

# INTERNATIONAL INVESTMENT

## The role of security markets

**Introduction** Since the end of 1958, when the principal European currencies reverted to external convertibility on current account, a number of steps have been taken both in the United Kingdom and on the Continent to remove restrictions on international capital movement, and the prospects for the restoration of a truly international security market have considerably improved. Public discussion of the part which the United Kingdom might play in such a market was stimulated by the Brussels negotiations, and continues in spite of the breakdown in those negotiations. Another factor which has served to focus interest on the international capital markets has been the additional strains placed upon the international balance of payments by foreign bond issues in New York.

This article seeks to provide some background to these problems by examining the main features of public capital markets in the United Kingdom and continental Europe, using the U.S. market as a point of reference, and giving special attention to the scope of these markets for foreign security issues and to the comparative costs of foreign security issues and dealings. Wherever possible information has been drawn from official published sources; in a few instances however use has been made of reliable unofficial sources.

**General background** The breadth of security markets and their capacity to raise new money depend to a large extent on the proportion of all domestic savings which they customarily attract, either directly or indirectly; and this is partly determined by their institutional structure. Since the early 1930s, when international borrowing on European markets virtually ceased, wide differences in structure have emerged from the

separate development of these markets in response to changes in the pattern of saving and investment.

An important change in all countries has been the rise of a new class of saver, whether due to economic growth itself or to a redistribution of income, through rising wages and progressive taxation, in favour of lower income groups. As a result, savings institutions, insurance companies and the like form an increasingly important channel for the investment of personal savings.

At the same time the small investor has turned increasingly to the unit and investment trusts, which provide for the spreading of risks by means of a wide portfolio managed by specialists, and this has fostered growth in market activity. At the end of 1962, 302 investment trusts in the United Kingdom reported assets of £2,361 million and fifty-four unit trusts reported assets of £257 million. Investment trusts are also of importance in Switzerland where, at the end of 1962, they numbered 138 with assets totalling some £500 million. It is estimated that more than one-third of their resources came from abroad; and, because of the limited investment opportunities available in Switzerland, their assets included a large proportion of foreign securities. In Western Germany there were twenty-three investment trusts with assets of about £235 million, and in France about fifty with assets in the region of £300 million. Investment trusts have played a considerable part in re-establishing the international market in portfolio securities.

Post-war experience of markets has been particularly varied. Only in the United Kingdom, the United States and Switzerland did capital markets emerge from the war intact. In contrast the German market was virtually destroyed, and other continental markets were

severely damaged, and have had to be re-established in conditions at times unfavourable to the accumulation of personal savings. At the same time there has been in most countries a very large increase in borrowing by the public authorities to finance nationalised industries, public services and housing. In continental Europe industry has been unable to raise all the outside capital which it required on the organised capital markets, and these have been supplemented or supplanted in varying degrees (particularly in Western Germany, Italy and France) by such alternative sources as public funds and long-term credits from banks or special financial agencies.

In addition, non-marketable institutional loans, which have been widespread in the United States since the thirties, have developed rapidly in recent years in Europe, particularly in Western Germany and the Netherlands. Such loans, against the promissory notes or other non-marketable instruments of municipal or industrial borrowers, with banks acting solely as agents, may carry a slightly higher rate of interest to compensate the holder for lack of a marketable security; they are popular with both lender and borrower because they are private, flexible and cheaper to arrange than a public issue. A parallel development in the United Kingdom has been the marked growth of local authority mortgages.

The relaxation of restrictions by Western European countries means that almost all of them now permit their residents to purchase foreign quoted securities (although residents of the United Kingdom, Belgium and the Netherlands are not permitted to acquire foreign exchange for this purpose at the official rate), and on the larger stock exchanges a growing number are quoted and actively dealt in. In the field of new issues the main effect of the limited freedom achieved so far has been to increase the flow of capital between European countries. But the possibilities for issues by these and other countries have been demonstrated during recent years by the successful placing of dollar loans in Europe. Although denominated in U.S. dollars, these loans represent lending by West European investors, particularly when they are not quoted on the

New York market. Other loans have been denominated in 'European Units of Account' but repayable in the currency of any member of the Organisation for Economic Co-operation and Development. Nevertheless, apart from Commonwealth borrowing in London, there has been little progress in the opening of public issue markets to foreign borrowers except in Switzerland and to a smaller extent in the Netherlands; and in these two countries foreign issues remain conditional upon a favourable balance of payments and subordinate to domestic capital requirements. A notable exception, however, has been the provision of development capital by the acquisition of funded debt of the International Bank for Reconstruction and Development by investors outside the United States. In recent years direct borrowing by the I.B.R.D. has been concentrated more heavily on European markets, and more than half of the I.B.R.D.'s outstanding debt is now held outside the United States.

