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I

(Information)

COUNCIL AND COMMISSION

EIGHTEENTH REPORT ON THE ACTIVITIES OF THE MONETARY COMMITTEE

FOREWORD

The purpose of this report is to give a brief account of the activities of the Monetary Committee in the course of 1976.

During the year, the Committee held 13 sessions and the working parties drawn from its own members or set up at its initiative met on many occasions.

At its session of 30 January it elected its officers. It elected as chairman Mr K.-O. Pöhl, Secretary of State in the Federal Finance Ministry, Bonn, and, as Vice-Chairmen, Mr J.-Y. Haberer, Ministry of Finance, Paris, Mr S. Palumbo, Ministry of the Treasury, Rome and, while awaiting a Council Decision creating a third vice-chairman, provisionally elected Mr S. Andersen, joint-Governor of Danmarks Nationalbank to this post. This was confirmed at its meeting of 31 March. The terms of office of the new officers will expire on 31 December 1977. A list of members as at 31 December 1976 is annexed.

The report was adopted as at 31 December 1976.

INTRODUCTION

1. In 1976, the world economy saw marked progress, with production and trade showing growth rates similar to those obtaining before the oil crisis. This favourable development was not, however, a return to the status quo. Balance of payments disequilibria continued to reflect the aftermath of the quadrupling of oil prices. The external deficit of the non-oil producing developing countries was reduced somewhat, but there was a sharp deterioration in the external position of the industrialized countries as a whole, which moved back into deficit, and the surplus of the OPEC countries was even higher than in 1975.

2. For the Community, 1976 marked an upturn out of the recession. The growth of output, very high in the first half of the year, but more moderate later, was not

however accompanied by any reduction in unemployment, because of the size of spare productive capacity and the increase in wage costs. The average rate of inflation diminished, although the differences from one country to another remained large. On the other hand, the Community's current account showed a sizeable deficit, particularly due to a worsening in the current account position of some countries which were already in deficit. In these conditions, divergences in the exchange rates of Community currencies were further accentuated. The activities of the Committee were concentrated on analysing these features and on trying to conceive of methods to cushion the effects of those problems on Community affairs. Moreover the Committee constructively worked on solutions to monetary questions in a worldwide context.

COMMUNITY ACTION AND THE ACTIVITIES OF THE COMMITTEE

3. In 1976, the Committee devoted a large part of its time to examinations of the economic situations of Member States, paying particular attention to monetary policy measures used in response to the overall economic situation. During the year all Community countries were examined at least once, and some of them much more frequently. These more frequent examinations were either undertaken in conformity with the provisions governing the use of Community credit mechanisms or as a consequence of the non-participation of Member States in the financing of intra-Community assistance.

4. One of the countries whose economy was examined by the Committee on numerous occasions was Italy. At the beginning of the year, the *ad hoc* working party chaired by Mr de la Genière prepared a report to the Committee on the economic situation in Italy and the economic policy conditions which could be attached to a Community loan to that country. The Committee adopted that report at its February meeting and submitted an opinion to the Council and the Commission (Annex I). This opinion was taken into account when the Council adopted a Decision on 15 March 1976 fixing the economic policy conditions to be observed by Italy. In November, the de la Genière group delivered a new report on the Italian economy which was approved by the Committee and submitted to the Commission in December 1976. The Italian lira came under renewed pressure in late April and May, and the Italian Government requested the Commission's authorization to take emergency measures under Article 108 of the EEC Treaty. The Monetary Committee was consulted on this occasion, and again on 2 October when the Italian authorities decided to introduce a temporary (for 15 days) tax on purchases of foreign currency and on 26 October when this tax was re-introduced although at a lower rate, along with a whole series of other measures aimed at stabilizing the Italian economy. The Committee continued to monitor the Italian situation on a permanent basis right through the year.

5. The Committee twice examined the situation in the United Kingdom, as required by that country's non-participation in the provision of medium-term financial assistance for Italy. The Committee, aided by the work of the *ad hoc* working party chaired by Mr Andersen, agreed that the United Kingdom's non-participation was justified by its balance of payments and reserves positions.

