EUROPEAN ECONOMIC COMMUNITY

FIFTH REPORT ON THE ACTIVITIES OF THE MONETARY COMMITTEE

Brussels, 5 avril 1963

CONTENTS

INTRODUCTION

The purpose of this report is to give a general picture of the activities of the Monetary Committee of the European Economic Community in 1962.

The Monetary Committee was set up under Article 105 (2) of the Treaty of Rome in order to promote the co-ordination of the Member States' monetary policies to the extent necessary for the efficient functioning of the Common Market.

The second paragraph of Article 7 of the Monetary Committee's Statute, stipulating that " the appointment of the chairman or of a vice-chairman may only be renewed once", was withdrawn by an EEC Council decision of 2 April 1962, and the Committee has reappointed its officers as follows: Chairman, Jonkheer E. van Lennep, Treasurer-General in the Netherlands Ministry of Finance; Vice-Chairmen, M. P. Calvet, senior Vice-Governor of the Banque de France and Dr. O. Emminger, a Member of the Direktorium of the Deutsche Bundesbank.

The Monetary Committee held 10 sessions in 1962. A list of the members is attached to this report.

Chapter I

GENERAL ACTIVITIES – CO-ORDINATION OF MONETARY POLICIES

1. In 1962 the Monetary Committee continued the work assigned to it in the Treaty of Rome, by which it was set up to promote the co-ordination of the monetary policies pursued in the Member States and so to contribute to the gradual establishment and the efficient functioning to the Common Market. The work has been carried out both within the Community, so as to forestall as far as possible the development of any elements of strain which might lead to balance-of-payments crises, and in relations with non-member countries, so as to enable the Community to make its contribution to world monetary equilibrium.

2. The co-ordination of monetary policies within the Common Market was facilitated by the fairly satisfactory development of general business trends. As is explained in Chapter III, the rate of growth in several member countries was less rapid than in 1961, but the loss of momentum was also accompanied by an easing of symptoms of "over-heating" and this gives more latitude for combating the upward trend in production costs. As a result of a distinct deterioration in trade balances, the Community's surplus on current payments with non-member countries was substantially smaller than in 1961 and this decline made its contribution not only to equilibrium within the Community but also to the re-establishment of equilibrium in international payments.

3. Accordingly, the Committee, in its periodic reviews of the situation in the member countries could limit the scope of its action to recommending measures of limited range aimed at the progressive re-establishment of external equilibrium and the consolidation of balances conditions at home.

Experience in the last five years shows, moreover, that in preparing their decisions the authorities in the member countries are guided more and more by the need to harmonize monetary policy measures. The result of this has been that intervention by co-ordinating bodies – in particular the Monetary Committee – has been concerned only with a small number of specific situations. It is true that since the entry into force of the Treaty circumstances have, by and large, been propitious; but it is also true that a growing determination to co-ordinate activity has helped to limit the number and size of the problems which have arisen. It may be hoped, too, that the experience gained in this field and the improvements and adjustments made to the instruments of monetary policy in recent years will mean that any difficulties which occur can be overcome more easily, with the result that recourse to safeguard clauses and to the mutual assistance provided for in the Treaty will only be necessary in quite exceptional cases.

4. However, further progress in the field of monetary co-ordination is desirable and possible. The liberalization of trade, the partial elimination of obstacles to capital movements, the introduction of a common agricultural policy and, in more general terms, the advance towards economic integration must be backed by more pervasive harmonization of monetary policies. In its Memorandum on the Action Programme for the Second Stage the European Commission echoes the Committee's previous reports in stressing the importance of monetary policy with regard both to the co-ordination of economic policies and to the maintenance of fixed relationships in exchange rates.

