EUROPEAN ECONOMIC COMMUNITY

FOURTH REPORT ON THE ACTIVITIES OF THE MONETARY COMMITTEE

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CONTENTS

INTRODUCTION

This Annual Report gives a general picture of the activities of the Monetary Committee of the European Economic Community in 1961.

The Monetary Committee was set up by Article 105 (2) of the Treaty establishing the European Economic Community in order to promote the co-ordination of the policies of Member States in monetary matters to the extent necessary for the functioning of the Common Market.

In 1961 the Committee held seven sessions under the chairmanship of Jonkheer E. van Lennep. The Deputy Chairmen of the Committee are M. P. Calvet and M. O. Emminger. The list of Committee members is attached as an annex to this Report.

Chapter I

GENERAL ACTIVITIES OF THE MONETARY COMMITTEE IN THE FIELD OF THE CO-ORDINATION OF MONETARY POLICIES

1. On 14 January 1962 the Council of the European Economic Community officially confirmed that the essence of the objectives laid down in the Treaty of Rome for the first stage of the transition period had in fact been achieved. The move from the first to the second stage which has thus become a matter of history, provides an occasion to review the lessons learnt in four years of co-ordinating the monetary policies of the Member States, the chief activity of the Monetary Committee.

2. The progressive elimination of the obstacles to trade between the Member States, provided for in the Treaty of Rome, and the gradual introduction of common policies in various branches of the economy, require the fulfilment of certain conditions in the monetary field. Freedom of transfer between the member countries should be ensured in all the sectors liberalized, and precautions taken to avoid any balance-of-payments crisis which might jeopardize this freedom. In the monetary and financial sphere harmonization must be such that the economies of the member countries can develop in a rational and balanced fashion. These conditions will not be fulfilled unless the monetary and financial policies of the Member States are closely co-ordinated. Though the Treaty of Rome maintains the sovereignty of the Member States in the monetary and fiscal fields, it expressly provides for co-ordination of monetary and financial policy. The Monetary Committee was instituted to be the instrument of this co-ordination and to assist the Council and the Commission in an advisory capacity.

3. The nature of the tasks entrusted to the Monetary Committee requires that its work should be confidential and carried out in a restricted circle. The Committee considered it desirable in principle to limit its deliberations to the members of the Committee themselves and their alternates. These officials hold important posts in the ministries responsible for monetary and financial questions or in the Central Banks of their respective countries, and are members of the Monetary Committee in their capacity as experts. The Committee meets at frequent intervals, usually once a month; at its meetings agreed views are worked out on how the problems at issue should be solved, and these views are submitted to the Council and the Commission as confidential documents.

It should be pointed out that the Monetary Committee is represented by its chairman at the regular meetings of the Ministers of Finance of the Community countries. The opinions of the Committee are thus heard at the level on which policy decisions are taken, while the studies entrusted to the Committee by the Ministers have in their turn helped to make these contacts closer.

The work done by the Monetary Committee has made it possible for those who shape monetary policy in the Member States to become more and more closely acquainted with the economic and financial structure in the other Community countries and to acquire greater understanding of the policy followed by their neighbours and, in particular, they will develop a feeling of collective responsibility with regard to the general aims pursued by the Community.

4. The work of the Monetary Committee during the past four years has been favoured by circumstances. Freedom of transfer between the Member States was already extensive before the Treaty of Rome came into force and it was widened at the end of 1958 when convertibility was introduced. Apart from the few initial difficulties which France had to face in the first year, no member country suffered from balance-of-payments crises during the first stage on a scale which could have endangered freedom of trade and freedom of transfer.

On the contrary, such problems as have arisen result from the overall surpluses registered by the member countries, with their repercussions in certain non-member countries. It is laid down in the Treaty that the Community shall remedy disequilibria in the balance-of-payments field, and this means in practice that, once allowance has been made for a satisfactory level of reserves, surpluses and deficits on the overall balance-of-payments should fluctuate around zero, any surplus being subsequently offset by a deficit, and vice versa.

Equilibrium as here defined must be compatible with a high level of employment, a satisfactory pace of economic growth and a relative stability of prices ; it must also be established with due regard to the desire of the Member States to furnish sufficient financial aid to the developing countries.

5. One of the general aims of the Treaty of Rome is freedom of movement for capital. To achieve this the Monetary Committee assists the Council and the Commission in the manner laid down in Title III, Chapter 4, of the Treaty.

The Member States have undertaken a triple commitment. They must in the first place endeavour to maintain the level of liberalization already reached. They must also agree on directives laying down minimum objectives for the progressive liberalization of capital movements. These directives are mandatory. Finally, in Article 71 of the Treaty the Member States have declared their readiness to go beyond the minimum level of liberalization of capital movements where their economic situation permits.

In the first stage of the transition period considerable progress was made in this field. The work done in this connection by the Monetary Committee during 1961 is analysed in greater detail in Chapter II, Section 3, of this Report.

6. The commitments undertaken in the matter of capital movements between the Member States make greater co-ordination of policies even more necessary. Failure to harmonize rates of interest, for instance, might easily lead to disturbances in the movements of capital between Member States.

