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I

(Information)

COUNCIL AND COMMISSION

NINETEENTH REPORT ON THE ACTIVITIES OF THE MONETARY COMMITTEE

FOREWORD

The purpose of this report is to give a brief account of the activities of the Monetary Committee in the course of 1977.

During the year, the Committee held 11 sessions and the working parties drawn from its own members or set up at its initiative met on many occasions. A list of members as at 31 December 1977 is annexed.

The report was adopted as at 31 December 1977.

INTRODUCTION

1. 1977 saw a slowdown in the expansion of world economic activity. All the major industrialized countries were affected, although to differing degrees, and international trade suffered as a result: from one year to another their rate of growth by volume diminished by almost half. Balance of payments disequilibria persisted but unequally: the deficit of the non-oil-producing developing countries diminished, as did the OPEC surplus; the deficit of the Community was also greatly reduced. On the other hand, a new disequilibrium, namely a considerable worsening of the US deficit, made itself increasingly felt in the course of the year.

2. The economic situation in the Community presented rather a contrast in 1977. The slowdown of expansion

was particularly marked, the rate of growth of output in 1977 scarcely exceeding half that of the preceding year. Because of this, the employment situation did not improve: unemployment at first continued to expand before stabilizing somewhat at the end of the year under the effect of specific measures adopted in a majority of countries. On the other hand, considerable progress was achieved on prices and external payments: a slowdown in the rate of inflation was to be seen in the Community as a whole, and was particularly marked in those countries where it had been highest; similarly, there was a considerable reduction in the current deficit of the Community, and it is mainly due to the improvement in the current balances of countries who had the largest deficits.

COMMUNITY ACTION AND THE ACTIVITIES OF THE COMMITTEE

3. In 1977, as in previous years, the Committee devoted a major part of its time to examining the

economic situations of Member States, to studying ways of reinforcing monetary and financial cooperation

within the Community and finding a common position on international monetary problems discussed primarily in the International Monetary Fund.

4. During the year, all Community countries were examined at least once and some of them much more frequently, either in accordance with procedures governing the use of Community credit mechanisms, or as a result of developments in the economic situation of those countries.

5. The countries whose economies were examined most often therefore, in 1977, were Italy, the United Kingdom and the Federal Republic of Germany. As required by the Council Decision granting a Community loan to Italy, the Committee was consulted by the Commission on the economic situation in Italy and the economic policy conditions to be observed by Italy in 1977. The opinion expressed by the Committee, based on the work carried out by the *ad hoc* group chaired by Mr de la Genière, were taken into account when the Council adopted a Directive on 17 May 1977 adapting the conditions attached to the granting of medium-term financial assistance to Italy in 1974 as well as two Decisions, one which authorized the Commission to borrow \$ 500 million on the capital markets and lend this sum to Italy and the other which fixed the economic policy conditions to be observed by this country in return for the Community loans received in 1976 and 1977.

The Committee also closely followed the situation in the United Kingdom, as the measures taken to meet the sterling crisis of autumn 1976 began to take effect. At the beginning of the year, the Committee received a report from its *ad hoc* group chaired by Mr Andersen on the economic situation in the United Kingdom, and in the light of this report, the Committee agreed that the continued non-participation of the UK in the provision of medium-term financial assistance to Italy was justified on the basis of the balance of payments and reserves situation. The Committee continued to monitor developments in the British economy throughout the year as the improvement particularly in the balance of payments and on the financial front, was maintained.

The Committee also frequently discussed the monetary situation in Germany and the way in which the German authorities could contribute to better equilibrium in balances of payments within the Community.

6. In January the Committee also adopted the report prepared by the Andersen group on the economic situation in Ireland and the respect of the economic policy conditions in 1976, in accordance with the requirements of the Decision granting a Community loan to Ireland. In December, the group met again to consider de-

velopments in 1977 and to prepare a report which will be submitted to the Committee early in 1978.

7. In the framework of the move to the 'own resources' system for financing Community expenditure in 1978, the Committee was consulted on the monetary problems involved in the Commission's proposal for the adoption of the European unit of account (EUA) in the Community budget. It approved the proposals of the Commission and recognized that the accounting method envisaged had no monetary implications (Annex I).

8. In November 1976, the Committee had presented a report to the Council and the Commission on a number of monetary problems faced by the Community, among which was the Community's exchange rate system. At their meeting of 8 November 1976, the Council took note of this report and requested both the Committee and the Committee of Governors to see how and under what circumstances the proposals to introduce a coherent exchange rate policy system for the Community as a whole could be implemented. (See paragraph 8 (a) of the 18th report on the activities of the Monetary Committee⁽¹⁾). After detailed discussions, the Committee approved the text of a declaration which it requested the chairman to make to Council at its session of 14 March (Annex II).

9. In this declaration, the Committee expressed its reluctance to propose the introduction of a target zone system to the Council at that time. On the other hand, it suggested that the strengthening of economic and financial cohesion of the Community could be done without delay by initiating 'periodic consultations on the direction and intensity of measures taken by the Member States in so far as they affect the development of exchange rates'. As a result, the Committee has held regular consultations on the development of exchange rates, and on three occasions has devoted a major part of its sessions to such consultations. These consultations could play a useful role in contributing to a better understanding of the exchange rate policies of Member States and therefore promoting a closer coordination of these policies.