5. The Committee considers that the effort at co-ordination should extend beyond the work of the central banks. In present circumstances budgetary policy sometimes has similar and perhaps more decisive importance in monetary development: a large part of the national income passes through the hands of the public authorities, and the surpluses and deficits on public budgets together with the methods of covering deficits are bound to have their impact on liquidity trends at home and on the monetary situation as a whole. If monetary policy in the broad sense is to be really effective, the policy of each central bank must be closely co-ordinated with budgetary policy in the individual Member States and even at Community level. So far the Member States have seldom succeeded in harmonizing credit and budgetary measures sufficiently for these instruments of policy to produce the full impact they could have on the economic situation. The main reason for these difficulties is that budgetary policy is subject to parliamentary control and to delays in implementation, and cannot therefore be adapted to economic exigencies with the requisite elasticity and speed. However this may be, the co-ordination of monetary policies should go hand in hand with the same kind of co-ordination in the sector of public finance.

These problems have been considered by the Economic Policy Committee and by the Monetary Committee, which have studied the conditions under which the public authorities can act on budget and tax matters, and more generally the weapons available to combat both a recession and mounting prices. The close co-operation between these two Committees is strengthened by the fact that the Chairman of the Monetary Committee is an ex officio member of the Economic Policy Committee.

6. Moreover, synchronization of monetary policies will become all the more vital as capital movements are further liberalized. Now, real integration of the capital markets would mean, among other things, that firms in each member country had free access to savings in other member countries. This is not yet quite the case; for although the directives adopted by the Council in 1960 and 1962 liberalized for all EEC countries capital movements for use in direct investment, portfolio investments, capital transactions connected with commercial transactions and capital transactions of a personal nature, it should be remembered that transfers of capital for financial reasons have been liberalized by only three Member States (Belgium, Luxembourg and the Federal Republic of Germany) and are still subject in the other countries to what are in some cases severe controls. In certain of these other countries it is felt that progress towards greater flexibility is still possible, but that conditions for complete liberalization

are not yet ripe with the Common Market at its present stage of development. The pursuit of liberalization is therefore hampered by certain obstacles arising mainly from the fact that within the framework of the general objectives fixed by the Treaty the Member States use different instruments and methods in applying their economic policies.

It is interesting to note that although there is still considerable progress to be made, there was a real reduction in the gap between medium and short-term interest rates in 1962, and that apart from the relatively low rates charged on the Netherlands market long-term interest rates no longer differ to any great extent from one country to another.

7. In more general terms, the question arises as to whether a closer co-ordination of monetary policies means that all countries must take similar decisions simultaneously. Although the Committee considers it very desirable that the central banks' means of action should be strengthened and brought closer into line, it considers – as stated at the end of its 1962 inventory of the instruments of monetary policy available to the various member countries – that what matters at the present stage of economic integration is not so much that measures should be identical as that they should tend in the same direction and that they should be effective. It has noted with interest that the Van Campen report, made on behalf of the European Parliament's Economic and Financial Committee, reaches similar conclusions.

The Committee wishes to stress that the economic policies of the member countries have moved considerably closer and that certain important conditions for a real co-ordination of monetary policies are already fulfilled – notably convertibility of the currencies of the six countries and liberalization within the EEC of the main financial transactions. Moreover the endeavour to achieve co-ordination, which has not always been given the attention it deserves, is continuing not only within the Monetary Committee but also in quarterly conferences of the Finance Ministers, which are attended by the Chairman of the Monetary Committee, and in talks between the governors of the Member States' central banks held when there is a meeting of the Bank for International Settlements. In this way the intentions expressed in general terms by Articles 103, 104 and 105 of the Treaty have already been translated into practice to quite a considerable extent, through recourse to various empirical devices. For a fuller attainment of the Treaty's objectives it would be desirable from now on to plan more systematic arrangements for mutual consultation before decisions are taken on the main lines of internal and external monetary policies. This in fact is an approach which the Committee has already adopted.

8. Necessary as it is within the Community if economic integration is to be gradually completed, close co-ordination of monetary policies is also indispensable in relations with non-member countries because of the considerable role played by the Member States in international trade.

Here the essential problem is the persistent disequilibrium which troubles the balance of payments. From the end of 1957 to the end of 1962 the official gold and foreign exchange of the six Community countries rose from $7.8 billion to $16.8 billion, whereas United States reserves dwindled over the same period from $22.8 billion to $16 billion and those of the United Kingdom stagnated at a relatively low level.