In principle, economic integration presupposes stability in exchange parities between the currencies of the Member States. However, this is no reason, at least in the transition period, to forbid the adjustment of exchange parities entirely, particularly if the adjustment manifestly furthers other important Community objectives, as was the case, for instance, with the devaluation of the French franc at the end of 1958.

The revaluations of the German mark and the guilder decided on in March 1961 are due less to imbalances in relations with the other Member States than to imbalances in relations with non-member countries. Although the Monetary Committee had studied this problem several times in the past, the final decisions on these changes were not preceded by perfect co-ordination within the Community.

7. The Monetary Committee has examined the instruments of monetary policy at present available to the different member countries. The results of this examination are discussed in Chapter II, Section 2. On the whole the instruments of monetary policy differ less at present than when the Common Market was initiated Nevertheless, the range of available means varies considerably from State to State and the circumstances in which they are used differ. Despite these differences, however, the authorities of the various member countries are generally in a position to counteract any disturbances likely to occur in practice.

This does not mean that there is no reason to reinforce the instruments of monetary policy and, a fortiori, the weapons available to economic policy as a whole. The economic aims of the Community are numerous and the elimination of obstacles to the free movement of goods, services, capital and persons in fact deprives the competent authorities of one class of weapon. If therefore the aims of the Community are to be attained, certain Member States may find it advisable to make good these losses by evolving other methods of influencing the economy.

It would in any case seem important that means should be available to exert greater influence on the trend of production costs. Moreover it is essential not just to complete the arsenal of weapons, but to be sure that all those which exist already – and they are not all within the province of the Monetary Committee – are used in a co-ordinated manner.

If things move in this direction, the gradual attainment of the various aims which form part of the Common Market will mean that when the time comes to change over from co-ordination to centralization of decisions, the transition will appear to be nothing more than one more step forward. Quite apart from purely political factors, which are outside the competence of the Committee, technical grounds will prevent this transition being made before the economic and financial structure of the Member States has been made much more homogeneous. Just as the move to convertibility appeared possible only when the situation was ripe on the internal plane in the different countries, so too their economic and financial structure will have to undergo many changes before it will in practice be possible to adopt a more centralized policy.

8. It should never be forgotten that the satisfactory economic development registered during the first stage of the transition period is in part attributable to exceptionally favourable circumstances. It would be foolhardy to assume that these favourable factors will continue to exist and to imagine that there is no reason to fear a recrudescence of balance-of-payments difficulties in the countries of the Community.

In order to prevent any such difficulties leading to a reversal of the movement towards liberalization, the Treaty provides various possibilities for mutual aid. These include the granting of limited credits by other Member States, subject to agreement of the latter. The aim of this mutual help, which must be approved by the Council on a recommendation from the Commission and after consultation of the Monetary Committee, is to assist in overcoming temporary balance-of-payments difficulties. The Council's approval must be coupled with recommendations on measures calculated to remedy the difficulties encountered by the State seeking assistance.

The Monetary Committee has not felt it necessary to define in detail the criteria to be applied in the event of an application for mutual aid taking the form of a request for a loan, for the problem has never arisen and an a priori regulation did not appear in any way called for. Moreover, the Committee considers the regular and detailed examinations of the economic and financial situation in the Member States, made by the most highly qualified representatives from these States, enable it to make an immediate study of any application for mutual help. Maintenance of these disciplines and continuance of these studies are indispensable if the Committee is not to be caught unprepared by an urgent case.

9. In addition to mutual aid, the possibility of recourse to IMF is always open in case of a balance-of-payments deficit. The close co-ordination of the monetary and economic policies of the Member States, the common interest of the Community countries in financing any payments deficit of one among them and the conditions in which such financing would take place are so many factors which require that recourse by a Member State to the IMF facilities should be preceded by consultation within the Community. Any other attitude would indeed be illogical in view of the many and thorough studies made by the Monetary Committee of the monetary and economic trend and of the policies applied. Article 108 of the Treaty of Rome in fact expressly refers to this concerted action in dealings with other international organizations to which the Member States may have recourse.

10. The increasingly close co-ordination of monetary policy within the Community makes a common position on international monetary problems more and more desirable. Liberalization of payments within the Community finds its natural extension in the liberalization of multilateral payments between the Community and non-member countries. The achievement of the aims of the Treaty therefore demands that the Member States should be constantly on the watch to maintain and strenghten the present system of convertibility.

This being so, the Community countries must also consult each other on questions arising from their responsibilities in monetary matters towards the outside world. In view of the scale of the surpluses registered by the Member States in recent years, the main requirement which at present stems from these responsibilities is for a reasonable policy in granting credits. The large amounts placed at the disposal of the deficit countries by the Member States of the Community show that this responsibility is fully appreciated. Of a total of $2 500 million outstanding drawing on IMF at the end of 1961, the counterpart of $1 050 million was supplied by the Community countries and $650 million by the United States. About $700 million had been made available from the gold reserves of the Fund. Of these drawings, then, 40% were financed by the Community countries, whose initial quotas scarcely represented 10% of all IMF quotas. To these credits must be added very important commitments under the Paris Agreement of 13 December 1961 (see Point 20).

11. In these circumstances Member States should reach agreement on a common analysis of the economic and financial situation, of the balance-of-payments position and of the policy followed by the countries with a deficit. A common attitude on the need to strengthen the international payments system even further and on the role which the Community might play in this respect should also be adopted.

