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THE CHANGING STUCTURE OF FINANCIAL MARKETS

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I. INTRODUCTION

The financial markets of the advanced industrial economies have undergone far reaching changes since the mid-1970s. These changes essentially stem from the following interrelated factors: (a) the progressive deregulation of financial markets both internally and externally in the leading countries; (b) the internationalisation of these markets; (c) the introduction of an array of new financial instruments allowing more risky and bigger financial investments; and (d) the emergence and increasing role of new players on the markets, particularly institutional investors. The main purpose of this essay is to provide an analytical description of these transformations and to outline some of their broader economic implications.

In addition to the questions of the macroeconomic vulnerability of an economy to such financial market developments and the issues of national economic policy autonomy, which are the main focus of this book, these changes also have extremely important repercussions for the savings and investment behaviour of individuals and firms. Specifically, a growing proportion of household savings are being directed towards the financial institutions - insurance companies, pension funds, mutual funds, unit and investment trusts. Institutional investors have an increasing influence on the national and international stocks and bonds markets. An important question is therfore: what will be the effects of (a) greater institutional investment and (b) international integration of capital markets on the magnitude and financing of real investment by industrial companies? Similarly one may ask, what is likely to be the nature of the relationship between the institutional investors and the domestic and foreign companies in which they hold shares in a more integrated financial market?

In principle, changes in financial markets could have a considerable impact on corporate control and performance. To provide a simple illustration, consider just three forms of corporate finance: shares, marketable debt and direct bank lending. Each raises the problem of asymmetric information and a variety of principal-agent relationships exist. Shareholders have the choice of passive or active reaction to information (ie simply sell shares or attempt to directly intervene). It can be argued that the concentration of shares in institutional holdings will result in more informed and more active involvement by the shareholders, or their representatives. On the other hand the

institutional investors may themselves be subject to short-term performance pressures which limit their desire, or ability for long-term involvement. Furthermore the globalisation of equities may have created a large class of marginal (ie volatile) shareholdings by foreign institutions. In the case of debt the immediate credit-worthiness of companies is of great concern. There is no doubt that the development of specialist credit-rating agencies has lowered the information cost in this area and given some large companies cheaper access to wider markets. However the stability of these new markets is not ensured and a danger exists of undue dependence on them. Finally, direct bank lending has traditionally involved a close relationship between the lender and borrower. This relationship can be both active and long-term as, for example, in Japan and Germany. New financial instruments such as the securitisation of credit may represent a move away from this close relationship. It is a moot question whether the net result would be an overall improvement or worsening in industrial investment performance.

II. THE INTERNATIONALISATION OF CAPITAL MARKETS AND THE DEVELOPMENT OF NEW FINANCIAL INSTRUMENTS

Since the demise of Bretton Woods and the introduction of the floating exchange rate, there has been an increasing internationalisation of capital markets which has led to the expansion of international lending and security dealing and to the development of new instruments to cope with the associated risk. This has been stimulated by several economic and political events. Floating exchange rates and the greater volatility of both exchange and interest rates have encouraged the adoption of new financial instruments. The large savings and investment imbalances which have been reflected in large current account payments imbalances among the industrial as well as the developing countries, have expanded international bank lending and built up the eurocurrency markets. The gradual dismantling of exchange controls in W Europe from the end of the 50's, with the landmark abolition in the UK of most exchange controls in October 1979, has freed international currency flows. This has permitted companies to seek out the cheapest sources of finance (associated also with the internationalisation of companies' trading activities) and has allowed investors to spread their risk by diversifying their portfolios internationally.

The reduction of exchange controls has been augmented by the deregulation of domestic financial markets. This has come about as a response both to the deregulation of other domestic markets and to international competitive pressures. Financial markets have been amongst the most regulated of markets, partly to ensure investor protection and financial stability and partly to form part of the monetary policy tools available to governments. These markets had developed in a compartmentalised fashion with constraints on both the assets and liabilities of the financial institutions operating in them. Competition was restricted not only between different types of institution but also within these compartments (due both to regulation and to concentration and entry barriers).

The last decade has seen significant changes in the regulatory climate which have promoted both competition and internationalisation. These changes have in part been in response to the emergence and growth of an unregulated financial sector both internationally and in the domestic market. A notable example was Big Bang in the UK markets in October 1986 which followed the threat of an enforced dismantling of

the Stock Exchange Rule Book dy the Restrictive Practices Court. The deeper underlying causes of which were the removal of exchange controls in 1979, the resultant opening of the domestic capital market to international competition; and the earlier deregulation of the New York market in 1975 which led to the fear that the London market would lose business overseas (since its commission rates were too high and capital resources of security firms too small). Along with the regulatory changes came major technological improvements and a merger of the domestic and international securities markets in London.

Elsewhere changes have occurred to decompartmentalise financial companies and through deregulation to increase the capitalisation of their securities business. Deregulation of financial markets has therefore involved opening up the markets internally (decompartmentalisation) and externally (by removing obstacles to the entry of foreign financial companies). This represents a shift in policy from the protection of domestic ownership and financial prudence towards the promotion of free competition and it is claimed market efficiency.

Finally, we note that the international financial market trends which we outline in this paper have coincided particularly in the 1980s with the US current account deficit. This raises the interesting question: how much of what is going on is just being driven by the US deficit, and how much is an independent trend which would have occurred even if the US had maintained external balance? In our view two factors have been fundamental to the processes examined in this paper: (a) the strong movement towards abolition of exchange controls in industrial countries in the 1970s and (b) internal and external financial deregulation. In general, both (a) and (b) have preceded the US balance of payments difficulties. Nevertheless, the US deficit and the change in the relative value of the dollar, have of course affected the nature and degree of globalisation of the financial markets - for example the incidence of Japanese and other countries' takeovers in the United States. In addition, it is important to recognise that the US deficit has most likely also contributed <u>indirectly</u> to these trends - in particular by hastening the process of financial deregulation in some countries. To counterbalance its deteriorating international position in manufactured products, the United States has pressed for freer trade in financial services and financial liberalisation in countries like Japan, and more recently in Korea. The continuing liberalisation of the Japanese financial market

in the 1980s has as we shall see been particularly significant in the global integration of the capital markets.

The marked growth and the change in the structure of international capital markets is shown in Table 1. The growth has been stimulated by, and has itself stimulated, the development of new financial instruments, which have been designed to increase the marketability and spread the risk of funds raised. Initially the growth of international capital markets was largely associated with bank lending which, at its peak in 1978-79, accounted for two-thirds of the total funds raised on international capital markets. Since that time the debt crisis, the reduction in banks' credit rating and the pressure to raise their capital ratios have led to a reduced attractiveness of bank lending both for banks and for borrowers (who were now able to borrow directly as cheaply as banks). The decline in syndicated bank lending has been more than compensated for by the rapid growth of bond, particularly Eurobond, issues as can be seen in Table 1.

