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# Information and Notices

Contents

I *Information*

**Council and Commission**

I

*(Information)*

# COUNCIL AND COMMISSION

## FOURTEENTH REPORT ON THE ACTIVITIES OF THE MONETARY COMMITTEE

Brussels, 12 April 1973

### INTRODUCTION

The purpose of this report is to give a brief account of the activities of the Monetary Committee during the period from 1 January 1972 to the end of 1972.

During this year, the Committee held 15 sessions and the working parties drawn from its own members or set up at its initiative met on many occasions.

In view of the Council's decision of 13 October 1972 harmonizing the dates of renewal of the terms of office of the officers and ordinary members of the various committees as from 1 January 1974 onwards, the Monetary Committee extended the terms of office of its present officers until 31 December 1973. A list of members as at 31 December 1972 is annexed.

Delegates from the countries joining the Community on 1 January 1973 (United Kingdom, Ireland, Denmark) were involved in the work of the Monetary Committee throughout the period under review, particularly in discussions of international monetary problems. These countries also joined the mutual information arrangements operating within the Committee.

The report was adopted as at 31 December 1972.

1. Disturbances in monetary relations in 1971 delayed the implementation of the monetary measures provided for in the Council's resolution of 22 March 1971 on the establishment by stages of an economic and monetary union. The new pattern of exchange rates agreed in December 1971 in Washington (the 'Smithsonian' agreement) opened the way to renewed action in this field. A resolution adopted by the Council on 21 March 1972 gave new force to some of the measures contemplated, and one of the results of this was that a start could be made on the work of giving the Community its own monetary personality. The first chapter of this report summarizes the sequence of events.

However, further waves of speculation again created difficulties in 1972. At the end of the year, the situation on the exchange markets was still unstable, since the payments balances of a number of the main industrialized countries had failed to revert promptly to a more satisfactory state of equilibrium; it was thus still not certain that the new pattern of exchange rates was the right one. Nor was any overall solution in sight to the difficulties caused by the steady increase in international liquidity, the non-convertibility of the main intervention currency (which had accumulated in large quantities in the countries' reserves), or to the erratic movements of funds, which tended to continue despite the severe but uneven restrictions imposed on capital movements by many countries.

But the dominating factor in economic life in the Community was almost certainly the strengthening of inflationary pressure in all the member countries. The scale of this problem is shown in the brief account of economic developments given in the second chapter of this report. The persistence of inflation is making the achievement of the economic and social objectives of the Community member countries increasingly difficult, and inflation control has therefore become a major policy goal at both national and Community level.

A third chapter is devoted to the Committee's work on the establishment of an economic and monetary union and on the reform of the international monetary system.

## CHAPTER I

## ECONOMIC AND MONETARY UNION

2. In 1971, the international monetary crisis had hampered progress in the first stage towards the economic and monetary union. In particular, it had prevented the Member States' central banks from complying with the Council's request that they should maintain exchange rate fluctuations between Community currencies within narrower limits than those imposed by the margins in force for relations with the US dollar ('the Snake in the Tunnel'). The leading industrialized countries met in Washington in December 1971 and agreed to widen to 2¹/₄ % the fluctuation margins of the currencies around their parities or central rates. The Committee therefore drew attention, in its last report, to the serious disadvantages this measure, when applied to the Community currencies, would entail for the smooth working of the Common Market. The Committee felt that the decision 'not only made possible but also necessitated the revival of efforts to give the Community its own monetary personality while ensuring effective coordination of the short-term economic policies'.

The Commission's work from January onwards enabled the Council to adopt, on 21 March 1972 (1), a resolution amplifying certain aspects of the resolution of 22 March 1971 (2). This was the first step towards the formation of a separate and individual monetary area. The prospective member countries endorsed this Community measure, the monetary aspects of which are summarized below.

3. The Council and the representatives of the Member States' Governments decided to introduce an arrangement for the gradual narrowing down of the exchange margins, intervention to take place in Community currencies. For this purpose, they called on the central banks to intervene on their respective exchange markets so as to scale down to 2·25 %, by 1 July 1972 at latest, the maximum discrepancy that can occur, at any one time between the Member States' currencies, while still complying with the fluctuation margins allowed by the IMF in world monetary relations (3). As early as 24 April 1972, the governors of the Member States' central banks implemented the reduction in intra-Community fluctuation margins. They had previously agreed on the arrangements for financing the interventions in Community currencies and for settling the debit and credit balances generated by these operations. These arrangements include very short-term credit facilities between central banks, settlement of which is based on a transfer of assets matching the composition of the debtor central bank's reserves. The central banks of three prospective Member States acceded to this agreement in May.

4. After a short period during which it worked as planned, the intra-Community exchange system ran into difficulties in June as a result of very heavy speculation against sterling. After very large-scale support of sterling, in which the member countries

(1) OJ No C 38, 18. 4. 1972, p. 3.
(2) OJ No C 28, 27. 3. 1971, p. 1.

(3) Technical details of this arrangement are described in the July/August 1972 Bulletin of the Banque Nationale de Belgique.

participated and which involved the United Kingdom in substantial losses of reserves, the British Government decided on 23 June 1972 to suspend intervention at the exchange rate limits — 2·25 % either side of parity — and to suspend its participation in the arrangement designed to narrow the fluctuation margins of the currencies of the Community countries. Because of the close monetary ties between the United Kingdom and Ireland, the Irish authorities followed suit. At the end of 1972, the effective devaluation of sterling — now floating — was roughly 10 % in comparison with the former official parity.

On 28 June, Denmark suspended implementation of the agreement (the 'snake'), but continued to hold its currency within the margins set *vis-à-vis* the dollar (the 'tunnel'). However, from 10 October 1972 onwards, Denmark reverted to the new Community system, while reserving the right, at the time, to choose what means it would use for implementing the necessary intervention measures.

To enable it to cope with any repercussions of the sterling crisis on the Italian exchanges, the Banca d'Italia was authorized on 26 June 1972 to intervene temporarily in dollars as well as in Community currencies, with a view to ensuring the maintenance of the narrower intra-Community fluctuation margins: in view of the losses of reserves incurred by the Banca d'Italia, this waiver, which was originally intended to last only until 30 September, was extended until 31 December 1972.

Speculation against sterling was followed by pressure on the dollar, strengthened by the sharp upward trend in gold prices from January onwards. The countries affected most by the renewed surge of dollar inflows — mainly Germany, Japan and Switzerland — adopted measures which probably helped to stem the flow for a time.

5. On 21 March 1972, the Council also adopted the directive on regulating international capital flows and neutralizing their undesirable effects on domestic liquidity which had been proposed by the Commission on 23 June 1971 (1). The directive calls on the Member States to strengthen machinery already available to them by creating certain specified instruments. These instruments are to be used by the national authorities, but the latter must bear in mind the interests of their Community partners.

The monetary events in June again highlighted the need for effective shielding against disruptive capital movements, and a number of Member States therefore adopted, strengthened or began studying various measures in line with the objectives of the directive.

6. With a view to more effective coordination of the short-term economic policies, a working party was set up and attached to the Council, comprising one representative of the responsible Minister or Ministers in each Member State and one Commission representative. The working party's purpose is to ensure a permanent flow of information between the Member States on their short-term economic and financial policies and the coordination of these policies within the guidelines defined by the Council. In addition, the Commission was instructed to table in the Council as soon as possible a proposed directive designed to promote stability, growth and full employment in the Community.

7. Lastly, the resolution of 21 March 1972 confirmed the instruction set out in the resolution of 22 March 1971 calling on the Monetary Committee and the Committee of Governors to submit by 30 June 1972 at latest a report on the organization, the functions and the statute of a European monetary cooperation fund which would later take its place as part of a Community organization of the central banks.

Having read the report and the relevant Opinions (see sec. 19), the finance ministers of the enlarged Community agreed, on 12 September 1972 in Rome, to set up the fund during the first stage of the economic and monetary union, and to entrust its management to the Committee of Governors of the central banks, under general economic policy guidelines adopted by the Council.

The ministers agreed that the European monetary cooperation fund should at the outset, have the following tasks:

- concerted action between central banks for the purpose of narrowing down exchange rate margins;
- multilateralization of claims and liabilities, resulting from financing in Community currencies, and multilateralization of intra-Community settlements;
- use for this purpose of a European monetary unit of account;
- management of short-term monetary support between the central banks.

In view of the new requirements, it was decided that the very short-term facilities deriving from the agreement on narrower margins and the short-term monetary support would be linked up in the fund through new machinery. For this purpose, there is to

(1) OJ No L 91, 18. 4. 1972, p. 13.

be a technical adjustment of the short-term support, but there will be no change in the main features: in particular the consultation procedures will not be affected.

8. The ministerial agreement was approved in the declaration adopted at the end of the Conference, held in Paris on 19 and 20 October 1972, by the heads of state or government of the member countries of the enlarged Community. By confirming all parts of the measures adopted by the Council and by the representatives of the Member States on 22 March 1971 and 21 March 1972, including the principle of parallel progress in the various fields of economic and monetary union, the heads of state or government again made clear on this occasion that the Member States are determined to build up a definitive economic and monetary union. The necessary decisions are to be taken during 1973 to enable the Community to move on to the second stage of the economic and monetary union on 1 January 1974, with a view to its completion by 31 December 1980 at latest.

The heads of state or government also stated that fixed but adjustable parities between their currencies were indispensible if the union was to be achieved, and expressed their intention to establish within the Community defence and mutual support machinery enabling the Member States to ensure compliance with this principle. For this purpose, they decided that the European monetary cooperation fund must be set up before 1 April 1973 (1). In addition, the Community bodies involved, including the Monetary Committee, were instructed to report on the adjustment of the short-term monetary support system by 30 September 1973 and on the gradual pooling of reserves by 31 December 1973 (2).

(1) On 3 April 1973 the Council adopted a regulation establishing the European monetary cooperation fund (OJ No L 89, 5. 4. 1973, p. 2).

(2) The two dates were brought forward to 30 June in connection with the events which led the Council to decide early in 1973 to speed up the implementation of the monetary union.

## CHAPTER II

## ECONOMIC AND MONETARY DEVELOPMENTS IN THE ENLARGED COMMUNITY

9. This chapter is devoted to an outline of short-term economic trends and of the inflation problem, covered first in the six countries of the old Community and then in the three prospective member countries (1).

Although only a temporary respite was achieved as a result of the general realignment of exchange rates in December 1971, the decisions taken helped to create better conditions for the expansion of trade, which was also spurred on by faster growth in a number of leading industrialized countries. Business was booming in the United States in particular, where the upsurge was associated with a slower rate of inflation. Real GNP growth was more than 6 % in 1972, compared with 2·7 % in 1971, while the implicit GNP price index increased by only 3·5 %, compared with 4·7 %.

10. In the Community, the rate of growth rose a little in the first months of the year in almost all the countries, partly as a result of fortuitous factors (notably the exceptionally warm weather), but then grew more moderate. However, there was evidence in the later months of the year that growth was gathering momentum once again. None the less, the increase in volume in the gross Community product was scarcely higher than the rate achieved in 1971 (3·7 %, compared with 3·4 %) (see Table 1). The figure is the composite measure of virtually unchanged growth in the Netherlands, a slight increase in Germany, Belgium and France, and, in Italy and Luxembourg, a substantial increase over the low rates recorded in 1971.