The work done by the Monetary Committee has clearly facilitated the task of the six member countries in their search for a solution to this problem. There is indeed cause for congratulation in the almost complete identity of views achieved among the Community countries at the 1961 negotiations on ways of increasing the resources of the IMF.

CHAPTER II

SPECIAL ACTIVITIES OF THE MONETARY COMMITTEE IN 1961

12. As already mentioned in Chapter I, the main activity of the Committee during 1961 again consisted in regular examinations of the monetary and financial situation in the various Member States. Details of this work are to be found in Section I of Chapter III, together with the recommendations put forward by the Committee. The present Chapter covers the more important of the Committee's other activities.

Section I

INTERNATIONAL LIQUIDITY AND THE WORLD SYSTEM OF PAYMENTS

13. The problems of the balance of payments, especially those caused by short-term capital movements between various countries led to international discussions on the world monetary systems and to proposals which would mean more or less profound changes if not complete reorganization of the system. As already mentioned in the previous Report the Monetary Committee, in compliance with the wishes expressed by the Community's Ministers of Finance, appointed a group of experts headed by Dr. Emminger, Vice-Chairman of the Committee and a member of the Directorate of the Deutsche Bundesbank, to study the problem of international liquidity. In the middle of 1961 this working party submitted a " Report on current problems of international liquidity ", the findings of which were endorsed by the Committee.

14. The group of experts examined the situation and the immediate outlook and also analysed in detail certain proposals for improvements in the international monetary system. The conclusions reached are summed up below.

15. It seemed clear that there was no reason to fear that, in the immediate or near future, a general shortage of international liquidity would lead to the emergence of deflationary trends on a world scale. On the contrary, it appeared that the persistent trends towards creeping inflation which were still a major source of concern almost everywhere meant that any artificial expansion of international liquidity would merely aggravate the inflationary trends.

This general conclusion is not invalidated by the existence of strains caused by imbalances which produced heavy surpluses in certain west European countries, while other countries, among them the United States and Great Britain, registered large deficits: these imbalances had to be redressed, whatever the international monetary system in force, or whatever the method used for building up reserves. What was needed to improve the balance-of-payments situation was not a deflationary policy in countries that had shown a deficit, but an effort to avoid inflation (especially cost inflation), for everywhere else in the world, and particularly in countries with a surplus, expansionary forces were still well to the fore.

16. A weakness of the present system was no doubt that in the long run the foreseeable supply of monetary gold might not suffice to meet fully the international requirements of monetary reserves, and that there are limits to the increase in international holdings of foreign exchange reserves: it would demand a substantial increase in the net indebtedness of the key currency countries – the

United States and Great Britain – and this would itself be conditional on the readiness of other countries to hold these reserve currencies; it would also lead to some instability in the system known as the gold exchange standard. However, no pressing problems should arise in the course of the next few years, for this weakness in the present system was appreciably offset by the extensive credit facilities available on the international plane. It was none the less true that the key currencies were still vulnerable to movements of short-term capital, especially if the situation in the countries concerned did not inspire full confidence.

17. After studying the various proposals for improvements in the present monetary system, especially the supply of readily available money, the experts concluded that it was neither advisable nor expedient to raise the price of gold; they thought it possible to solve the current rather acute problems without resorting to a measure in which the drawbacks would greatly outweigh any possible advantages. The general introduction of fluctuating exchange rates was also considered inappropriate, because of the dislocation it would cause to trade and capital movements. Again, proposals for reorganizing the IMF into a sort of international central bank did not seem practicable at the present time.

18. There was, however, no doubt that the working of the present monetary system could be improved. According to the findings of the Report the leading industrial countries should, both by their own efforts and through effective international co-operation, endeavour to:

- Improve the equilibrium of the balance of payments without delay;
- Take action to remedy the difficulties caused by sudden and disorderly movements of short-term capital, as these threaten to disrupt the existing international monetary system.

19. In this connection closer collaboration between the central banks, both in order to forestall capital movements due to differences in interest rates and to offset speculative currency movements, led at the time of the Sterling crisis in spring 1961 to a series of arrangements known as the Basle Agreements. By their very nature however, these credit arrangements constitute no more than limited short-term assistance; they could be no more than a " first line of defence ", to be backed up by supplementary remedies.

20. The experts, who felt that a more thorough study and closer co-ordination were necessary, welcomed the suggestion that there should be a " second line of defence " resting on a system of special credits – within the framework of international institutions – as this would strenghten the present monetary system by making it less sensitive to sudden crises of confidence. The agreement reached on 13 December 1961 by the Ministers of Finance of ten industrialized countries, members of the International Monetary Fund, is an attempt to solve this problem. Its aim is to facilitate the task of the Fund, under conditions of freer convertibility, by enabling it to procure additional resources with which to forestall or counteract movements that might endanger the international monetary system.

The common market countries' share of $2 450 million in the standby credit of $6 000 million constitutes more than 80% of the credits in currencies other than key currencies. By its very existence this agreement makes a substantial contribution towards averting grave disturbances in the monetary system of the Western world.

