

EUROPEAN COMMUNITIES

MONETARY COMMITTEE

**ELEVENTH REPORT
ON THE ACTIVITIES
OF THE MONETARY COMMITTEE**

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Brussels, 15 May 1969

INTRODUCTION

The purpose of this report is to give a brief account of the activities of the Monetary Committee during the period from 1 May 1968 to 15 May 1969. Apart from the tasks assigned to it by the Treaty, in particular that of monitoring the monetary and financial situations in the Member States, the Committee devoted particular attention to problems connected with the working of the international monetary system and objectives in the field of monetary relations within the EEC.

During the period under review, the Committee held sixteen meetings and its working parties met on many occasions.

The term of office of its Chairman and Vice-Chairmen having expired at the end of the statutory two-year period, the Committee unanimously re-elected as Chairman Jonkheer Mr. E. van Lennep, Treasurer-General in the Netherlands Ministry of Finance, and as Vice-Chairmen, M. B. Clappier, Deputy Governor of the Banque de France, and Dr. O. Emminger, member of the Directorium of the Deutsche Bundesbank. A list of the members of the Committee is annexed.

The report was adopted on 15 May 1969. It takes no account of subsequent monetary and financial trends or measures in or outside the Community.

1. In 1968 and early 1969 economic activity in the Community as a whole expanded vigorously. The growth of GNP in real terms — at about 5.5% for 1968 — was well above the 1967 figure (3%). It was particularly rapid in Germany (7%), in the Netherlands (6%), and in Italy (5.7%); it was substantial in the Belgo-Luxembourg Economic Union (4.5%); in France it was as high as 4.2% despite the heavy production losses due to the social disturbances in the spring.

2. In all member countries prices were relatively stable in the early months of 1968. In most of them the trend then changed because of a variety of factors: with more and more firms running at or near capacity, strains of varying severity gradually emerged in the second half of 1968 and the early months of 1969; costs mounted rapidly in France; and TVA was introduced in the Netherlands. In Italy, where growth reserves were still relatively large, the price climate, which had been very calm until the last months of 1968, changed in 1969: for the first four months of the year the rise in prices was equivalent to 4% per annum.

3. In the early months of 1968 the key to the healthy business situation in the member countries was the rapid expansion of exports; later, the expansion of home demand, fostered both by gross fixed asset formation and by private consumers' expenditure, assumed greater importance.

The higher rate of growth entailed a sharp rise in visible imports from non-member countries: this category of imports, which had virtually marked time in 1967, jumped by 9%. But as exports from the Community also expanded (by 11.5% in value for 1968, compared with 7.5% for 1967) the surplus on trade (customs returns), which in 1967 had been \$700 million, rose to \$1 700 million in 1968. In early 1969, however, there was evidence that the trade balance was tending to deteriorate.

4. The Community's surplus on current account, according to provisional figures, was about \$5 000 million in 1968 compared with rather less than \$4 400 million in 1967.

Net exports of capital — mostly privately-owned — increased, mainly because European residents were purchasing more American securities, and the Community's basic balance, which had shown a surplus in 1967, was almost in equilibrium for 1968. Since there were net exports of short-term funds and since the terms of payment tended to be less favourable, the overall balance on external accounts, which had shown a surplus of \$1 500 million in 1967, closed with a deficit of about \$2 000 million in 1968.

This was reflected in a contraction of net official gold and foreign exchange reserves (including the Community's net position in the IMF) of \$2 600 million, while the net short-term external position of the commercial banks improved by about \$600 million.

When the trend of payments is examined country by country, it is apparent that the current account surpluses of Germany and Italy, which had already been heavy in 1967, increased still further. Both countries, however, exported considerable amounts of long-term capital. Germany's basic balance was practically in equilibrium for 1968; however, the overall balance showed a surplus of more than \$900 million because of short-term capital inflows. Italy's overall surplus was \$600 million. In France, on

the other hand, where the current account had in 1967 been in near-equilibrium, there was a heavy deficit, which was aggravated by a change in the terms of payment and a net outflow of capital; these developments entailed an overall deficit for 1968 amounting to some \$3 200 million. The Dutch and BLEU overall accounts each show a deficit of about \$100 million.