6. During autumn, the pound sterling came under severe pressure on the exchange markets, and at its meetings in September and December, the Committee held an examination of the economic situation in the United Kingdom and of the economic and monetary policy

measures being taken to meet this situation. The Committee, during its deliberations, kept itself informed about financial assistance made available to the UK by other international organizations.

7. The working party chaired by Mr Andersen also met in December to prepare a report on the economic situation in Ireland and the extent to which the economic policy conditions for 1976 in connection with the Community loan to that country had been met. The Committee took note of the progress made and estimated that a basis for further progress in 1977 had been established.

8. In response to the communication 'Economic and Monetary Policy Measures' presented by the Commission to the European Council on 1 and 2 April, and to the suggestions put forward by the Netherlands President of the Council for strengthening the economic and financial cohesion of the Community, the Committee devoted a number of meetings to examining three aspects of monetary problems which presented themselves to the Community. These were the Community's exchange rate arrangements, the fixing of quantitative monetary policy objectives, and control of the Euro-currency markets. At the end of its discussions it adopted a report, which was submitted to the Council and the Commission (Annex II).

(a) Discussion on the Community's exchange rate arrangements was based on proposals made by the Netherlands members. Account was also taken of proposals made by the French members in 1975. The objective of both sets of proposals was to aim at a more coordinated and less divergent system of exchange rates in the Community. The Dutch proposals reflected a desire for a better cooperation between snake countries and those countries whose currencies float independently without recreating exchange rate rigidities. The essence of these proposals was to provide a framework for discussion within the Community on exchange rate policies and related measures by introducing a system of so-called target zones expressed in effective exchange rates. The Committee concluded that the introduction of a coherent system to cover all Member States along the lines suggested, would not be feasible at present, given the wide divergences in the trends of the economies of the Member States as well as differences of opinion on various aspects of the proposed scheme. However, the Committee proposed to the Council that it continue its discussions on the proposals. Work is now proceeding to see how and

under what circumstances the proposals could be implemented and the Committee will report back to the Council in early 1977.

- (b) Discussion on the fixing of quantitative monetary policy objectives was based on an initial exchange of views on the experiences of Member States in using this kind of instrument, and on a preliminary report prepared by the Working Party on Harmonization of Monetary Policy Instruments (Annex III). The Committee concluded that internally established monetary objectives which vary from one Member State to another should be discussed from time to time in the Committee, which should compare the outturn with the objectives, examine and account for any deviations and discuss possible remedies. The theoretical and technical studies of ways and means of gradually aligning intermediate objectives without encroaching upon national powers and areas of responsibility is being pursued in the working party.
- (c) The examination of ways of controlling the Euro-currency markets was prepared by the Working Party on Short-term Capital Movements, which submitted a report to the Committee on 'The Euro-currency markets and the regulation of international financial flows' (Annex IV). The Committee was sceptical of the practical possibility of introducing control of the Euro-currency markets by monetary policy means, and concluded that only steps aimed at improving transparency of these markets could be undertaken at present. It supported efforts being made in various fora to improve the available information on countries' indebtedness and to resolve the problems involved in a greater degree of collaboration between national risks bureaux.

9. In March, the Council took a decision to raise a Community Loan in favour of Italy and Ireland. This

loan, upon which the Committee was consulted, for a total amount of \$ 1 100 million and DM 500 million, was made up of four parts. Firstly, a fixed-interest, six-year bond issue of \$ 300 million, a fixed-interest seven-year bond issue of DM 500 million, a fixed-rate four-year private placement of notes of \$ 500 million, and a five-year floating rate bank loan of \$ 300 million. Later in the year, it was considered opportune and useful to consolidate a part of the floating-rate bank loan into a medium-term fixed interest loan. The Committee was consulted on this proposal at various stages of the negotiations, and on the filing of the registration statement with the SEC following the assignment of a triple A rating to the Community. This operation was successfully concluded in October with the floating of a \$ 100 million five-year note issue on the New York market.