Section II

THE INSTRUMENTS OF MONETARY AND FINANCIAL POLICY

21. The work of the Monetary Committee in this field covered two questions : the instruments of monetary policy within Member States, and monetary and financial policy in the event of a recession. An account is given below of the study of these two questions.

A. The instruments of monetary policy

22. From the outset the Committee's regular studies of the monetary and financial situation in the Member States have shown how necessary it is to have a careful analysis made of the means of action available to the Central Banks and the other monetary authorities : bank rate policy, compulsory special deposits, open market operations and also the possibility of using public financial operations to finance the liquidity of the banks and the economy. The significance of these weapons in the Member States was not always very clear, and in any case the circumstances in which they were used were not sufficiently known.

23. The Committee therefore suggested that the services of the Commission should make the necessary studies in collaboration with the monetary authorities of the Member States. These individual studies for each country and a synoptic review comparing the situation in all countries of the Community have been used as a basis of discussion in the Monetary Committee itself, which intends to have the studies expanded and brought up to date with developments as they occur.

The extensive knowledge gained in this way will make it easier to align the instruments and methods of monetary policy in the various countries. As a result of the discussions in the Committee its members can improve their own monetary policies in the light of the experience gained by the other countries in using the various instruments of monetary policy. The adoption in Belgium at the beginning of 1962 of measures for the creation of a system of compulsory deposits and the previous institution in France of a special system of minimum reserves may in this connection be looked upon as steps inspired by the Committee's work.

24. It has been decided that these studies on the instruments of monetary policy in the individual states of the Community shall be published together with the synoptic review.

B. Monetary and financial policies in the event of a recession

25. As stated in the third report on the activities of the Monetary Committee, it had been agreed with the Economic Policy Committee of the EEC that the Monetary Committee should consider the monetary and financial measures that should be taken in the event of a recession. Though the present economic situation and the outlook for the near future rob this matter of any immediate interest, the possibility of importing a recession or of a deterioration in the situation within the Community should not be ruled out. The Economic Policy Committee therefore sent out a questionnaire on the means that can at present be used to deal with such a situation and on the criteria applied by Member States in deciding that action is needed.

26. In this connection the Monetary Committee also drew up a questionnaire on any monetary and financial policies that were being planned. The members of the Committee replied to this questionnaire for each of the Common Market countries and a synoptic review of their replies was prepared. Early in 1962 these documents, together with an accompanying memorandum, were submitted to the Economic Policy Committee and to the Commission of the European Economic Community.

27. For its part the Economic Policy Committee will add this material to its own studies. It will use the collated information in pursuing its own work and in any papers it may submit, with appropriate proposals, to the Community institutions concerned.

Section III

LIBERALIZATION OF CAPITAL MOVEMENTS

28. The first Directive pursuant to Article 67 of the Treaty, adopted on 11 May 1960 by the Council of the European Economic Community, requires the Monetary Committee to examine at least once a year the restrictions still applied to movements of capital and to suggest which of these restrictions could be lifted. The Committee carried out the first of these examinations in 1961. It found that the Member States – where they had not actually gone beyond the degree of liberalization laid down in the Directive – had taken the necessary steps to fulfil the obligations arising therefrom. In some cases the Member States had at the same time removed restrictions on certain types of capital movement in respect of which the Directive did not require immediate action.

Moreover, the Committee noted with satisfaction that – with the exception of a few cases of little significance or of pure form – the Member States had also extended to non-member states the measures they had taken. The Committee attaches particular importance to this wider liberalization of capital movements and welcomes every effort to further the process, including the measures taken in this connection in other international organizations, notably in OECD.

29. In making this first examination the Committee bore in mind the fact that the first Directive pursuant to Article 67 had not long been in force and it refrained from proposing more extensive measures of liberalization; none the less it reviewed certain problems which it considered to be of prime importance and submitted to the Commission its views on the points in question.

30. The first of these concerns transfers of capital on the free market. Here the rates can fluctuate more widely than on the controlled markets where, under IMF rules, fluctuations are kept within certain limits. The question came up for study because from January to May 1961 the rates on the free market of the Belgo-Luxembourg Economic Union had differed from the rates on the controlled market by 2.2 to 3.6%. These differences subsequently disappeared and today there is no problem. Nevertheless, the Monetary Committee wishes to stress the importance it attaches to the maintenance of the greatest possible stability in exchange rates, particularly with regard to direct investment and the other capital operations covered by Article 1 of the Directive.

31. The Committee also tackled the problem of the authorization procedures which some Member States are still applying to certain movements of capital.

Even where these have been liberalized under the Directive, these procedures have now been simplified in order to eliminate any risk of delay in executing the relevant transactions.

32. Finally the Committee considered the question of the floating of loans on the capital markets of the several States. In this connection the first Directive authorizes the maintenance of restrictions where liberalization in this field might hamper a Member State in the attainment of its economic objectives. The right to maintain restrictions has been exercised in France, the Netherlands and Italy. Nevertheless some progress was made in this field last year. The Netherlands, for instance, allowed non-residents to raise a considerable amount in loans on the Dutch capital market; Italy too, which for a long while had not allowed foreigners to draw on its capital market, agreed that international organizations at least should be able to raise loans.