In most of the countries, export demand was the key to overall demand trends in the early months: in Italy and in Luxembourg, indeed, this was the case throughout the year.

However, domestic demand played a steadily more important role as a growth factor: stimulated mainly by the sharp increase in available incomes of households, private consumers' expenditure expanded vigorously. On the other hand, the trend of investment by firms lacked vigour in almost all the countries for most of the year: in Italy and the Netherlands, there was an actual decline.

(1) These trends are illustrated by statistical tables given in Annex II.

11. The strains on the employment markets which were still discernible at the beginning of the year in most of the member countries gradually eased. None the less, in Germany, and, to a lesser extent, in France, the increase in the number of foreign workers did not suffice to eliminate the manpower shortage. Despite the revival of economic activity, the unemployment rate was higher, at the end of 1972, than in the previous year, in most of the countries. The change in the pattern is probably largely due to structural factors, such as unemployment among school-leavers, insufficient labour mobility from area to area, and the shortage of skilled workers, which is partly a result of the difficulty of adapting worker skills to technical progress.

12. Despite the moderate expansion of economic activity, the rate of inflation remained high throughout the year: early in the autumn, it actually gathered momentum in all the countries.

In previous years, economic relations with other countries had helped to aggravate inflationary pressure in the member countries: the increase in the prices of imported raw materials had this effect in 1972. For some time, however, internal causes have been steadily gaining in importance in the group of factors forcing prices up within the Community. In this connection, the shortage of certain agricultural items and the persisting upward pressure of wage costs, the increase in which was running well ahead of productivity gains in all the countries, were particularly important. All in all, the increase in the Community's consumer prices was even sharper than in 1971 (see Table No 2).

13. Economic trends in the prospective member countries shared common features with those in the Community: heavy inflationary strain and moderate growth, except in Denmark, where neither technical capacities nor labour resources were fully utilized. However, unemployment declined in the second half of the year in the United Kingdom and in Denmark (in Ireland, it showed a slight further increase).

14. After lively expansion in the first part of the year, the member countries' exports to non-member countries slowed down. There was another spurt in the later months of the year to give a total rate of growth for 1972 of 11·9 %, the increase of imports being 6·9 %. Given these trends and the improvement in the terms of trade for the member countries resulting from the exchange rate realignment, the Community's merchandize trade balance showed a surplus of about $ 4 700 million compared with $ 1 500 million in 1971 (cif-fob, on the basis of customs returns).

The external payments situations of the three prospective members developed along divergent lines. For Ireland and particularly for Denmark, the current accounts closed with smaller deficits than for 1971, but there was a sharp deterioration in the United Kingdom's current account because of poor external trading results: the current account surplus of £ 1 051 million for 1971 dwindled to practically nothing in 1972.

15. Despite the increase in the deficit on unrequited transfers, the surplus on the 'old' Community's current account showed a further increase. However, because of relatively calm conditions on the exchanges, net imports of long- and short-term capital were appreciably lower than in 1971, so that the surplus on the overall balance of payments declined from $ 8 000 million to $ 5 500 million. The surplus was reflected in an increase in the monetary authorities' exchange assets (gold and foreign exchange reserves, IMF position, SDRs) of $ 6 700 million and a deterioration in the banks' net short-term external position of $ 1 200 million (see Table No 3 for the trend in the external situation by country).

Capital movement trends played a key role in 1972 in the external situation of the United States as well: this country's deficit (official settlements was cut from $ 30 400 million for 1971 to $ 10 300 million. What happened was that a very heavy outflow of short-term capital in 1971 gave way to a modest movement in the other direction in 1972. There was also a decline in the deficit on long-term capital, this being the result of a decline in direct American investment abroad and of an increase in foreign portfolio investment in the United States. On the other hand, with imports, particularly from Japan and Canada, soaring, the merchandize trade balance closed with a record deficit of $ 6 800 million (against $ 2 700 million in 1971): the composite result was that the deficit on the basic balance came very close to that recorded for 1971.

16. In the early part of the year, the authorities in all the member countries felt that there was little cause to change the economic policies (which were expansionary, though not to the same extent in each country) which they had been conducting since the second half of 1971, the aim being to forestall any appreciable decline in economic activity. However, as the recovery steadily gained strength and the upward price movement gathered momentum, official

measures gradually became more restrictive in those countries nearest full employment. Where public finance policy failed to help curb inflation, monetary and credit policy was the main weapon used. Measures were taken to curtail the rapid growth of the money supply — usually due to the excessive expansion of bank credit — which had accompanied the increase in inflationary strain (see Tables 4 and 5). A number of countries also strengthened policy by direct price and income controls.

17. The Community authorities were well aware of the close links of independence which have now developed between economic trends in the Community countries and of the threat which continuing inflationary pressure represents for the harmonious working of the Community. They therefore decided to support national measures by concerted action.

Thus, on 5 December 1972, the Council adopted a resolution, based on a Commission draft, on inflation control (1), under which the Member States are to endeavour to reduce the rate of increase in consumer prices to 4 % between December 1972 and the end of 1973. The new Member States accepted this target and declared themselves willing to implement the measures required, subject to adjustments necessary to their respective situations.

The Council still regards monetary policy as having a key role to play in the overall measures taken in the various fields of economic policy to achieve the inflation control objective. The resolution includes a commitment for the Member States to slow down gradually the rate of growth of the money supply (money and near-money) until it matches that of real GNP plus a 'normative rate of increase as regards prices' determined in relation to overall economic policy goals, account being also taken of the structural development of the relationship between money supply and national product. This objective is to be achieved by the end of 1974. The resolution also designates the range of instruments which should be available to the Member States if they are to be able to take prompt action on interest rates, liquidity, and, as necessary, the volume of credit. Lastly, to prevent the expected impact of the use of these instruments being offset by unwanted inflows of capital from outside, the Member States were invited to strengthen their control machinery in this area, as appropriate. This was done early in 1973.

18. Since the adoption of this resolution, many measures have been taken or strengthened in the countries of the enlarged Community, particularly in the area of monetary policy. In all the countries, the refinancing rates charged by the central banks have been raised. For example, by the end of the year, the discount rate — usually rising — was 9 % in the United Kingdom, 8 % in Ireland, 7·5 % in France, 7 % in Denmark, 5 % in Belgium, 4·5 % in the Republic of Germany and 4 % in Italy and in the Netherlands (see Table No 6). The upward movement in interest rates was also lively on the money markets and substantial (though not to the same degree in each country) on the capital markets of almost all the nine countries.

Action to slow down the growth in the money supply was taken and measures already in force were tightened up by the countries which had already introduced restrictive machinery: in Germany, the discount ceilings for the credit institutions were lowered several times. In France, the compulsory reserve requirements were made more stringent, partly by an increase from 15 to 33 % in the reserve ratio applying to incremental credit, and the terms for personal loans and the financing of housing were made more severe. In Belgium, the gentlemen's agreement between the Banque Nationale and the banks on the 'sterilization' of funds was extended and its scope widened. In Luxembourg, the authorities introduced quantitative restriction of consumer credit. The Bank of England used the 'special deposits' technique. The central bank authorities in Ireland introduced a liquidity coefficients system to facilitate credit control, and the central bank of Denmark extended credit ceiling restrictions and increased the various ratios in force governing the commercial banks' indebtedness with the central bank.

(1) OJ No C 133, 23. 12. 1972, p. 12.

## CHAPTER III

## THE ACTIVITIES OF THE MONETARY COMMITTEE

19. As stated in the Introduction, the Committee was mainly concerned with work towards the economic and monetary union and with the reform of the international monetary system.

From the beginning of the year, the Committee assisted the Commission in the drafting of the proposed resolution which was adopted by the Council on 21 March 1972. As already reported, the resolution invited the Committee to draft a report with the Committee of Governors on the organization, the functions and the statute of the European monetary cooperation fund. On the basis of a report drafted by a joint working party of the two Committees, the latter submitted Opinions to the Council and the Commission on 5 September and 11 September 1972 respectively (1), and the finance ministers drew heavily on these Opinions in establishing the main features of the fund when they met in Rome (see sec. 7).

20. The Committee had been asked in 1971 to advise on the drafting of the directive for the control of international financial flows, a directive which was also adopted by the Council on 21 March 1972. It provides that the Committee will assist the Commission in the maintenance of close coordination between the policies pursued in this area by the relevant authorities of the Member States. For this purpose, the Committee set up an *ad hoc* working party in March to list all the instruments, whether provided for or not by the directive, available to the Member States. Subsequently, in October, the Committee set up a new working party to carry out a collective scrutiny of the use of the instruments and of those instruments which the Member States might establish in the future.

21. As part of its preparatory work on the Commission's inflation control proposals (see sec. 17), the Committee examined, on the basis of a report drafted by its alternates, monetary measures suitable for inclusion in a comprehensive programme. However, it ascertained that the appreciable differences between the current economic situations in the various member countries and in the degree of importance attached to the correlation between the money supply changes and price trends meant that the achievement of such an objective would involve differing degrees of restraint and differing timings in the various countries. Moreover, the instruments were not the same in the various countries and were not used in the same ways, so that the Committee felt that the countries should be free in their choice of measures, though it recognized that it would be in the interests of the Community countries as a whole to supplement and harmonize these instruments at some time in the future.

22. The Committee kept the monetary and financial situations of the Member States under review: it held several consultation meetings — for example, further to the decision taken by the British government in June.

It also adopted two Opinions (2) for submission to the Council and to the Commission: the first concerned the rate of conversion of sterling and the Irish pound into units of account or into any other currency for transactions to be carried out under the common agricultural policy; the second concerned problems deriving from the Commission's proposed Council directive for the elimination of restrictions on freedom of establishment and freedom to supply services in connection with 'self-employment' activities of banks and other financial establishments. The second Opinion, drafted on the basis of the work of an *ad hoc* group, led to the establishment of a list of banking services in the directive now being adopted by the Council. Lastly, in accordance with the Council resolution of 21 March 1972, the Committee was consulted by the Commission on a draft directive designed to promote stability, growth and full employment in the Community.

23. The working party on securities markets carried out its regular examinations of trends on the capital markets in the member countries and on the international markets. It also endeavoured to ascertain what facilities would enable the coordination of the Member States' policies on their

(1) The Monetary Committee's Opinion is given in Annex III.

(2) These Opinions are annexed (Annex III).

capital markets to be strengthened. It reported on its work to the Committee, which approved the findings (1).

24. As in previous years, the Committee spent a large proportion of its time on international monetary problems. It discussed methods of establishing a common standpoint on the fundamental objectives of the reform of the international monetary system, the establishment of the Committee of the Twenty as a new forum for negotiations, and the possible activation of special drawing rights for the second period. Its findings as to the fundamental objectives were used as a basis for the agreement reached at the conference which the finance ministers of the future Community held in London on 17 and 18 July 1972. The agreement, confirmed at the Summit Conference held in Paris on 19 and 20 October, is based on the following principles: fixed but adjustable parities; general convertibility of currencies; effective international regulation of the world supply of liquidity; a reduction in the role of national currencies as reserve instruments; effective and equitable functioning of the adjustment process; equal rights and duties for all participants in the system; the need to lessen the unstabilizing effects of short-term capital movements; the taking into account of the interests of the developing countries.

These objectives were recalled by the Member States at the annual meeting of the International Monetary Fund held in Washington from 25 to 29 September 1972. Though not necessarily endorsing all of them, all the participants at this meeting recognized the need for a reform of the international monetary system and declared their readiness to open effective negotiations.

