange

Notes: 1 calculated on the basis of figures supplied by De Nederlandsche Bank NV

2 estimate

3 foreign and domestic

Table 6 Issues on the Dutch capital market 1985

(ECU million)

	1981	1982	1983	1984	1985
Bonds					
Public loans					
- government and local government	4,072	7,116	9,381	10,107	8,350
- other domestic bonds	721	918	946	793	1,600
- foreign	432	727	867	1,189	992
- convertible bonds and warrants	72	-	639	119	329
Total public	5,297	8,761	11,234	12,208	11,270
Private sector					
- mortgage bonds	793	344	355	555	568
- bank certificates and other	252	536	631	634	487
Total private	1,045	880	985	1,189	1,055
Shares					
Public					
	144	11	355	277	726
Private sector					
- converted shares	144	0	512	0	86
- investment company shares	0	191	709	951	875
- other	396	77	946	436	1,487
Total Private sector	541	268	2,168	1,387	2,448
Total General	6,883	9,908	14,387	14,784	14,773

Source: Amsterdam Stock Exchange

Table 7 Balance of foreign transactions on the Amsterdam Stock Exchange, 1981-85

(ECU million)

	1981	1982	1983	1984	1985
Transactions in foreign securities					
Stocks	250	41	-17	783	-130
Bonds	-29	-300	-194	-713	-1,534
Total	221	-260	-211	69	-1,663
Transactions in Dutch securities					
Stocks	192	427	479	-94	1,037
Bonds	1,119	1,243	1,061	1,528	2,138
Total	1,311	1,670	1,541	1,434	3,175

Source: Amsterdam Stock Exchange

Note: a negative sign indicates payment on account of net purchase (and redemption) by residents

Market Overview

One of the main features of the Dutch capital market is that there exists an 'important private market alongside the public market' (Hendrie, 1985). Corporate customers from both the public and private sector can get long-term finance from institutional investors, with the banks and security credit institutions acting as intermediaries. This peculiar Dutch phenomenon is essentially a long-term market. A private placement is basically a fixed interest loan which has a maturity up to twelve years. These loans are offered predominantly by institutional investors like savings banks and pension funds, it has helped maintain the relatively high level of institutional savings within the Netherlands. This market accounted for over 40 per cent of net supply and demand for securities in 1979.

The Amsterdam Stock Exchange is the only exchange in the Netherlands. At the end of 1985 the official list was comprised of 2,077 securities, of which 70 per cent were domestic and foreign bonds, the remaining 30 per cent being Dutch and foreign shares. The official exchange has more US stock listings than any other exchange outside the United States. Direct trading in US stocks began in 1980 and the development of the American Shares Amsterdam System (ASAS) helped foster greater European interest in investing in US stocks. Over forty per cent of foreign equities traded on the exchange are American. Securities turnover for 1985 amounted to ECU 82.4 billion, over half of which was traded in equities. Foreign shares, however, accounted for approximately 0.6 per cent of total turnover and only one per cent of share turnover.

There are three categories of members of the Stock Exchange Association:

- commercial banks (credit institutions)
- brokers not registered as credit institutions
- hoeklieden

'Banks and stockbrokers maintain the contact with the public and act as agents for the execution of their clients' orders' (ISSA, 1986). Banks in this case include a small number of savings banks, the commercial banks and Rabobank Nederland. These institutions are involved in the issuing business, either by acting as intermediaries for the issuing companies or by underwriting and placing issues. They are also involved in other aspects of securities business such as trading, safe custody and the like. Some of these financial institutions, especially the large universal banks are prominent in the market for international issues. Hoeklieden are members of autonomous firms who act as intermediaries between banks and stockbrokers, they have no close business relationship with the investors.

'Although no precise figures for the percentage of equity holdings by investor groups are published, the following estimates can be given: foreign investors 50 per cent, domestic individuals 35 per cent and institutional investors 15 per cent' (Hildeburn, 1986).

On 1st January 1986, the Dutch authorities introduced certain regulations that aimed to liberalise the Amsterdam Stock Exchange and capital markets in general. The new legislation enabled banks to issue CDs (certificates of deposit), and also allowed foreign banks to lead manage guilder bonds and euro-guilder notes (as long as reciprocal arrangements exist for Dutch banks operating abroad). Foreign banks are now also allowed to obtain funds from the guilder markets, as long as the reciprocity principle applies. Although this was seen as the move towards a more liberal market place, foreign banks and securities houses have not flooded into Amsterdam. The four major Dutch banks, AMRO, Algemene Bank Nederland (ABN), Pierson Heldring and Pierson, and Bank Mees and Hope still dominate most of the new issues business. The structure of the savings market, with over 60 per cent of all national savings being controlled by domestic institutional investors makes it more difficult for foreign companies to place paper (see banking and credit section for role of banks in brokerage business).