10. The second monetary problem which the Committee discussed in its report of November 1976, was the use of quantitative monetary policy objectives. This was also to be the subject of periodic discussion in the Committee, and in addition to its regular surveys of national monetary policies, the Committee has held one detailed examination of the experience of Member States in using such quantitative monetary policy objec-

OJ No C 195, 15. 8. 1977, p. 2.

tives, of the different types of objectives used, and Member States' assessment of the usefulness of such objectives in achieving the goals of overall economic policy.

11. Following the decision of the United Kingdom in November 1976 not to renew the bilateral three-month renewable credit it had extended to Italy at the time when that country was granted MTFA, the Commission requested the Council for permission to negotiate a \$ 500 million loan under the Community loan mechanism set up in February 1975. As required by the provisions of the Regulation governing such loans, the Committee was consulted on this proposal, and at later stages of the procedure, which culminated in the issue of a \$ 500 million Euro-bond issue in two tranches, one of \$ 200 million for five years at 7.5 % and one of \$ 300 million seven years at 7.75 %. The Committee was again consulted on proposals to change the floating rate portion of the original loan operation to fixed rates. (One such operation had already been done in October 1976 — see 18th report, paragraph 9). The consolidation was completed by means of a \$ 100 million fixed interest bank credit provided by a group of Dutch banks in April and a \$ 100 million public offer of notes on the New York market in July.

12. At the Council meeting of 18 July, the Belgian President-in-office had put forward a series of proposals for improving the Community's short- and medium-term credit mechanisms and thereby providing for convergence in the economies of Member States. The Council had then requested the Monetary Committee (along with the Committee of Governors) to examine these proposals, which essentially involved an increase in the quotas in the short-term monetary support system and in the amounts of the ceilings in the medium-term financial assistance, and increasing the conditionality of both. Concentrating mainly on the question of the MTFA, the Committee adopted a preliminary report which was submitted to the Council on 17 October (Annex III). In response to a further request from the Council, the Committee continued its examination and presented a supplementary report to Council on 21 November (Annex IV). This report proposed a doubling of member countries' commitment ceilings in the medium-term financial assistance mechanism provided satisfactory adjustments were made to the rules of the

system on conditionality of loans, supervision of compliance with policy conditions accompanying the granting of loans, conditions for possible exemption, and mobilization of claims and the currency in which credits made available are to be denominated. On the basis of these two reports, the Commission prepared a draft proposal and at its meeting of 19 December, the Council adopted a Decision amending the MTFA mechanism along the lines suggested by the Committee.

13. The Committee, along with the Economic Policy Committee, was requested to examine the proposal presented by the Commission to the European Council on 29 and 30 June on 'investment and borrowing in the Community'. This communication proposed that the Commission be permitted to raise loans up to an amount of 1 000 million EUA. On the basis of a report prepared by the alternates, the Committee adopted a preliminary report to the Council and Commission at its meeting of 12 October (Annex V). In the light of this report, the Council then invited the Monetary Committee to pursue its examinations in order that it could take a decision at its November meeting. At its meeting of 15 November, the Committee adopted a supplementary report setting out a possible compromise solution to the problems described in its first report (Annex VI). This proposal was accepted by the Council and a formal decision will be taken early in 1978.

14. As usual, the Committee also discussed international monetary questions on a number of occasions, in preparation for the meetings of the Interim Committee in April, and the annual meetings of the International Monetary Fund and World Bank in Washington in October. This year, the main questions with which the Committee was called upon to deal were international liquidity, in the framework of the seventh review of quotas, the liquidity of the Fund itself, surveillance by the Fund of exchange rate policies, and the role of the SDR in the international monetary system.

15. The Committee also examined various other matters, including consultations under Article 108 of the EEC Treaty, and proposals to change the conversion rates for national currencies into units of account for the purposes of the common agricultural policy.

WORKING PARTIES OF THE MONETARY COMMITTEE

16. The Working Party on Securities Markets met three times in 1977, and continued to examine de-

velopments in the capital markets of the Member States and in the international bond markets, and also discus-

sed capital market policies. It further pursued the work begun in 1976 on the implications of the increasing use of floating-rate loans, both on the international markets and on national fixed-interest bond markets, as a means of raising long-term capital.

17. The Working Party 'Harmonization of Monetary Policy Instruments', a joint group of the Committee and the Committee of Governors, met several times in 1977. It continued its studies of simulation exercises with monetary policy instruments, and analyses of the transmission process of monetary policy, with a view to presenting a new report to the Committee in 1978.

LIST OF MEMBERS AND ALTERNATES OF THE MONETARY COMMITTEE

Chairman

Mr K-O. Pöhl
Vizepräsident der Deutschen Bundesbank
(Frankfurt-am-Main)

Vice-Chairmen

Mr S. Andersen
Governor — Danmarks Nationalbank (Copenhagen)

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

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

Members

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

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

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

Mr A. Dondelinger
(until 25 January 1977)
Commissaire au contrôle des banques (Luxembourg)

Dr O. Emminger
(until 1 June 1977)
Vizepräsident der Deutschen Bundesbank
(Frankfurt-am-Main)

Mr K. Hansen
Director-General — Det Økonomiske Sekretariat
(Copenhagen)

Mr M. Horgan
Department of Finance (Dublin)