The situation, however, improved a little in 1962 : the United States' balance-of-payments deficit shrank slightly, the United Kingdom was able to repay its 1961 drawings on the International Monetary Fund (IMF) before the due date and the official gold and foreign exchange reserves of the EEC countries increased by only $ 580 million as against $ 1 200 million in 1961.

The economic trend in the EEC and certain measures taken by the Member States have undoubtedly made their contribution to this tentative improvement in the international monetary situation.

9. The easing in the strain experienced in international monetary relations has stemmed in part from the play of market forces : economic expansion in the Community has been accompanied by a marked growth in imports, a distinct decline in trade surpluses and a general rise in production costs and prices. The consequence has been a certain adjustment of the trading positions of the EEC countries in relation to those of the United States and of Great Britain.

10. In 1962, as in previous years the EEC countries took a series of measures which also helped to improve the situation : advance redemption of external debts by France, Italy and the Netherlands (nearly $860 million altogether), arms purchases from the United States by certain countries so as to offset in part the costs of maintaining Americam troops in Europe, the conclusion of support agreements between the United States monetary authorities and those of the countries of Continental Europe ; and financial aid to the developing countries. In addition, European currencies were again in heavy demand, as in the past, in drawings on the International Monetary Fund, notably for the drawing made by Canada.

11. It should, however, be pointed out that the improvement in the international situation took place at a period when the rate of economic expansion in America was relatively low. The persistence of a low rate of progress makes it difficult to strengthen confidence in the dollar. A higher long-term rate of expansion of the American economy would seem in any case to be essential. It would not necessarily lead to a deterioration in the balance of payments, provided fuller use of resources did not jeopardize the stability of production costs and of prices on the home market. The decline in the surplus on trade which could occur in a period of more rapid expansion ought not to harm the United States's balance of external payments provided it is accompanied by a reduction in the net exports of short and long-term private capital which have been a major factor in the deterioration of this balance ; this reduction would reflect the increased attraction of the home market and higher interest rates. The Committee would therefore like to stress the fact that whether the problem of the American balance-of-payments deficits is solved or not depends mainly on the measures adopted and the policy pursued by the United States to re-establish the balance of their external

payments and by using the appropriate instruments of economic policy to achieve a rate of economic expansion which would be both higher and lasting.

12. It is also open to the countries of the EEC to give some help in re-establishing equilibrium in international payments. True, the efforts to be made in this direction should not take the form of an attempt to eliminate balance-of-payments surpluses through a reckless increase in costs and wages in Community countries. They should rather be designed to lead to the elimination of artificial factors in trade such as certain arrangements by which aid to underdeveloped countries is tied to the export of goods, to a liberal commercial policy towards non-member countries, to the advance repayment of external debts and to measures facilitating capital movements.

13. This year as in the past the various measures designed to improve the international payments situation were submitted before being implemented for discussion in the Committee, which has been endeavouring to establish a common approach to the more important monetary problems facing the world. This effort to achieve co-ordination can be found in most of the questions submitted for examination to the Board of Governors of the International Monetary Fund, to Working Party No. 3 of the OECD Economic Policy Committee and to the Board of Management of the European Monetary Agreement. For instance, the Monetary Committee has discussed matters such as swap credit agreements between the United States' Federal Reserves System and certain European central banks, the selection of currencies for drawings on and repayments to the International Monetary Fund, and the conditions for the extension of the European Monetary Agreement.

14. The Committee has given consideration to the problem of improving the international monetary system, for it recognizes the existence of difficulties facing the "key currencies". It has therefore examined the proposals made in various quarters for a reform of current arrangements, and is actively studying the problem, though for the moment its studies are still at the theoretical stage.

Chapitre II

ACTIVITIES IN SPECIAL FIELDS

Section I

THE UNIT OF ACCOUNT

15. At the request either of the Council or of the Commission, the Monetary Committee has on several occasions in the last few years gone into the problems involved in expressing in monetary terms the rights and commitments which emerge from the implementation of the Treaty of Rome.

The Committee considered that as long as there was no common currency these problems could only be solved by reference to a unit of account.

The unit of account however has several functions:

a) It serves as a common denominator for the expression of certain rights and commitments among member countries;
b) It safeguards the value of Community assets against the consequences of monetary manipulation;
c) It maintains at a fixed level the member countries' respective shares in Community expenditure despite possible changes in exchange rates.