33. If the obstacles still hampering the issue of foreign securities on the capital markets of Community countries are to be removed – this move finding a natural corollary in the freer admission of foreign stocks and shares to the stock exchanges – it will be necessary, owing to the differing fiscal system, to eliminate the factors distorting transactions between member countries. The Committee therefore tackled some of these questions and discussed among other points the problem of taxes on transfers of capital; it felt that everything should be done to allow capital to circulate as freely as possible, and that in particular any obstacles presented by taxes on capital transfers should be eliminated These questions, to the solution of which the Committee attaches great importance for reasons of monetary policy and in order to liberalize the capital market, are at present being dealt with in committees of experts from Community countries.

Chapter III

THE INTERNAL AND EXTERNAL POSITION OF THE MEMBER STATES IN 1961

GENERAL

34. In 1961 economic expansion continued. Although on the whole the progress registered was somewhat less than in 1960, it was nevertheless very satisfactory. The real gross national product in the Community, according to initial estimates, increased by almost 5.5%, compared with nearly 7% in 1960. The chief reason for this lower rate of advance is the exhaustion of man-power reserves, particularly in West Germany, France and the Netherlands. In other countries, where manpower reserves had still been considerable, there was an appreciable fall in unemployment. The lower rate of expansion is therefore attributable to insufficient capacity rather than to any weakening of demand.

35. In fact, internal demand remained on the whole very firm. The propensity to invest was strengthened by the increasing need for rationalization, and consumer demand continued to rise rapidly in step with the appreciable advance of household incomes. The rise in these incomes was mainly due to pay increases, which in most member countries rose faster than productivity.

36. This trend has made it rather more difficult to keep prices stable. On the whole, however, rises were not very marked, since keener competition led some sectors to narrow their profit margins rather than to pass higher costs on to the consumer.

37. Exports progressed more slowly in 1961 than in 1960, and the rise in imports from non-member countries was appreciably smaller than in 1960, largely because of the cautious stock-building policy of enterprises. The most recent estimates show that, as in 1960, the Community's trade balance was practically in equilibrium, while the surplus on services was slightly down. The fact that the gold and foreign exchange reserves of the monetary institutions went up by only about $ 1 200 million in 1961, compared with $ 3 300 million in 1960 is explained by transactions with the IMF and other private and public transfers of capital. A policy of moderate interest rates discouraged the inflow of short-term money whilst the outflow of capital was considerable.

38. The surplus on external transactions made for greater liquidity in the money markets, and the banks had no difficulty in meeting the increased demand for credit resulting from the continued high level of business activity. As firms had a smaller margin available for self-financing yet showed a marked propensity to invest, greater calls were made on the financial market.

Section II

THE POSITION IN THE INDIVIDUAL COUNTRIES AND THE MAIN FINDINGS OF THE MONETARY COMMITTEE

FEDERAL REPUBLIC OF GERMANY

39. In its last Report the Committee discussed the economic policy dilemma which faced the Federal Republic of Germany in 1960, when the balance of payments was showing considerable surpluses, despite the high level of internal demand and the great strain on the apparatus of production. Various measures taken since the autumn of 1960 by the Federal Government and the monetary policy applied concurrently by the Bundesbank are clear illustrations of the efforts of the responsible authorities to resolve the difficulties arising from this situation. The 5% revaluation of the mark on 6 March 1961 contributed to an improvement in the internal and external balance which was particularly noticeable in the second half of 1961.

40. In 1961 the real gross national product went up 5.3%, as against 8.3% in 1960. This slackening of the growth rate is mainly attributable to the manpower shortages which hampered the expansion of production in numerous sectors. Although demand by households and public authorities again moved ahead with little loss of momentum, demand from abroad and the demand for equipment goods tended to ease from the spring of 1961 onward.

41. The general trend of prices was slightly upwards throughout the year. Prices increased chiefly in the sectors least exposed to foreign competition, in particular building and construction and in certain services. Pay rises of about 10% were distinctly higher than the gain in productivity. The resulting rise in production costs led to a reduction in profits in many branches of industry and to certain price increases, which would have been larger if the mark had not been revalued.

42. The highest surpluses both on the trade balance and on current account were reached during the early months of 1961. In the second half of the year the surpluses on trade fell slowly and there was a deficit on invisible transactions. This reduced the surplus on current account to $760 million. As a result of considerable advance repayments of external debts ($800 million), the balance

of payments showed a deficit of about $ 150 million. In addition, owing to a substantial increase in contributions to the International Monetary Fund ($ 330 million), the Bundesbank's total net reserves fell by nearly $ 480 million in 1961, whereas they had gone up sharply in 1960.

43. By lowering interest rates and lifting certain credit restrictions, the monetary authorities have avoided the shrinkage of liquid funds thad would otherwise have been caused by the higher holdings of public money in the Bundesbank and the outflow of foreign exchange, which began about the middle of the year. It was thus possible on the whole to meet the cash requirements of the economy.

44. In the field of public finance the distribution of tax revenue between the Federal Government, the Länder and the local authorities gives rise to certain problems of monetary and economic policy. Certain adjustments in this field would make it possible for financial policy to be more closely adapted to the needs of the economic situation.