Mr P. Jaans
(since 25 January 1977)
Commissaire au contrôle des banques (Luxembourg)

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

Mr N. Jordan-Moss
H. M. Treasury (London)

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

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

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

Mr T. O'Grady-Walshe
Central Bank of Ireland (Dublin)

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

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

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

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

Dr A. H. E. M. Wellink
Thesaurier-generaal bij het Ministerie van Financiën
(The Hague)

Chairman of the Alternates of the Monetary Committee

Mr J. G. Littler
(until 7 July 1977)
H. M. Treasury (London)

Mr H. Baquiast
(since 9 September 1977)
Sous-directeur à la direction du trésor ministère de
l'économie et des finances (Paris)

Alternates

Dott. V. Barattieri di san Pietro (until 12 October 1977)	Banca d'Italia (Rome)
Drs. D. H. Boot	Onderdirecteur van de Nederlandsche Bank NV (Amsterdam)
Mr P. J. Bull (since 17 May 1977)	Bank of England (London)
Mr H. Dalgaard	Kontorchef — Danmarks Nationalbank (Copenhagen)
Dr W. Flandorffer	Ministerialrat — Bundesministerium für Wirtschaft (Bonn)
Mr R. H. Gilchrist (until 17 May 1977)	Bank of England (London)
Mrs M. Hedley-Miller (since 7 July 1977)	H.M. Treasury (London)
Mr P. Jaans (until 25 January 1977)	Commissaire au contrôle des banques (Luxembourg)
Mr G. Jennemann	Bankdirektor — Deutsche Bundesbank (Frankfurt-am-Main)
Mr G. Lefort	Directeur général des services étrangers de la Banque de France (Paris)
Dott. S. Masera (since 12 October 1977)	Banca d'Italia (Rome)
Mr J. Mertens de Wilmars	Conseiller économique de la Banque nationale de Belgique (Brussels)
Mr L. Meulemans (until 1 May 1977)	Inspecteur général à l'administration de la trésorerie (Brussels)
Mr G. Reynolds	Central Bank of Ireland (Dublin)
Mr M. Schmit	Inspecteur des finances (Luxembourg)
Mr B. Scully	Department of Finance (Dublin)
Mr N. Ussing	Kommitteret — Det Økonomiske Sekretariat (Copenhagen)
Drs. R. van Boven	Ministerie van Financiën (The Hague)
Mr J. Vanormelingen (since 1 May 1977)	Administration de la Trésorerie (Brussels)
Dr M. Wegner	Director in the Directorate-General for Economic and Financial Affairs — Commission of the European Com- munities (Brussels)
Mr P. Zimmer (since 25 January 1977)	Commissariat au contrôle des banques (Luxembourg)
Dott. A. Zodda	Ministero del tesoro (Rome)

Secretariat

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

ANNEX I

OPINION TO THE COUNCIL AND THE COMMISSION

1. At its meeting of 30 March 1977 the Monetary Committee examined the monetary problems involved in the adoption of the European unit of account (EUA) in the Community budget, on the basis of documents presented by the Commission departments and in the light of the proposal for a Regulation of the Council adopting the EUA in the budget. The Committee considered the other possible applications of the unit of account which include:

- (a) the European monetary cooperation fund;
- (b) short-term monetary support system;
- (c) medium-term financial assistance;
- (d) Community loan.

The Committee noted that the Commission did not propose the application of the EUA in respect of the European monetary cooperation fund and the short-term monetary support system, for which the EMUA is used. They noted also that the Commission had deferred proposals to apply the EUA to medium-term financial assistance and that it was not proposed to apply the EUA in respect of Community loans.

2. Considering the problem of the application of the EUA to the budget, the Committee agreed that there are no monetary consequences of adopting the EUA for accounting purposes of the Community and examined separately the problems arising in connection with expenditure and those arising on the revenue side.

3. The Committee felt it could accept the principle of determining budgetary expenditure in the EUA. It noted the Commission's intention to implement this principle gradually and to achieve it with the necessary flexibility.

It recognized, however, that by far the largest proportion of Community expenditure is presently denominated in national currencies, and in the agricultural unit of account (representative rates) and some of them were sceptical about the likelihood of the proportion of EUA-determined expenditure reaching a significant level in the near future. Some members expressed particular concern about the application of the EUA to the Community's contractual relationships. Moreover, concern was expressed that the determination of payments to residents in units of account might lead to exchange control difficulties. It was noted in this connection that in the Commission's view the determination of payments in units of account would in all cases be subject to national exchange control regulations. The Committee finally felt that the provisions for a price revision index as laid down in Article 14 were unacceptable from a monetary point of view.

4. Most members of the Committee were not ready to accept the development of the EUA as a means of payment or a significant expansion of accounts held with commercial banks and denominated in EUA over and above those already in existence for ECSC use. Such an expansion in the view of some members would have the consequence of giving rise to a paral-

lel currency, of provoking undesirable capital movements, and would entail costs for banks in covering the foreign exchange risks in several currencies.