The use and spread of new financial instruments is shown in Table 2. These instruments are used for hedging against and distributing risks and their popularity is a response to the greater scale and volatility of financial markets in recent years. New instruments, such as floating rate notes (FRN's), interest rate options and interest rate futures, provide borrowers and lenders with the possibility of hedging against the risk of interest rate movements. The underlying trend in the use of the new instruments has been the gradual replacement of traditional bank loans with marketable security issues (equities and bonds) on which virtually all the new instruments are based. Marketable securities have turned out to be an effective funding instrument for industrial risk spreading. Unlike direct bank loans, these securities allow risks to be split among a large number of investors, who can manage them in a more dynamic and flexible manner because of their liquid character.

Table 1 Funds Raised on International Markets, 1972-1986

(US$ bn)

	1972	1977	1982	1986
Bonds	11.2	36.1	75.5	228.1
Equities	-	-	-	11.7
Syndicated Loans	8.7	34.2	98.2	52.8
Note Issuance Facilities	-	-)	5.2	24.8
Other Back-up Facilities	-	-)		
Total Securities and Committed Facilities	19.9	70.3	178.9	321.9
Euro-commercial paper programmes	-	-	-	59.0
Other non-underwritten facilities	-	-	-	8.6
Total Uncommitted Borrowing Facilities	-	-	-	67.6
Grand Total	19.9	70.3	178.9	389.5

Source: OECD Financial Market Trends (various issues)

The table shows that floating rate notes (FRN's)[1] have grown from insignificant levels at the end of the seventies to $51bn in 1986 and at that time represented about one quarter of bond issues. Another significant development supporting disintermediation and the securitisation of credit has been the growth of note issuance facilities (NIF's)[2] and other back-up facilities (e.g. RUF's)[3]. The development of one set of new markets leads in turn to the expansion and development of others. There has been a marked increase in the use of the swap technique and of financial futures and options. The use of swaps was important in the growth of bond issues and tended to tie the domestic and international markets even closer together. 'Because of their depth and greater efficiency, or because of fiscal and regulatory advantages, an increasing proportion of the credit flows between domestic savers and investors is intermediated directly or indirectly via the international markets.' (BIS 1986 pp. 92-93).

For banks the new instruments have provided fee income (through providing guarantees, standbys, back-up facilities etc) at a time when they feel constrained in increasing their conventional lending. Banks actively engage in managing their assets and liabilities by trading in these new financial markets so as to ensure an appropriate balance sheet structure. In the US the rise in the cost of borrowing as a result of the downgrading of the banks' credit-rating, along with the tougher capital requirements imposed by banking supervisors, has led to another example of securitisation. This is the repackaging of conventional bank loans for sale as marketable securities. The growth of mortgage-backed securities (e.g. CMO's)[4] has been especially fast.

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(1) Floating rate notes are short-term, floating interest rate securities with the interest rate pegged normally to the London Interbank Offered Rate. FRN's reduce the risk exposure of investors to rising interest rates.

(2) Note issuance facilities are offered by groups of commercial banks to ensure that a borrower can place Euronotes.

(3) The revolving underwriting facility is similar to the NIF but here the banks ensure that a borrower can place three to six months Euronotes on a revolving basis, thereby assuring the borrower of medium-term finance.

(4) The collateralised mortgage option is a private sector debt security offering returns from a pool of mortgages held by the issuer.

Corporate borrowers generally have become major borrowers on international markets via these new instruments and non-bank institutions have become major investors on these markets. For investors and borrowers the international market and these new instruments provide a cheaper, more flexible and less risky source of borrowing or investment. Table 2 shows that another growth area has been international issues of equities and equity-related bonds (warrants and convertibles). This is associated with the globalisation of equity markets, a subject which will be discussed in section IV below.

Table 2 International Capital Markets: Major Instruments, 1984-1988
(US$ bn)

	1984	1985	1986	1987	1988
Straight bonds	58.4	94.7	141.4	124.0	162.8
Floating Rate Notes[1]	38.3	58.7	51.0	10.7	19.3
Equity-related bonds	10.9	11.2	26.9	39.1	44.5
Other bonds	3.9	4.5	8.8	3.5	2.7
Equities	-	2.7	11.7	18.2	5.8
Syndicated loans	45.8	36.0	52.8	79.4	108.4
"Managed" loans[2]	11.2	7.0	-	9.4	6.7
Note Issuance Facilities	17.4	34.4	24.8	28.1	20.7
Other Back-up Facilities	11.4	8.5	4.5	1.8	1.8
Euro-commercial Paper Programmes	-	12.6	59.0	55.3	58.0
Other Non-underwritten Facilities	-	10.6	8.6	14.3	18.9
Total	197.3	280.9	389.5	383.8	449.6

Source: OECD Financial Market Trends (various issues)

1. Including medium-term floating-rate certificates of deposit
2. Syndicated loans extended in connection with restructuring agreements

In 1986 about 85% of international market activity was accounted for by security-related funding. After the stock market crashes of October 1987, straight bond issues (particularly those denominated in dollars) and equity-related issues came almost to a halt. There was a revival of the syndicated bank loan, but this cannot be interpreted simply as a move away from securitisation since it was associated with the development of new instruments such as the multi-option facility (MOF). The MOF can be thought of as a flexible, securitised instrument with a back-up line of credit and is, along with NIF's and RUF's, another way of packaging Euronote deals. Interest and exchange rate volatility, which hit the bond market, probably stimulated bank lending. The bond market was also hit by the stagnation of the FRN market. The collapse of the FRN market was a major event and illustrated the fragility of this new market form. For borrowers it meant the elimination of a major source of international finance. For intermediaries it meant losses on the investment in staff and resources in this type of activity. As the OECD observed 'recent events have dealt a major blow to FRN investors who not only have incurred significant losses but, more importantly, who have had a tangible proof of how ephemeral the liquidity of negotiable financial assets can become if suspicions arise about the capability of trading houses to maintain an orderly market' (OECD Financial Market Trends No. 37).