25. In view of the value of establishing a single viewpoint, as among the nine countries, for the negotiations, the Committee decided to hold systematic concertation meetings concerning the agenda items for the meetings of the alternates and the members of the Committee of Twenty, which is studying all aspects of the reform problem.

For this reason and in implementation of the study tasks entrusted to it by the London conference of finance ministers, the Committee devoted a large number of meetings in the latter months of 1972 and the early months of 1973 to examining problems connected with the choice of the 'numéraire' for the new system and with the unfreezing of gold, with settlement in reserve assets and the consolidation of dollar balances, with the control of short-term capital movements, with the adjustment process and with the utilization in this context of quantitative indicators. On this last problem, the Committee succeeded in defining the outline of a single position which was recorded in a memorandum transmitted to the alternates of the Committee of Twenty (2). This position was also explained by the current chairman of the Council of the European Communities at the ministerial meeting of the Committee of Twenty held in Washington on 26 and 27 March 1973.

(1) This report is given in Annex V.

(2) Attached as Annex IV.

*ANNEX I*

## THE COMMITTEE: MEMBERS AND ALTERNATES

*Chairman:*

| | |
|---|---|
| B. Clappier | Sous-gouverneur de la Banque de France (Paris) |

*Vice-Chairman:*

| | |
|---|---|
| Dr O. Emminger | Vizepräsident der Deutschen Bundesbank (Frankfurt) |
| Prof Dr C. J. Oort | Thesaurier-generaal bij het Ministerie van Financien (The Hague) |

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|---|---|
| *Other Members:* | |
| F. Boyer de la Giroday | Director in the Directorate-General for Economic and Financial Affairs, Commission of the European Communities (Brussels) |
| M. D'Haeze | Directeur général de l'administration de la trésorerie et de la dette publique — Ministère de finances (Brussels) |
| C. de Strycker | Vice-gouverneur de la Banque nationale de Belgique (Brussels) |
| Dr W. Hankel until 14 May 1972 | Ministerialdirektor — Bundesministerium für Wirtschaft und Finanzen (Bonn) |
| Dr D. Hiss since 17 May 1972 | Ministerialdirektor — Bundesministerium der Finanzen (Bonn) |
| C. Lamboray | Directeur adjoint de la Caisse d'épargne de l'État (Luxembourg) |
| Mr A. W. R. Baron Mackay | Directeur der Nederlandsche Bank NV. (Amsterdam) |
| Prof G. Miconi | Direttore generale del tesoro — Ministero del Tesoro (Rome) |
| Dott U. Mosca | Director-General for Economic and Financial Affairs, Commission of the European Communities (Brussels) |
| Dott R. Ossola | Vicedirettore generale della Banca d'Italia (Rome) |
| C. Pierre-Brossolette | Directeur du trésor au ministère de l'économie et des finances (Paris) |
| J. Schmitz | Conseiller de gouvernement au ministère des finances (Luxembourg) |
| *Chairman of the alternates:* | |
| Prof Dr J. Mertens de Wilmars | Conseiller économique de la Banque nationale de Belgique (Brussels) |
| *Other alternates:* | |
| J. de Larosière | Chef du service des affaires internationales à la direction du trésor — Ministère de l'économie et des finances (Paris) |
| Drs G. de Man | Ministerie van Financiën (The Hague) |
| A. Dondelinger | Commissaire au contrôle des banques (Luxembourg) |
| Dott L. Fronzoni | SADIBA (Perugia) |
| Dott D. Gagliardi | Ispettore — Ministero del commercio estero (Rome) |
| G. Jennemann | Bankdirektor — Deutsche Bundesbank (Frankfurt) |
| H. Koch | Directeur général des études à la Banque de France (Paris) |
| M. Meulemans | Conseiller à l'administration de la trésorerie et de la dette publique — Ministère des finances (Brussels) |
| Dr B. Molitor | Director in the Directorate-General for Economic and Financial Affairs, Commission of the European Communities (Brussels) |
| M. Schmit | Inspecteur des finances (Luxembourg) |
| Drs A. Szasz | Onderdirecteur van de Nederlandsche Bank NV (Amsterdam) |
| Dr G. Willmann | Regierungsdirektorin — Bundesministerium der Finanzen (Bonn) |
| G. Wissels | Director in the Directorate-General for Economic and Financial Affairs, Commission of the European Communities (Brussels) |

*Secretariat:*

G. Morelli

G. Lermen

*ANNEX II*

TABLE 1

EXPANSION OF GROSS NATIONAL PRODUCT (VOLUME)

*(in %)*

| | 1971/1970 | 1972/1971 |
|---|---|---|
| Federal Republic of Germany | 2·7 | 2·9 |
| Belgium | 3·7 | 3·8 |
| France | 5·0 | 5·3 |
| Italy | 1·4 | 2·9 |
| Luxembourg | 0·7 | 3·5 |
| Netherlands | 4·3 | 4·2 |
| Community of the Six | 3·4 | 3·7 |
| Denmark | 4·3 | 5·1 |
| Ireland | 3·0 | 3·0 |
| United Kingdom | 1·2 | 2·4 |

TABLE 2

CONSUMER PRICE INCREASES

*(in %)*

| | December 1971<br>December 1970 | December 1972<br>December 1971 |
|---|---|---|
| Federal Republic of Germany | 5·8 | 6·5 |
| Belgium | 5·6 | 6·4 |
| France | 6·0 | 6·9 |
| Italy | 4·7 | 7·4 |
| Luxembourg | 5·4 | 5·9 |
| Netherlands | 8·4 | 7·9 |
| Denmark | 5·1 | 7·3 |
| Ireland | 8·6 (1) | 8·2 (1) |
| United Kingdom | 9·0 | 7·7 |

(1) November/November.

TABLE 3

**BALANCE OF PAYMENTS**

*(in millions of European u. a.)*

| | Current payments (1) | Long-term capital | Short-term capital (2) | Allocation of SDRs | Total |
|---|---|---|---|---|---|
| Federal Republic of Germany | | | | | |
| 1971 | 310 | 1 786 | 2 053 | 171 | + 4 320 |
| 1972 | 378 | 3 719 | 507 | 170 | + 4 774 |
| BLEU | | | | | |
| 1971 | 830 | — 226 | — 96 | 72 | + 580 |
| 1972 | 1 023 | — 454 | — 179 | 71 | + 461 |
| France | | | | | |
| 1971 | 525 | 3 | 1 334 | 161 | + 2 023 |
| 1972 | 525 | — 725 | 530 | 160 | + 490 |
| Italy | | | | | |
| 1971 | 789 | 128 | — 60 | 107 | + 964 |
| 1972 (3) | — 22 | — 929 | 10 | 106 | — 835 |
| Netherlands | | | | | |
| 1971 | 128 | 336 | 61 | 75 | + 600 |
| 1972 | 1 205 | — 718 | 355 | 74 | + 916 |
| Denmark | | | | | |
| 1971 | — 420 | + 400 | + 103 | 28 | + 111 |
| 1972 | — 92 | + 380 | — 165 | 28 | + 151 |
| Ireland | | | | | |
| 1971 | — 168 | + 374 | | 12 | + 268 |
| 1972 | — 144 | + 254 | | 12 | + 122 |
| United Kingdom | | | | | |
| 1971 | 2 523 | 5 224 | | 300 | + 8 047 |
| 1972 | 43 | — 3 078 | | 297 | — 2 738 |

(1) On a transactions basis for FRG, France, Denmark, Ireland and the United Kingdom; settlements for BLEU, Italy and the Netherlands.
(2) Including residual items; not including bank operations in the case of the countries of the old Community.
(3) December 1971 until November 1972.

TABLE 4

**EXPANSION OF MONEY SUPPLY**

*(in %)*

| | December 1971 / December 1970 | | December 1972 / December 1971 (1) | |
|---|---|---|---|---|
| | M 1 | M 2 | M 1 | M 2 |
| Federal Republic of Germany | 12·3 | 14·5 | 14·6 | 17·0 |
| BLEU | 10·1 | 12·3 | 14·0 | 16·1 |
| France | 11·1 | 17·6 | 15·4 (2) | 18·5 (2) |
| Italy | 18·8 | 17·3 | 19·1 | 18·9 |
| Netherlands | 15·0 | 8·1 | 17·6 | 11·8 |
| Denmark | 10·0 | 9·6 | 17·1 | 15·1 |
| Ireland | (3) | (3) | 16·0 | 14·2 |
| United Kingdom | 10·9 | 13·0 (4) | 13·6 | 25·8 (4) |

M 1 = Money supply.
M 2 = Money supply plus near-money or secondary liquidity.
(1) November 1972/November 1971, Italy.
(2) Provisional figures.
(3) Figures not available owing to a strike in the banking sector.
(4) M 3.

TABLE 5

EXPANSION OF BANK LENDING TO FIRMS AND INDIVIDUALS

*(in %)*

| | December 1971 / December 1970 | December 1972 / December 1971 |
|---|---|---|
| Federal Republic of Germany | + 13·8 | + 15·9 |
| France | + 20·2 | + 22·5 |
| Italy (1) | + 12·6 | + 16·1 |
| Netherlands | + 14·4 | + 16·1 |
| Belgium (1) | + 15·4 | + 18·6 |
| Luxembourg (1) | + 31·8 | + 36·6 |
| Denmark | + 4·4 | + 12·3 |
| Ireland | (2) | + 33·6 |
| United Kingdom | + 17·3 | + 51·11 |

(1) September 1972.
(2) Bank employees' strike.

TABLE 6

BANK RATE

*(in %)*

| | 31 December 1971 | 31 March 1972 | 30 June 1972 | 30 September 1972 | 31 December 1972 |
|---|---|---|---|---|---|
| Federal Republic of Germany | 4 | 3 | 3 | 3 | 4½ |
| BLEU | 5½ | 4 | 4 | 4 | 5 |
| France | 6½ | 6 | 5¾ | 5¾ | 7½ |
| Italy | 4½ | 4 | 4 | 4 | 4 |
| Netherlands | 5 | 4 | 4 | 3 | 4 |
| Denmark | 7½ | 7 | 8 | 8 | 7 |
| Ireland | $4^{13}/_{16}$ | $4^{13}/_{16}$ | $6^{1}/_{16}$ | $7^{3}/_{16}$ | 8 |
| United Kingdom | 5 | 5 | 6 | 6 | 9 |

*ANNEX III*

Brussels, 17 January 1972

## OPINION OF THE MONETARY COMMITTEE

In accordance with instructions given by the Council at its session of 8 and 9 June 1970, the Committee has examined certain problems connected with the Commission's proposed Council directive on the elimination of restrictions on freedom of establishment and freedom to supply services in respect of the 'self-employment' activities of banks and other financial establishments.

As a result of this discussion, the Committee has ascertained that freedom of establishment and freedom to supply services not connected with capital movements raise no credit-policy problems for the Member States.

With regard to services connected with capital movements, the Committee feels that the Council directive should apply at this stage solely to the services connected with the transactions in lists A and B annexed to the first and second directives on the liberalization of capital movements. The Committee believes that the draft directive should be accompanied by the attached list of services connected with the transactions.

Canvassing also raises a problem, which is not a monetary policy problem, but is connected with the protection of the saver. In so far as canvassing has monetary implications, a technical solution should be found establishing conditions for non-residents matching those for residents.