5. The Committee also considered the principle proposed by the Commission that the value of the budget receipts should be maintained in EUA. The departments of the Commission justified this principle on the following grounds: although only a small proportion of expenditure will at first be in EUA, the currency of payment of the majority of expenditure is unknown at the time of the budgetary decision. Therefore the Committee considered that it is correct to maintain the value of receipts over a spread of national currencies and that using the EUA weighting is the most neutral and least contestable solution from a Community point of view. Two methods of ensuring this maintenance of value were examined:

- (a) Own resources collected in national currencies would be transformed into EUA on the date of payment. This can either be done by the Commission holding EUA accounts with the central banks, or by the Member States giving an EUA guarantee. The national authority would then be free to choose whether to guard against the exchange risk by purchasing the EUA 'basket' to the amount of its obligation or to carry the exchange risk itself.
- (b) Own resources are held in an account in national currency in the Commission's name with the national monetary authorities. The Commission would then administer these funds and could in particular make transfers from one currency to another.

6. The Committee felt that it might be possible and attractive to look for ways of matching expenditure and revenue by currency: to the extent that expenditure and revenue could be accurately forecast this would have the advantage of reducing the amount of net transfers of funds to the minimum required to accommodate net flows of financial resources between Member States. However, the Commission departments pointed out that the prediction of currency requirements both in the short-run and in the long-run is uncertain, since Community policy may be changed in mid-year in the face of special circumstances, (such as in 1976 when the basis of payment of monetary compensatory amounts was changed), and that under the own resources system, forecasting of receipts by currency is also very difficult. To the extent that a large margin of error would exist, currency transfers might well be substantial and frequent, thus raising difficulties for the monetary authorities in their management of exchange markets.

7. To the extent that offsetting expenditure and revenue by currency is not feasible, the Committee felt that an alternative fairly well defined and administratively defensible criterion for guiding the transfers between currencies would be for the Commission to match its currency holdings to the EUA basket.

8. While applying the principle of keeping currency holdings in step with the EUA weights there was still scope for cancelling out, as far as possible, receipts and payments in the same

national currency so as to reduce to a minimum the need for currency transfers. It was pointed out that the Commission intended to continue its current practice of concentrating its receipts and payments in time, thus minimizing the number of transactions needed to maintain the value of receipts.

9. Although some of them found the first type of solution paragraph 5 (a) as proposed by the Commission acceptable, the members of the Committee generally felt that the option in paragraph 5 (b) appeared to be the system which is least complex, most easily managed, offers most opportunity for cancelling out payments and receipts and does not require the open-

ing of EUA-denominated bank accounts. However, it was recognized that in operating such an arrangement the Commission would still have to make some transfers. These transfers should be subject to concertation with the monetary authorities so as to minimize their impact on exchange markets and reserves management.

10. It was felt that this system offered significant scope for experimentation: the Committee, like the Commission, recognized the need for a broad guideline, but it considered that a flexible and pragmatic approach should be adopted at least in the initial stages so as to allow for eventual reconsideration and adjustment.

ANNEX II

ORAL STATEMENT TO COUNCIL ON THE COMMUNITY EXCHANGE RATE SYSTEM

At the request of the Council (416th session of 8 November 1976), the Monetary Committee has again examined how and under what circumstances the Dutch proposals on the strengthening of economic and financial cohesion of the Community could be made operational. The Committee has asked its chairman to make an oral report to the Council on this subject.

The members of the Monetary Committee, in their discussions, supported the objectives of the Dutch proposals. They unanimously agreed that the main point of this initiative is to initiate more consultations in order not only to reduce the danger of divergent developments in exchange rates between members of the European exchange arrangement and other members of the Community, but also to foster convergence in economic policy and exchange rates. As was emphasized on several occasions in the Committee, these consultations should cover all areas of economic and financial policy which are relevant to the development of exchange rates. There are, even now, sufficient grounds for this procedure, certainly at a time when the economic policies of the Member States and their exchange rates obviously do not show a sufficient degree of convergence. I might add that existing Council Decisions already require such consultations, and this irrespective of whether and when 'target zones' can be established.

As indicated in its report to the Council and the Commission of 4 November 1976, the Committee considers that, for the foreseeable future, it would not be feasible to introduce a coherent exchange rate policy system, if such a system were to go beyond consultations and also contain binding obligations whether in respect of general economic policy or exchange rate policy in particular. Such obligations can only be undertaken when appreciable progress has been made towards the con-

vergence of economic policies and when there is a sufficiently parallel development on the exchange markets.

It is mainly on these grounds that the Committee is reluctant to propose the introduction of a target zone system to the Council at the present moment. There is also the fact that a number of differences of opinion still remain in the Committee on individual aspects of the target zone concept (method of calculation and usefulness of effective rates, uncertainty as to the reaction of the exchange markets to the establishment of target zones). Discussion of these questions should continue in the Monetary Committee.

I believe I am interpreting correctly the views of all the members of the Committee when I say that it is more a question of practical action and pragmatic procedure than formal decisions. Therefore I suggest that:

- the Monetary Committee initiate, without delay, periodic consultations on the direction and intensity of measures taken by the Member States in so far as they affect the development of exchange rates,
- the Commission be requested to make available all the necessary data to the Monetary Committee for this purpose,
- the Monetary Committee report to the Council and the Commission on the outcome of its consultations,
- Member States decide in the Council to what extent the recommendations of the Monetary Committee can be put into effect.

I am convinced that such consultations in the Monetary Committee would be an initial realistic step towards taking account of the proposals of the Dutch and French Ministers of Finance as well as one of the aspects of the Tindemans Report.