10. As usual, the Committee discussed international monetary problems on a number of occasions, including the finalizing of the revision of the IMF Articles of Agreement, and problems arising out of the sale of gold by the IMF, with a view to arriving at a common position of Community countries. In addition, it monitored the work of the fourth commission (finance) of the Conference on International Economic Cooperation. The Committee was also instrumental in arriving at common positions of Member States for the annual meetings of the World Bank and International Monetary Fund at Manila in October.

11. The Committee also examined various other matters, the main ones being foreign exchange market practices and regulations in Member States, proposals to change the conversion rates for national currencies into units of account for the purposes of the Common Agricultural Policy, and monetary compensatory amounts within the Common Agricultural Policy.

WORKING PARTIES OF THE MONETARY COMMITTEE

12. The Working Party on Securities Markets met four times in 1976, and continued to examine developments in the capital markets of the Member States and in the international bond markets and also discussed capital market policies. In view of the growing tendency for issuers to use variable rate techniques for raising loans in a period of monetary erosion and instability of interest rates, the working party decided to undertake a study of the different formulae used for issuing floating rate notes on the international market, and the implications of this method for the future of the national fixed-interest bond markets as a means of raising long-term capital. This work has begun and will be continued in 1977. In addition, the working party also held an ex-

change of information on accounting procedures and tax treatment of transactions in securities.

13. The Working Party on Harmonization of Monetary Policy Instruments, a joint group of the Committee and the Committee of Governors, met several times in 1976. In June, it submitted an interim report (Annex III) to the two Committees who examined it and, on this occasion, confirmed the direction in which the working party proposed to orient its work. As a result, the working party then commenced a new series of studies of simulation exercises with monetary policy instruments and analyses of the transmission process of monetary policy.

14. Following the revised terms of reference given to it by the Committee and the Committee of Governors in 1975, the joint Working Party on Short-term Capital Movements continued its work on the 'Euro-currency markets and the regulation of international financial

flows'. It submitted a report on this matter to the two parent Committees in June (Annex IV) and this report formed the basis for the Committee's discussions and subsequent report on this topic (see paragraph 8 (c) above).

LIST OF MEMBERS AND ALTERNATES OF THE MONETARY COMMITTEE

Chairman

Mr K.-O. Pöhl Staatssekretär — Bundesministerium der Finanzen (Bonn)

Vice-Chairmen

Mr S. Andersen Nationalbankdirektør (Copenhagen)

Mr J.-Y. Haberer Chef du service des affaires internationales à la direction du trésor —
ministère de l'économie et des finances (Paris)

Dott. S. Palumbo Dirigente generale al Ministero del Tesoro (Rome)

Members

Mr M. J. Balfour Bank of England (London)

Mr F. Boyer de la Giroday Director in the Directorate-General for Economic and Financial Affairs —
Commission of the European Communities (Brussels)

Mr B. J. Breen
(until 17 November 1976) Central Bank of Ireland (Dublin)

Mr R. de la Genière Sous-gouverneur de la Banque de France (Paris)

Mr A. Dondelinger Commissaire au contrôle des banques (Luxembourg)

Dr O. Emminger Vizepräsident der Deutschen Bundesbank (Frankfurt-am-Main)

Mr K. Hansen Departementschef — Det Økonomiske Sekretariat (Copenhagen)

Mr M. Horgan
(since 10 September 1976) Department of Finance (Dublin)

Mr G. Janson Directeur de la Banque nationale de Belgique (Brussels)

Mr N. Jordan-Moss
(since 19 January 1976) H.M. Treasury (London)

Mr R. Kirsch Conseiller de gouvernement — Ministère des finances (Luxembourg)

Prof. G. Magnifico Banca d'Italia (Rome)

Dott. U. Mosca Director-General for Economic and Financial Affairs — Commission of
the European Communities (Brussels)

Mr T. O'Coifagh
(until 10 September 1976) Department of Finance (Dublin)