Besides administrative controls there are other barriers to a country's ability to provide facilities for foreign issues. The size of the economy may place absolute limits on expansion of the capital market, or shortcomings in the structure or efficiency of the market may restrict the proportion of total savings which it is able to attract. Traditional prejudices of investors may be slow to change; exchange risks, and legal provisions designed for quite different purposes, such as the protection of depositors or savers, may inhibit institutions such as insurance companies or pension funds from investing abroad.

**Organisation  
of markets**

The securities market in the United Kingdom can be described as a single market with its headquarters in London, as the U.S. market is similarly centred in New York. Although there are some twenty provincial stock exchanges in the United Kingdom and seventeen regional exchanges in the United States, the size and strength of the London and New York markets are both a cause and a consequence of a tendency towards the centralisation of the flow of savings through the banking systems and

institutions such as insurance companies and pension funds.

On the Continent, the French, Dutch and Belgian markets are similarly centralised; in Western Germany, however, there are eight trading centres with separate stock exchanges (the most active being Frankfurt and Düsseldorf) and in Switzerland seven (Zürich accounts for about two-thirds of all dealing in securities in Switzerland and is the most active continental market, although Basle and Geneva are also important). In Italy there are ten stock exchanges of which Milan is the most active. However, modern communications have removed many of the difficulties arising from the growth of separate centres in these countries.

An important aspect of all capital markets is the role played by the banks. In the United States, Belgium, France and Italy the functions of investment banking and deposit banking are divorced by law, which may affect the extent to which commercial banks may provide equity and long-term capital and subscribe to or underwrite security issues. In the United Kingdom the traditional specialisation tends to preserve a similar distinction, although there is much overlapping. Short-term finance is supplied primarily by the banks, discount houses and hire purchase finance companies. Long-term finance is provided chiefly through the new issue market which consists of merchant banks and other specialised issuing houses, stock-brokers acting as issuing houses, and underwriting syndicates composed of various financial institutions such as insurance companies, pension funds and investment trusts.

In Western Germany and Switzerland the large commercial banks engage in an extremely wide range of activities. They are large holders of securities and act both as dealers, and as brokers for customers' account. (Nearly all twenty-six members of the Zürich Stock Exchange are banks—there are also about fifty-five dealers authorised to trade outside the exchange—while in the Frankfurt Exchange some seventy-five banks are represented, whose transactions dominate the market.) The banks conduct the bulk of new issue business, and like investment banks elsewhere they customarily take up, as a syndicate, an entire issue for subsequent resale to the public, thus acting in

effect as underwriters. On bourses where the banks' business predominates, the market may be extremely thin when the banks are inactive, and at all times may reflect closely the banks' reactions to money market conditions.

There are differences too in the methods of dealing in securities. In the London capital market the business of dealing is divided between brokers and jobbers. A broker acts as an agent of the public, charging a commission on each transaction, in accordance with a minimum scale laid down by the Stock Exchange. A jobber works as a principal, buying and selling securities on his own account, deals with brokers and normally specialises in certain securities. He makes the price and his profit or loss lies in the difference between his buying and selling price. Since, however, his purchases and sales are not necessarily done at the same time, the jobber, like the middleman in any market, stands to gain or lose according to the movement in the market between the time at which he buys and sells. It is not, therefore, possible to say to what extent, if at all, the jobber's 'turn' increases dealing costs in London. Indeed, the idea that there is necessarily a 'turn' in every transaction is a misconception.

The jobber's willingness to hold the securities in which he deals and the very large facilities available to jobbers in the gilt-edged market for borrowing stocks, enable deals to take place without brokers having to match buyers and sellers. Not only is this method of dealing a convenience for brokers and so reduces their expenses but, particularly where large orders are concerned, it is likely to result in smaller movements in price than would occur under alternative systems. Indeed, the jobbing system can normally absorb or part with stock in sufficient quantities to prevent relatively small transactions having a disproportionate effect on prices; in periods of crisis sharp adjustments in price may well occur, but so they do under all other systems.

The jobbing system is unique to the London Stock Exchange. In most other stock exchanges the function of marrying the bulk of buying and selling orders and establishing an official price rests with a group of members who may be either specialist brokers or dealers, or stock exchange officials. They

may or may not be permitted to take up a position. Official prices may be established continuously (as in New York and Zürich), at fixed intervals (as in Amsterdam, for active securities, seven times each day) or only at the opening and close of business. There are considerable variations in the degree of responsibility borne by members for maintaining an orderly market and on some continental exchanges the method of trading (quite apart from the size of the market) tends to permit rather wider fluctuations in prices than might be expected in London or New York.

