

European Capital Markets Need Overhaul To Meet Future Demands, Conferees Say

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CANNES, France — Europe's capital markets will probably suffer less strain in 1967 than in 1966 but still need a major overhaul if they are to satisfy future money needs of American and European companies.

That is the main conclusion to be gained from talks with many of the 60 prominent bankers and industrialists from the U.S., Europe and Japan who met here over the weekend for a conference on capital markets. The meeting, one of several recent signs of concern about Europe's money market, was sponsored by the Atlantic Institute and the Business and Industry Advisory Committee of the Organization for Economic Cooperation and Development. Both are research organizations that draw their support largely from member countries of the North Atlantic Treaty Organization.

Among the official recommendations of the conference were that governments move to encourage and expand pension plans and other forms of personal savings that could be used for long-term investment; that regulations covering investments by banks and other institutions be relaxed along with other rules that restrict such institutions, and that there be new tax inducements for investment in corporate stocks.

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The opinion that corporations may find it a bit easier this year than last to raise money in Europe was shared by a number of conference participants. Douglas Dillon, former U.S. Secretary of the Treasury, said Federal Reserve Board moves to provide easier money in the U.S. will take some pressure off the European short-term money market. This market makes heavy use of Eurodollars, which are U.S. dollars owned by foreign residents. Last fall, at the height of the U.S. "liquidity crisis," it is estimated that American banks took \$1.8 billion of the approximately \$12 billion Eurodollars on deposit out of the European money market and put it to work in the U.S. That isn't likely to happen again this year, Mr. Dillon said.

Herman J. Abs, president of West Germany's Deutsche Bank, said the West German recession will also ease some of the pressure. He predicted that his country's economic decline will continue at least through the second quarter this year, after which the beginnings of a recovery are likely. He said a leveling-off of housing demand in West Germany is slowing the rise in mortgage demand, freeing more long-term funds for business use.

But despite these signs of short-range easing of the European money supply, there was agreement that widespread reforms are needed in Europe if the capital market is to carry the load it will have in the future. The Earl of Cromer, former governor of the Bank of England and currently senior managing partner of Baring Brothers & Co., a British investment bank, said this modernization will have to take the form of a gradual merger of Europe's separate, inadequate national capital markets into one large market, where money could flow freely across national boundaries and where large enough sums could be raised to meet the needs of big corporations. He said European governments also have a stake in this development because government agencies make heavy use of the capital market to finance roadbuilding, housing and other projects.

Largest Group From U.S.

Of the 14 countries represented at the meeting, the largest delegation was from the U.S., as was the conference director, economist Sidney E. Rolfe of New York.

The American group consisted of Mr. Dillon, George Ball, former U.S. Undersecretary of State and currently chairman of Lehman Brothers International; Tom B. Coughran, executive vice president of the Bank of America; Emilio Collado, an executive vice president of Standard Oil Co. (New Jersey); Grant Keehn, president of Equitable Life Assurance Society of the U.S.; George Moore, president of First National City Bank of New York; Andrew N. Overby, vice chairman of First Boston Corp.; Russell Pippin, vice president of Du Pont Co.; Paul Volcker, vice president of Chase Manhattan Bank, and John M. Young, partner in Morgan Stanley & Co.

The reason for the intense U.S. interest is that in the past two years, because of the interest-equalization tax and U.S. voluntary restraints on the export of capital, American banks and corporations have had to turn heavily to Europe as a source of capital for their foreign operations. Last year, American corporations borrowed about \$700 million in Europe, nearly double the \$365 million of the year before. In so doing, they discovered, according to Mr. Ball, that "this market is pretty thin over here."

The Japanese interests here resembled the Americans'. Although the Japanese haven't expanded heavily into Europe, they have shown an interest in doing so.

Until the American "invasion," Europe felt little pressure to broaden its capital market. But not only is the American borrowing creating such pressure, rising competition from large American companies is making it necessary for European concerns to raise more money for expansion, acquisitions and modernization.

According to Mr. Rolfe, one principal problem isn't a lack of personal savings, but a lack of savings in a form that enables them to be used in the long-term capital market.

With a few exceptions, such as in the United Kingdom and Sweden, there are few of the large institutional investors, such as pension funds and insurance companies, that play such an important role in the U.S. long-term capital market. Unlike banks, such institutions hold "contractual" savings, which cannot be easily withdrawn by the saver, and so they can safely make long-term investments.