16. The definition of any unit of account must contain two main elements: the reference to a standard measure of value, and the establishment of a procedure for reviewing this standard measure (or, under certain circumstances, for adapting the counterpart in national currencies of the rights and commitments concerned). In view of the particular problems to be solved in the various fields of Community activity where resort must be had to a unit of account, different solutions may be needed in differing cases, especially in connection with the review or adaptation procedure. However, to prevent the adoption of conflicting solutions, the Monetary Committee should be consulted whenever the Community has to cope with this kind of problem in the future.

17. The first consultation of the Monetary Committee on this subject took place in February 1960. The problem was the definition of a unit of account for the financial transactions of the EEC and of the EAEC, and the Committee decided

in favour of a standard unit of account based on a given weight of fine gold (0.88867088 grams), a weight corresponding to that of the United States dollar as defined in 1934. The Committee also considered that since the unit of account was to be standard, provision should be made by which the commitments themselves rather than the unit of account could in certain circumstances be varied.

In 1962 it was twice called on to give opinions first with regard to the definition of a unit of account for financial aid transactions and technical co-operation in support of the Associated African States and Madagascar, and secondly with regard to a draft regulation on the exchange rates and the unit of account to be used for transactions under the common agricultural policy. For the implementation of this policy it was also necessary to lay down what exchange rates should be used in applying certain regulations.

A. The unit of account in the Convention between the Member States and the Associated African States and Madagascar

18. The following are the principal considerations guiding the definition of the unit of account in the Convention of Association with African States and Madagascar:

In the first place, the unit of account must enable the scale of contribution by each member country to be maintained; it must also, as far as possible, ensure the stability of the aid granted to the associated countries and of the commitments corresponding to the loans; lastly, it must ensure the maintenance of the percentages of aid distribution between the receiving countries as agreed at the outset.

19. On the basis of the opinion given by the Committee, it was decided that the contributions promised by the member countries and the aid expected by the associated countries should be expressed in units of account with the same weight of fine gold as the unit of account used in the financial regulations. If one or more of the Member States' parities is altered, the balances of the contributions converted into the respective national currency or currencies will be raised in the case of a devaluation or cut for a revaluation pro rata. The scale of contributions agreed at the outset – in units of account – will remain unchanged. The volume of aid will be adjusted to meet the changes in total contributions.

However, in order to obviate any arbitrary variation in the real value of financial aid granted to the Associated States in the case of a uniform change in relation to gold occurring in the value of all the currencies, the Convention provides that the weight of gold in this unit of account is to be altered in inverse ratio to the change. If there were to be devaluation or revaluation and one or more Member States did not fall in line with the general adjustment of parities in relation to gold, or did not do so completely, the Council would have to examine the consequences of this situation and adopt the necessary measures on the basis of a proposal from the Commission and after consulting the Monetary Committee.

B. The unit of account in the common agricultural policy

20. The Council of Ministers considered it necessary to prevent as far as possible any alteration in the parity of one or more currencies from affecting the proper application of the common agricultural regulations, particularly in respect of those Community components which must be standard for all the member countries even before the end of the transitional period. For this purpose, the sluice-gate prices for certain imports from non-member countries must be adapted at once if the parity of one or more currencies is changed, as must also the sums representing a protective margin or protective level uniformly applicable throughout the member countries.

21. The Monetary Committee considered that the best way to ensure adaptation was to define these elements in terms of units of account.

On the other hand defining the levies in terms of units of account would not, the Committee found, ensure immediate adaptation of the level of protection if currency parities were changed. Since the size of the levies during the transitional period is not the same throughout the Community, the Committee could see no reason for, or advantage in, expressing them in units of account.

C. Rates of exchange to be used in connection with the common agricultural policy

22. Since the unit of account is a weight of gold, the problem arose under the common agricultural policy of the currency parities to be used to convert into national currencies sums given in units of account, and vice versa.