Lastly, the need to prevent the monetary policy of one country being neutralized by heavy capital counter-movements has led the Committee to propose that a clause be included stipulating that the directive cannot be used in such a way as to hamper cooperation between monetary authorities of the Member States.

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*ANNEX*

**Table of banking services corresponding to the capital movements mentioned in lists A and B of Annex I of the first Directive of 11 May 1960, amplified and amended by the second Directive of 18 December 1962 (1)**

LIST A

*Direct investments*

— Commercial and financial information (commercial prospecting, information on the customer's solvency, statistics, forwarding of accounting information),

— Assistance and representation in relations with the authorities (administrative and legal) and other agencies,

— Consultancy and assistance to firms with a view to mergers (search for possible partners abroad, expert advice, etc),

(1) The headings underligned correspond to those in lists A and B of the Directives on capital movements mentioned.

— Assistance in large acquisitions of shareholdings (eg for takeover bids) with a view to acquiring control of a firm (stock exchange formalities, assessments of asset values and financial assessments, etc),

— Physical exchange of securities [1],

— Custody of securities,

— Issue of securities assigned to shareholders.

*Liquidation of direct investments*

— Commercial and financial information (commercial prospecting, etc),

— Assistance and representation in relations with the authorities (administrative and legal) and other agencies,

— Consultancy and assistance to firms with a view to facilitating liquidation operations,

— Assistance in large sales of shares,

— Physical exchange of securities,

— Custody of securities.

*Real estate investments and their liquidation*

— Commercial and financial information,

— Assistance and representation in relations with the authorities (administrative and legal) and other agencies,

— Consultancy and assistance to firms with a view to facilitating liquidation operations,

— Asset management (assistance and representation for the maintenance of the asset, letting, etc),

— Assistance for the constitution and the mobilization (if appropriate) of sureties and guarantees of all kinds not granted by a bank.

*Personal capital movements*

— Management of bequeathed assets (payment of taxes, search for missing persons, etc).

*Granting and repayment of short- and medium-term credits related to commercial transactions or to the supply of services in which a resident is participating*

— Assistance and representation in relations with the authorities (administrative and legal) and other agencies,

— Consultancy and assistance to firms with a view to facilitating liquidation operations,

— Consultancy in matters of financing of undertakings,

— Debt recovery,

— Cashing of securities,

— Domiciliation of securities.

— Management of documentary credits,

— Assistance for the constitution and the mobilization (if appropriate) of sureties and guarantees of all kinds not granted by a bank,

(1) The securities are defined in the explanatory notes annexed to the first Directive for the implementation of Article 67. The definition has been followed in this table.

— Blocking of types of security belonging to a customer and guaranteeing an obligation of this customer with regard to a third party,

— Canvassing for third parties,

— Services connected with a factoring operation.

*Guarantees of existing debts, other guarantees and pledges and transfers connected with them* (sureties and guarantees granted by a bank)

*Estate duties*

— Tax information,

— Fiscal guarantees.

*Other list A capital transactions*

The corresponding bank transactions are in fact transfer payments only.

## LIST B

*Operations in securities dealt in on a stock exchange, excluding units of unit trusts*

— Assistance for the issue of bearer certificates representing securities previously issued and dealt in on a stock exchange,

— Formalities for securities (stamping, renewal of coupon sheets, exchanges, renewal, regrouping, division, destruction),

— Financial service (payment of coupons, reimbursement of securities, assistance for the exercise of drawing and subscription rights, etc),

— Financial information (current information, analysis, etc),

— Advice for investment in stock exchange securities (1),

— Management of a portfolio of stock exchange securities (1),

— Acceptance and execution of instructions for the exercise of the rights of bearers of stock exchange securities (eg representation at shareholders' meetings and before the courts),

— Custody of securities,

— Conversion of securities,

— Assistance for operations connected with the stock exchange quotation of securities assigned to the holders of stock exchange securities,

— Canvassing for third parties in respect of stock exchange securities, search for a party contracting in his own name for the acquisition or sale of stock exchange securities,

— Operation as offsetting fund.

(1) These services concern both individuals and institutional investors.

Brussels, 12 July 1972

## OPINION TO THE COUNCIL AND THE COMMISSION

Article 2 of Regulation No 129 of 23 October 1962 provides that, for the conversion of any currency into another currency for operations to be carried out under the common agricultural policy, the exchange rate to be applied will be that which corresponds to the par value communicated to the IMF.

Further to the decision taken by the British and Irish authorities to discontinue for the time being compliance with the fluctuation limits provided for in current international agreements, the Committee is of the opinion that, pursuant to Article 3 of the same Regulation, the value of sums denominated in sterling or in Irish pounds, should in future, for the purposes of conversion into units of account or into any other currency, be calculated by reference to their market rates in terms of dollars.

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Brussels, 5 September 1972

## OPINION DELIVERED TO THE COUNCIL AND TO THE COMMISSION

In the Resolutions of the Council and the representatives of the Governments of the Member States on 22 March 1971 and 21 March 1972, the Monetary Committee and the Committee of Governors of Central Banks were asked to present a report on the organization, functions and articles of a European Monetary Cooperation Fund. Acting on these terms of reference, the two Committees set up a joint group of experts which, on 1 June 1972, presented a report, enclosed with the present Opinion as an annex, on the basic technical aspects of the problem.

At its sessions of 11 July and 5 September 1972, the Monetary Committee examined this report and concentrated its discussions on the fundamental options open in the matter.

### I. Questions of principle

The Committee feels that the creation of a Fund is just one of the measures envisaged in the Council Resolution of 21 March 1972 on the establishment by stages of economic and monetary union, the others being: coordination of monetary policies, increased convergence of economic policies, adoption of appropriate measures in the fields of regional and structural policy, tax harmonization gradual development of a capital market, narrowing of margins, regulation of capital movements. The Committee takes the view that it will be absolutely necessary in an ultimate stage to establish a European system of central banks and to pool monetary reserves if economic and monetary union is to be achieved. The creation of a Fund may be considered as an initial contribution towards this objective, and any assessment of its value should be made in the light of the contribution it represents.

One purpose of such a Fund, at all events, would be to facilitate the settlement between partners of positions resulting from interventions in Community currencies in connection with the narrowing of margins.

Over and above this objective, some members of the Committee feel that the Fund should organize mutual support of the member countries' currencies, and ensure that their reserves are better used, by supplying the member countries with a sufficient volume of unconditional credits to finance reversible capital movements, without, however, slackening balance-of-payments discipline. This approach would also highlight the will of the EEC monetary authorities to defend their currencies jointly and severally against monetary disruptions caused by factors outside the fundamental economic trends in one or more member countries.

Some members consider that the functions of such a Fund should develop in line with the evolution of economic and monetary integration in the Community. Finding that the convergence of the member countries' economic policies is still insufficient, they feel that the creation of a Fund should not give rise to an extension of the credit facilities already available. In any case, conditions would have to be attached to any additional credits and they would thus fall outside the competence of the central banks and the authority of the Fund. It should be borne in mind here that, in addition to the credit machinery planned in connection with the narrowing of margins, and the machinery of short-term monetary support, means for providing conditional credit already exist in the Community in the shape of the machinery for medium-term financial assistance approved by the Council on 22 March 1971. This machinery should not be incorporated in the Fund, as the Fund will have to be administered by the Committee of Governors of Central Banks, whereas the Government authorities are responsible for the medium-term machinery.

## II. Functions of a fund

The report by the group of exports gives a detailed survey of the tasks which might be entrusted to a Fund at the various stages of its development and which are analysed under A, B, C and D below. The Committee examined the functions which the Fund could be given in the initial stage. However, the Committee did not consider it advisable to fix a timetable for the follow-up to these initial functions, as this is largely dependent, firstly on the experience gained in the early stages of the Fund's operation, and secondly on progress achieved in establishing economic and monetary union.

### A. *Concertation*

Although the Committee acknowledged that a Fund should be created for more purposes than simple concertation between central banks as part of the machinery for narrowing the margins of fluctuation between the currencies of the Community countries, the Committee nevertheless feels that the Fund should be responsible for this concertation task. The methods of concertation could be those set out in paragraphs 21-26 of the report by the group of experts.

### B. *Multilateralization*

The Committee reviewed the various procedures of multilateralization of the positions resulting from interventions in Community currencies and of intra-Community settlements connected with these interventions, i.e. transformation of bilateral claims and debts into claims on and debts with the Fund and their expression in units of account (paragraphs 27-43 of the report). All the members of the Committee are, in principle, in favour of multilateralization of this kind.

In this section of their report, the experts also dealt with the question of the Fund's management of short-term monetary support, in particular as a link-up between the credit facilities envisaged in the agreement on the narrowing of margins. For the longer the period fixed for the settlement of positions, the greater are the possibilities of multilateralization.

At all events, the Committee feels that the Fund should also be responsible for the management of short-term monetary support. It further considers that certain technical adjustments should be made to this support mechanism, to enable it to be incorporated in the Fund.

Some members feel that if the two short-term credit instruments are to be linked within the Fund, they should not be modified as regards the amount, the period and the conditions of financing. Other members take the view that recourse to the credit facilities available in the system should be made more automatic. A third current of opinion advocates the establishment of 'revised machinery', which would include the two earlier instruments in a more flexible and more effective framework and would be equipped with more extensive credit facilities that would be made available to the Fund either on its creation or gradually thereafter.

### C. *Pooling of reserves*

The Committee examined the different lines of thought on the pooling of reserves (paragraphs 44-55 of the report).

The majority of the members feel that at the present time it would be premature to pool reserves, even partially, because the necessary economic conditions have not yet been fulfilled. On the other hand, some members are of the opinion that the pooling of at least a small fraction of the reserves would, as the report states (paragraph 44), 'be justified by the fact that the interventions of each central bank on the foreign exchange markets result not only from the external payment situation of the country concerned but also from the application of the agreement on the narrowing of margins'. In addition, a progressive pooling of reserves would enable all the Fund's functions to develop regularly and would prepare the way for its later absorption into the Community system of central banks, as planned in the Council Resolutions. These members also felt that if a start was not made on pooling reserves, the creation of a Fund would lose a great part of its importance.

Finally, the Committee stresses that the list of techniques described in the report by the group of experts is not exhaustive and that the whole problem needs to be studied more deeply.

A member of the Committee proposed a plan for the beginning of a pooling of reserves: under this plan each country would deposit with the Fund the equivalent in dollars of its share in short-term monetary support and the equivalent of twice this share [1] in its national currency. The Fund would credit the member countries with the corresponding amount in units of account and this could be used for the settlement of positions resulting from interventions by the central banks. Furthermore, the

(1) The shares of the central banks of the member countries of the enlarged Community in short-term monetary support are (in millions of units of account):

| | |
|---|---|
| Deutsche Bundesbank | 300 |
| Banque Nationale de Belgique | 100 |
| Banque de France | 300 |
| Banca d'Italia | 200 |
| Nederlandsche Bank | 100 |
| Denmarks Nationalbank | 45 |
| Central Bank of Ireland | 17·5 |
| Norges Bank | 37·5 |
| Bank of England | 300 |

Fund could buy back for national currencies, from countries so desiring, dollar assets which those countries were forced to accumulate following the inflow of speculative capital. This technique would make it possible to introduce a guarantee in European units of account, which would be granted jointly by the Member States in proportion to their shares. The Committee has not been able to judge this plan and its technical and financial implications, but considers that a thorough study should be made of it

D. *Unit of account*

The multilateralization of positions, whatever form it may take, implies recourse to a unit of account (paragraphs 56-60). To begin with, it would be possible to adopt the unit of account which is currently used in the Community (i.e. 0·88867088 grams of fine gold).