45. As the Committee has pointed out, a continuation of the present trend in the balance of payments would not constitute a threat to the Federal Republic. Even if it meant a temporary reduction in reserves, this would be welcome from the point of view of international liquidity. How official exchange reserves subsequently shape will depend above all on the structure of the balance of capital transactions. It should be possible to increase German exports of private capital, in particular by means of foreign issues on the financial market of the Federal Republic. Such issues would be facilitated by a reduction of long-term interest rates. The Monetary Committee also recommends that in future aid to developing countries should not be tied, legally or in practice, to purchases of German goods.

FRANCE

46. In its last Report the Committee noted that the improvement in the economic and financial situation of France had continued in 1960.

47. Developments were again favourable in 1961, and France has now for three years experienced regular expansion in a climate of relative stability. According to preliminary estimates, the gross national product went up about 5% by volume, as against a little over 6% in 1960, so that taking the two years together the aims of the Interim Plan have been slightly exceeded. The maintenance of a high rate of expansion is the result of an increase of internal demand and of exports, with the exception of those exports which go to the franc area. Stimulated by the need to cope with the shortage of skilled manpower and with foreign competition, firms have stepped up their fixed investments more rapidly. Consumption has been encouraged by an appreciable rise in household incomes linked with the increase in wages, in agricultural earnings and in transfer incomes.

48. During the closing months of the year the upward trend of prices became more marked. It was attriburable in part to the slow but fairly constant rise in the price of manufactures as a result of wages increasing more rapidly than average productivity and of the inevitable rise in the prices of services,particularly rents; more important however were the increases in agricultural prices; in certain cases these exceeded the usual seasonal rise and were the consequence of less plentiful harvests, but more often they resulted from decisions by which the public authorities sought to give farmers a larger share in the national income. By liberalizing trade, by reducing customs duties before the appointed date and by adopting certain taxation measures, the French Government showed its determination to prevent any excessive rise in the cost of living.

49. Exports to foreign countries continued to develop favourably. A more hesitant trend in imports, which reflected a decline in purchases of non-franc petroleum and agricultural products, coupled with a more cautious stock-holding policy, led to a distinct improvement in the balance of trade, particularly in the latter half of the year. Despite large advance repayments of foreign debts ($ 320 million), the balance of payments closed with a surplus of more than $ 1 000 million. France was thus able to increase its official foreign exchange reserves by $ 870 million while contributing larger amounts to the International Monetary Fund ($ 235 million).

50. As in 1960, surpluses on the balance of payments helped to maintain abundant liquidity on the money and capital markets. Because of the rapid rise (18%) in the amount of cash credits granted by the banks and other financial institutions, the Banque de France sent a warning to the banks on 23 November 1961 and, with effect from 28 February 1962, imposed a figure of 32% as against 30% under the special system of minimum reserves (coefficient de trésorerie) introduced a year earlier.

51. Some caution is indeed called for in monetary and financial policy. The situation at home and abroad continues on the whole to be satisfactory but, as the Monetary Committee has pointed out, care must be taken to avoid the tendency for prices to rise being reinforced, thanks to excess liquidity, by a sudden surge of demand; this could jeopardize stability at home and, in the longer term, affect the balance of payments. But the surpluses are for the present sufficiently large for it to be possible and desirable for the French authorities to pursue their policy of repaying foreign debts in advance.

ITALY

52. In its last Report the Committee concluded that economic expansion in Italy would continue without any cause for uneasiness either on the domestic or the foreign plane.

53. The economic situation continued to be very favourable in Italy and in the last months of 1961 it even improved. According to the preliminary estimates, the gross national product went up more than 7% by volume, roughly as much as in 1960. This favourable trend reflected an expansion of demand both at home and from abroad. Investment by enterprises grew rapidly and consumer demand showed a sharp rise thanks to an advance of household incomes attributable in particular to higher employment and a rise in real wages. In some branches of industry, wages rose faster than productivity, but on the whole prices remained stable.

54. Demand from abroad also grew rapidly. Exports in the second half-year rose more than imports and the resulting improvement in the trade balance, in conjunction with a rise in receipts from services, led to an appreciably higher surplus (about $ 365 million) on current account. In spite of certain advance repayments of external debts, the balance of payments closed with a surplus of nearly $ 580 million. Italy was thus able to increase its official foreign exchange reserves by about $ 340 million while making a large contribution ($ 175 million) to the International Monetary Fund.

55. The surpluses on the balance of payments helped in no small measure to increase internal liquidity. Nevertheless, a shortage of ready funds obliged firms to make heavier calls on the money and capital markets. This resulted in some tightness, which however was only temporary, since the policy of the authorities was to maintain adequate liquidity.

56. The Committee therefore can do no more than reiterate the conclusions of its earlier reports. Approximate equilibrium in the balance of payments should be achieved and temporary deficits might even be accepted in view of the favourable situation of Italy's exchange reserves. If various factors are now working towards a reduction of the balance-of-payment surpluses, the policy of the Italian authorities can facilitate the play of these correctives. It is essential that in the field of public finance programmes for the expenditure of public money should be executed by the dates laid down.

In addition, the policy of reducing Italy's foreign indebtedness by advance repayments should be continued and greater efforts should be made to liberalize capital movements by abolishing the remaining administrative obstacles and by taking further steps on the road towards liberalization.

NETHERLANDS

57. In its last Report the Committee described the dilemma presented to the Netherlands' authorities by the conflicting requirements of domestic and of external equilibrium.