Mr T. O'Grady-Walsh
(since 17 November 1976) Central Bank of Ireland (Dublin)

Dr C. J. Oort Thesaurier generaal bij het Ministerie van Financiën (The Hague)

Drs. A. Szasz Directeur van de Nederlandsche Bank NV (Amsterdam)

Mr J. van Ypersele de Strihou Conseiller du ministre des finances (Brussels)

Dr H. H. Weber Ministerialdirektor — Bundesministerium der Finanzen (Bonn)

Chairman of the Alternates of the Monetary Committee

Mr J. G. Littler H.M. Treasury (London)

Alternates

Mr H. Baquias (since 24 June 1976)	Sous-directeur à la direction du trésor — ministère de l'économie et des finances (Paris)
Dott. V. Barattieri di San Pietro	Banca d'Italia (Rome)
Mr J.-M. Bloch-Lainé (until 24 June 1976)	Sous-directeur à la direction du trésor — ministère de l'économie et des finances (Paris)
Drs. D. H. Boot	Onderdirecteur van de Nederlandsche Bank NV (Amsterdam)
Mr C. F. Cavanagh (until 25 March 1976)	Department of Finance (Dublin)
Mr H. Dalgaard	Kontorchef — Danmarks Nationalbank (Copenhagen)
Dr W. Flandorffer	Ministerialrat — Bundesministerium für Wirtschaft (Bonn)
Mr R. H. Gilchrist (since 21 June 1976)	Bank of England (London)
Mr F. L. Hall (until 21 June 1976)	Bank of England (London)
Mr P. Jaans	Secrétaire général au commissariat au contrôle des banques (Luxembourg)
Mr G. Jennemann	Bankdirektor — Deutsche Bundesbank (Frankfurt-am-Main)
Mr G. Lefort	Directeur général des services étrangers de la Banque de France (Paris)
Mr D. McCormack (until 30 January 1976)	Central Bank of Ireland (Dublin)
Mr J. Mertens de Wilmars	Conseiller économique de la Banque nationale de Belgique (Brussels)
Mr L. Meulemans	Inspecteur général à l'administration de la trésorerie (Brussels)
Mr J. E. Nash	Director in the Directorate-General for Economic and Financial Affairs — Commission of the European Communities (Brussels)
Mr G. Reynolds (since 30 January 1976)	Central Bank of Ireland (Dublin)
Mr M. Schmit	Inspecteur des Finances (Luxembourg)
Mr B. Scully (since 25 March 1976)	Department of Finance (Dublin)
Mr N. Ussing	Kommitteret — Det Økonomiske Sekretariat (Copenhagen)
Drs. R. Van Bovèn	Ministerie van Financiën (The Hague)
Dr M. Wegner	Director in the Directorate-General for Economic and Financial Affairs — Commission of the European Communities (Brussels)
Dott. A. Zodda	Ministero del Tesoro (Rome)

Secretariat

Mr G. Morelli
Mr G. Lermen
Mr A. Chapman

ANNEX I

REPORT TO THE COUNCIL AND THE COMMISSION ON THE ECONOMIC SITUATION IN ITALY AND THE ECONOMIC POLICY CONDITIONS WHICH COULD BE ATTACHED TO A COMMUNITY LOAN**Introduction**

1. At its meeting of 16 February 1976, the Council authorized the opening of the negotiations necessary for a Community Loan operation in favour of Italy. Council Regulation (EEC) No 397/75 concerning Community loans, lays down (Articles 3 and 8) that the Council, acting on a proposal from the Commission, which consults the Monetary Committee on the matter, shall decide the economic policy conditions to be fulfilled by the beneficiary Member State in order to redress its balance of payments.

2. In accordance with this Regulation, on 27 February 1976, the Committee held an examination of the economic situation in Italy, prepared by an *ad hoc* working party chaired by Mr de la Genière, First Deputy-Governor of the Banque de France. The Monetary Committee's conclusions on this matter are summarized in this report, which revises and up-dates that which the Monetary Committee prepared on 28 November 1975 (II/858/75) in the framework of the medium-term financial assistance granted to Italy by Council Directive 74/637/EEC.