Another major difference between the London, the continental and, to a lesser extent, the U.S. markets lies in the method of transferring securities. In the United Kingdom the vast majority of securities are in registered form. On the Continent they are generally in bearer form (except in Italy where nearly all shares must be in registered form). In the United States they take both forms, but registered stock passes by delivery with endorsement in blank. The difference between U.K. and continental practice springs partly from the differing preferences of U.K. and continental investors and partly from exchange control, which in the United Kingdom has restricted the issue of bearer securities from 1940 until this year. There is much to be said for either system. Bearer undoubtedly avoids the cumbersome formalities attaching to the transfer of a registered security, although these formalities would be appreciably simplified in the United Kingdom with the enactment of the Stock Transfer Bill now before Parliament. On the other hand, bearer places on the holder the onus of safe keeping. On the Continent there is a widespread movement towards centralisation of holdings of bearer stocks with administrative agencies which serve not only as safe deposits but also as a form of security clearing; the system is said to be easily adaptable to mechanised accounting methods.

Each market has its own convention for settlement. In London, transactions in British government and government guaranteed securities are settled in cash the next day; transactions in company securities are settled about ten days after the end of an account period which is usually two weeks long. In New York, settlement for short-term Federal government securities takes place on the same

day; deals in other government securities and in corporation and municipal bonds are settled on the following day, while all other security transactions are for settlement within four days. In continental countries, most deals are settled in cash within one to four days; settlement may also be for the account which, for example, runs to the end of the month in Paris, or in Zürich and Milan may run to the end of the following month. Settlement in Brussels is twice monthly.

**Size and scope of markets** It is not easy to compare the size and activity of the various markets. In the United Kingdom nearly all deals in quoted securities are made through the stock exchanges; this is also the rule for shares in the Netherlands and for all securities in Belgium (where the banks are consequently unable to offset their transactions). In Western Germany, on the other hand, banks and other dealers may transact business outside the exchanges. They may deal in officially quoted securities only at official stock exchange prices; there is, however, a large market inside and outside the exchanges in securities not officially quoted. In the United States, the 'over the counter' market, a complex network of dealing rooms linked by telephone or teletype, is perhaps the largest security market in the world and its turnover far exceeds that of the New York Stock Exchange and the American Stock Exchange combined.

Thus statistics of stock exchange turnover, when available, may ignore a large volume of business carried on outside the exchanges. (In the United Kingdom adequate statistics are not yet available even of transactions inside the stock exchanges.) Similarly, the total of new issues is a poor guide to the capacity of a market if it excludes a large volume of privately placed institutional lending, whether against marketable securities or against instruments such as promissory notes. Nevertheless, the statistics shown in Table I, which are compiled from published sources, do give a worthwhile approximation of the relative size of markets in the United States, the United Kingdom, the countries of the European Economic Community, and Switzerland.

**Table I: Security markets :**

Figures in items 1, 2, 5 and 6 are in £ millions

		Belgium	France	Western Germany
1. Net new issues <sup>(a)</sup>				
	1958 ... ..	240	502	779 <sup>(b)</sup>
	1961 ... ..	189	490	1,008 <sup>(b)</sup>
	1962 shares ...	..	288	196 <sup>(b)</sup>
	bonds ...	..	428	860 <sup>(b)</sup>
	total ...	..	716	1,056 <sup>(b)</sup>
		(1961)	(1961)	(1962)
2. Gross fixed capital formation ...		790	3,970	7,634
3. New issues as % of capital formation		23.9	12.3	13.8
4. Number of securities quoted <sup>(e)</sup>				
	shares ...	812 <sup>(f)</sup>	1,300 <sup>(g)</sup>	319 <sup>(h)</sup>
	bonds ...	320 <sup>(f)</sup>	1,500 <sup>(g)</sup>	1,506 <sup>(h)</sup>
	total ...	1,132 <sup>(f)</sup>	2,800 <sup>(g)</sup>	1,825 <sup>(h)</sup>
5. Market value of securities quoted <sup>(e)</sup>				
	shares ...	..	8,150 <sup>(g)</sup>	3,361 <sup>(o)</sup>
	bonds ...	..	..	5,775 <sup>(o)</sup>
	total ...	..	..	9,136 <sup>(o)</sup>
6. Turnover value <sup>(e)</sup> ... ..		146 <sup>(f)</sup>	1,494 <sup>(g)</sup>	..
7. Yields % <sup>(r)</sup> bonds: government ...		4.64	5.06	6.0
	industrial ...	5.03	6.23	6.0
	shares ... ..	4.09 <sup>(t)</sup>	1.73	3.63
	Treasury Bills <sup>(u)</sup> ...	3.00	2.88	2.63

.. Not available.