58. The boom conditions which were a feature of 1960, and which had produced obvious signs of strain, continued in 1961. According to initial estimates the gross national product in real terms increased by about 2.5%; the rise in 1960 had been nearly 7%. This definite deterioration was mainly due to growing manpower shortages, aggravated by a fairly rapid reduction of working hours in the spring and summer of 1961. These developments led to a temporary fall in production and in general some increase of wage costs per unit of output. Thus reduction of supply rather than weakening of demand was responsible for the slackening of activity which occurred during the year.

59. Domestic demand in fact remained lively. On the one hand investment, particularly for rationalization, advanced very rapidly; on the other, demand by households was brisk, despite a slight fall-off in the middle of the year. The rising trend of home prices became stronger.

60. Exports continued their advance in 1961 although at a reduced pace. The more rapid increase of imports, encouraged by the 5% revaluation of the guilder on 6 March, adversely affected the trade balance. The surplus on current transactions was about \$ 140 million. Largely as a result of advance repayments of foreign debts (\$ 50 million), the balance of payments showed a slight deficit (\$ 90 million). Owing inter alia to increased contributions to the International Monetary Fund (\$ 120 million), the official foreign exchange reserves fell by about \$ 55 million.

61. Some temporary tightness was felt on the money market, but the Central Bank reduced the cash reserve ratios and also increased the liquidity of the banks through its open-market operations. By the end of the year the symptoms of tightness had disappeared.

62. The economic and financial situation does not seem to call for any special comment at present. According to forecasts, the surplus on current transactions in 1962 may be lower than in 1961, and may not even be enough to finance normal exports of capital. However, as the Monetary Committee pointed out, the question arises whether wages may not exceed the limits contemplated and become a threat to domestic stability and external balance.

BELGIUM

63. The Committee has in the past emphasized the need for Belgium to carry out structural reforms in certain important sectors of its economy and to put its public finances in order; an expansion of economic activity based in the main on exports and investments could contribute to the achievement of these reforms.

64. The economic trend in 1961 has largely responded to these requirements. According to initial estimates the growth of the gross national product in real terms was slightly over 3%; it was thus roughly the same as in 1960.

65. Internal demand was buoyant. Productive investment by enterprises advanced strongly. To some extent this reflects the implementation of programmes benefiting from advantages under the laws passed in July 1959 to stimulate the economy. Activity was also very high in the construction sector, but consumer demand increased only moderately, largely because of the relatively small rise in household incomes.

66. Since productivity on the whole went up more than wages, enterprises enjoyed more latitude for self-financing and some prices fell, thus improving the competitive position of Belgian products on foreign markets.

67. This trend favoured exports, which were also encouraged by boom conditions in the other member countries. Imports, particularly of equipment goods, also rose appreciably. It may be expected that the balance of current payments will show a surplus of about $ 110 million. The overall balance of payments showed a small surplus of some $ 15 million. An additional $ 70 million was transferred to the International Monetary Fund. The net increase in the gold and foreign exchange reserves of the Banque nationale de Belgique amounted to $ 170 million.

68. Fairly easy conditions prevailed on the money and capital markets. Bank rate was reduced in three steps from 5% to 4.25%. Finally, a reform of the money market was put through at the beginning of 1962.

69. The increase in budget receipts resulting from favourable economic conditions and from certain fiscal measures made it possible to reduce the cash deficit. The short-term foreign indebtedness grew until May but increased no further after that date and has now been partly funded.

70. The Committee points out that the favourable international business situation will, if it continues, doubtless help to sustain activity in Belgium and so facilitate structural improvement and the strengthening of the country's finances. It also notes that an increase in overall savings is still required if the Belgian economy is to reach and sustain the level of expansion and investment envisaged. However, as an increase in the present high level of private savings is hardly to be expected, the overall increase must come mainly from the public sector. The Belgian authorities have succeeded in balancing the ordinary budget and this has made some progress possible in the direction of sounder finance. But to create genuine public savings there must be a broader concept of public finances, allowing part of the investment programme to be financed out of ordinary revenue.

LUXEMBOURG

71. The economic situation in Luxembourg continued to develop favourably in 1961, although in the last quarter of the year there was a certain slow-down due mainly to a weakening of the iron and steel market. This was reflected in a slight fall in production and a fall in selling prices. On the whole, however, the

situation remains favourable. Tax revenue has substantially increased under the influence of boom conditions. The Government's financial position is still very strong, and it has been possible to build up reserves for an anticyclical financial policy in the event of a recession.

Section III

OUTLOOK

72. By studying present economic trends it is possible to forecast the main lines of development in the first half of 1962.

73. First, it seems that demand is likely to remain buoyant. On the one hand, external trade should continue to show slight surpluses, at least during the coming months, for it may be expected that the recovery in the United States and some other industrial countries will continue and lead to further increases in their purchases from the Community.

74. Internal demand, too, will remain at a high level, although the rate of increase in investment by enterprises may fall off owing to the narrower margins for self-financing or the less urgent need to increase production capacity in some branches. To judge by the number of building permits issued, activity in the construction sector, on the other hand, should increase.

Private consumption should also rise appreciably. Wage increases granted in 1961 or early 1962 will push up mass incomes, even if the growth of the working population is smaller than hitherto.