ANNEX III

REPORT TO THE COUNCIL AND THE COMMISSION ON THE BELGIAN PROPOSALS

1. At the Council meeting of 18 July 1977, the Belgian Presidency submitted a programme for action in the field of economic and finance. In particular, this programme makes suggestions for amending and improving the short- and medium-term credit mechanisms which exist at present within the Community. The Council asked the Monetary Committee to examine these suggestions and report back in time for the October Council meeting. In response to this request, the Monetary Committee is submitting the present report which embodies the conclusions of its preliminary discussions on this matter.

2. The work of the Monetary Committee at its meetings of 9 September and 12 October was based on a memorandum from the Belgian members which spells out in detail their ideas concerning the Community credit mechanisms. The Belgian memorandum suggests that the credit mechanisms be amended as follows:

(a) *Short-term monetary support*

- existing debtor quotas for each central bank would be doubled by adding a second debtor tranche of an equal amount,
- creditor quotas would be increased by 50 %,
- the *rallonge* would be doubled,
- barring exceptional circumstances, no country could receive more than half the *rallonge*,
- any drawing involving utilization of the second tranche and any or all of the *rallonge* would be open only to those countries who have agreed to announce the adoption of intermediary monetary objectives.

(b) *Medium-term financial assistance*

- the credit ceilings would be doubled,
- access to the facility would be subject to stricter conditions, in particular in the field of public finance,
- where appropriate the medium-term financial assistance could be disbursed in instalments, the drawing of each instalment being subject to the observation of specific conditions.

3. The Committee shares and approves the motivations which have guided the Belgian members in making their proposals. Indeed there was agreement in the Committee that ways of enlarging and improving the existing credit mechanisms and at the same time of making conditionality more effective should be considered in conjunction. In addition, the Committee feels that present credit arrangements should be reviewed so as to provide accommodation for more than one member country and to avoid them being used up almost entirely by a single beneficiary.

4. On the problem of increasing the amounts available within the two Community credit arrangements, the Committee has not been able to reach a unanimous position. It is generally recognized that given the development of balance of payments and reserve positions there is no urgent demand for financial assistance within the Community at present. Most members argue that periods of relative calm should be put to good use and consider that the Belgian suggestions to increase the

amounts within the two credit mechanisms should be examined now so that they are available in the future when new difficulties might arise. Some members consider that the lack of urgency at present and in the foreseeable future argues in favour of postponement. They also see no need to increase the amounts of the short-term mechanism in advance of the quinquennial review referred to in Article 2 of the Agreement of central banks of 9 February 1970.

5. The resources available in the short-term monetary support system were already substantially increased in March 1974. Even so, the credit facilities currently available to individual countries under the short-term system are not notably higher than those available under the medium-term financial assistance. Members agreed that it would be difficult under the short-term monetary support to impose conditions which could not be fulfilled or properly monitored in the short-term. While taking note that the Belgian proposals are not to be interpreted in this sense, the Committee felt that these proposals should be worked out in greater detail.

In any case, the Committee noted that the Belgian proposals concerning the short-term monetary support mechanism were being examined by the Committee of Governors of Central Banks.

6. A clear majority of the Committee recognized that an increase in the resources available in the medium-term financial assistance mechanism is warranted on several grounds: these resources have remained unchanged ever since the mechanism was created in March 1971; almost all funds available are presently used up by one single borrower; and there is, finally, a good case to match the medium-term resources to those available in the short-term, as in actual practice it is to be expected that the latter would often precede the former. This last argument is further reinforced by the fact that the majority of the Committee thinks that the resources in the short-term monetary support should themselves be increased. Some differences of opinion emerged in the Committee concerning the extent of the increase that would be justified in present circumstances and the timing of it in the light of the parallel discussion on IMF quota increases.

All members supported the idea that an increase in resources should be combined with more effective conditionality. Disbursements of the medium-term facility in instalments over a period of time could be an appropriate way of achieving that result. Doubts were however expressed on the possibility of implementing disbursements by instalments whenever substantial recourse to the short-term monetary support precedes the granting of medium-term financial assistance.

In any event, it was felt that before any decision were taken on modifying and enlarging the medium-term mechanism, careful attention should be devoted to such important aspects as opt-

ing-out clauses and mobilization of claims (Articles 4 (1) and 5 (3) respectively of Council Decision 71/143/EEC of 22 March 1971). Some members further consider that before a decision is taken, attention should be devoted to the possibility of a parallel expansion of the Community loan mechanism.

They also suggested that the adoption of the EUA for Community credit mechanisms should be examined.

7. The Committee emphasizes that the conclusions of the present report are preliminary and that it has not been possible to agree on all points. It is hardly possible for the Committee to pursue the matter further without the Council's endorse-

ment of the view that the convergence of the economic policies of member countries at this juncture could (and hence should) be promoted through an enlargement of the Community credit arrangements combined with strengthened procedures for effectively securing the fulfilment of conditions attached to borrowing under these arrangements.

However, if Ministers could reach agreement in principle on the above point of view, the Committee could analyze more closely the technical problems and implications; it points out in this connection that it is for the Committee of Governors of Central Banks to take and implement the decisions regarding the short-term support mechanism.