5. For the first time since 1957 — and for wholly fortuitous reasons — there was a small surplus on the United States external accounts (liquidity basis), after the deficit of \$3 600 million in 1967. This was partly due to the heavy purchases of American securities by non-residents, transactions which cannot be regarded as anything other than exceptional. It was also due, to a great extent, to the trend of the other types of capital movements. The United States authorities having tightened up their regulations on 1 January 1968, American companies cut their exports of capital in the form of direct investment abroad and repatriated a larger share of the incomes of their foreign subsidiaries, while the banks reduced their loans to non-residents. At the instance of the United States Treasury, too, several countries consolidated their dollar assets, mainly in the form of medium-term bonds; without these special operations, the overall deficit would have been more than US \$2 000 million. While the trend of capital movements was thus favourable for the United States, the traditional surplus on trade almost disappeared in 1968, although it was \$3 500 million in 1967. Mainly because of an excess of home demand and of various social difficulties, imports grew (23%) much more than exports (10%). The tendency for the trade account to deteriorate continued in the first quarter of 1969, when it showed a deficit of \$300 million.

In view of the fact that the United States is traditionally a net exporter of capital, the trend of the various payments items in 1968 cannot be regarded as an improvement. In fact what happened was the reverse of what was desirable. Consequently the American authorities have acted in the monetary and tax fields to curb the excessive expansion of the economy, which is affecting the current account; it has already been decided to slacken somewhat the restrictions on exports of capital.

6. In 1968 the United Kingdom's external situation changed only slightly. The basic balance closed with a deficit of £458 million, a little below the 1967 deficit (£515 million). The increase in the deficit on trade (£796 million compared with £635 million) was more than offset by the increase in net receipts for services (£377 million against £236 million) and by a contraction in the deficit on long-term capital movements (£39 million against £116 million). The trend in the course of the year shows an appreciable improvement, since the deficit on the basic balance fell from £427 million in the first half to £31 million in the second. But this improvement is less fundamental than might appear at first sight, and the foreign trade figures have been unsatisfactory since the beginning of 1969. In view of this and of the weight of external debt due for redemption in the next few years, the British authorities are being compelled to place severe curbs on the development of domestic demand and to step up exports.

7. In the period up to the end of 1968, monetary policy pursued by the United States and the United Kingdom authorities did little to restrain the creation of domestic liquidities. In recent months, however, action has been more effective; the demand for loans remaining very high, interest rates have soared to record heights. The restrictive monetary policy has also induced the United States banks to use the Euro-dollar market more and more, so that rates on this market have increased even more than in the United States itself.

With signs of inflation discernible in the Community, the Member States have been compelled, one after the other, to adopt restrictive credit measures, and this has led to a change in the trend of interest rates. Although some increase in rates seems inevitable, given the internal business trend of the Community, the Committee feels that the Member States should perhaps endeavour to curb overall demand by increased use of tax policy measures, i.e. by improving the economic policy mix. However, such a "Community" policy will not hold interest rates down to acceptable levels unless major non-member countries follow the same principles in the steps they take to regulate overall demand.

8. In its last annual report, the Committee noted that in 1967 business trends within the Community had varied widely from country to country. The incipient recovery in Germany during the second half of the year and the economic policies implemented by other Member States suggested that these disparities might gradually disappear. And, in fact, some tendency for business trends in the Community countries to converge was apparent in early 1968. In Italy and the Benelux countries, expansion — partly due to the recovery in Germany — was substantial and gathered momentum in the second half of the year. France, too, experienced a period of balanced growth in the first four months of the year.

9. The events of May and June in France brought an unexpected change in the economic situation of that country. In order to cushion in the very short term the impact on external trade of a prolonged cessation of activity and of the sudden increase in production costs, the French Government adopted, with the agreement of the Commission, certain temporary and exceptional arrangements which impaired — though only to a modest extent — the freedom of intra-Community trade. To combat the flight of capital, the French authorities also introduced exchange control.