<sup>(a)</sup> Includes issues of government securities. For the United Kingdom, includes net official sales (+), or purchases (-), of government and government guaranteed securities (see page 113); these were +141 in 1958, -237 in 1961 and +599 in 1962. For the United States, includes gross proceeds of all securities issued.

<sup>(b)</sup> Includes some private placings.

<sup>(c)</sup> Private sector only; figure for government fixed investment is not available.

<sup>(d)</sup> As figures of net new issues and of total fixed investment are not available [see footnotes <sup>(a)</sup> and <sup>(c)</sup>], no meaningful comparison is possible.

<sup>(e)</sup> For each country, the latest figures available.

<sup>(f)</sup> Brussels Stock Exchange only.

<sup>(g)</sup> Paris Stock Exchange only.

<sup>(h)</sup> Frankfurt Stock Exchange only.

<sup>(i)</sup> Milan Stock Exchange only.

<sup>(k)</sup> Amsterdam Stock Exchange only.

Table 1 (page 111)

Item 4. Number of securities quoted, shares—United States  
For 7,659 read 1,565

comparative figures

Italy	Netherlands	Switzerland	United Kingdom	United States
369	167	35	436 <sup>(b)</sup>	12,301 <sup>(b)</sup>
744	105	179	386 <sup>(b)</sup>	12,676 <sup>(b)</sup>
..	46	54	256 <sup>(b)</sup>	626 <sup>(b)</sup>
..	55	108	907 <sup>(b)</sup>	10,079 <sup>(b)</sup>
..	101	162	1,163 <sup>(b)</sup>	10,705 <sup>(b)</sup>
(1961)	(1961)	(1962)	(1962)	(1962)
2,891	1,063	1,111	4,626	26,200 <sup>(c)</sup>
25.7	9.9	14.5	25.1	.. <sup>(d)</sup>
140 <sup>(i)</sup>	1,056 <sup>(k)</sup>	190 <sup>(l)</sup>	6,792 <sup>(m)</sup>	7,659 <sup>(n)</sup>
211	1,310 <sup>(k)</sup>	560 <sup>(l)</sup>	2,342 <sup>(m)</sup>	..
..	2,366 <sup>(k)</sup>	750 <sup>(l)</sup>	9,134 <sup>(m)</sup>	..
9,343 <sup>(p)</sup>	2,850 <sup>(k)</sup>	..	35,318 <sup>(m)</sup>	123,518 <sup>(n)</sup>
3,874 <sup>(p)</sup>	..	..	19,991 <sup>(m)</sup>	39,675 <sup>(n)</sup>
13,217 <sup>(p)</sup>	..	..	55,309 <sup>(m)</sup>	163,193 <sup>(n)</sup>
778	170 <sup>(k)</sup>	1,743 <sup>(l)</sup>	..	20,165 <sup>(q)</sup>
4.92	4.11	3.06	5.60	3.97
5.94	4.38 <sup>(s)</sup>	3.69	6.30	4.37
4.00	..	1.76	4.49	3.24
3.52	1.88	..	3.76	2.92

<sup>(i)</sup> Zürich Stock Exchange only.

<sup>(m)</sup> London Stock Exchange only. Provincial stock exchanges list many securities quoted in London and, additionally, some 900 securities not quoted in London.

<sup>(n)</sup> New York Stock Exchange only.

<sup>(o)</sup> Nominal value; unquoted securities are included.

<sup>(p)</sup> Estimated holdings of banks and private individuals at end-1961.

<sup>(q)</sup> Excludes U.S. government bonds.

<sup>(r)</sup> At end-March 1963. For the United Kingdom, the yield on government bonds is the redemption yield on an 18-year bond, and on industrial bonds is the average redemption yield, allowing for stamp duty, on twelve industrial debentures with about twenty years to maturity; in both cases accrued interest is excluded and tax ignored. The figure quoted for U.K. shares is the dividend yield derived from the F.T.-Actuaries 500-industrial ordinary share index. For other countries the nearest comparable yields have been quoted.

<sup>(s)</sup> At end-January 1963.

<sup>(t)</sup> At end-December 1962.

<sup>(u)</sup> Twelve months' Bills for France and Italy; three months' Bills for other countries.

By any standard the U.S. market is the largest in the world, as regards both the volume of new issues and the turnover of existing securities. New York is also the only market on which non-residents have enjoyed uninterrupted freedom to borrow since the war, whether by public issue or by private placing of securities or term-loans. Since 1945 the total of foreign loans publicly offered on the New York market, excluding refunding issues, and all issues by the International Bank and Canadian borrowers, has exceeded the equivalent of £650 million. A large proportion of loans raised by European borrowers is known to have been taken up by European investors, though the extent to which they provided new money or switched from existing U.S. investments is not known.