When the Euronote market was first established, borrowers typically used NIF's. More recently, as shown in Table 2, borrowers have tapped the short-term note market by issuing Euro-commercial paper (ECP), which is placed by dealers on a 'best efforts' basis. At times of financial volatility borrowers may find that the ECPs cannot be placed at favourable rates and so they wish to have alternative sources of committed finance. The MOF can potentially offer both greater flexibility and insurance to the corporate borrower, particularly when doubts arise about the liquidity of some of the new markets. 1988 has seen some recovery on the Euro-bond market and the Euro-commercial paper market has continued to grow, but the main source of growth has been the continued revival of the market for syndicated bank loans. Equity-related bonds have started to recover, but the FRN market has remained in a slump.

Finally, in relation to new financial instruments, Table 3 presents data on aggregate open interest in major world financial futures and options contracts. The aggregate open interest in financial futures

and options, a measure of speculative capital at risk in the market, has increased at a phenomenal rate in recent years: it has increased more than eight-fold since 1980. Over the same period, the daily trading volume in futures and options contracts has increased seven-fold. Levich (1987) reports that in 1984 and 1985 the volume of average daily trading in the US Treasury bonds futures was about four times greater than in the underlying cash market; the same was true of stock-index futures in relation to the purchase of equity shares. This raises important questions about whether the increasing internationalisation of the capital markets and the growing role of financial futures makes the underlying spot markets more volatile.

Table 3 Aggregate Open Interest in Major World Financial Futures and Options Contracts

(Billions of US Dollars)

	1975	1980	1984	1985	1986:3
Futures	0.2	81.0	190.7	253.7	439.9
Interest Rate Contracts	0.0	78.8	182.1	236.0	412.4
Bonds	0.0	35.9	25.0	49.5	104.3
Money Market	0.0	42.9	157.1	186.5	308.1
Stock Index Contracts	0.0	0.0	4.6	9.7	18.1
Currencies	0.2	2.2	4.0	8.0	9.4
Options	0.0	0.0	40.3	138.2	239.6
Interest Rate Contracts	0.0	0.0	21.5	88.8	161.9
Bonds	0.0	0.0	21.5	41.4	45.8
Money Market	0.0	0.0	0.0	47.4	116.1
Stock Index Contracts	0.0	0.0	14.7	37.1	38.9
Currencies	0.0	0.0	4.1	12.3	38.8
Aggregate Open Interest[a]	0.2	81.0	231.0	391.9	679.5

Notes: a - Measured by dollar par or index value of outstanding positions on the last day of the period

Source: Salomon Brothers, Inc (1986 p 23) and Levich (1987)

Another important analytical issue is how integrated are the international capital markets. Following Feldman (1986), Levich (1987) has proposed three approaches. The legal approach focuses on the extent to which the law provides the right and opportunity for cross-border capital flows. The quantity approach posits that a larger volume of cross-border transactions is associated with greater internationalisation. The price approach is the most exacting. It suggests that the internationalisation of a market is complete when its prices are brought into an international equilibrium. Feldman takes the interest rate parity relationship as his standard; when deviations from covered interest parity are small, markets are assumed to be integrated under the price approach.

Levich provides evidence of the increasing integration of the capital markets on all three counts. For example on the price test, a study by Mahajan and Fraser (1986) examined 92 matched pairs of offerings in the Eurobound and US bond markets between 1975 and 1983. Mahajan and Fraser concluded that once they had standardized for issuer, maturity, rating and coupon, they could not reject the hypothesis that yields were similar in the two markets. This suggests an integration and harmonisation of terms between these two markets. However, such close integration, as we shall see below, is unlikely to have been achieved to such an extent in all international financial markets (particularly the equities market).

III. THE ROLE OF FINANCIAL INSTITUTIONS IN SAVINGS AND INVESTMENT

Table 4 summarises the main changes over the last decade in the portfolio composition of the private non-financial sector in the leading industrial countries. These data highlight the significant increase in institutional investment which has occurred in all industrial countries since the mid-1970's. This is in part due to financial deregulation and financial innovations; these have helped to make the non-bank financial intermediaries attractive to savers, usually at the expense of the traditional banks. As a consequence, the share of institutional investment in the financial portfolios of households and non-financial enterprises has risen substantially in the leading industrial countries over a period of less than 10 years. Thus in the UK the share has risen by 50% and even in the case of Canada, which exhibits the smallest change, it has gone up by 15%.

In the 1980s the fastest growing financial institution in the US and the UK have been the mutual funds or the unit trusts. The sales of mutual investment funds in the US increased from about $10 billion in 1981 to over $100 billion in 1985; their assets increased over the same period from about $75 billion to over $250 billion. The number of funds and the numbers of shareholders nearly tripled between 1981 and 1985. (In 1985 there were over 20 million shareholders in U.S. mutual funds[(1)]) [OECD (1987)]. Similarly in the UK, as the last row of table 5 indicates, the assets of Unit Trusts have increased more than eight-fold between 1978 and 1986. In terms of aggregate values however it is pension fund investment which is the dominant force.

The investment patterns of these institutions is clearly of central importance in evaluating the impact of this savings behaviour. Table 5 reports on the investment portfolios of the UK financial institutions over the period 1978 to 1986. The data indicates that domestic U.K. company equities loom very large in the portfolios of all types of institutional investors: they comprise more than a third of the assets of insurance companies and about half the assets of pension funds, unit trusts and investment trusts.

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(1) Not surprisingly, the growth of mutual funds and unit trusts has suffered a sharp set-back following the stock market crash of October 1987.

Table 4 Portfolio composition of the Private Non-Financial Sector[1]

Country and Items	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
	As a percentage of gross financial assets									
United States										
Deposits	33	34	35	33	32	33	33	32	34	32
Bonds[2]	10	10	10	10	9	9	9	9	10	11
Shares	20	18	17	18	20	18	18	18	16	17
Institutional investment[3]	20	20	20	20	21	21	22	23	24	25
Japan										
Deposits	51	53	53	52	51	51	52	51	49	49[4]
Bonds[2]	4	5	5	5	5	6	6	6	7	6[4]
Shares	9	8	9	8	8	8	8	9	10	12[4]
Institutional investment[3]	7	7	8	8	8	8	9	10	11	11[4]
Germany										
Deposits	57	57	58	57	55	55	54	53	51	48
Bonds[2]	9	9	9	10	10	11	11	11	13	13
Shares	12	12	12	10	10	10	10	11	11	15
Institutional investment[3]	9	9	9	10	11	12	12	12	12	12
United Kingdom										
Deposits	33	32	32	32	32	33	31	30	29	29[4]
Bonds[2]	6	6	5	5	5	4	5	4	4	4[4]
Shares	12	14	13	12	12	11	11	12	13	12[4]
Institutional investment[3]	19	21	23	23	25	25	28	29	30	30[4]
Canada										
Deposits	31	32	32	32	32	31	31	29	29	29[4]
Bonds[2]	8	8	8	7	6	6	7	8	8	9[4]
Shares	17	17	18	17	18	17	17	17	16	16[4]
Institutional investment[3]	15	16	15	15	15	16	16	17	18	18[4]