ANNEX IV

SECOND REPORT TO THE COUNCIL AND THE COMMISSION ON THE BELGIAN PROPOSALS

1. At the Council meeting on 18 July 1977, the Belgian President put forward an action programme on economic and financial matters featuring, among other things, proposals for adjusting and improving the Community's existing short and medium-term credit mechanisms. The Council instructed the Monetary Committee to examine these proposals. The Committee drew up a preliminary report that it submitted to the Council on 17 October. The Council expressed the view that convergence of Member States' economic policies must go hand in hand with moves to adjust the credit mechanisms together with moves to strengthen the procedures aimed at ensuring effective compliance with the economic policy conditions attaching to these mechanisms. It called on the Monetary Committee to present its definitive report in sufficient time for it to take a decision on the matter at its meeting to be held on 21 November.

A — Medium-term financial assistance

2. The Committee takes the view that the medium-term financial assistance arrangements should be improved, starting from the proposals put forward by the Belgian delegation. Doubling member countries' commitment ceilings is feasible provided satisfactory adjustments are made to the medium-term financial assistance rules on conditionality, supervision of compliance with policy conditions accepted, conditions for exemption and mobilization of claims, and the currency in which credits made available are to be denominated.

3. In any event, it is essential that drawing by a single Member State on the medium-term financial assistance should not exhaust the resources of the system. It is therefore assumed that no Member State could in principle draw more than 50 % of the total of credit ceilings, having due regard to the size of the borrowing country.

4. Where a Member State applies for all medium-term financial assistance, the economic policy conditions to be entered into by the beneficiary must aim at restoring internal and external economic equilibria. To ensure compliance with these conditions, resources made available under the medium-term financial assistance arrangements would, so far as possible, be paid in successive instalments, the release of each instalment being conditional on a review of economic performance based on targets fixed in advance.

5. The Committee is of the view that the present procedure, under which any Member State can be exempted from participating in a medium-term financial assistance operation by a simple declaration that it is experiencing balance of payments difficulties, should be amended. It is proposed that where one or more countries represent that they would have difficulty in financing the whole, or any part of their contribution, they shall be exempted to the extent necessary only if the Council, acting on a recommendation from the Commission and on an opinion delivered by the Monetary Committee, has taken a decision by a qualified majority that the exemptions in question are justified and on how, in consequence the shortfall in contributions shall be financed.

6. Member States that experience balance of payments difficulties after contributing to the financing of a medium-term financial assistance operation and request mobilization of their claim are to be treated on a similar footing as countries granted an exemption. With this in mind, the Committee is of the opinion that all the necessary steps should be taken to ensure the effective implementation of the mobilization procedure. In this connection, several members suggested that an agreement signed with the BIS would serve as an effective guarantee of mobilization, and that the possibility of using the Community loan mechanism should be considered.

7. The present procedure is that exempted countries are subject to monitoring by the Monetary Committee. A similar

provision should also apply to any country granted mobilization of its claim. This examination should cover not only the situation with regard to its balance of payments and reserves but also to the general economic situation.

8. Claims and obligations arising in connection with application of the medium-term financial assistance arrangements would be denominated in European units of account, in accordance with methods which will need to be examined.

9. The majority of the Committee supports the principle that the Community loan mechanism should be adjusted as soon as possible along the same lines as the medium-term financial assistance arrangements. Some members think, however, that the Community loan mechanism must not be renewable since it was approved as an exceptional support measure designed to remedy balance of payments difficulties stemming from the higher oil prices. The members in question have also pointed out that, unlike the medium-term financial assistance arrangements, the Community loan machinery is not based on the

Article providing for mutual assistance in the event of balance of payments difficulties (Article 108 of the Treaty of Rome).

B — Short-term monetary support

10. Noting that adjustment of the short-term monetary support arrangements will be dealt with by the Committee of Governors in a separate report to the Council, the Monetary Committee has only examined in detail the question of conditionality. In its view, the special consultation procedure provided for in Article 4 of the Council Decision of 16 February 1970 in connection with the granting of support but not incorporated in the Council Decision of 18 February 1974, should be reintroduced. Such consultation could cover the economic situation of the beneficiary country, its economic policy stance and also the latter's compatibility with the guidelines laid down by the Council. At the same time, the different consultation and coordination procedures provided for within the Community would need to be observed and more effectively applied.

ANNEX V

REPORT TO THE COUNCIL AND THE COMMISSION ON THE COMMISSION PROPOSALS

1. As instructed by the Council, the Monetary Committee considered, at its meetings of 21 September, 7 and 12 October, the proposals presented by the Commission, in its communication of 15 June 1977 to the European Council, concerning the creation of a new Community borrowing instrument (Com(77) 300 fin., 'Investment and borrowing in the Community').

2. The Committee considers that the Commission's ideas need to be elaborated in much greater detail and their implications spelt out before the proposal can be fully evaluated. In particular, it believes that the Commission should explain more precisely how their proposals would relate to existing financing mechanisms in the Community, including the European Investment Bank and Regional Development Fund; and how they would attain the desired objective.

A — General considerations

3. The Commission representatives explained that the conceptual background of their proposal was on the one hand, the

very low level of activity and employment in the Community, and on the other hand, the slowdown in the rate of fixed investment. The envisaged action has therefore a double objective: short-term and structural. Indeed it aims at sustaining the level of economic activity and employment, and at the same time at improving Community economic structures by encouraging investment in the priority fields of energy, regional infrastructure and redevelopment. It must be emphasized that the projected action could remain within modest limits — the ceiling for outstanding loans could, in a first phase, be limited to one billion EUA — since the proposal aimed at producing a sort of psychological triggering effect on public opinion to facilitate the development of a general climate of recovery in activity and particularly in investment.