In the United Kingdom direct control over new issues has steadily diminished in recent years, and since February 1959 has been

suspended for issues by domestic borrowers, though the timing of larger issues is still subject to approval. Since the war, new overseas issues on the London market have been mainly reserved for Commonwealth borrowers. Issues by all overseas borrowers have totalled £508 million (excluding refunding issues) of which Commonwealth borrowers have taken £479 million while those outside the Commonwealth have borrowed no more than £29 million. It has, however, very recently been agreed to allow access by all member governments of the European Free Trade Area.

In 1962 new capital issues on the U.K. market (excluding British government and government guaranteed securities, local authority mortgages and issues by unquoted companies) are estimated<sup>(a)</sup> at £630 million gross and £564 million net of redemptions. These are analysed by method of issue in the following table:

**Table II: New capital issues in the United Kingdom<sup>(a)</sup>**

ANALYSED BY METHOD OF ISSUE

£ millions

Year	Total gross issues	UNITED KINGDOM BORROWERS					OVERSEAS BORROWERS			
		Gross issues by companies					Local authorities gross issues (b)	Total gross issues	Public issues	Placings
		Total	Public issues and offers for sale	Tenders	Placings	Issues to shareholders				
1959	511.6	409.4	32.0	3.2	71.9	302.3	45.2	57.0	46.7	10.3
1960	573.5	473.4	35.6	5.2	72.7	359.9	59.3	40.8	36.8	4.0
1961	692.5	595.8	27.3	5.2	101.4	461.9	53.3	43.4	39.2	4.2
1962	630.0	445.2	67.1	9.2	108.2	260.7	160.4	24.4	22.2	2.2

<sup>(a)</sup> A description of these estimates was given on page 35 of the December 1961 issue of this *Bulletin*.

<sup>(b)</sup> All public issues except for placings of 1.1 in 1962.

In 1962, total issues of British government and government guaranteed securities amounted to £1,993 million gross and £935 million net of redemptions. But, because part of each new issue of these securities is generally taken up initially by Government Departments, such figures do not necessarily reflect the amount taken up by the market in a particular period; a better indication of the market's contribution in any given period is perhaps provided by the total of net official sales of these securities. In 1962 they amounted to £599 million.

As may be seen from Table II, well over half of issues by U.K. companies in 1962 took the form of issues to shareholders, a quarter were by placings, and the remainder, apart from a small proportion by tender, were by public issues and offers for sale. A fair proportion of the money raised will have come from institutions such as the insurance companies and pension funds, particularly so in the case of placings. The significance of the institutions' role can be deduced from the fact that in 1956 and 1957 up to a third of all new issues (included in the estimates published in Table 15 of the Statistical Annex) were subscribed for by members of the British Insurance Association.<sup>(a)</sup> In many cases holdings were no doubt acquired as a result of underwriting commitments. The immediate underwriter is generally the issuing house responsible for the loan, who then 'lays it off' with sub-underwriters. Insurance companies are believed to sub-underwrite about half of all public issues, the remainder being largely sub-underwritten by banks, pension funds and investment trusts.

As an indication of the capacity of the market to absorb large new issues, new loans within the range of £10-£15 million for U.K. local authorities or companies are a regular feature. It is beyond the capacity of almost all of the continental markets reviewed below to provide loans of this size with the same frequency as in London.

The supply of capital in Switzerland, arising from a high level of savings and repeated inflows of funds from abroad, has in the past exceeded the demand for domestic investment. This has kept interest rates low—at present a first-rate domestic borrower pays 3½% and a

foreign borrower 4½% for a 10-15 year loan. An important feature of the market is the extensive use of mortgage loans; through its effect on rents and wages the mortgage bond rate has a particular importance and at present is held at 3½%. The largest domestic borrowers on the market are public utilities, local authorities, cantonal banks and mortgage institutions, while the Federal Government has little need to borrow and there are relatively few bond issues by industrial borrowers.

Direct access by foreign borrowers to the Swiss market is regulated jointly by the banks and the financial authorities; National Bank approval is also required for lending to non-residents in excess of S.Fcs.10 million, whether by public issue or by private loan. Official encouragement has been given to the expansion of foreign lending in the past when this has appeared necessary to offset an inflow of foreign funds and protect the domestic economy against the resulting increase in liquidity. (For the same reasons the National Bank has secured the agreement of the commercial banks to discourage the investment of foreign funds in Swiss domestic securities and property.) Public issues of foreign loans on the Swiss market since 1945 have exceeded the equivalent of £400 million—more than half the U.S. total, even though the Swiss national product is less than one-fiftieth the size of that of the United States. However, the high level of foreign lending already achieved by the Swiss market in relation to the size of the economy suggests that the scope for further expansion based on domestic savings may be limited.