1. On the basis of non-consolidated balance sheets for the household and business sectors: in the case of the United states, except for sole proprietors and agriculture. The sum of the sub-totals does not add up to 100 because some items, such as commercial credit and direct investment abroad, are not included.
2. Except for directly held mortgage debentures.
3. Mutual funds, pension funds, assets management funds and insurance company funds not classed as deposits.
4. Estimates

Source: National balance sheets data, Bank for International Settlements and OECD (1987)

Table 5 Asset Distribution of Portfolios of UK Financial Institutions 1978-86

Type of Asset	Insurance Companies			Pension Funds			Unit Trusts			Investment Trusts		
	1978	1980	1986	1978	1980	1986	1978	1980	1986	1978	1980	1986
UK Public Sector	27.7	29.4	19.8	22.8	22.6	15.1	1.0	1.6	1.8	3.6	3.2	1.3
UK Company Securities	35.7	34.5	47.0	50.7	48.4	53.1	81.6	73.9	57.3	60.5	57.5	45.2
of which: Ordinary	27.4	28.0	35.2	47.5	45.9	51.1	78.6	72.5	54.1	57.8	55.3	42.4
Unit Trusts	2.8	2.6	8.5	0.6	0.7	1.3	-	-	-	-	0.6	1.4
Other	5.6	3.8	3.3	2.6	1.8	0.7	2.9	1.4	3.2	2.7	1.6	1.4
Overseas Company Securities	3.2	3.9	10.3	5.0	8.4	16.2	17.4	23.7	40.3	33.3	52.1	50.3
of which: Ordinary	3.1	3.8	9.8	4.8	-	15.8	17.1	23.4	38.9	32.0	49.1	46.8
Other	0.1	0.1	0.5	0.2	-	0.4	0.3	0.3	1.4	1.3	3.0	3.5
Overseas Government Securities	0.4	0.2	1.4	0.2	0.2	0.6	-	-	-	0.6	0.3	2.5
Loans, Mortgages, Land and Property	31.2	30.3	16.8	20.9	18.9	8.5	-	-	-	-	0.2	0.2
Other (net)	1.9	1.6	4.7	0.3	1.5	6.5	0.1	0.8	0.6	2.0	1.2	0.4
Total Investments	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Value of Total Investments £m	36760	52130	158551	29584	51886	190044	3474	4625	30344	6460	8352	20422

Source: Financial Statistics (various issues)

The table also shows the very large increase in the holdings of overseas company equities by all financial institutions since the abolition of exchange controls by the U.K. government in 1979. In 1986, the unit trusts held 40 per cent of their assets in foreign company shares; the proportion was higher still for investment trusts. By 1986, even Pension Funds had increased their holdings of foreign equities to 15 per cent of their total portfolios. The question of foreign equity holdings will be discussed further below. The holdings of domestic equity have placed the institutions in a dominant position in the UK market as Table 6 shows. The data suggest that institutions now hold nearly 60 per cent of the shares in companies quoted on the U.K. stock markets. In 1985 the Pension Funds alone controlled about a third of the market value of all listed companies; this compares with a figure of less than 20 per cent just 10 years earlier.

Table 6 Beneficial Holdings of UK Equities by Financial Institutions 1976-85 (at year end)

	1976		1980		1985	
	£bn	%	£bn	%	£bn	%
Insurance Companies	6.7	16.3	16.2	18.9	47.5	19.4
Pension Funds	7.4	18.1	23.7	27.5	78.2	31.9
Investment Trusts	2.6	6.3	4.3	5.0	7.4	3.0
Unit Trusts	1.7	4.1	3.4	3.9	11.1	4.6
Total Holdings	18.4	44.8	47.6	55.3	144.2	58.9
Market value of all listed securities	41.0	100.0	85.9	100.0	244.7	100.0

Source: Cosh, Hughes, Lee and Singh (1989)

Table 7a provides corresponding information for the U.S. for the period 1952-78. It shows a similar picture of the increasing

ownership of corporate equities by the financial institutions in the US. During the last decade, the domination of institutions over the US corporate stock has increased still further. For instance, the US Pension Funds alone now control assets worth around $2 trillion. This represents about 25% of all equities (compared with 9% in 1970) and over 50% of the equities in the Standard and Poor's index of the top 500 companies. [Economist, 29 April 1989].

Finally Table 7b demonstrates the increasing importance of financial companies in the ownwership of Japanese equity which, in this case, is combined with an increase in holdings by industrial companies. It has been estimated that by 1986 financial institutions held 43.5% of outstanding stocks compared with 23.9% by individuals [Nikko Research Centre (1980)].The quantitative importance of the equity ownership, both domestic and foreign, by financial institutions, their decisions with respect to portfolio choices, takeovers, and the degree of participation in corporate governance, are clearly of great significance in the determination of real corporate investment and performance in these economies.

The relative role of financial institutions and of banks in relation to the ownership of equity shares has of course been different in countries such as Germany and Japan compared with the U.S. and the U.K. In the case of the Germany the small size of the equity market (in terms of numbers of listed companies and market capitalisation relative to GDP) and the relative predominance of loan finance has led to a key role for banks in the finance of industry, either as loan providers or as trustees of the relatively closely held equity of industrial companies [Cable(1985),Scott(1985)]. In Japan the equity market is much larger and better developed, but an integrated and stable pattern of share ownership and control has emerged centred around financial / industrial combines which include both banks and non-bank financial institutions. In both Germany and Japan inter-corporate shareholdings between non-financial and financial companies are common. In contrast to the US and the UK, takeovers and company reorganisations are not the result of public battles for listed blocks of equity shares on the open market, but take the form of negotiated and coordinated activity between financial institutions and key corporate stockholders [Dore(1985),Corbett(1988), Scott(1985]. It has become common to attribute various virtuous effects to these structures as part of the explanation for the superior postwar performance of these economies relative to the stockmarket-based

Table 7a The Share of Financial Institutions in Total US Corporate Stock Outstanding 1952-78

Year	Personal trusts*	Pension funds**	Investment companies	Life Insurance Companies	Other	All financial institutions++
1952	11.4%	0.9%	3.0%	1.1%	2.5%	18.9%
1958	11.4%	3.1%	4.6%	1.1%	1.5%	22.7%
1968a	9.1%	5.6%	5.7%	1.3%	2.3%	24.0%
1968b	8.6%	6.4%	6.1%	1.4%	2.3%	24.6%
1974	11.1%	9.9%	5.4%	3.5%	3.3%	33.3%
1978	8.9%	13.6%	3.5%	3.4%	5.3%	34.7%

Source: Kotz(1978), Herman(1981).