### III. Organization and articles

The Committee was, generally speaking, in agreement with the section in the experts' report devoted to the organization and articles of the Fund (paragraphs 61-67). The question of the division of responsibilities between the various competent authorities was raised.

### IV. Conclusions

Despite the diversity of views expressed on certain aspects of the functions which might be assigned to the Fund, the members agreed unanimously that, if the Fund were set up, it could assume on its creation not only the management of short-term monetary support but also the tasks described in the experts' report under IV A, 'The organization of concertation between the central banks', IV B (ii) (a) 'The multilateralization of positions resulting from financing at very short term', IV B (ii) (b) 'The link-up between the two types of financing' and IV D 'Unit of account'. The Committee is aware that many questions, in particular some of those listed above, must be examined in further detail before the Fund can be set up and also with a view to the later development of its tasks.

## *ANNEX IV*

## THE ADJUSTMENT PROCESS — USE OF QUANTITATIVE INDICATORS

### A. General considerations

1. Deputies representing member countries of the EEC share the view expressed in the US paper (C/XX/Dep/Doc/72/10) that 'a reformed international monetary system should promote prompter and more effective adjustment of balance of payments disequilibria'; indeed, this view has been reinforced by the events of the first half of February which have also demonstrated the validity of the Canadian Deputies' observation that 'the principal failure of the system is that it has not been able to accomodate the large secular shift in the economic growth of continental Europe and Japan' (C/XX/Dep/Doc/73/15).

2. At the same time, we believe that it is important to preserve as much of the Bretton Woods' system as possible to serve as a foundation for a reformed system. In particular, it seems to us vital to retain the concept of 'fundamental disequilibrium' because this implies that both internal and external factors have to be taken into account when reaching a judgment about the need for adjustment. This is not to deny the usefulness of quantitative indicators — but to see them rather as a means of making the concept of fundamental diesequilibrium operationally effective.

3. The need which we see to retain this concept is also founded on our belief that while — as the US paper recognizes — no automatic rule prescribing the choice of adjustment policy is possible, any choice by a major country is a matter of concern to the international community; this is true whether the choice falls on domestic policy measures, on the exchange rate, on controls on the capital account or on some combination of the three. In the final analysis the choice must be one for the Government of the country concerned in the light of the structural circumstances of that country; but the rest of the international community must, if the adjustment process is to work more effectively, be in a position to have their views taken into account. Further discussion is needed about the implementation of this principle.

4. Some further general observations should be made here about the concept of symmetry. There are obvious asymmetries inherent in the size of the US, and in the relation between the internal and external sectors of its economy, as compared with the size and economies of the individual members of the EEC. Such differences will diminish as European integration proceeds but in the meantime it is essential to take proper account of their

existence. Nevertheless we accept that, so far as possible, there should be equivalent treatment of the dollar and other major currencies. Similarly, the burden of adjustment should — again as far as possible — be symmetrically shared between surplus and deficit countries. Recent decisions on exchange rates were in accordance with these principles.

5. As far as symmetry between surplus and deficit countries is concerned, however, there are conflicting considerations which need to be borne in mind. Guidelines for the consultation process might usefully draw attention to these, in particular:

(a) There is some need to stress the value of symmetry and to encourage the consultation process to bear upon surplus as well as deficit countries because of the heavy bias of natural pressures against deficit countries.

(b) The belief that the present degree of inflationary pressures in the world economy — which may well persist — makes it appropriate for deficit countries to be required to bear somewhat more of the burden of adjustment. This is relevant to the value of the numeraire in terms of which currency values may change and in this context the conditions for the future agreed creation of international liquidity will be a major significance.

(c) In many given situations of international disequilibrium it is likely that the positions of most individual countries will be felt to be in mutual harmony, whilst one or more others are diverging relatively. It would seem right as a general principle to seek the minimum number of adjustments and to this end the international community should press for adjustment by those diverging from the main group at the time, irrespective of whether they are in surplus or in deficit.

6. It seems to us important to recognize that the available evidence (vide C/XX/Dep/Doc/73/3 and 7) points to a real distinction to be made between quantitative indicators which may be useful:

(a) as signals for the start of a consultation procedure;

(b) as creating a presumption that adjustment action is required.

We accordingly propose to discuss the use of quantitative indicators in the adjustment process under two headings — signals for consultation and presumptions for adjustment action.

### B. Signals for consultation

7. The Chairman's summing-up at the January Deputies' meeting reflects very fairly the discussions which had taken place about consultation. In particular, we should like to express our agreement with his formulation that, whatever is done to improve the machinery of consultation, it should 'supplement rather than supersede existing procedures.' While there will be a need for institutional changes in the IMF, discussion of which will come at a later stage, the existing procedures for consultation between the Fund and its members have built up a corpus of knowledge and experience which can help to make more effective a more regular multilateral framework for consultations.

8. While the existing Fund consultation arrangements will continue to allow adequate surveillance of the need for adjustment by the majority of its members, such consultations now take place — unless the member has a floating exchange rate or has drawn in the higher credit tranches — only at fairly long intervals. This means that the detection of incipient disequilibria is necessarily imperfect — in particular as regards surplus countries and, more generally, as regards imbalances which may arise from adjustment actions taken by other countries.

9. We believe that these deficiencies can be overcome by giving the management of the IMF a specific mandate:

(a) to keep the balance of payments positions of at least the major countries under continuous review;

(b) to call the attention of the Fund Board at any time to situations which appear to merit further examination — in other words, to initiate the process of consultation.

In this connection guidelines might be offered to the management to ensure that special attention was given to evidence of any structural changes emerging in the balance of payments, even where offsetting tendencies within the overall balance were leaving official reserves unaffected. Members of the Fund would also have the obligation to call for examination of payments developments both in their own and in other countries which the Fund management appeared to be ignoring. This provision would go a long way towards overcoming one of the difficulties which we foresee in the US proposal to use one single indicator to trigger the consultation process.

10. The comprehensive procedure suggested above, which is quite similar to that put forward by the Canadian Deputies, might be thought sufficient on its own to provide signals that examination was appropriate and that the consultation procedure should be set in motion. However, it would be a helpful safeguard to provide also for the use of a quantitative indicator or indicators.

11. Two approaches are possible — to use one indicator or several; there are difficulties in constructing any useful composite indicator for this purpose, although this problem might be further explored. In favour of using several indicators is that this would reduce the risk both of wrong signals leading to unnecessary consultations and, more importantly, of a necessary consultation not being signalled; however, this latter risk can perhaps be averted by use of our suggestions in paragraph 8 above. Against the use of several indicators is the prospect that one might

be faced with conflicting signals and that in general their use might militate against the need for promptness in consulting with countries which may be in incipient disequilibrium. On balance, therefore, we are in favour of selecting one single indicator of the need to set the consultation process in motion.

12. The choice seems to us to lie between reserve movements and basic balances, while recognizing that the historical evidence suggests that neither would be entirely satisfactory on its own (vide C/XX/Dep/Doc/73/3). However, we accept that there are good reasons for preferring reserve movements as an indicator of the need for consultation, notably:

(i) their conceptual advantage, expounded by the US Deputies both orally and in writing, in relation to a regime of convertibility;

(ii) the speed at which they become available is in accord with the need for promptness in initiating examination and consultation; and

(iii) the relative ease with which common standards for composition can be achieved and the absence of any need for extended analysis.

13. However, before adopting reserve movements as the sole indicator of a need for consultation, further exploration is needed of three aspects:

(a) to what extent should movements in actual reserves be used, as opposed to movements from adjusted levels which would take account of individual countries' reserve needs?

(b) should movements in gross or net reserves be used and what common definition of the components of either can be found?

Should special account be taken of movements in the liabilities of a reserve currency country in circumstances where full asset settlement is not in force?

(c) should a consultation be triggered by a reserve movement to a defined level above or below the base figure, and, if so, how large a movement would be appropriate? Or should one seek to apply the concept of a maximum percentage movement over time for each major country — perhaps by establishing a proportionate relationship between sizes of reserve movements and some outside criterion such as IMF quotas?

The choices made under (a), (b) and (c) above must take account of the problem of existing market sensitivity to movements in reserves. This may be no more than a transitional problem, as markets learn that:

(i) reserve movements, while leading to consultation, do not always lead to adjustment action and, in particular, to exchange rate changes;

(ii) adjustment action may sometimes be taken in the absence of reserve movements.

However, given that the ways in which the questions in (a), (b) and (c) above are answered are not likely to remain secret, this will be an important problem in the early stages of a reformed system.

14. To summarize this section, our preference — indicated in paragraph 9 above — for a continuing process of examination and consultation is strengthened by the difficulties which we foresee in using even the most attractive single indicator of the need for consultation. It seems reasonable, therefore, to expect that a procedure like the one which we have outlined — which would no doubt be improved in the light of experience — would work well enough to allow the use of a quantitative indicator as a signal for consultation eventually to be dispensed with. It might also happen that a quantitative indicator different from the one originally selected would be shown by experience to work more effectively. For these reasons we would be opposed to including in the revised Article of the IMF any code of procedure for the initiation of consultations.

## C. Quantitative indicators as presumptions for adjustment action

15. As has already been clearly stated, we do not accept that any quantitative indicators should be used as automatic signals for action — whether to compel action, or to permit action of a sort that might otherwise be subject to international scrutiny. We therefore do not agree with the proposal in the US paper that small devaluations should be freely permitted, without the need for IMF approval, whenever a country's reserves are below a base level.

16. On the other hand, we support the view that it should be possible, through the processes of consultation, to create the presumption that measures of adjustment are desirable. These presumptions could become stronger as successive stages in the consultations procedure are completed. If the failure of one country (or a few countries) to take adjustment action — whether domestic or external — that has been generally judged to be desirable were to lead to significant difficulties for the international system as a whole, we accept that it should be permissible in the last resort for other countries to adopt compensating measures. We therefore endorse the general approach of 'graduated response' which is illustrated in Part I of C/XX/Dep/Doc/73/2.

17. An example of the type of situation in which compensating measures would be justifiable is where one country persistently accumulates reserves on a scale that is out of all proportion to the rate of creation of primary reserves in the system.

18. A key question is how far the judgments that are arrived at in the course of consultation, and particularly the identification of fundamental disequilibrium, are to be guided by the use of quantitative indicators. The simplicity of movements in reserves was a leading reason why we were prepared to accept them as a trigger for consultation, but it is that same simplicity that demands great caution in accepting reserve movements as a presumptive signal for adjustment action. It is necessary to identify the separate components of any movement in reserves before any judgment can be reached on the need for action or on the type of action that would be appropriate. The first distinction to be made is between the basic balance and movements of mobile capital. Among the possible responses to reserve changes brought about by short-term capital flows, one that might be appropriate in certain circumstances is simply to finance them until they are reversed. It is envisaged that the normal rules of asset settlement might be modified at times of heavy flows of mobile capital, perhaps through the provision of a special short-term financing facility under the surveillance of the IMF. The persistence of such flows, or their resistance to attempts to control or reverse them, might call for a more positive response, as is pointed out in the US paper. In particular, it would be sensible to explore the possibility of treating continuing flows of capital, even though they took the form of purchase or sale of short-term assets and liabilities, as structural flows and therefore as forming part of the basic balance. Another structural problem to be resolved, would be how to cover situations in which a deficit was being financed by increases in private foreign holdings of a particular currency.