In the Netherlands, as in Switzerland, the ready supply of capital has kept interest rates low. The yield on long-term government bonds is a little over 4%, and on industrial debentures about 4½%. The Dutch market also has a long tradition of international lending and borrowing, and was reopened to foreign borrowers in 1954 and 1955, and again since 1961, though to an extent determined administratively with regard to domestic capital requirements and to the level of the Dutch exchange reserves. Net new foreign bond issues totalled Fl.432 million (£43 million) in 1961 but only Fl.142 million (£14 million) in 1962.

<sup>(a)</sup> Based on evidence submitted by the British Insurance Association to the Radcliffe Committee on the Working of the Monetary System.



At the end of the war little remained of the German capital market, and its revival in the Federal Republic was delayed for a long period by a low level of personal savings, a complete loss of confidence in fixed interest securities and the statutory limitation of interest rates and dividends. The acute shortage of capital led to an exceptionally heavy reliance by companies on self-finance, generous depreciation allowances, and bank loans; and it was not until 1954 that the public market again began to play a significant role in the provision of long-term capital.

The extent and importance of bank lending during these years, particularly at medium and long-term, brought the banks into close relationship with the stock exchanges, operating both for their customers and on their own account, and channelling private savings deposited with them into the capital market. Their business dominates the stock market which has accordingly in the past tended to be somewhat narrow and subject to sharp fluctuations in prices. However, since 1957 the growth of public issue business in Western Germany has been rapid. Net bond issues placed by the banks in 1962 amounted to DM 9.6 milliard (£860 million) and DM 2.2 milliard (£196 million) was raised by share issues. Of a total of DM 60.8 milliard (£5,429 million) fixed interest securities outstanding in Western Germany at the end of 1962, DM 29.7 milliard were issued by the public sector and DM 21.9 milliard were mortgage bonds, while only DM 5.8 milliard (9.6%) were industrial bonds. The market is capable of raising, say, DM 500 million (£45 million) in a single operation for the Federal Government and perhaps DM 100-DM 150 million (£9-£13 million) for a first-class industrial name, but issues of this size are exceptional. Turnover on the exchanges in 1961 had risen to nearly nine times the 1953 level for bonds, and nearly six times for shares.

Owing largely to continued domestic demand, interest rates are high; bond rates have been as high as 8%, and never for long below 6%. 1958 saw the first public issue for a foreign borrower for forty-five years, but although continuous efforts have been made to encourage foreign loans to offset the rapid growth in foreign exchange reserves, only about DM 700 million (£63 million) has been raised in this way.

The markets discussed so far are the only ones on which external borrowing has, up to the present, taken place on any significant scale. Those described below have been almost exclusively concerned with raising capital for domestic borrowers.

The Italian market has expanded rapidly and new issues have quadrupled over the past ten years, reaching, in 1961, a total of Lire 1,301 milliard (£744 million) of which Lire 884 milliard were in bonds and Lire 417 milliard in shares. However, the extensive use of specialised credit institutions, and the preference of private savers for savings banks (or foreign securities purchased abroad) has made the market particularly narrow; and it remains essentially a national one, not least because of the intense demand for capital for the development of Southern Italy. Italy made a start in foreign lending, however, in 1961 and 1962 when three international institutions placed bonds there to a total of Lire 45 milliard (£26 million).

In Belgium industrial concerns rely heavily on self-finance and loans from banks and a variety of special institutions. Total new issues in 1961 of B.Fcs.26.5 milliard (£189 million) included B.Fcs.21.0 milliard (£150 million) of public sector bonds, most of which enjoy tax privileges. Two loans by international organisations totalling B.Fcs.800 million (£6 million) have been issued in recent years.

In France the existence of many specialised credit institutions (such as the *Crédit National*, *Crédit Foncier* and the *Crédit Agricole*) which lend at preferential rates, issue their own bonds, and channel savings directly or indirectly into medium-term lending, has had a limiting effect on the public market. Also the existence of special facilities for rediscounting medium-term credits at the *Banque de France* reduces the need for industry to borrow by means of public issues. Nevertheless, total bond placings in 1962 were Fcs.5.9 milliard (£428 million) and shares Fcs.4.0 milliard (£288 million), while turnover on the Paris Stock Exchange was estimated at Fcs.20.6 milliard (£1,494 million) in 1961. The Government or a first-rate nationalised industry borrower might place a new issue for Fcs.1 milliard (£72 million) or more, and a private borrower might raise Fcs.200 million (£14 million) but issues of this

size are infrequent. The demand for loan funds exceeds the supply and it is necessary to impose a time-table on new issues. The market is essentially a domestic one and apart from franc area issues, no external bond issue has been permitted on the Paris market since 1951.