* Personal trust funds managed by commercial bank trust department and trust companies.
** Private noninsured pension funds
\+ Includes commercial banks, mutual savings banks, property insurance companies, and common trust funds
++ Excludes three categories of funds managed by commercial bank trust departments: estates, agency accounts, and employee benefit funds other than pension funds.

Table 7b Beneficial Ownership of Japanese Company Shares 1950-80

Type of Holder	% of corporate shares held by type 1950	1960	1970	1980
Public sector	3.2	0.2	0.3	0.2
Financial companies	24.5	34.3	33.5	40.5
Non-financial companies	11.0	17.8	23.1	26.0
Foreign companies	0.0	1.1	3.0	4.0
Persons	61.3	46.6	40.1	29.3
Totals	100	100	100	100

Source: Scott(1985)

systems of the UK and the US [Mayer(1988), Ellsworth(1985), Tylecote (1988), Hughes(1986) and the references cited therein]. It is notable however that in both Germany and Japan, the growing institutional investment noted above has been associated with an increased securitisation of non-financial sector balance sheets. Thus in the case of Japan short and long term loans fell from 80.4% of funds of

the non-financial sector in 1969 to 64.8% in 1984 and from 69.6% to 64.3% in Germany over a similar period [OECD(1987)]. Moreover in the case of Japan overseas funds rose from 19.5% of total corporate capital raised in the period 1975-79 to 39% in the period 1980-85 [Yamaichi Research Institute of Securities and Economics]. The impact of these changes on traditional patterns of coordination and control of investment behaviour in these economies is a key issue arising from the capital market changes we have described.

There is an interesting paradox in the fact that, despite the enormous growth of the financial markets in recent years, the equity markets have not been significant suppliers of funds for net new investment in Germany, Japan, the UK or the US. [Retentions and depreciation provisions have played a key role in each case along with loans in Japan and Germany [Mayer(1988)]. This does not however imply that equity markets are of no consequence. The secondary trading in existing equities has a crucial role in the reallocation of existing assets between managements via takeover; it also plays a key role in the determination of the cost of capital and the time horizons of corporate investors [Hughes and Singh(1986),Tylecote (1988)]. It is to the globalisation of these equity markets which we now turn.

IV. THE GLOBAL EQUITIES MARKET AND CAPITAL MARKET INTERNATIONALISATION

A global market in equities and bonds is an age-old phenomenon in the history of capitalist development. In the first decades of the 20th century, U.S. securities accounted for a large proportion of trading on the London Stock Exchange. It is estimated that at the beginning of this century, U.S. investors held $600 million of foreign securities [Lambert (1987)]. However, the growth of the international equities market during the last decade has been extremely rapid. By 1983 foreign listings were an established part of the major world stock exchanges. This was especially true of mainland Europe and the UK, where the imperial and colonial past and the more recent development of the European Community have left a legacy of overseas companies with quotations (including US companies seeking to locate within the EC). Thus Table 7c shows foreign listings in the UK as 23% of domestic listings compared with less than 1% in Japan.

Table 7c Foreign Listings on Major Stock Exchanges in 1983

Country	Number of firms listed	
	Domestic	Foreign
United States		
- New York	1500	50
- American	774	48
Japan	1441	11
United Kingdom	2217	515
W Germany	442	173
Switzerland	120	164
France	518	179
Netherlands	215	256

Source: Hawawini (1984)

The recent growth of the international equities market is due both to a number of proximate causes as well as structural features on both the supply and demand side. The most important among the latter, already referred to in section II, include the following: the outright abolition or lowering of exchange controls in several countries; de-regulation of financial markets which has often taken a competitive form among the leading financial centres; the opportunity

for foreign financial institutions to become members of national stock exchanges; and the increasing role of the financial institutions and the desire of fund managers to diversify their portfolios and to seek the highest risk adjusted rates of return. This has been matched by the desire of some multinational companies to become truly global suppliers of their equities by having shareholders from several countries to match their business interests.

Let us first briefly consider the motivation for international fund diversification. There is primafacie evidence that fund managers can in principle improve their returns by diversifying into foreign equity markets. For example the correlation coefficients between the national stock market indices of leading industrial countries and Japan over the period 1960-1980 are given below.(1)

	Japan	Germany	France	Italy	USA	England
Japan	1.000	0.302	0.361	0.307	0.216	0.171

The degree of correlation in the share price movements in different markets over this period is quite low which indicates that portfolio diversification would be beneficial. Although in the 1980s there is a much greater convergence in the indices of the leading stock markets, these are still far from being perfectly co-linear [IMF (1988)]. Hence there is considerable scope for usefully including foreign equities in institutional fund managers' portfolios.(2)

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(1) These figures are quoted in Brunello (1988)

(2) Between January 1981 and September 1987, the monthly average correlation between the 23 largest national stockmarkets was just 0.22 in local currency terms. In October 1987, most of the 23 stockmarkets fell by more than 20% and the average correlation rose to 0.76. With the last three months of 1987 included, the correlation since 1981 nearly doubled to 0.42. [See Economist, 11 March 1989 and Bertero and Mayer(1989)]. However even this higher correlation leaves ample opportunities for profitable portfolio diversification.

In addition to possibly cheaper or more tax-efficient funds and a wider investor base, overseas equities listings can offer other advantages to a company. Naslund (1984), Howe and Kelm (1987) and Wallgren and Karlsson (1988) have referred to factors such as the desire for publicity and prestige, the generation of increased interest in the company's products, and the need to show commitment to the foreign financial community and government and hence reduce political risk. In addition there is evidence that companies that obtain a foreign listing experience, ceteris paribus, a rise in share prices. This is especially so for companies from small countries (Sweden, Denmark, Australia) which achieve a quotation on larger markets (eg the London or New York stock exchanges).[1] This no doubt reflects in part the segmentation of the small country markets from those in the UK or the US. The disadvantage to the company of a foreign stock market listing is that it may have to disclose more information than it might in its national market. Depending on the nature of the institutional and legal constraints on takeovers in its own country and the impact of the flotation on the dispersion of its shares, an international stock market listing may also make a company more vulnerable to acquisition by foreign predators.