By accepting early in July responsibility for about half the monetary assistance accorded France in a wider framework and by pursuing their economic policy based on expansion, the other Member States tried to facilitate the action of the French Government. At the time there was reason to hope that the French economy would soon be in a position to restore internal and external equilibrium.

10. In the final months of the year, however, the trend of production costs, the spurt in home demand, the scale of the budget deficit and the expansion of the volume of credit aroused fears that the restoration of external equilibrium would prove more difficult and take longer than had been supposed. At the same time the persistence of a very heavy current account surplus in Germany, despite the rapid expansion of economic activity made a DM revaluation seem more likely.

11. In these circumstances, with the internal monetary situation in a state of strain, a monetary crisis was unleashed in November by a wave of speculation on the parity changes, particularly those of the German mark and the French franc.

This led the countries concerned to adopt measures to restore their external equilibrium. France took restrictive action on the budget, taxation and credit; it also brought back and tightened the exchange control arrangements which had been dropped early in September. An important German measure was an impost on exports and a refund on imports, the trade effect of which was similar to a corresponding revaluation of the currency. As a result of these measures the tide of speculative capital ebbed fairly rapidly.

12. German exports of long-term capital increased considerably: in the first three months of 1969 they were appreciably larger than the surpluses on current account, so that Germany's monetary reserves contracted until the end of March 1969, reverting to the level of early 1968.

There was a further wave of international speculation at the end of April and early in May, leading to a major expansion of German monetary reserves. The German Government announced that the DM parity would remain unchanged, and a series of measures were adopted to combat the inflow of speculative currency and to ensure the stability of prices, which was exposed to the danger of over-heating due to the uninterrupted expansion of business activity.

13. In conclusion the Committee notes that the events of 1968, the very year in which customs union between the Six was completed, led to the adoption of temporary restrictions on the free movement of goods and capital within the Community.

In this respect, it cannot be too heavily emphasized that any lasting exception to the freedom of intra-Community trade in goods and services would be liable to jeopardize the success of the Community venture and to shake confidence in the permanence of the progress made in this field. The Committee therefore welcomes the fact that the French authorities lifted early in 1969 the restrictions on movements of goods imposed after the events of the previous spring. It also hopes that the restrictions on capital movements introduced in 1968 and 1969 by a number of countries will also be completely withdrawn as soon as possible.

14. During the period under review, the Committee continued its study of ways and means of strengthening the co-ordination of monetary policies both within the Community and externally.

As one of its regular duties, it kept the trend of international payments under review and held prior consultations in view of adopting, as far as possible, a common position on problems to be discussed in other international organizations. It also examined the monetary and financial situations of the member countries, particularly following the events which occurred in France during May and June, and the monetary crises of November 1968 and May 1969.

In October 1968 the Committee examined Part I of the Report from the Working Party on Negotiable Securities Market, which described the procedures and instruments designed to ensure the equilibrium of the bond markets in the EEC countries; Part II of this Report, which will consider how these procedures and instruments were used in 1967 to 1969, is now being drafted; it will be laid before the Committee before the end of the year.

15. Following a meeting of the Ministers of Finance and of Economic Affairs in Rotterdam on 9 and 10 September 1968, the Committee intensified its research work with a view to further progress in the field of monetary relations within the Community. On 15 January 1969, it submitted to the ministers a report summarizing tentative conclusions on ways and means of strengthening co-operation between the Member States.

16. In this report the Committee noted that the events of 1968 had brought out even more clearly than before the need, already stressed by the Committee, for economic policies within the Community to be better co-ordinated.

This need stems from the very existence of the common market. The customs union, now complete, has forged very close commercial links between the Member States, and so the repercussions of any imbalance developing in one economy are transmitted more rapidly than before to the others. The resulting interdependence has the effect not only of limiting the efficacy of economic policies applied at national level, but also of exposing the Community as a whole to the impact of measures adopted in any of the six countries. Moreover, some of the arrangements set up for institutional integration in the various sectors of activity, notably in agriculture and in taxation, are tending to restrict the freedom of manoeuvre enjoyed by each Member State in the discharge of its national responsibilities.