19. With this qualification, the state of and prospects for the basic balance is believed to be a better leading guide to the general need for adjustment than is the movement in reserve levels. With both indicators, there is the problem that has been recognized in Part V of the US paper, that the present distribution of reserves does not correspond with any reasonably defined equilibrium position. It is to be expected that countries will aim at basic balances, and corresponding movements in reserves, which will help to adjust their reserve stock to a more desired level. There can therefore be no simple and universal measure of the reserve movement or of the basic balance that can be regarded as representing a position of 'equilibrium' for every country. Measurement must necessarily be against some notional set of balance of payments aims, which must be both realistic for individual countries and, if the principle of symmetry within the system is to be upheld, consistent with each other and with the rate of reserve creation.

20. It will, moreover, often be important to have regard to the composition of the basic balance in expressing balance of payments objectives. It has to be recognized that countries do in practice have separate objectives for the balances of current or of long-term capital transactions. It might perhaps be possible to develop a code of conduct for capital transactions whose universal observance amongst developed countries would enable the basic balance to be adopted as a single indicator. Such a code might provide, for example, that developed countries should be expected to ensure that their net outflow of long-term capital to other developed countries should not be large or persistent.

21. In many cases, this condition might be satisfied without any need to operate specific controls over capital flows — as US representatives argued would be so of their country, in the discussions preceding the Smithsonian agreement. But the suggested code would require that effective controls should be available for use if necessary, should the condition not be met. A code on these lines would conform with the principle that there should be no restriction on the flow of long-term resources to developing countries, or on the earning of current surpluses, to finance such flows. Failing agreement on a code for capital transactions, the use of the basic balance as the leading indicator of the need for adjustment action would need to be supplemented by consideration of current account balances, particularly in arriving at a judgment on the nature of the adjustment action required. It would also be relevant to consider information on cost and price trends, including the probable future effects of past and present changes in competitiveness which have not fully worked themselves out, before coming to a final judgment.

22. Even if evaluation of the basic balance and other indicators should lead to the conclusion that the required adjustment includes changes in the current account, there need still be no presumption that a change in exchange rates is called for. It has to be asked, first, to what extent the observed current balance has been affected by cyclical factors which may be expected, over a period of time, to cancel themselves out. Imbalances attributable to different countries being at different stages in the economic cycle call for purely domestic action on demand management. Domestic action, seeking to influence cost and price trends, may well be the appropriate response where an incipient imbalance is detected in the underlying (cyclically adjusted) current balance. Those departures from balance that would not be eliminated by domestic action alone would be indicative of fundamental disequilibrium, and under such circumstances an exchange rate change would normally be both justifiable and desirable.

23. To summarize the conclusions of this section, while we accept quantitative indicators as an integral part of the consultations process, we do not believe that any single indicator, or any group of indicators, can be used in a general and uniform manner to establish an automatic presumption that adjustment action is needed. We believe that the basic balance is the most satisfactory leading indicator for adjustment action, but argue against too ready a presumption that exchange rate adjustment is the appropriate action. A number of other factors need to be taken into account, most notably the composition of the basic balance. We see a place in certain circumstances for specific action to regulate capital flows, including flows of long-term or structural capital. Above all, we are convinced that the successful working of the adjustment process, through consultation among countries, depends on the willingness of all participants to make it work: this cannot be assured by the adoption of automatic signals for adjustment action, which might well damage rather than contribute to the spirit of international cooperation.

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## *ANNEX V*

## REPORT ON THE ACTIVITIES OF THE WORKING PARTY ON SECURITIES MARKETS

During the period covered by this report (October 1971 to October 1972), trends on the Community's bond markets were, generally speaking fairly favourable. The volume of issues increased on all the markets, while interest rates tended, in the main, to ease down in most of the countries, at least until September 1972.

These developments are the reflection of a trend in the formation — new saving which, despite the persistence — and indeed the strengthening — of inflation, was high, of the growing interest of private investors in fixed-income securities, and of an exceptional abundance of liquidity. Nevertheless, borrowers were apparently somewhat hesitant to contract loans, mainly because of uncertainty as to interest rate trends, and in several countries potential subscribers were increasingly sensitive to interest rate levels.

However, trends were not uniform in all the countries. For example, in the Netherlands, and, to a lesser extent, in Belgium, the downward interest rate trend levelled out for a time in the spring of 1972; in Germany, the situation actually grew tighter on the market at this time, and interest rate levels have risen by more than 1 % since then, despite an appreciable decline in the volume of issues. In Italy, the interest rates have been stable since June after a long period of decline. In France, where interest rates had not declined in 1971 as they had in the other countries, there was a more definite downward trend. In addition, towards the end of the period under review interest rates tended to fall, in all the countries except Italy, mainly as a result of more restrictive monetary policies. So that the mutual relationships of the different countries underwent a change, although all the rates are still within a range fairly similar to that obtaining at the beginning of the period, except that the span between lowest and highest rates has become a little wider, growing from 1·25 to 1·5 %.

The highest rates were in Germany, and not in France as in the previous year. Germany was also the country in which the interest rate decline was smallest, and Italy was the country in which rates declined most.

Official policies in the member countries with regard to their capital markets were broadly similar — there was little attempt to oppose market tendencies. The factors, which, operating freely, tended to widen the markets, increase the volume of issues and bring down interest rates were allowed to work unopposed: nor was any attempt made to curb increases where the adjustment of capital supply and demand made such increases necessary or where the authorities felt that in view of the loss of purchasing power of money, there was a case for maintaining the rewards accruing to savers. Indeed, certain countries take the view that there are structural reasons for maintaining interest rates at a sufficiently high level.

In almost all the member countries, the equities markets, somewhat depressed in the fourth quarter of 1971, gained strength from the beginning of the new year, the stock exchanges having anticipated the business revival.

Prices rose particularly sharply in the Netherlands and in France. However, Italy, where the economic outlook showed little improvement, was left completely outside this trend. At the end of the third quarter of 1972, prices began to fall again in several countries. All in all, issuers took little advantage of the favourable trend which prevailed during most of the period to increase the volume of issue: the figure for this variable remained relatively modest.

In *Germany,* the capital market was fairly receptive. For one thing, household saving continued to expand sharply and savers showed a particular interest in fixed-income securities; secondly, there was a heavy inflow of foreign capital, the bulk of which, in the period up to the end of June, was being invested in German securities. In addition, the banks increased their securities portfolios, particularly in January and February 1972. Interest rates declined early in 1972, though from March onwards there was a steady upward movement. The trend changed direction because private investors and the banks, expecting an increase in interest rates on the capital market due to the heavy and persistent demand for capital, were holding off the market.

To facilitate market stabilization, 'one-time' issuers stopped borrowing at the end of March: the pause was maintained until the end of May. Only after this date were issues resumed, with a German State Railway loan. The nominal interest rate, which had fallen to 7 % at the end of February had to be raised, after a period of strain, in two steps to 8 % during March. It was once again possible to place 'one-time' issues at this rate from June onwards without difficulty on the capital market.

Although there was a fairly large number of foreign loans denominated in DM, they had no decisive influence on the German capital market, since they were virtually all subscribed by foreign investors. As domestic issues also remained very attractive for non-residents, capital imports again increased appreciably because of transactions in internal DM loans, many of them generated by official Swiss action to stem capital imports. So that the Federal German Government was compelled to impose an import licence, at the end of June, for purchases by non-residents of bearer and registered bonds issued on the domestic market.

In view of the important role which foreign capital had played in the placing of German fixed-income securities in the first half of the year, there was some reason to fear a fall in market prices; this, however, did not occur, partly because private domestic investors took over from the non-residents. Since the beginning of September, the Bundesbank has relaxed the import authorization scheme and authorized credit establishments — in the first instance, for six months only — to sell to foreigners domestic fixed-income securities in amounts not exceeding those of the securities of this kind previously sold by non-residents in the Federal Republic of Germany or maturing in the portfolios they hold.

Since a recovery in business activity and an improvement in profits were foreseen in 1972, the equities market was lively from November 1971 onwards. The increase in prices, further strengthened by the interest of non-residents in German equities, continued until the end of August with a few short interruptions. Subsequently, as the business recovery proved only modest, the market lost tone and prices fell.

In the last weeks, the upward movement in interest rates already mentioned gathered momentum, entailing an appreciable increase in the cost of long-term capital. This should curb the demand for capital goods, particularly in the building and construction industry.

In *France,* ample funds were available on the bond market, as that in the fourth quarter of 1971 and in the first quarter of 1972 the volume of issues was appreciably higher than in the same quarters of the preceding years. However, the rate of issues slowed down in the second quarter of 1972 because private borrowers and the public authorities had adopted a 'wait-and-see' attitude, the former having preferred less expensive bank credit, the latter having accounted for a considerable proportion of their borrowing requirements during the first quarter. The exceptional results achieved during the period under review as a whole owed a good deal to the maintenance of nominal rates at a high level: with the value of money still declining, it would not have been desirable to reduce the remuneration earned by household saving, and the high rates did not, in fact impair industrial investment or hamper the efforts of companies to improve their financial structure. However, the declining rates on the secondary market, which gathered momentum from January onwards, and the relaxation of conditions on markets abroad led the banks to reduce nominal rates by 0·25 % on two occasions, in agreement with the authorities. This brought them down to 8·25 % and then to 8 % by the end of April.

The depressed trends on the equities market in the fourth quarter of 1971 gave way to exceptionally favourable stock exchange conditions from the beginning of 1972 onwards. This was partly due to buying by non-residents. On the other hand, the amount of equities issues dropped during the fourth quarter of 1971 and again in the first quarter of 1972. The situation showed some improvement thereafter, but figures recorded in the first half of 1972 still fell short of those reached in the first half of 1971.

In *Italy,* the bond market continued to develop favourably. The appreciable increase in the volume of issues on the domestic market in the last quarter of 1971 continued in the first half of 1972; supply, both from the public, which subscribed 60 % of the new issues, and from financial intermediaries in a position to provide ample funds, responded to the high level of net demand for funds. So that the Banca d'Italia was able to sell bonds in an amount of Lit. 187 000 million in the first eight months of 1972, although it had been a net purchaser of Lit. 312 000 million in the corresponding period of 1971. The Treasury and the nationalized undertakings were the main beneficiaries of the increase in bond issues, followed by international institutions. Personal-property credit establishments later became important among the chief borrowers.

The fall in yields which began in the middle of 1971 continued in the last quarter of the year. This trend was tending to mark time in the first two months of 1972, but a substantial decline occurred in April and May, followed in the most recent period by stable yields at a slightly higher level (about 7½ %). The downward trend was encouraged by the monetary authorities, which pursued a policy designed to promote a recovery in industrial investment and at the same time to align domestic rates on those obtaining on foreign markets.

Italian borrowers were using foreign markets much less in 1971 than in 1970. This was mainly due to a trend in the last quarter, during which, in the absence of new issues on the international market, redemptions of loans contracted abroad entailed net capital outflows of the order of $500 million. The movement continued during the first part of 1972, during which $600 million were reimbursed in this way. During the summer, this attitude changed, and financial institutions again turned to the international market.