Developments in technology have also clearly played a part in the globalisation of the stock market trading but its role should not be exaggerated. It is also not a new phenomenon. The opening of Atlantic Cable in 1896 cut the communication times between London and New York from several days to a matter of minutes and thus significantly improved the arbitrage between the two financial centres. In comparison, the current improvements in information technology seem less significant. The main impetus for the globalisation of stock markets has come not from technology but from the other factors outlined here. What technology has done is to facilitate the process, so that for shares of about 200 leading companies there truly is an international market which according to Mr John Tagino, head of global equity trading at Merrill, 'gives the

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(1) See Swartz (1987), Alexander and Eun (1985), Alexander, Eun and Janakiramanan (1988). On the other hand Howe and Kelm (1987) report negative effects for US companies newly listed on European and Tokyo exchanges in the period 1962-85.

customer the ability to have instant liquidity any time of the day or night, he (or she) wants it'.(1) Whether this new capacity is also necessarily good for the company in the long run, or more importantly for the real economy, is an open question.

Although, as we shall see below, the equity markets of leading capitalist countries have taken important steps towards internationalisation in recent years, the global equity market is still in its infancy. There is a large degree of segmentation among the national stock markets. For the market to be truly global, each and every investor should have an access to all possible asset claims. [Swartz (1987)]. Information barriers, transaction costs, legal impediments, varying national tax regimes may mean that many investors are obliged to limit their investments to a subset of the universe of assets (eg the shares of companies in their own, or a small number of, stock markets).

Such considerations have led Nicol (1988) to observe that: 'in a sense the global equities market could be said not to exist at all. It remains essentially an agglomeration of national markets and depends on their individual strengths'. These national markets have undoubtedly been expanding, thus Table 8 shows that during the last decade, in part due to the structural and other factors mentioned earlier, there was an enormous increase in the activities of major stock exchanges in the OECD countries. Turnover on the New York and Tokyo stock exchanges increased seven-fold between 1975 and 1985. Table 9 provides complementary information to that in Table 8; it reports on the size of the secondary (resale) markets for securities in relation to the primary markets (original issues). The much greater size of secondary market is due to the intense level of activity among the financial institutions and highlights the significance of the portfolio strategies discussed earlier. [OECD (1987)].

(1) Financial Times, October 21, 1987

Table 8 Turnover on Major Stock Exchanges : 1975-85

Billion $

	Total value of turnover					
	1985	1984	1983	1982	1981	1975
United States						
New York SE	970.5	755.9	751.3	459.4	395.0	133.7
Japan						
Tokyo First Section	321.2	267.1	213.8	141.2	217.8	51.2
Germany						
All exchanges	75.5	29.7	32.9	14.0	13.5	11.1
United Kingdom						
London	70.2	48.4	42.5	32.3	32.7	19.6
Canada						
All exchanges	39.3	25.3	28.7	16.5	23.6	5.4
France						
Paris	17.8	10.2	12.4	8.9	12.1	7.3
Netherlands						
Amsterdam	17.1	11.9	10.0	4.8	3.9	2.5
Australia						
All exchanges	15.6	10.8	9.3	5.1	8.2	0.7
Italy						
Milan	14.3	3.8	3.8	2.8	9.7	2.1
Hong Kong						
All exchanges	10.0	6.2	5.2	7.6	18.9	2.1
Sweden						
Stockholm	9.9	8.5	9.9	4.3	3.6	0.5

Source: Euromoney, and OECD (1987)

Table 9 Domestic Corporate Securities Markets: primary and secondary transactions ($ millions)

	1982 primary markets				Secondary markets		Secondary transactions/ Primary issues	
	Gross new issues of shares		Gross new issues of corporate bonds		Domestic[2] share trades[3]	Domestic[2] corporate	Percentage values	
	Number of issues	Amounts	Number of issues	Amounts	Value	Value	Shares	Bonds
Australia	260	2,601	25	1,658	(8,179)	(38)	314	2.3
Belgium	12	492	0	0	1,034	..	210	..
Canada	70	846	110	5,442	17,988	..	2,126	..
France	66	533	..	1,309	(8,403)	..	1,576	..
Germany	35	535	2	49	(13,470)	360	2,517	735
Japan	192	3,288	149	6,361	(266,426)	(5,710)	6,852	90
Netherlands	2	15	17	667	4,826	8,946	32,173	1,341
Switzerland	109	276	103	3,372	(15,537	..	5,629	..
United Kingdom	80	3,108	39	1,687	32,737	2,131	1,053	126
United States	1,320	23,399	552	42,296	603,861	7,073	2,580	17

1. All amounts have been converted to $ at the respective average annual exchange rates.
2. Traded on the stock echange(s): figures in () represent 1981 results, at 1981 end of year exchange rates.
3. Netherlands and United Kingdom trade values represent one-half of reported figures, to make them conform to other country reporting practices, and also include foreign shares in the case of the United Kingdom.

Source: International Finance Corporation, World Bank, 1985, and OECD (1987).

These recent developments in world stock market activity have been associated with a declining relative importance of the U.S. stock-market in the world equity index. Table 10 shows that the U.S. represented about half the capitalisation of world equity markets five years ago. By August 1987, before the crash, the U.S. markets accounted for less than forty per cent of the world equity. On the other hand, the share of Japanese and East Asian stock-markets has greatly increased in recent years. This is mostly due to the rise in Japanese share prices and the strength of the yen.

Notwithstanding the present segmentation of the national stockmarkets, an important indication of an emerging trend towards their integration and globalisation is provided by the size of the cross-border trading volume in company shares. Saloman Brothers estimated this volume to be about $400 billion in 1985 and $750 billion in 1986. [Financial Times, 21 October, 1987]. Table 11 reports on gross and net transactions in U.S. equities by foreigners in 1986 and 1987. The gross trading volume rose from $277 billion in 1986 to nearly $500 billion in 1987 but, as a consequence of the stock-market crash, net purchases in 1987 were lower than in 1986. Before the stock-market crash, the net purchases of U.S. equities in 1987 were expected to amount to $30 billion, but in the event the total was just over $16 billion.