In July 1962 the Council had submitted to the Monetary Committee a request for an opinion on a draft regulation concerning the exchange rates to be used in connection with the common agricultural policy. This regulation provided that where transactions required the expression in one currency of sums given in another, the exchange rate to be used was that corresponding to the parity notified to, and recognized by, the IMF. The Monetary Committee considered that this arrangement was satisfactory from the angle of general monetary policy and that it had the advantages of clarity, stability in the calculation of the levies, and the maintenance of a certain flexibility in actual commercial transactions.

23. However, as a temporary measure the exchange rates recorded on the most representative exchange market or markets might be used if variations in the effective exchange rate on the exchange markets subject to the control of national monetary authorities endangered the working of the common agricultural policy, even though they remained within the limits fixed by IMF rules. In the Committee's opinion such a procedure could only be adopted in exceptional cases for which it was proved that without it the common agricultural policy would be very seriously hampered.

The same procedure would be followed in the case of the currencies of countries which had not notified a parity to, or whose parity as notified was not recognized by, the IMF.

Section II

LIBERALIZATION OF CAPITAL MOVEMENTS

24. After obtaining the Monetary Committee's opinion the Council, acting on a proposal from the Commission, adopted on 18 December 1962 the second directive for the implementation of Article 67 of the Treaty. The purpose of the directive is to amend and widen the liberalization measures taken in 1960 under the first directive.

Thus, transactions by residents in Member States affecting foreign securities dealt in on a stock exchange were freed from the major restriction left by the first directive; this restriction, contained in Article 2 (3) of the directive, provided that the right of residents to acquire foreign securities could be temporarily limited to financial institutions and to enterprises acquiring the securities of foreign companies having objects similar to their own. Consequently, action must now be taken to extend to all classes of residents the right to buy and sell such securities.

In addition, the second directive has extended the liberalization of capital movements to new sectors. It requires the Member States to authorize the transfer of capital from one Member State to another where an enterprise in one Member State needs this capital to finance the supply of services. It also provides for the abolition of quantitative restrictions on certain capital movements of a personal nature and requires Member States to liberalize certain capital movements of lesser importance.

25. Now that these two directives, which constitute the Member States' minimum commitments in this field, have entered into force, the situation is as follows:

a) Unconditional liberalization in all Member States of such items as direct and real estate investment, certain capital movements of a personal nature, and capital movements connected with the financing of commercial transactions and the supply of services where the capital constitutes a short or medium-term loan and a resident participates in the transaction.

b) Unconditional liberalization in all the Member States, if necessary by general licence, of dealings in stock exchange securities and the physical movement of the securities other than investment trust shares and bonds issued on a foreign market and denominated in the national currency.

26. Other capital movements, notably issues of securities on the capital markets, loans and financial-type credits, long-term credits linked with commercial transactions or the supply of services and dealings in securities outside the stock exchanges, have been accorded unconditional liberalization only in Belgium, Luxembourg and in the Federal Republic of Germany.

It should in conclusion be noted that the unification of the Italian and of the French foreign exchange markets means that arrangements for capital transfers are now the same in all the member countries except the Netherlands, where dealings in securities are carried out on a special market, and in the B.L.E.U., where transfers of private capital are generally carried out on the free market.

27. In accordance with Article 4 of the First Directive pursuant to Article 67 of the Treaty of Rome, the Monetary Committee has carried out a second annual review of the restrictions on capital movements between the Member States.

With regard to the problem of free markets for foreign exchange, the Committee has found that in 1962 exchange rates varied less than 1% in the B.L.E.U. The Committee has not therefore thought it useful, for the time being, to specify what variations – in terms of duration and amplitude – would be considered as incompatible with the first directive. It has, however, come to the conclusion, that studies ought to be undertaken jointly with the B.L.E.U. authorities in order to find and introduce at the earliest opportunity solutions which are acceptable in principle and establish a more homogeneous situation within the EEC, particularly with respect to the transfer to those types of capital listed in schedule A to the first directive as amended by the second directive. The Committee has expressed its preference for a merger of the two B.L.E.U. markets.

28. In addition the Committee has studied the question of legislative and administrative obstacles, and although strictly speaking these are not within its purview, has made certain general recommendations which would make further progress towards the more complete liberalization of capital movements possible.