Some progress is being made in establishing such sources. Lennart Dahlstrom, managing director of the Swedish Pension Fund, a national fund managed privately, says that in the fund's seven-year existence its assets have soared to the equivalent of \$3 billion. In the next three years it will grow by another \$3 billion. The fund has become a big source of capital for Swedish companies and has grown so large that it dwarfs the Swedish stock markets. According to Mr. Dahlstrom, the fund will seek government permission to make investments outside Sweden.

Mr. Dahlstrom says government officials from Norway, Denmark and England have sought his advice about setting up similar systems. But although there is general agreement that there should be more pension funds—that was one recommendation of the meeting here—not everyone agrees that the Swedish system is the best. For one thing, it gives great investment power to a single fund, says one critic. In contrast to the Swedish plan, national pension funds in France and some other countries don't accumulate large sums for investment because they are designed for a quick payout of incoming money.

One of Europe's major problems is a lack

of equity financing. European companies, which have traditionally shied away from promoting broad stock ownership, are partly to blame for this. But there are signs that they are changing their attitudes as rapid expansion forces them to accumulate debt without a corresponding rise in equity capitalization. "We at one time tried to maintain a 1-to-1 ratio between the two," says the finance director of one major European company, "but now the ratio of equity to debt is very low. As a result, our interest cost is cutting heavily into our earnings."

German companies have traditionally tried to generate capital largely through cash flow, or the combination of earnings and allocations for depreciation and other reserves. But Dieter Spethmann, chairman of Deutsche Edelmetallwerke A.G., a West German metal company, says the threat of rising American competition, particularly through new technology, is convincing managements that they must raise more money externally. He notes that the present system also means that during a recession the resulting reduction in cash flow can endanger expansion plans.

One problem in raising equity capital in Europe is that the low level of activity on European stock markets often doesn't assure investors that when they buy newly issued stock they will have a suitable place to sell it. Partly because of the market lethargy, stock prices on most European markets have suffered major declines in recent years. The group that met here hoped that stock buying can be stimulated by tax incentives and by fuller disclosure of corporate results.

While American interest in the European capital market is high, there were signs that the European participants here were equally concerned. P. J. Van Der Burg, director of finance for Holland's Philips Lamp N.V., thinks lack of sufficient capital may be a factor in the slowdown of Europe's growth. Philips itself faces the prospect of laying off 2,500 workers during the first half.

Many recommendations here parallel those submitted to the European Economic Community last week by a special committee of economists set up by the EEC to study capital markets of the six member nations.

Cold Shoulder for an "SEC"

On one point the recommendations didn't coincide, however. The report to the EEC suggested a study of whether confidence in stocks could be improved in Europe by establishment of an agency resembling the U.S. Securities and Exchange Commission to police the securities industry. This idea received a cold shoulder from participants here.

One main point in the recommendations here was that governments should "adjust their borrowing policies by limiting their demands to a level commensurate with an orderly functioning of the capital markets, by coordinating all types of public borrowing, by aiming at financial equilibrium and self-sufficiency for state enterprises and by limiting the activities of public and semipublic lending institutions to the purpose for which they were created." According to the background paper prepared by conference director Rolfe, heavy government borrowing in Europe in recent years has preempted the supply of savings from private industry and helped drive interest rates up and equity values down.

The report also recommended that governments rely more heavily on trimming their budgets rather than tight monetary controls to curb inflation. Some participants feel this might provide easier money policies in Europe but also might make it easier for governments to dismantle some of the exchange controls and other policies that impede the flow of capital from country to country. The reason is that if a country maintains tight money and high interest rates as a means of curbing inflation, it must also put up barriers to prevent outside money from entering in search of high interest rates.

One subject that conference delegates discussed widely but didn't mention in their report was the Eurodollar market, which already provides a source of capital that flows freely across national boundaries. Eurodollars have become an important source of money in Europe but have been used largely for short-term financing. Long-term financing is Europe's major problem, and while some dollar-bond issues have been floated in Europe, they haven't become numerous.

Most European governments have already taken steps to liberalize capital markets. France, largely because of Gen. de Gaulle's hope to make Paris a major world financial center, has liberalized its rules covering the types of investments banks can make.

The recommendations made here will be turned over to special study groups within the OECD and Atlantic Institute. They will try to convert them into specific proposals that might be translatable into legislative changes by European nations. Most delegates here were optimistic that there will be a steady trend toward liberalization.