17. The key problem to be dealt with through improved co-ordination of economic policy decisions is to forestall the emergence of sharp divergences in cost and price trends and, more generally, in the way overall demand and the balance of payments develop in each Member State.

The Member States should therefore agree their longer-term economic policy aims, making sure that they are mutually consistent and in line with the objectives of the Treaty of Rome.

With regard to price stability, the Committee notes that price increases are tolerated in widely differing degrees in the different Member States. These differences, if allowed to continue, would in the long run cause fundamental disequilibria between the Member States. In this connection, the Committee is aware that the Common Market countries, given the scale of their external trade with the rest of the world, could well make a useful contribution to the world economy by pursuing a policy which made them a centre of price stability.

18. But harmonization of the basic objectives of the member Governments is not enough; the practical measures taken to achieve them must also be co-ordinated.

This is no easy task. The trend of prices, costs and payments may sometimes be determined by forces which largely escape governmental control. But a greater problem is that conflicts may arise between national interests and the requirements of a co-ordinated economic policy. The existence of these constraints and the influence of unforeseeable obstacles highlight the need to strengthen any instruments and procedures of co-operation that can increase solidarity between the Member States.

The aim of the concertation arrangements must therefore be to bring out the common objectives and the interests of the member countries and to ensure that they are given due consideration when individual Governments are preparing those decisions for which they have retained responsibility. Co-ordination here could not of course be confined to currency and credit matters but should cover both budget policy, the impact of which on final demand and on the monetary situation is manifest, and all measures affecting prices and incomes.

The Monetary Committee's activities must dovetail into those of the other Community committees, in particular the Short-term Economic Policy Committee and the Budget Policy Committee; taking as its basis the medium-term economic policy objectives — the establishment of which is mainly a matter for the Medium-term Economic Policy Committee — the Monetary Committee has to examine more especially the monetary and financial aspects of the co-ordination of economic policies.

19. The Committee has put forward proposals for organizing prior consultation within the Committee itself on a more effective and regular basis.

Thanks to the decisions taken by the Council in May 1964, progress has already been made towards fuller co-ordination of external monetary policy.

These decisions provide a prior consultation procedure for any case where one or more Member States propose to change the parity of their currencies. There is also a procedure for consultation on any decision and any important position a Member State intends to adopt in the field of international monetary relations — unless the circumstances, and particularly the question of timing, make this impossible. Consultations carried out by the Committee in recent years in this field have proved effective and have played an important role in international negotiations. The Committee is none the less studying ways and means by which the existing procedures could be improved. The arrangements governing certain decisions which are to be taken at international level in the near future are such that the Community can make its weight felt only if it adopts a common position. The importance of concertation is also enhanced by the responsibilities which the Six have to assume in financing the international support given to certain currencies.

20. In the field of internal economic policy — which, as has been pointed out, is not the concern of the Monetary Committee alone — there is a case for improving the process of consultation at present in operation and for widening its scope. Consultation should cover any important measures contemplated by a Member State which might have a substantial impact on the economies of the other Community countries.

The existence of such a procedure safeguards the freedom of the Member States as to final decisions, within the limits of the obligations stemming from the Treaty; it is however up to them to take into account the results of these exchanges of view when working out their economic policy.

It is neither feasible nor realistic to establish a detailed catalogue of the measures the adoption of which should be preceded by consultations. The Committee therefore feels that a procedure under which the Community's institutions could regularly discuss developments in economic policy at the stage when Governments are planning to review them or to take certain measures, but before a final decision had been reached. Under this consultation procedure, the Committee has important duties, since economic policy decisions usually have monetary or financial implications.

To make these consultations more systematic, the Committee has already adapted its work procedures to the new tasks. While continuing the detailed examinations of the economic situation of each Member State which it normally makes once a year, it will henceforward, whenever the circumstances so require, make the first point on its agenda a discussion of economic and monetary problems and of the outlook in that sector. Since the Committee meets frequently, it will normally be possible for each member country to consult its partners in the Committee in good time.