Table 10 The World's Equity Markets

National markets by capitalisation as a percentage of the world's total

	Aug 1987	Aug 1986	Dec 1985
Australia	1.52	0.94	1.25
Austria	0.06	0.06	0.06
Belgium	0.57	0.55	0.48
Canada	2.15	2.15	3.00
Denmark	0.18	0.18	0.23
France	2.01	2.19	1.71
West Germany	3.36	4.51	4.90
Hong Kong	0.91	0.69	0.81
Ireland	0.10	0.06	0.07
Italy	1.49	2.47	1.44
Japan	35.48	31.82	22.85
Malaysia	0.08	0.05	0.07
Mexico	0.09	0.05	0.06
Netherlands	1.31	1.41	1.51
New Zealand	0.21	0.20	0.16
Norway	0.06	0.12	0.18
Singapore	0.16	0.11	0.11
South Africa	0.81	0.52	0.64
Spain	0.87	0.67	0.44
Sweden	0.32	0.33	0.33
Switzerland	1.15	1.34	1.31
United Kingdom	9.67	8.50	9.48
United States	37.43	41.07	48.93
The World	100.00	100.00	100.00

Source: Drawn from the FT-Actuaries World Indices: Copyright The Financial Times, Goldman Sachs & Co, Wood Mackenzie & Co Ltd 1987 Financial Times, October 21, 1987

Table 11 Foreign Activities in US Equities, 1986 and 1987

(Figures in $m)

Country	1986 Gross Activity	1986 Net Transactions	1987 Gross Activity	1987 Net Transactions
Europe	141,811	9,559	232,283	1,864
Belgium-Luxembourg	8,525	633	11,708	435
France	9,581	459	19,920	903
Germany	9,992	341	16,204	(74)
Netherlands	6,246	936	11.267	890
Switzerland	36,982	1,560	59,493	(1,162)
U K	64,608	4,825	103,820	517
Canada	34,584	816	49,524	1,116
Latin America & Caribbean	39,192	3,031	46,870	1,318
Bermuda	11,836	794	10,428	(101)
Netherlands Antilles	11,506	226	15,551	224
Asia	55,285	4,851	142,349	11,535
Hong Kong	8,574	403	12,500	658
Japan	26,904	3,305	102,554	11,365
'Other Asia'	16,269	976	20,545	(1,361)
Total All Countries	277,509	18,719	481,500	16,273

Source: Financial Times, 1988

Table 12 provides information on cross-border flows for equities for the leading industrial countries during 1987 as a whole and in the last quarter of 1987. The table indicates an enormous sale of foreign

Table 12 International equity flows, net transactions*
Leading Industrial Countries. Last Quarter 1987 & 1987

$ bn	Investors from					
Market Fourth quarter 1987	United States	Japan	Britain	West Germany	Rest of World	Total
United States	-	1.9	-5.0	0.4	-4.5	-7.2
Japan	-2.8	-	-6.0	-0.4	-13.1	-22.3
Britain	0.5	0.2	-	0.0	1.0	1.7
West Germany	-0.5	0.0	-1.4	-	-2.1	-4.0
Rest of World	-0.8	-5.4	-4.2	0.7	-5.0	-14.7
Total	-3.5	-3.3	-16.6	0.7	-23.7	-46.5
Market 1987						
United States	-	11.4	0.5	0.8	3.5	16.2
Japan	-6.0	-	-8.0	-1.4	-27.0	-42.8
Britain	3.0	1.5	-	0.2	5.7	10.4
West Germany	-0.2	0.3	-1.9	-	0.9	-0.9
Rest of World	2.2	3.7	-7.4	0.6	10.0	9.1
Total	-1.5	16.9	-16.8	0.2	-6.9	-8.1

* Minus sign denotes repatriation
Source: Salomon Brothers and Economist, 1988

equities following the October crash: a net $46 billion in the last three months of the year. British investors, particularly the financial institutions, were the biggest net sellers both in the U.S. and the Japanese stock-markets. Despite the crash, the Japanese seem

to have increased their net purchases of U.S. shares by nearly $2 billion in the last quarter of 1987. As far as the foreigners selling of shares is concerned, the Japanese stock-market seems to have suffered the most in the post-crash period, much more so than the U.S. market.(1)

This discussion of the global equity markets would be incomplete without some reference to the emergence of third world stock-markets. At present there are over 35 equity markets in developing countries with a market capitalisation of over $130 billion and close to 8000 listings. In 1986 the five largest - Brazil, India, Malaysia, Korea and Taiwan - ranged in size from $42 billion to $13 billion. [See Table 13]. This makes them bigger than many of the medium-sized European stock-markets. A number of Third World stock-markets enjoyed spectacular boom conditions in 1987 until the stock-market crash of Black Monday. In the first nine months in 1987, share prices on the Mexican stock-market rose six-fold.(2) However, following Black Monday, prices fell to a tenth of their pre-crash level. The World Bank, and the International Finance Corporation are encouraging the development of Third World stock-markets. They are also promoting foreign equity investments in these markets in order, among other things, to facilitate 'debt-equity swaps' as a part of the solution to the third world debt problem.

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(1) As noted before, the financial institutions are the big players in the global equities market, with the U.K. institutions being particularly important. The U.K. pension funds, for example, on average hold 20 to 25 per cent of their equities in foreign stocks. This compares with a figure of about 5 per cent for the U.S. pension funds. On the 'global' argument that fund managers' exposure in the domestic market should be in proportion to its contribution to capitalisation of the international market, the U.S. financial institutions need to invest 60 per cent of their funds abroad and the U.K. institutions should have less than 10 per cent in the domestic market [See Riley(1988)]. This is clearly extreme but with progress towards free trade in services and greater integration of national financial markets (eg as a result of 1992 in Europe, the Uruguay Round at the international level), the share of foreign equities in institutional fund managers portfolios in most countries is bound to increase appreciably from its current levels. However if there were to be a huge increase in the correlation between share price movements in different stockmarkets (see footnote 2,p20), this would dampen their enthusiasm for foreign porfolio diversification.

(2) Financial Times, 21 October 1987.

Table 13 Emerging Equity Markets in the Third World: Market Capitalisation 1980 to 198

(in US $ millions)

	1980	1982	1984	1986
Brazil	9,220	10,260	28,990	42,084
India	10,350	-	12,550	18,000 est
Taiwan	6,080	5,080	9,870	15,366
Malaysia	12,397	13,905	19,401	15,065
Korea	3,830	4,410	6,220	13,924
Mexico	12,992	1,719	3,661	5,952
Chile	9,400	4,530	2,110	3,027
Thailand	1,238	1,257	1,720	2,878
Jordan	1,605	2,845	2,222	2,549
Nigeria	3,119	1,457	3,190	2,138
Philippines	2,096	1,236	-	1,991
Pakistan	643	878	1,157	1,710
Argentina	3,865	974	1,171	1,591
Greece	3,016	1,923	766	1,129
Colombia	1,605	1,322	762	710
Turkey	477	952	957	97

* Table in order of 1986 market capitalisation

Source: International Finance Corporation, Washington and the Banker
Reproduced from the Financial Times, 21 October 1987