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4.8 Spain

Statistical Overview

Table 1 Number of listed companies and total market value, Madrid Stock Exchange 1981-85

Table 2 Market value by sector, Madrid Stock Exchange, end-1985

Table 3 New shares issued by sector, Madrid Stock Exchange, 1985

Table 4 Madrid Stock Exchange turnover, 1980-84

Table 5 Trading by foreign investors, Madrid Stock Exchange, 1981-85

Table 1 Number of listed companies and total market value, Madrid Stock Exchange 1981-85

Year	Number of companies	Market value (ECU million)
1981	498	15,829.8
1982	448	13,048.5
1983	394	13,347.5
1984	375	18,128.3
1985	347	23,283.5

Source: Madrid Stock Exchange

Table 2 Market value by sector, Madrid Stock Exchange, end-1985

Sector	ECU million
Banks	7,212.5
Electricals	5,579.0
Agriculture and food	731.8
Construction and property	1,679.6
Investment trusts	1,214.5
Metal and engineering	1,000.0
Chemicals and textiles	1,324.6
Communications	3,532.0
Miscellaneous	1,009.8
Total	23,283.8

Source: Madrid Stock Exchange

Table 3 New shares issued by sector, Madrid Stock Exchange, 1985

(ECU million)

Sector	Market value
Banks	33.2
Electricals	486.4
Agriculture and food	18.3
Construction and property	12.2
Investment trusts	10.1
Metal and engineering	38.5
Chemicals and textiles	7.6
Communications	527.1
Miscellaneous	32.5
Total	1,165.9

Source: Madrid Stock Exchange

Table 4 Madrid Stock Exchange turnover, 1980-84

(ECU million)

	1980	1981	1982	1983	1984
Public stocks	131.1	119.7	119.3	220.6	351.1
Debentures	24.8	19.3	18.4	18.0	126.3
Bank bonds	230.4	274.1	385.7	418.7	564.1
Shares	559.9	1,148.8	1,166.9	1,076.4	2,259.6
Documented discount notes	93.4	338.6	462.2	151.5	10.1
T-bills	-	-	147.6	569.5	3,518.1
C-paper	-	-	24.9	137.1	214.1
Promissory notes	-	-	-	2.7	0.7
Total	1,039.7	1,900.5	2,325.0	2,594.5	7,044.0

Source: Madrid Stock Exchange

Table 5 Trading by foreign investors, Madrid Stock Exchange, 1981-85

(ECU million)

Year	Purchases	Sales	Balance	Turnover as % of total
1981	93.5	37.4	56.1	11.4
1982	41.8	39.8	2.0	7.0
1983	68.8	39.7	29.0	9.7
1984	206.1	105.6	100.5	13.8
1985	619.3	229.6	389.7	15.7

Source: Madrid Stock Exchange

Market Overview

Spain has four stock exchanges, Madrid, Barcelona, Bilbao and Valencia; the latter being purely a local market. Madrid is 'the most active and the most international, accounting for nearly 50 per cent of total market capitalisation of both bonds and stocks' (Hildeburn, 1986). In 1985 total trading on the Madrid Stock Exchange (Bolsa) was Ptas ECU 13.14 billion (\$12 billion) of which government bonds accounted for more than half, shares for slightly less than a third, with the remainder being made up of dealings in other commercial paper. Approximately four-fifths of all Madrid's turnover is in three sectors, commercial banking, electronic utilities and Telefonica, the state-controlled telecommunications firm. Over fifteen per cent of equities traded on the Madrid Exchange are done by foreign investors. Security brokers dominate the trading of financial securities on the Exchange. (Brokers do not have a monopoly over Treasury bill trading and business can be freely enacted over the telephone.) 'Most of the orders come from banks, on behalf of their customers, for their own accounts. Each time a trade is made it requires a broker's stamp to make the transfer of ownership legal' (Euromoney, 1986). Brokers do not have sufficient capital to make markets and do not provide any research facilities. Both the banks and the government have been airing their discontent with the system over the last eighteen months. The government would like brokers to have access to larger sources of capital (see Euromoney, 1986) but the banks wanted a majority shareholding in any bank/broker association. It seems likely that the Madrid Exchange will follow in the deregulatory footsteps of London and Paris in the not too distant future.

Business on Spain's stock exchanges is dominated by the banks, savings banks, large investors, wholesale private business or institutional investors such as insurance companies and investment funds. Most of the trading is done through the banks. In addition, 'Most of the larger banks have within their groups investment divisions which handle portfolio management and investment counselling' (Hildeburn, 1986). The trend in Spanish banking is for this type of business to increase over the next decade.

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