There was no steady trend on the equities market. The definite expansion in the volume of issues in the last of 1971, as compared with the corresponding quarter of 1970, gave way, in the first quarter of 1972, to a sharp decline, which was then in its turn followed by a recovery of issues in the second quarter, mainly in favour of small- and medium-sized firms. The stock exchange market, on which the number of transactions was relatively low throughout the period under review, showed few important changes during the last months of 1971 and the first quarter of 1972; the upward movement in prices which then began more than offset the fall in the first quarter.

In the *Netherlands,* interest rates fell in the latter months of 1971. Business activity was losing momentum at the end of the year, and the decline in interest rates gathered pace early in 1972, so that the trend then matched those recorded on foreign markets. The movement changed direction in the spring of 1972, mainly because the supply situation was weak, but early in the second half of the year interest rates one again declined slightly.

Throughout the period under review, the bond market was sufficiently flexible. The demand for funds was exceptionally high in the last quarter of 1971, and the volume of issues in the first three quarters of 1972 remained heavy. Virtually all of these issues were placed with residents, the supply of funds from abroad making only a marginal contribution to the placing of domestic securities since the introduction of the 'bond-florin'.

Initially, the aim of the Nederlandsche Bank was to forestall any unduly rapid decline in interest rates. From the spring-time onwards, official attitudes moved to a more neutral position, the intention being to allow the market equilibrium to be established by independent forces. In April, certain official measures were taken to promote the liberalization of capital movements and to provide incentives to capital exports. For this purpose, the Nederlandsche Bank declared its willingness to authorize non-residents to issue private loans denominated in florins on the market. However, not many borrowers availed themselves of this facility.

Prices on the equities market fell in October and November 1971 but then rose steadily and continuously almost throughout the period under review, the main reason being the sustained interest of foreign subscribers in this market. Share issues, which are traditionally weak in the Netherlands, totalled Fl. 38 million in the first three quarters of 1972, compared with Fl. 58 million in the corresponding quarters of 1971.

The *Belgian capital market* expanded sharply during the period under review. The volume of issues reached a very high, perhaps exceptional level, in the periods up to the end of the first quarter of 1972. The trend lost a little momentum in the second quarter, but there was a further recovery in the third quarter. This trend was accompanied by a slow but steady decline in interest rates, which began at the beginning of 1971 and which was interrupted for only a short period in the spring of 1972: in the third quarter, interest rates were again running at an exceptionally low level.

There was no difficulty as to the subscribing of issues, since capital saving was still being formed in large amounts. Apart from a convertible bond issue in the second quarter, only the public sector was using the market. Faced with a heavy inflow of foreign capital, the central Government increased the volume of domestic issues for a short time beyond its borrowing requirement, and this enabled a large proportion of its external debt to be redeemed.

On the equities market, prices fell during the August-November 1971 period, but thereafter made steady progress. On the *Luxembourg capital market,* the market for loans denominated in Luxembourg francs was opened to non-resident borrowers.

With a view to forestalling any disequilibrium that might result from this measure, the Luxembourg authorities introduced an issue schedule for 1972 based, normally, on a quarterly volume of issue of about Lfrs. 300 to 400 million. The market accounted very easily for the sums foreseen in the schedule for the first half of the year, whilst yields continued to decline. On the other hand, the public supply in Luxembourg of Euro-loan securities slowed down a little from the fourth quarter of 1971 onwards, because of the perceptible decline in issues denominated in units of account.

Trends on the countries' individual markets were generally favourable and this was also true for the *international markets,* where, indeed, trends were even more favourable in certain respects. In the period from the fourth quarter of 1971 to the third quarter of 1972, the volume of issues totalled $5 300 million, compared with $4 800 million in the preceding twelve months. Out of this total, issues denominated in $ US accounted for $2 600 million, i.e. 49·6 % (1), international loans in DM, $1 200 million, i.e. almost a quarter of the issues, issues in Swiss francs, $576 million, i.e. 10·9 %.

(1) The percentage for conventional bond issues, not including convertible bonds, is substantially lower.

As in the past, currencies of issue were chosen on the basis of an assessment of the exchange risk and of interest conditions prevailing on the various markets. In this connection, it is noteworthy that disparities between the interest or yield rates on the markets of the individual issue currencies widened in periods of increased instability and, in their turn, narrowed down when confidence in the stability of the current relationships of the principal currencies was restored. The respective trends of rates of yield on DM and dollar issues in particularly illuminating in this respect.

The rapid adjustments of rates of yield also had the effect of keeping the distribution of the issued amounts by currency relatively stable. Issues denominated in US dollars still account for more than half of the total; those denominated in DM and in Swiss francs also showed little variation. Only the French franc made noteworthy gains as an international issue currency, while issues in Luxembourg francs constitute a recent development the future of which it is too early to foresee. Moreover, the volume of international private-treaty loans denominated in florins (not included in the figures given above) increased sharply.

Interest rates generally tended to fall during the greater part of the period under review. Yields on issues in US dollars fell back relatively fast from the very high level reached in the autumn of 1971, even before the Washington agreements terminated the period of insecurity caused by the adoption of floating exchange rates; during the first three quarters of 1972, they fluctuated within a narrow range; at the end of the period they were tending to ease downwards. Under the influence of very heavy purchases by non-resident investors, a sharp fall in interest rates on international bonds denominated in DM was recorded, occurring mainly during the first half of 1972.

Having fallen to about $5^3/_4$ % in August, following the ban on purchases of bonds issued by German borrowers, the rates recovered by almost 1 % because of arbitrage operations in favour of bonds denominated in currencies providing better yields and because of the heavy volume of new issues. As a result of a policy of cautious official authorization, interest rates on the international Swiss franc loan market dropped by about half a percentage point — from 6 to $5^1/_2$ % — at the beginning of the period under review. Since then, however, interest rates have staged a recovery because of the restoration of confidence in the dollar, which made the Swiss currency relatively less attractive and brought home more strongly to investors how relatively low are yields on these securities. On the international market in private-treaty loans denominated in florins, trends were much like those on the market for international loans denominated in DM. International issues in French francs were fairly successful in the early part of the period, and this enabled borrowers to cut interest rates; however, in the third quarter of 1972, conditions deteriorated as a result of a plethora of new issues on the market and the revival of interest in issues denominated in other currencies, particularly in US dollars.

The policy of the Member States' monetary authorities with regard to the international bond markets consisted in allowing participation, within certain limits, in these markets, while endeavouring to cushion the impact of such participation on their economies, by various means. The measures used were carefully selected and applied, and the policies took account — to extents varying according to country and period — of balance-of-payments considerations and of considerations arising from current business trends or structural needs. For example, the authorities made access for resident borrowers to international markets more difficult in Germany and in France, while the Italian authorities encouraged such access in Italy, the aim in the first case being to avoid capital inflows, and in the second case to facilitate such inflows.

Again, the authorities, while favouring capital exports, offered an uneven range of facilities for the placing of Euro-issues with their residents. Placing by public offer remained limited in Belgium and France, while it was authorized very freely in Germany. In addition, the contribution of Belgian and Luxembourg subscribers to the Euro-issues market expanded, although certain limits were set to the placing with residents of these countries of loans denominated in Luxembourg francs, the volume of which increased appreciably.

Indeed, on some occasions the authorities intervened to control both inflows and outflows of capital, for example, in the Netherlands, by forbidding the use within the country of the yield from Euro-issues on the one hand, and by reducing the scope for issues in florins for non-resident borrowers, on the other. In France, exchange controls were maintained, although they were used mainly to curb capital inflows.

Moreover, by authorizing, under certain conditions, the development of Euro-issues in Community currencies, several Member States made it possible to meet the non-resident investors' need for diversification in their investments. At the same time they avoided capital flows deemed undesirable and endeavoured to shield the domestic national markets from the influence of external factors. Here, it was felt that the financial institutions of the countries concerned should assume control of the guarantee and placing consortia for these issues, so as to ensure fuller implementation of official policy. Thus, the authorities also improved the position of the financial institutions of their own countries in the guarantee and placing consortia for international loans, at their request. This was a contribution to the development of the international status of their capital markets.

Another constructive aspect of the use of certain European currencies as media for Euro-issues is the fact that it facilitates the participation in the international market of Community issuers and investors and that it strengthens the role of Community currencies alongside the dollar in international financial transactions.

In the last analysis, this development reflects an increased participation of European transactions in the Euro-issues market, the gradual scaling-down of conventional foreign issues on each of the national markets and continuing an even severer market fragmentation. The result has been a considerable build-up in Euro-issues, particularly in

Community currencies, instead of the integration of the national markets into a common capital market.

Nonetheless, there is no escaping the fact that at the present time the development of Euro-markets in DM, FF, Fl., and Lfrs. separated from the national markets is leading to the juxtaposition of isolated markets, of narrow resources and weaker than an integrated European market would be. While an increase in conventional foreign issues would help to widen the range of securities available on each of the national markets, and more intra-Community placings would have the effect of broadening the supply of capital on these markets, the development of Euro-issues, even in Community currencies, does not bring with it the important advantage which an integration of the national markets should provide — that of overcoming their narrowness. It is true that, for balance-of-payments reasons, several member countries are opposed to an increase on their markets of the supply of capital from abroad.

Another point is that as the Euro-issues market has no withholding tax, even the Member States wishing to maintain this tax on their domestic markets have been virtually unable to apply it to their residents where they are issuing on the international market, nor to all the Euro-issues in their own currencies, and the effect of this has been to give the Euro-issue market an advantage over the national markets. This development may well be connected with the fact that interest rates for Euro-issues in the Community currencies have been running below those for domestic issues, at least for French francs and the DM (1). It is probably also connected with the tendency towards specialization of the markets which seems to be gathering momentum in certain countries, since the main borrowers on the Euro-issues market belong rather to the private sector than to the public sector, whereas public borrowers account for most of the business on the national markets. In the long run, distortions of this nature could have disadvantages of which a common capital market based on harmonized taxation would be free. Suggestions in this connection were made in the Working Party's last annual report.