4. According to the Commission, although the action was designed to adjust the current trend, the projected instrument was intended to apply to essentially structural operations; it is in this area that the low level of activity in the Community seems to present dangers for the future and must be tackled. With this in mind, the Commission foresees the possibility of carrying out successive operations within a lending ceiling so that amounts reimbursed by borrowers could, if necessary, be used for re-establishing the ceiling. The envisaged action

should be rapidly undertaken to satisfy its cyclical objective and continue over time to satisfy its structural objective. At all events, the fixing of priority sectors which would be done by Council on a proposal from the Commission should be done flexibly to match changing circumstances.

5. The Commission feels that the Community's present financial instruments are not adapted to such a scheme. Two of them (ECSC and Euratom) have a very specific purpose. With regard to the EIB, the trend of its operations presupposes an increase in its capital which would take time and, until now, the majority of its operations have been devoted to regional development.

6. The Commission considered that the creation of an additional borrowing instrument for it to administer would allow extra funds to be collected without any deterioration in the excellent standing of the Community 'name'. The Commission's experience on capital markets led it to believe, at a conservative estimate, that it could step up total funds raised by all Community agencies by up to 1 500 million to 2 000 million EUA per year. On this basis, it thought that its proposal for a limit of 1 000 million EUA was modest, and could be achieved without difficulty.

7. To see if there is really a need which the Commission's proposals will satisfy, the Committee considered it necessary to look at the means for financing investment which currently exist in Member States, both internally and externally. It appeared that, in most countries, and despite differences in their financial structures, existing private and public mechanisms were largely able to satisfy the demand for investment funds. In this respect, several members stressed the basic role in the adjustment process played by the free operation of the capital markets in the economy of their country. Other members, moreover, emphasized the existence in their countries of public intervention and correction mechanisms designed specifically to ensure the matching of needs and financing possibilities while respecting fundamental economic equilibria. However, it seems that for the majority of Member States the functioning of these internal mechanisms in no way excludes recourse to external financing, even for very substantial amounts. But recourse to such financing was for the most part motivated by the need to cover the balance of payments of the borrowing countries. In several countries, though use of external investment financing may be not only for such balance of payments needs but may mainly arise out of a desire to match all sources of credit to needs generated within the economy, particularly in certain sectors: in these countries external financing is seen as the best method of satisfying some essential investment needs.

8. Some members emphasized that the present low level of investment can, in most cases, not be attributed to a shortage of financial resources. They held the view that at least in their countries, investment was hindered not only by a lack of profitability but also by political, sociological or ecological constraints. They doubted therefore whether an additional financial mechanism which in no way contributed to a solution of these difficulties could be justified or efficacious.

9. To assess whether a new Community mechanism for financing investments was needed, the Committee briefly examined Member States' judgements on the functioning of the present Community financing instruments. They thought that existing Community credit mechanisms had usually been adequate for their purpose — that of supplying 'top-up' financing in the relevant sectors and institutional domains. The majority felt that these mechanisms were adequate at the moment for current needs. If an increase in Community financing was necessary however, these members would prefer existing machinery to be developed possibly by improving their procedures rather than the creation of new instruments. They thought that the EIB in particular could take responsibility for satisfying the needs that had led the Commission to draw up its proposals. A step in this direction had already been made with the EIB Governors' decision in principle to increase the bank's capital next year, thus enabling the bank to increase the volume of its operations. They felt that the banks' operations, in particular as defined in Article 130 of the Treaty of Rome, could fully cover the projects which the Commission intends to finance with the new instrument. These same members also remarked that in the field of energy, the Community had recently set up a new credit mechanism under Euratom, where at least some assessment of experience was necessary to see if this action would suffice for the energy sector, as was recently believed.

Some members believed that the objectives pursued by the Commission could also be attained by increased use of other instruments in the Community budget, such as the Regional Development Fund, but the implications of this proposal could not be looked at in the time available.

10. Some members thought that although existing mechanisms were useful and effective, they were unduly restricted as to sector of intervention or as to the criteria for selecting projects: according to them, the EIB could not consider projects with deferred or low profitability. In addition, it operated case by case, using banking criteria, without any overall action programme coordinated with national development plans.

Finally, it does not sufficiently consider social projects and favours the productive sector. For these members, consequently, a new mechanism would only be attractive if it allowed these constraints to be overcome by assuring the financing of projects of a social nature, of weak, uncertain or deferred profitability or highly labour intensive. In addition, some members emphasized two limitations of the EIB financing: the creation of an exchange risk for the borrower and the requirement of a market interest rate. Any new mechanism should not involve these two aspects. It would be necessary in particular to link it with an interest subsidy mechanism within the Community budget: in principle, such interest subsidies can already be granted by the Regional Development Fund for EIB loans. The majority of members considered that the problem of interest subsidy is of a different nature, and does not concern the present proposals.

11. The Committee emphasized that, in any case, the purpose of the proposed mechanism was not to finance balance of payments needs. Several members expressed the view that an agreed common regional, sectoral and structural policy which would help to promote integration in the Community, would provide a particularly appropriate framework in which to create any new mechanism.