Economic situation in Italy

3. The Italian economy was hit by the recession in 1975. The main economic indicators show, however, that the trend pattern varied during the year: the recession steadily deepened in the first three quarters but a turning point was reached in the fourth, when signs of a recovery appeared. Compared with the same periods last year, the unadjusted index of industrial production fell 11.9% in the first quarter, 12.2% in the second, 12.3% in the third and 2.5% in the fourth, a drop of 9.8% for the year as a whole. As a result, the gross domestic product in terms of volume for 1975 was some 3.4% below the 1974 level.

4. The downturn in production in 1975 led to a progressive deterioration in the employment situation and an increase in unemployment, on an annual comparison of 0.5% in the first quarter, 37.8% in the second, 17.6% in the third, and 15.6% in the fourth (source: ISTAT). It should be added that these figures do not tell the full story, since they do not take account of short-time working, whether or not 'compensated' by the Cassa Integrazione (the number of hours covered by payments from this body increased three-fold between 1974 and 1975).

5. The rate of price increases slowed down somewhat in 1975. Thus, compared with the previous quarter, wholesale prices,

after rising 0.4% in the first quarter, increased only 0.1% in the second quarter but 0.9% in the third quarter and 2.4% in the fourth. The rise in consumer prices, after reaching 3.6% in the first quarter of 1975 and 2.7% in the second quarter, was 1.9% in the third quarter and 3.0% in the fourth (still compared with the previous quarters). A further increase of 1.1% was recorded in January 1976. For 1975, the rise in wholesale prices averaged 8.5% and that in consumer prices 17.0%.

Although the rate of increase (year-on-year) lost momentum, the trend in recent months remains a source of concern.

These price rises were accompanied by a sharp increase in wages and salaries. During the year, hourly wages rose by 27%, representing an increase in real wages and salaries and hence a considerable extra burden for firms whose profit margins had already considerably narrowed.

6. The balance of payments improved in 1975: the overall deficit narrowed to Lit 1 129 000 million (as against Lit 3 588 000 million in 1974) and so roughly matched the drop in official reserves (Lit 1 239 000 million). On the basis of foreign currency statistics, the deficit on the trade balance (cif-fob) was Lit 2 520 000 million (as against Lit 6 481 000 million in 1974), and the balance of service transactions and transfers showed a surplus of Lit 1 079 000 million (Lit 607 000 million in 1974), giving a deficit on current account of Lit 1 368 000 million (Lit 5 830 000 million in 1974).

The most striking feature of this development was the recovery of the trade balance, which is all the more remarkable since it took place in a period of contraction in the volume of international trade. Imports fell 5.7% in terms of value in January-December and 14% in terms of volume in January-November 1975, compared with the corresponding periods in 1974. By contrast, exports during the same periods increased 15.6% in terms of value and 1.7% in terms of volume (all on a trade statistics basis). These figures, however, indicate the precarious nature of the recovery as it is shown to be primarily due to the fall in imports following the contraction in domestic demand: it should be noted that a third of the trade deficit in 1975 was recorded in the fourth quarter, when the recovery got under way.

The economic policy pursued in 1975 and observance of the economic policy conditions laid down for the grant of medium-term financial assistance to Italy
(Articles 6 and 7 of Council Directive 74/637/EEC of 17 December 1974)

7. From the beginning of 1974, the authorities, faced with the stagnation of domestic demand, had eased the restrictive nature of monetary policy; the depth of the recession in 1975

prompted them to adopt a monetary policy aimed at assisting the recovery of domestic demand. This policy resulted in a significant fall in interest rates, a return to a 'normal' structure of rates and, at the same time, a revival on the financial market. Together with a sharp expansion in the Treasury's borrowing requirement, it caused the ceilings fixed in connection with the grant of medium-term financial assistance to be considerably exceeded.