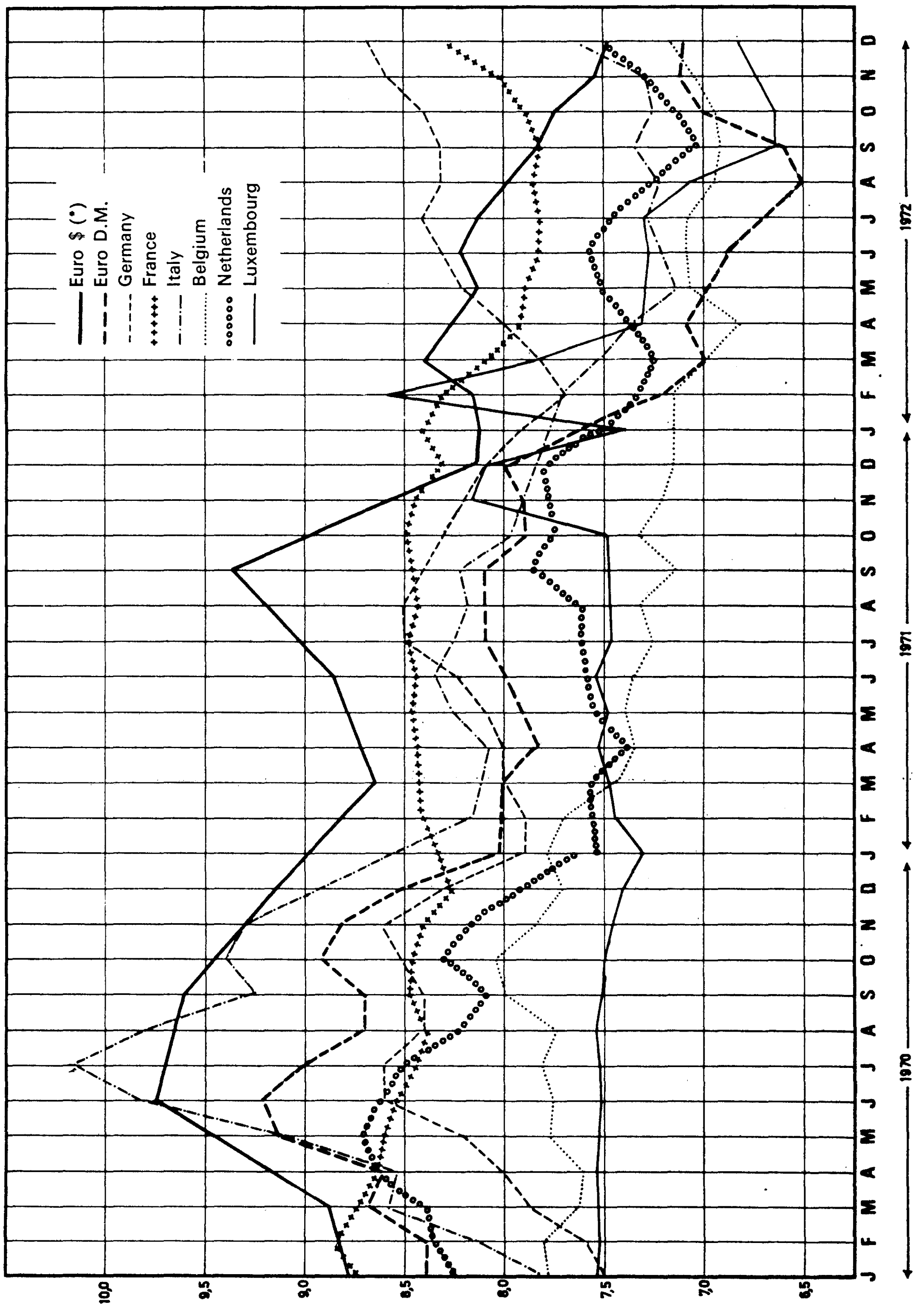
It goes without saying that the integration of the Community markets will necessitate coordination of economic and monetary policies and elimination of risks deriving from possible parity changes, i.e. in effect, a single currency. However, even before progress on such a large scale is made on the monetary level, interpenetration of the national capital markets by the gradual mutual concession of facilities for floating issues by an increase in security quotations from other member countries and by an increase in the scope for mutual placing by member countries' residents on the domestic markets would yield some of the advantages to be expected from the development of a European capital market which the Euro-issue market cannot provide.

The Working Party regrets that developments in the course of the year brought the Community no nearer these objectives. Balance-of-payments considerations in certain countries and differing trends in business activity delayed monetary integration and actually led to the creation of additional barriers between the countries.

In this context, the Working Party believes that there can be no complete and lasting integration of the Community's securities markets before disparities in business trends in the member countries, and therefore in the economic and monetary policies, have been narrowed down. Consequently, it believes that progress in monetary integration must be made if capital market policies are to be harmonized; this finding does not mean that efforts should not be continued in this field or that any opportunity should be neglected to eliminate institutional and technical obstacles to the reciprocal opening of the capital markets.

(1) There is a 25 % withholding tax for non-residents drawing interest on domestic DM and FF issues, but Euro-issues in these currencies are exempt.

Stock market yields



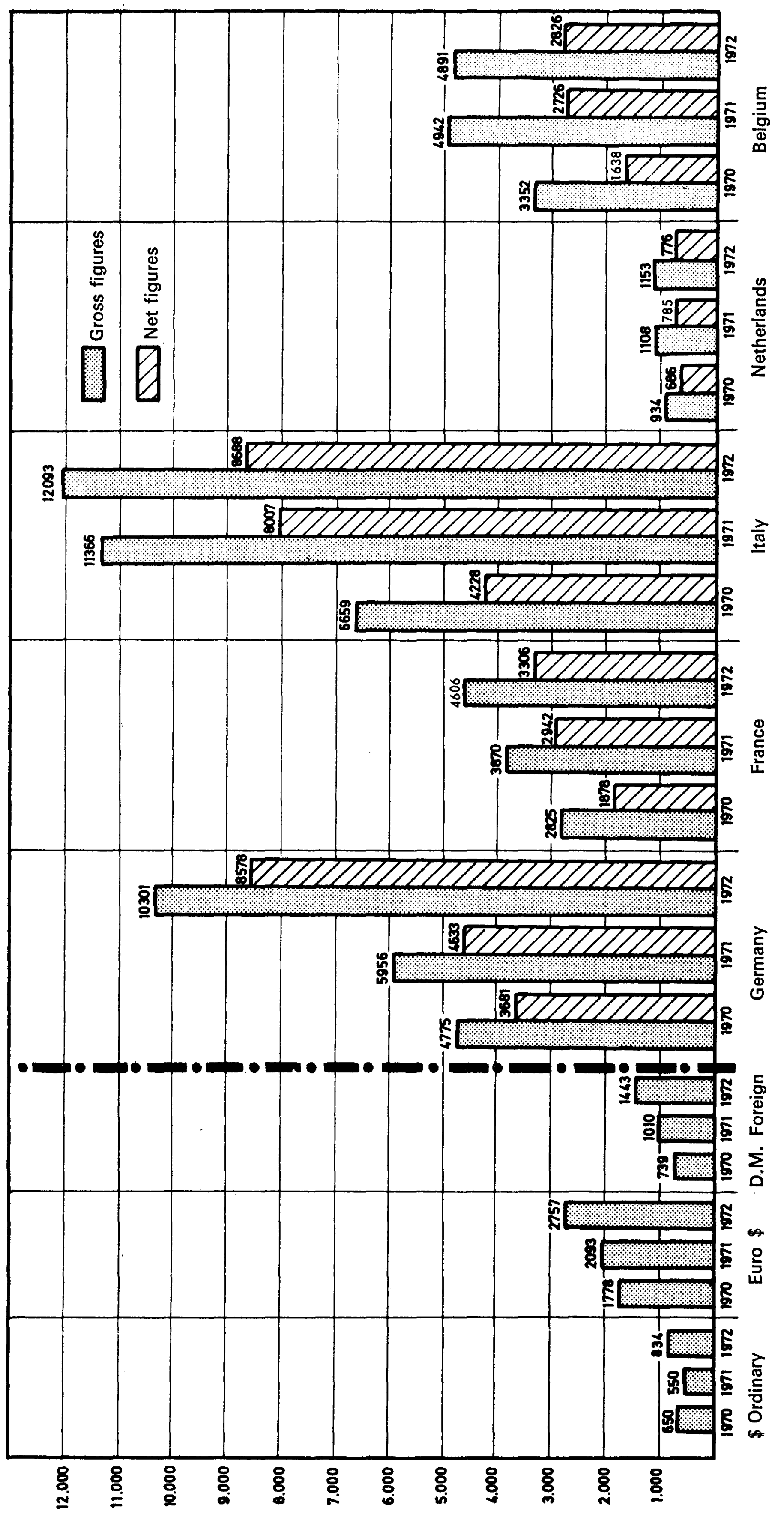

(*) Quarterly figures until December 1971.

**Note on stock market yields graph**

For the Member States the reference is to the rates considered as the most representative on the market. In the absence of series for the entire market, the rates referred to are those of the issuers operating most frequently on the relevant market.

| | |
|---|---|
| *Germany:* | stock market yield of all fixed-income securities. |
| *France:* | stock market yield of bonds issued or guaranteed by the central government and bonds having the same status. |
| *Belgium:* | stock market yield on state loans maturing in more than five years. |
| *Italy:* | stock market yields on bonds issued by credit institutions (personal property credit establishments). |
| *Netherlands:* | for 1970, stock market yield of the 4·5 % loan of the Bank voor Nederlandsche Gemeenten: for 1971 and 1972, average of the last three State loans maturing in 20 years. |
| *Luxembourg:* | stock market yield of thirteen Luxembourg State loans issued from 1955 onwards (14 loans from October 1971 onwards, 15 loans from January 1972 onwards). |
| *Euro $:* | average yield on ordinary bonds calculated over the average life of the loan (source: OECD-BONDTRADE). |
| *Euro DM:* | stock market yield from bonds of foreign issuers denominated in DM (source: Deutsche Bundesbank). |

Volume of bond issues
(Millions of EUR u.a.)



*ANNEX VI*

## LIST OF MEMBERS OF THE WORKING PARTY ON SECURITIES MARKETS

| | |
|---|---|
| *Chairman:* | F. De Voghel, vice-gouverneur honoraire de la Banque nationale de Belgique, président de l'Institut de réescompte et de garantie, Brussels |
| GERMANY | Dr K. Andreas, Leiter der Hauptabteilung Kredit, Deutsche Bundesbank, Frankfurt |
| | Ministerialrat Borgböhmer, Bundesministerium der Finanzen, Bonn |
| | Ministerialrat G. Wetzler, Bundesministerium der Finanzen, Bonn |
| BELGIUM | M. D'Haeze, directeur général de l'administration de la trésorerie et de la dette publique, Brussels |
| | F. Junius, Banque nationale de Belgique, Brussels |
| | E. Kestens, inspecteur général au ministère des finances, Brussels |
| FRANCE | Y. Berger, conseiller auprès du gouverneur de la Banque de France, Paris |
| | Ph. Cosserat, direction du trésor, ministère de l'économie et des finances, Paris |
| | P. de Larosière, sous-directeur des affaires internationales à la direction du trésor, ministère de l'économie et des finances, Paris |
| | Mme. L. Beauvais, Banque de France, Paris |
| ITALY | Dott. P. Battaglia, condirettore centrale, Banca d'Italia, Rome |
| | Dott. G. Monterastelli, condirettore centrale, Banca d'Italia, Rome |
| | Dott. M. Napolitano, ispettore generale, direzione generale del Tesoro, ministero del Tesoro, Rome |
| LUXEMBOURG | A. Dondelinger, commissaire au contrôle des banques, Luxembourg |
| | E. Israel, directeur à la Banque internationale, Luxembourg |
| NETHERLANDS | Drs. M. M. Keyzer, Nederlandsche Bank NV, Amsterdam |
| | Drs. P. C. Timmerman, Onderdirecteur van de Nederlandsche Bank NV, Amsterdam |
| | Drs. J. Grooters, directeur binnenlands geldwezen, Ministerie van Financien, The Hague |
| COMMISSION OF THE EUROPEAN COMMUNITIES | F. Boyer de la Giroday, Director for Monetary Affairs, Directorate General for Economic and Financial Affairs, Brussels |
| | M. Sarmet, Chief of Division for Financial Institutions and Capital Markets, Directorate General for Economic and Financial Affairs, Brussels |
| | M. Zucker, Directorate General for Economic and Financial Affairs, Brussels |
| SECRETARIAT | G. Morelli, secretary of the Monetary Committee, Brussels |
| | G. Lermen, Brussels |