V. THE GLOBAL MARKET FOR CORPORATE CONTROL?

In their survey of mergers and acquisitions in the industrial countries in the post-war period, Hughes and Singh (1980) observed that the 'golden age of capitalist development' (ie the years 1950-73) was 'also attended by another extremely important phenomena - a merger wave that occurred more or less simultaneously in several countries and that in a number of them, again by past standards, was immense'. In explaining this simultaneity of the merger movements in industrial countries, particularly in the 1960s, Hughes and Singh emphasised among other aspects the important role of international factors, in particular the liberalisation of international trade and the impact of multinational investment. Nevertheless, they noted that the overwhelming proportion of this huge merger activity - the largest ever recorded to that date in the Anglo-Saxon countries - was confined to mergers among national firms. There were relatively few international mergers involving firms of more than one country. Table 14 reports on international mergers in the six original EEC countries during the period 1966-73. These numbers were minuscule compared with those involving mergers between firms in the individual countries themselves. As Jacquemin and De Jong (1977) pointed out such mergers evidently encounter a number of legal institutional and psychological obstacles.

Table 14. International Mergers in the EEC, 1966-1973

	West Germany	France	Italy	Netherlands	Belgium	Luxembourg
1966	22	19	13	16	24	6
1970	24	22	12	13	22	7
1971	22	24	11	12	24	7
1973	16	26	7	13	22	16

Source: Jacquemin and De Jong (1977).

The liberalisation of financial markets in recent years has coincided with cross-border merger and takeover activity on a far larger scale. This is clear from the data in Table 15 on national and international mergers involving the largest one thousand European Community firms from 1982/3-1985/6. The financial press reports if anything a further big rise in international takeovers over the last two years. According to W.T. Grimm and Company, in the first half of 1988, the number of cross-border acquisitions involving a US company increased

Table 15 Industrial Mergers Involving the Largest 1000 European Community Firms 1982-83 to 1985-86

	All	Intra-National		Intra-Community[1]		Extra-Community	
		No.	%	No.	%	No.	%
1982-83	117	59	50.4	38	37.5	20	17.1
1983-84	155	101	65.2	29	18.7	25	16.1
1984-85	208	146	70.2	44	21.2	18	8.6
1985-86	226	144	63.7	52	23.0	30	13.3

Source: Table 2, p 18, Thirteenth Annual Report of Competition Policy in the European Community 1986

1 International but involving only companies in EC member states.

by 12%, to 1,032, over the same period of 1987. The value of these deals rose by 42% in the period, to $129.4 billion. The very large increase in value can be attributed to the greater number of big acquisitions. There were 195 deals valued over $100 million, 29 more than in the year earlier period. Transactions of $1 billion or more rose to 30 from 17. In the first nine months of 1988, there were 283 purchases by British companies in the United States worth $18 billion. In 1987, there were only 134 such acquisitions, totalling $1.25 billion.(1)

(1) W.T. Grimm counts as an acquisition any deal involving an American company in which at least 10% of another company's stock is being purchased or in which the purchase price is likely to be at least $10 million. See further International Herald Tribune, 10 November 1988, special financial issue on mergers and acquisitions.

In a recent survey of cross-border takeover activity, based on newspaper reports of deals involving a shift of majority control, it was found that in 1987, the countries making the most transnational acquisitions were Britain, 427; France, 194; United States and Canada, 167 (only with European sellers); West Germany, 137; Netherlands, 126; and Switzerland and Austria together 120. The countries in which the most companies were acquired by foreign firms, according to the study, were the United States and Canada, 417 (only from European buyers); West Germany, 269; France, 178; and Britain, 138.(1)

Obviously financial liberalisation is not the only factor responsible for this large increase in international takeovers. There are, for instance, good product market reasons for the merger activity arising from the creation by 1992 of a single European market and fears about the protectionist pressures in the United States. However, financial deregulation in the non-Anglo-Saxon countries and the international integration of capital markets have undoubtedly played a significant role in facilitating this process if only by the ready availability of funds for international transactions.(2) As financial deregulation proceeds further (e.g. national obstacles to foreign takeovers are removed), international takeover activity is likely to remain at least as significant as at present.

In relation to industrial performance, the question which arises is whether the presence of international predators affects the efficiency of the stock market selection process by, for instance, increasing the supply and quality of raiders. Whilst there is some recent evidence to suggest that acquired company shareholders gain in international takeovers in much the same way as they do in domestic takeovers [Conn and Connell(1989)], the broader welfare issues of the sources of these

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(1) The survey was carried out by ALW/MA International - France, a Paris based mergers consultant. See further International Herald Tribune, 10 November 1988.

(2) Thus for example the abortive 1985 bid by the Australian company Elders IXL for the much larger UK conglomerate, Allied Lyons, was to be funded by a complex package involving banks from three continents - Citibank, Banque Paris bas and Hong Kong Bank Group.

gains remain unclear; as does the net effect when the impact on the acqurers' stockholders is taken into account. Thus it may also be the case that cross national mergers serve to strengthen oligopolistic market links in international markets. They may also worsen problems of regional or national autonomy and economic performance as a result of the geographical redistribution of headquarters staff, R&D personnel and local sourcing connections, including in particular financial and professional services. All these are important policy issues which require systematic exploration.

VI. CONCLUSION

This paper has traced during the last fifteen years the increasing integration of international capital markets, deregulation and financial liberalisation, the emergence of new financial instrument and the growing role of financial institutions in domestic and global equity markets. In addition to the questions of national macroeconomic vulnerability and autonomy, we have argued here that these trends have very important implications for the savings and investment behaviour of economic agents as well as for industrial performance. With respect to the latter we suggest that, in the relationship between financial and industrial capital, the suppliers of funds are becoming more expert, more technical, more international and more informed. On the other hand their relationship with the users of funds is likely to become more short-term, more arms-length and more diffused. There can be no doubt that many of these changes have been beneficial in the technical efficiency sense of stimulating a more competitive atmosphere in capital markets and by facilitating the management of risk. However these changes are of most benefit to the largest companies. Preferential terms are given to these companies in the new markets and so their market power may be reinforced. In addition the changes seem to encourage a distant relationship between borrowers and investors and an environment in which institutions seek to reduce their exposure to a problem rather than tackle it directly. This 'marketisation' of industrial problems, as well as the readier access to both long and short term debt, is reflected in the huge increase in mergers, takeovers and sell-offs over recent years. The impact of intranational mergers on economic performance has not been notably beneficial. It remains to be seen whether their international counterparts are any more beneficial in their effect on long-term industrial performance. equipment and to long term industrial performance.

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