**Costs** Comparative statistics of the incidental costs of borrowing or investing in different markets are difficult to compile. In no centre is there a uniform scale of issuing costs; taxes imposed on the borrower—in most countries a relatively small part of total costs—are the only component for which a published scale is uniformly applied. Other costs, which include underwriting charges, and various fees payable to the issuing house and to the banks and brokers involved, besides stock exchange quotation fees and advertising expenses, may vary widely according to the size of the loan and the standing of the borrower. In some centres total percentage charges for a small loan may be double the figure quoted below.

Finally, the compounding of stamp duty on transfers and recurring charges connected with service of the loan cannot be satisfactorily measured, nor can legal costs.

It is impossible to generalise on the relative attractiveness to an investor of individual markets. The yield on investment is affected not only by the level of interest rates but also by his tax position and by the level of incidental costs; and the investor will also pay regard to the stability of the currency in which he is investing. Both the cost and the convenience of dealing in a particular market, and therefore its ability to attract foreign investors, are affected by its efficiency and method of operation.

Figures used in Tables III and IV have been obtained from a number of sources and while there can be no certainty that like is compared with like, they are thought to give a reasonable guide. Table III compares the initial costs of raising new money in the various centres, expressed as a percentage of the sum raised.

**Table III: Initial costs of public issues**

*Percentages of sum raised, except where indicated*

	Domestic companies				Foreign governments	
	Initial tax		Approximate total costs		Initial tax	Approximate total costs
	Loan	Share	Loan	Share		
Belgium ... ..	0.7	2.3 p.v.	3½—5	5¼—6¼	1.6	..
France ... ..	Nil	1.7	6 <sup>(a)</sup>	7½—8 <sup>(a)</sup>	Nil	..
Western Germany	2½ p.v.	2½	7 —8	8 —8½	2½ p.v.	7 —8
Italy ... ..	0.62 <sup>(b)</sup>	1.12 <sup>(c)</sup>	5½—8½	.. <sup>(c)</sup>	..	..
Netherlands ...	¾ p.v.	2½	3¼	5⅞—5⅝	2	4 —5
Switzerland ...	0.6 p.v. <sup>(d)</sup>	2 <sup>(d)</sup>	3—3½ p.v.	4½ <sup>(e)</sup>	1.2 p.v. <sup>(d)</sup>	3½—5
United Kingdom	⅛ p.v. (in registered form) <sup>(f)</sup>	½ p.v. (in registered form)	3	3¼	2 (in bearer form) <sup>(f)</sup>	4¼—4½
United States ...	0.16 p.v. <sup>(g)</sup>	0.13 <sup>(g)</sup>	1 —2	4 —4½	Nil <sup>(g)</sup>	1¼—4¼

p.v. on par value.

.. not available.

(a) Including turnover tax.

(b) Including 0.5% annual tax on bonds normally paid by borrowers and not reclaimed from subscribers.

(c) Share issues (apart from rights issues) are infrequent and are usually privately subscribed.

(d) In addition, a tax of 3% on interest and dividend payments is payable annually by Swiss companies; for non-resident borrowers the tax is payable in advance at 2% of total interest payments.

(e) This can vary very widely.

(f) Stamp duty is shown at the reduced rates for which provision is made in the Finance Bill now before Parliament.

(g) Ignoring a small fee payable to the Securities and Exchange Commission when the documents are filed.

The costs of a debenture issue by a domestic company are probably highest in Italy and, partly because of a heavy initial tax, in Western Germany; in France and Belgium they are relatively high. Costs in the United Kingdom, at about 3%, are almost certainly the smallest among the European countries considered, although larger than the low direct costs of 1%-2% found in the United States.

A comparison of the costs of a debenture issue by a foreign borrower is even more difficult since in some countries such issues are infrequent or have not been made at all for a long period. For a foreign government or first-rate company of international standing total charges may be  $\frac{1}{2}\%$ - $1\frac{1}{2}\%$  higher than those of a domestic company, or may be comparable if the borrower's bonds already circulate in the lending market. In Belgium, the Netherlands and Switzerland stamp duty or its equivalent is higher for a non-resident borrower.

In all countries the costs of a public issue of shares are higher than those of a debenture issue, and this is particularly so in the United States. However, the cheaper procedure of issues to shareholders may be more common than that of offers to the public; this is the case in the United Kingdom, for which the figure of  $3\frac{1}{4}\%$ , shown in Table III as the cost of a public share issue, may therefore be unrepresentative. However, companies rarely, if ever, raise equity capital by public issue in a foreign centre.

Table IV compares dealing costs for purchases of equities and government bonds, expressed as a percentage of total cost. The figures are based on purchases equivalent to £10,000—in some centres commissions vary for round and broken amounts, while percentage costs may fall sharply as the size of the purchase increases. In some cases dealing commissions are smaller if settlement is for the account.