8. The growth in total lending will probably exceed the ceiling of Lit 24 700 000 million fixed for the period from 1 April 1975 to 31 March 1976 (Article 6 of Directive 74/637/EEC mentioned above) by about Lit 5 000 000 million, as the Treasury deficit is likely to be much higher than expected. Total lending has been running ahead of this ceiling since October 1975; until then, the intermediary objectives had been observed.

The ceilings on public finances fixed in Article 6 of the Directive were, likewise, very substantially exceeded: the rate of increase in central government expenditure was of the order of 23% in 1975 instead of the 16% laid down, and the deficit on Treasury transactions exceeded the figure of Lit 8 000 000 million by about Lit 5 400 000 million. It should, however, be noted that, while in 1974 three-quarters of the Treasury deficit had been financed by recourse to the Banca d'Italia, in 1975 only about 40% of it was financed in this way.

Outlook for 1976 and the economic policy conditions to be observed by the Italian authorities

9. According to macro-economic forecasts prepared by the Italian experts, the growth of GDP in 1976 could well amount to 1 to 2% in real terms. These forecasts assume a growth of 6% in the volume of world trade, with Italian exports maintaining their relative share. The expected rate would be based on a 2 to 3% increase in private consumption and a continuation, although at a slower pace, of the decline in investment (affecting primarily plant and machinery). There will probably be a further increase in unemployment over and above the high level reached at the end of 1975. Prices, measured in terms of the GDP deflator, will probably rise by 16%. Finally, the payments deficit on current account is likely to be of the order of Lit 500 000 to Lit 1 000 000 million.

Recent economic developments in Italy have thus highlighted the fragile aspects of the economy. Budgetary measures designed to stimulate demand, coupled with an easy monetary policy, have led to a certain upturn in activity but also to a deterioration in the balance of payments and to the risk of a quickening in the pace of inflation.

10. Given these macro-economic forecasts, the Committee has, together with the Italian authorities, reviewed the economic policy conditions laid down in Council Directive 75/784/EEC of 18 December 1975 adapting the conditions laid down for the grant of medium-term financial assistance to Italy. It has been found that the recent deterioration in Italy's

internal and external situation would, if no corrective measures were taken, cause the ceilings fixed in that Directive to be once again considerably exceeded in 1976. Under these circumstances, the Italian authorities could, in connection with the grant of a Community loan, contemplate taking measures to ensure compliance with these conditions, some of which could even be tightened.

11. Directive 75/784/EEC provided that the growth of total lending in 1976 would be limited to Lit 31 000 000 million. The Italian authorities could lower this ceiling to Lit 30 000 000 million, necessitating a contraction in the public sector borrowing requirement and, at the same time, a reduction in the growth rate of the private sector's financial assets, which recently triggered flights of capital out of the country. In these circumstances, the rate of growth of money supply in 1976 will be at a similar level to previous years (about 18%).

12. Directive 75/784/EEC had limited the rate of increase in central government current expenditure to 15% in 1976. The present forecasts of current expenditure suggest that the rate laid down will be exceeded. The Italian authorities have proposed that it be replaced by a cash ceiling on total expenditure; so as to curb expenditure, they could accept a ceiling of Lit 40 000 000 million, which is slightly lower than the forecast of Lit 40 600 000 million in the Monetary Committee's November report (doc. II/858/75). The rate of growth of total expenditure will thus stabilize in 1976 at about 25%, the same as in 1975.

13. The deficit on Treasury transactions had been limited to Lit 14 800 000 million in 1976. The Italian authorities feel that this ceiling could be lowered to Lit 14 300 000 million. The main emphasis would have to be on cutting or postponing certain items of expenditure, but, to achieve the objective laid down, it would also be necessary to increase the tax burden.

14. By contrast, the Italian authorities have pointed out that the ceiling of Lit 5 700 000 million fixed for central bank financing of the deficit on Treasury transactions cannot be lowered and might even be exceeded.