To judge by the budgets presented in the member countries, a sizable increase can be predicted in public expenditure on investment and consumer goods.

75. The wide-spread labour shortages will probably continue in the first half of 1962. Higher costs may mean a rise in prices. This can only be kept within bounds if the increase in incomes does not greatly exceed the gain in productivity and if an expansion of imports makes up for the inelasticity of internal supply.

76. Nevertheless, the Community's current transactions with the rest of the world will probably show a considerable surplus. It is therefore still necessary, as already emphasized by the Committee in its previous Report, that the Member States pursue a liberal policy in the fields of trade and of capital movements.

ANNEX I

MEMBERS AND ALTERNATES OF THE MONETARY COMMITTEE

Chairman:

Jonkheer mr. E. van LENNEP	Thesaurier-generaal (The Hague)

Vice-Chairman:

M. P. CALVET	Premier sous-gouverneur of the Banque de France (Paris)
Dr. O. EMMINGER	Mitglied des Direktoriums der Deutschen Bundesbank (Frankfurt/Main)

Members:

Dr. P. BAFFI	Direttore generale of the Banca d'Italia (Rome)
M. P. BASTIAN	Commissaire du gouvernement (Luxembourg)
Dr. F. BOBBA	Director-General for Economic, and Financial Affairs in the EEC Commission (Brussels)
M. A. de LATTRE *(from 1.1. 1962)*	Directeur des finances extérieures (Paris)
M. F. DE VOGHEL	Vice-gouverneur of the Banque nationale de Belgique (Brussels)
Prof. Avv. A. GAMBINO	(Rome)
Dr. L. GLESKE	Director in the Directorate General for Economic and Financial Affairs in the EEC Commission (Brussels)
Dr. R. GOCHT	Ministerialdirigent, Bundesministerium für Wirtschaft (Bonn)
M. J. HEINEN	Conseiller de direction with the Caisse d'épargne de l'Etat (Luxembourg)
Prof. S. POSTHUMA	Directeur of the Nederlandsche Bank N.V. (Amsterdam)
M. J. SADRIN *(till 31.12.1961)*	Directeur des finances extérieures (Paris)

M. M. WILLIOT	Directeur général de la Trésorerie in the ministère des finances (Brussels)

Chairman of the alternates:

M. A.W.R. Baron MACKAY	Onderdirecteur of the Nederlandsche Bank N.V. (Amsterdam)

Alternates:

M. F. ASPESLAGH *(till March 1962)*	Sous-directeur of the Banque nationale de Belgique (Brussels)
Dr. BONUS *(from June 1961)*	Ministerialrat, Bundesministerium der Finanzen (Bonn)
Dr. M. CARDINALI	Ministero commercio estero (Rome)
M. P. ESTEVA	Sous-directeur in the ministère des finances (Paris)
M. H. FOURNIER	Directeur général des études et du crédit of the Banque de France (Paris)
M. W. GERBER *(till June 1961)*	Regierungsdirektor, Bundesministerium der Finanzen (Bonn)
Drs. J. GROOTERS	Financial Attaché in the Netherlands Mission to EEC and Euratom (Brussels)
M. R. LOMBA	Chef du service des relations financières avec l'étranger in the ministère des finances (Brussels)
M. J. MERTENS de WILMARS *(from March 1962)*	Sous-directeur of the Banque nationale de Belgique (Brussels)
Dr. G. SCHLEIMINGER	Bankdirektor, Abteilungsleiter in der Deutschen Bundesbank (Frankfurt/Main)
M. M. SCHMIT	Chef du service du budget (Luxembourg)
Dr. H. STEFFE	Director in the Directorate General for Economic and Financial Affairs in the EEC Commission (Brussels)
Dr. A. VERNUCCI	Condirettore dell'Ufficio italiano dei cambi (Rome)
M. R. WEBER	Membre du Comité de direction of the Caisse d'épargne de l'Etat (Luxembourg)

Secretariat:

M. A. PRATE *(till 31.12. 1961)*
M. R. de KERGORLAY *(from 1.1. 1962)*
Dr. H. BURGARD

ANNEX II

OFFICIAL FOREIGN EXCHANGE RESERVES OF THE MEMBER STATES *

(million dollars)

	Reserves on			Rise or fall		Reserves on 31-12-61 as % of imports 1961	Reserves on 31-12-61 as % of GNP 1960
	31-12-59	31-12-60	31-12-61	1960	1961		
Germany (F.R.)	4 533	6 737	6 542	+ 2 204	– 195	60	9
France	1 723	2 070	2 939	+ 347	+ 869	44	5
Italy	2 953	3 080	3 420	+ 127	+ 340	65	10
B.L.E.U.	1 315	1 474	1 644	+ 159	+ 170	40	13
Netherlands	1 339	1 742	1 715	+ 403	– 27	34	15
Total EEC	11 863	15 103	16 260	+ 3 240	+ 1 157		

Sources : Deutsche Bundesbank
Ministère français des finances et des affaires économiques
Ufficio italiano dei cambi
Banque nationale de Belgique
Nederlandsche Bank
Imports : Statistical Office of the European Communities
GNP : International Financial Statistics (IMF)

* Gross gold and convertible foreign exchange reserves

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