**Table IV : Costs of purchasing securities<sup>(a)</sup>**

*Percentages of total cost, based on purchases equivalent to £10,000*

	Shares		Government bonds
	Including stamp duties	Excluding stamp duties	
Belgium	1.1 (0.8)	0.8 (0.6)	0.4
France	1.3 (0.8)	0.7 (0.5)	0.3 (0.2)
Western Germany <sup>(b)</sup>	1.0	0.9	0.5
Italy	0.4	0.3	0.2
Netherlands	0.7	0.6	0.7
Switzerland <sup>(b)</sup>	0.4 <sup>(c)</sup>	0.4	0.3
United Kingdom	1.8 <sup>(d)</sup>	0.8	0.2
United States	1.2—0.4 <sup>(e)</sup>	1.2—0.4 <sup>(e)</sup>	<sup>(f)</sup>

<sup>(a)</sup> Where significantly different rates are applied for cash deals and deals for the account, the latter are shown in brackets.

<sup>(b)</sup> Including duty at the reduced rates applicable to non-resident investors.

<sup>(c)</sup> Including a small stamp duty.

<sup>(d)</sup> Stamp duty has been included at the reduced rate of 1% for which provision is made in the Finance Bill now before Parliament.

<sup>(e)</sup> New York Stock Exchange commission rates decrease as the price of the individual share unit rises. The rates chosen cover a range of share prices from \$28 per share (1.2%) to \$140 per share (0.4%).

<sup>(f)</sup> Negligible.

In the United Kingdom stamp duty on share purchases, even after the proposed reduction from 2% to 1%, will remain appreciably higher than in other centres; in all of the continental countries considered stamp duty is charged on both purchases and sales but only in France does the total amount paid exceed 0.6%. Excluding stamp duties, costs in the United Kingdom are higher than in Switzerland, the Netherlands and Italy, but are broadly comparable with those in the remaining countries.

Continental investors are used to being able to show a profit on sale if the quoted price of a share rises some 2% above its purchase price. In London a rise of about 3%-4% (with stamp duty at 1%) would be needed. Despite relatively high charges, however, the size of the London market and the ease of dealing offer certain advantages over some continental markets where price movements are more abrupt and sales of larger amounts of stock may be difficult without provoking an adverse move in prices.

For purchases of government bonds, costs in the London market compare favourably with those abroad. There is no stamp duty in the United Kingdom other than the contract stamp which is negligible, while commission rates are among the lowest. In addition the gilt-edged market here is very much broader than in other European centres, the variety of maturity dates and coupons is unrivalled and very large amounts can be freely dealt in; and bearer facilities are being re-introduced.

**Taxation** The incidence of taxation on non-resident ownership of stocks and shares is extremely complex. An investor may obtain a different net return from a purchase of the same international share in Amsterdam, London, Zürich or New York and for a useful comparison it is necessary to take into account the investor's tax liability at home, the amount of tax deducted in the market in which the security is purchased and the tax liability of the company invested in. The terms of the relevant double taxation agreement, if any, and the amount of unilateral tax relief obtainable are also important.

Broad generalisations are not therefore possible and, even though differences in net

yields due to tax are usually a more important factor than variations in dealing costs, the relative attractiveness of a particular centre can be assessed only in terms of an individual investor, or at most a group of investors.

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From the foregoing it is clear that New York is pre-eminent in providing by far the widest and most competitive market in securities, with London easily next in importance. New York still supplies the bulk of the money raised by foreign borrowers in foreign security markets, though in many cases a substantial part of the subscription comes from non-residents.

The continental markets, with the exception of Switzerland and, to a lesser extent, the Netherlands, are still almost exclusively concerned with domestic issues and make only a small contribution towards providing investment capital for other countries through their security markets. The reasons for this derive partly from the structure of their markets and partly from the absolute levels of interest rates ruling there, often also much influenced by their general financial structure and background. Steps designed to broaden and improve their markets are being taken by the monetary authorities in many of these countries but it is bound to take time to restore full confidence in fixed interest securities and to attract savings from existing channels.

The U.K. market does not suffer from the structural limitations present in some continental markets. It is institutionally well organised for foreign lending, a state of affairs which derives from a long tradition and which has survived substantial changes in the underlying circumstances. Neither the international economic position of the United Kingdom nor the flow of overseas borrowers with a familiar and unquestioned record in the market are comparable with what they were in the heyday of the foreign bond market. Nevertheless there is no reason why the United Kingdom should not play a useful part by acting as a financial entrepôt, in which funds mobilised from a variety of sources are channelled into foreign loans issued on the London market.