21. The supply of information for use in the analysis of economic situations and outlooks must be improved and harmonized before consultation can be effective.

Generally speaking, Member States should lose no time in taking steps to implement the Council recommendation of 28 July 1966 on improving statistics relating to the business trend.

In accordance with the Treaty of Rome, the Committee has also decided to strengthen the system of reciprocal information already established for its own members.

22. Again, the endeavour to concert policies will not be effective unless each country possesses satisfactory machinery for implementing its own economic policy. As has already been stressed, the high degree of integration attained in certain sectors has

increased the rigidity of various overall adjustment instruments. To remedy this situation, ways and means of improving certain intervention techniques, particularly in the budgetary and fiscal fields, should be studied.

In 1967 the Committee published a report on the instruments of monetary policy in the Member States in order to compare them and to study their range. It intends to pursue its research and — as already announced in its Tenth Annual Report — to publish a further paper on this subject.

23. The Committee's report of 15 January was merely interim in character, since the Commission was to frame wider proposals on which the Committee would have to express its views: the Commission has in fact asked the Committee to give an Opinion on the memorandum relating to the co-ordination of economic policies and monetary co-operation within the Community which it had forwarded to the Council on 12 February 1969. Because of the importance of these proposals the Committee has decided that this Opinion, submitted to the Council and to the Commission on 10 May 1969, should be published; it appears as an annex to this Report.

ANNEX I

OPINION OF THE MONETARY COMMITTEE ON THE MEMORANDUM SENT BY THE COMMISSION TO THE COUNCIL ON 12 FEBRUARY 1969

At its meetings of 27-28 February, 25-26 March, 16 April and 9 May 1969, the Committee examined the Memorandum on the co-ordination of economic policies and monetary co-operation within the Community which the Commission had sent to the Council on 12 February 1969. The Committee welcomes the Commission's initiative, which should make a valuable contribution to the development of economic and monetary co-operation and therefore to the more harmonious development of the Community.

The comments which the Committee felt it must make on a number of points are given below. Although the Commission's proposals are presented as a coherent set, the Committee has, as a matter of convenience, summarized its comments under two headings:

- i) The co-ordination of economic policies,
- ii) The mechanism for monetary co-operation in the Community.

1. Co-ordination of economic policies

The Committee finds that the Commission's analysis is broadly in keeping with the arguments which the Committee had set out in its interim report of 15 January 1969 to the Ministers of Finance and Economic Affairs, in which stress was laid on the need to co-ordinate the economic policies of the Member States more effectively by harmonizing their medium-term economic objectives and improving the procedures for consultation on their short-term economic policies.

Harmonization of the medium-term objectives pursued by member Governments so as to ensure their compatibility with the objectives set out in the Treaty of Rome is undoubtedly necessary if the co-ordination of short-term economic policies is to be strengthened. In this connection, the Committee draws attention to the substantial divergencies in cost and price trends which have been apparent within the Community in recent years. Therefore, the Member States must summon up the political will needed first to agree on convergent medium-term objectives and then to implement the policies enabling these objectives to be attained.

The task of defining these economic objectives is primarily one for the Medium-term Economic Policy Committee. The Monetary Committee notes that the Commission has asked the Medium-term Committee to consider whether the medium-term guidelines for national policies could be worked out jointly. On the monetary and financial aspects of the work the Monetary Committee proposes — as it has indicated in its interim report — to work in close association with the Medium-term Economic Policy Committee.

The Committee is also in agreement with the main lines of those proposals in the Memorandum which concern the co-ordination of short-term economic policies, since they support the idea of prior consultation, especially on measures which would have a substantial impact on the economies of the other countries of the Community.

Prior consultation is already a requirement for any change in the currency parity of one or more Member States. It is also necessary before any decision or any important position adopted by a Member State with regard to international monetary relations, unless the circumstances, and particularly considerations of time, make it impossible. The principle of prior consultation should be extended to key decisions in domestic economic policy.

The Committee has considered the case for making the principle legally binding. Some members felt that a formal Council decision was in no way indispensable. Others, on the

