Money Market Merits

By Atsushi Nishimura

A major factor behind the proposed integration of the European Community in the financial and capital markets is the rapid development of the European Monetary System (EMS) since the latter half of the 1970s. The EMS has made possible a measure of stability among the currencies of EC member states. The system's successful operation has prevented any major monetary crises resulting from massive flights of capital.

Originally, the EMS was greeted with skepticism. Now that it has proven successful, however, the EC member countries have gained confidence in their ability to forge a single market, a confidence revealed in the active moves toward integrating their financial and capital markets.

The success of the EMS has also aided the conduct of economic policy by the EC states and strengthened their economic fundamentals. In Italy, for instance, the relative stability of the lira has put a halt to the past chronic spiral of prices and wages. Given the heavy dependence of Italian enterprises on exports, they would have collapsed had product prices and wages continued to soar at a time when the lira's exchange rate was relatively stable. That possibility drove Italian corporations to grapple with the task of improving their managerial efficiency.

From that drive in turn emerged a mood for reform which might be called a new entrepreneurship. Trade unions, threatened by the imminent prospect of massive unemployment, embraced the need for change and toned down their traditional militancy. The incidence of labor disputes in Italy decreased markedly in the 1980s, and by the middle of the decade most major corporations had gone from deficits to surpluses.

Deregulation is the prime mover behind the current drive toward EC financial and capital market integration. British Prime Minister Margaret Thatcher took the initiative in this regard when she abolished regulations governing the London foreign exchange market and liberalized the London capital market in the round of measures, known as the "Big Bang," that accompanied the large-scale computerization of the London stock market.

The Big Bang triggered a wave of deregulation in financial markets in other EC states. In fact, the programs announced recently by various EC countries to integrate their financial markets as part of the broader efforts toward a single EC market were prompted largely by Thatcher's deregulation policy.

In 1988, discussions on integrating EC financial markets entered a new phase as plans to create either an EC central bank or a common EC currency took center stage. Whereas the integration debate of previous years was aimed principally at eliminating interstate regulations, the new moves are designed to strengthen the Community's functions as an integrated entity.

While EC member states were almost unanimous in their support for a single market so long as the discussions were confined to deregulation, disagreements surfaced once the thrust of the debate shifted in the direction of investing the Community with sovereign functions. Thatcher took a particularly strong stance against such moves.

Photo: Reuter-Sun

The "Big Bang" deregulatory measures in London spurred financial market integration in the EC.

The new plans to give the Community greater authority over national financial markets attracted attention in financial centers around the world. A proposal requiring EC Commission approval of mergers and acquisitions exceeding a given scale stirred concern in international financial centers, with critics charging that corporate acquisitions, requiring as they do quick decisions through secret talks among the parties involved, would be virtually impossible if they were subject to the suggested reporting and approval requirements.

One of the greatest problems for other world financial markets, however, is the problem of so-called reciprocity regarding market access for financial institutions. The EC is trying to apply this principle to Japan and other major countries, arguing that EC financial institutions should be allowed to do business in these countries on a reciprocal basis.

Yet the pluses and minuses which reciprocity would bring to both EC and non-EC countries are not yet well understood, particularly in the field of financial services. This is because the effects of reciprocity on financial services cannot be separated from the distribution of international money centers and international money flows. The problem cannot be put in proper perspective without considering whether EC economic integraton will have a major impact on the present location of the Euromarket and the reorganization of the EC financial industry. Until that question is answered, reciprocity will remain a moot point in the debate on the integration of EC credit and capital markets.

Atsushi Nishimura is chief economist at the Economics Division II of the Long-Term Credit Bank of Japan, Ltd.