15. Finally, it should be noted that Italy's application for a Community loan of around \$ 1 000 million comes at a time when a deficit on the current balance of up to Lit 1 000 000 million (\$ 1 200 million) is forecast. In addition, there is the need to take into account debt maturities totalling \$ 2 300 million (about Lit 1 800 000 million) in 1976.

16. The Committee has noted the economic policy measures taken by the Italian authorities on 25 February 1976 to reduce internal liquidity. The Committee has also noted the adjustments envisaged by the Italian authorities to the economic policy targets for 1976 fixed by the Community, to take into account recent developments in the Italian economy. While appreciating the efforts that will have to be made by the Italian authorities to respect the revised targets, the Committee em-

phasizes that the restoration of internal and external equilibrium necessarily implies a significant reduction in the rate of monetary expansion which last year exceeded nominal growth of GNP by 5.9 percentage points (nominal GNP growth 15.6%, M2 growth 21.5%). A significant reduction in the Treasury deficit would facilitate the achievement of this objective. Moreover, the target for Treasury financing by the Central Bank is excessive and should be further reduced.

Outside the strictly monetary and financial sphere, the Committee suggests that an essential element for the re-establishment of equilibrium in the Italian economy is a moderation in

the rate of increase of nominal incomes. Monetary and budgetary policy cannot by itself moderate in a satisfactory manner pressures which are incompatible with growth of output in real terms.

Finally, the Committee recognized that, in accordance with their specific declarations, the Italian authorities will not take any measures of a financial or commercial nature to restrict imports or subsidize exports. In this context, the Committee recognizes that, given the Italian balance of payments prospects, the proposed Community Loan operation is opportune.

ANNEX II

REPORT TO THE COUNCIL AND TO THE COMMISSION

1. In a communication entitled 'Economic and Monetary Policy Measures' the Commission presented certain propositions to the European Council on 1 and 2 April 1976. At the Council meeting (Economic and Financial Affairs) held in July 1976, the Netherlands President put forward certain suggestions for strengthening the economic and financial cohesion of the Community. It was these two events which led the Committee to examine three aspects of the present currency problems which are very closely interlinked and of great importance to the Community, namely, the Community exchange rate arrangements, the fixing of quantitative monetary policy objectives and control of the Euro-currency markets.

In accordance with the Council's request of 26 July 1976, the Committee now submits a summary of its findings.

Community exchange rate arrangements

2. A working paper presented by the Netherlands Members served as basis for discussion of this topic. Account was also taken of proposals made by the French delegation in 1975. The Committee noted that the two sets of proposals are motivated by the same considerations. Both:

- are based on the belief that the present situation is unsatisfactory;
- reflect a desire for a better cooperation between snake countries and those whose currencies float independently without recreating rigidities to the detriment of currencies which are currently outside the snake;
- are based on the recognition of the fact that exchange rate developments of all Community currencies should be subject to some kind of Community coordination.

3. The essence of the Netherlands Members' proposals is:

- (a) to provide a framework for discussion within the Community on exchange rate policies and related measures (in particular monetary policy, intervention and exchange controls) with the aim of coordinating the various policy aspects;
- (b) to avert the threat of a politically undesirable division between those Member States which take part in the European snake arrangement and those which do not. Snake members have clear obligations towards each other which make coordination of policy a necessity. Member countries which do not participate in the snake arrangement do not have the same obligations in respect of exchange rate policies as snake members;
- (c) to create certain flexible guidelines which could contribute to improving the coordination of economic policies. These guidelines might include:
 - (i) fixing of non-binding 'target zones' in terms of effective exchange rates either for the floating currencies alone or for all Community currencies. These target zones will initially serve only as a trigger for consultation on the Community level, when market rates move outside the target zone;
 - (ii) negative intervention and monetary policy obligations (no obligation to keep the exchange rate within the target zone, but the commitment to refrain from policy measures which would push the exchange rate out of that zone in a downward direction);
 - (iii) possibly, in a later stage, the obligation to direct monetary policy at preventing a depreciation below the target zone.