12. Without prejudice to the final answer to the essential point of the need for the new machinery, and in the light of the reservations set out above, the Committee went on to consider the main technical aspects of the proposed mechanism. It did not try to reach a consensus on these various aspects, but merely drew up a preliminary inventory of the reactions and suggestions put forward. It emphasizes that this is only an initial outline summary which could not fully reply to the request from the Council and merely aimed at providing an interim report for Council on 17 October.

B — Technical observations

13. Amount

The amount of 1 000 million EUA, suggested by the Commission, had no specific technical foundations; it was based both on the Commission's estimate of the amounts likely to be available on the capital markets and the approximate sum necessary to achieve the psychological 'trigger' effect on investments hoped for. Several members thought that the volume of real needs should be examined: some of them doubted that profitable projects requiring such sums were immediately available. Many members felt that the size of the mechanisms also depended on the reactions of the market.

14. Duration

The Commission's proposal for a mechanism with no time limit was justified by the fact that the stimulation of investment was a long-term task. Many members felt that this aspect was incompatible with a counter-cyclical action, and believed that an operation with a time limit and excluding the automatic re-establishment of the ceiling would be more justified. They emphasized that a proposal aiming primarily at structural objectives of unlimited duration would make existing problems more difficult and would give rise to new ones which would require further serious examination.

15. Examination of projects, financing decisions and management

There were two possible procedures. Under the first procedure, which appears to be that favoured by the Commission, the Commission would recommend that the Council should take the basic decision and adopt general guidelines on a proposal from the Commission who would then be responsible for execution. The Commission would therefore decide on the

eligibility of projects, i.e. their compatibility with the Community's overall policies, whilst they would be examined from a technical point of view by the EIB. Under the second, basic decisions would also be taken by the Council on a Commission proposal; but decisions on the projects and examination would be the responsibility of the EIB. The majority of members thought the second procedure had the advantage of drawing on the technical expertise and experience of the EIB without introducing an institutional change lying outside the Committee's purview. It goes without saying that, as for the EIB, no project would be financed, in whole or in part, which would be opposed by the Member State in whose territory it is to be carried out.

16. Some members suggested that a straightforward expansion of the EIB's operations would achieve the same end as the proposed action but without altering any present procedures, so that action would be quicker and more efficient. Others felt that this solution would endanger the emphasis put on the originality and specificity of the operation, while that proposed by the Commission would allow a better coordination of projects under the aegis of the Commission.

17. Guarantee

The Commission did not consider that there was any need for a specific guarantee by the member countries to the Community, like that granted in connection with the Community loan. It thought there would be no difficulty in borrowing on the security of the Community budget alone. There were considerable advantages in this solution, from the point of view of simplicity and avoiding the need to involve the credit rating of Member States. Some members doubted however, whether, without specific guarantees by the Member States, the Commission would indeed be able to borrow an additional 1 000 million EUA on the market.

The Committee did not pursue the question of accounting for the operations arising from this mechanism at this stage.

18. Lending conditions

The Commission hoped as far as possible to carry out 'blank transactions', with absolute equality between the terms for Community borrowings and the terms of the loans granted. These lending conditions would be a function of the borrowing terms, so that arrangements for obtaining and using funds would be identical, and the Community budget would not be affected. However, according to some members if the principle of 'blank transactions' were always maintained, this could lead to lost opportunities when circumstances were favourable to borrowing, and thus hinder the smooth running of the proposed mechanism. These members emphasize the danger to the Community name of too many small borrowing operations.

19. *Market reactions*

The entry on the market of a new name might be seen as a way of increasing total borrowable resources, were it only because of investors' desire to diversify. But it might also carry a risk of the Community's signature being devalued, and lead to stiffer terms not only for Community agencies but also for Member States seeking funds on the international market. At all events, issue time tables would have to be coordinated by Community issuers among themselves. Some members also sought coordination between Community issuers and issuers from member countries, to avoid causing problems for the latter. To solve this problem it was suggested that the Monetary Committee would be the most suitable body to play a coordinating role. Other members, while emphasizing the risks of competition, felt that the idea of such coordination would not be practicable under present circumstances.

20. Community loans would usually be placed on markets outside the Community but there might be a case in certain circumstances for using the national markets of Member States with the agreement of the authorities of the countries con-

cerned. The numerous problems of exchange rate risk, which involve both the Community and beneficiaries of loans, must be studied in further detail.

21. *On-lending*

It seemed that the on-lending of funds obtained by the new financial instrument could not really follow any predetermined criterion; any idea of quotas by country, or other systems of geographical distribution, was to be ruled out. The Council would decide on the sectors to be granted loans, periodically, and in the light of circumstances and needs in the Community.

22. For many members, the preceding considerations show that a number of aspects of the proposed mechanism must be considered in banking terms and suggest that a banking-type solution might be the best one, both for raising funds on the market, and for on-lending. In this light, they think that the EIB should be responsible for implementing the proposed operation. At any rate, a special 'window' for this purpose could be set up within the EIB.

ANNEX VI

SECOND REPORT TO THE COUNCIL AND THE COMMISSION ON THE COMMISSION PROPOSALS

1. The Commission recently presented a communication to the Council on investment and borrowing in the Community. As requested by the Council, the Monetary Committee prepared a report which was presented to the Council at its meeting on 17 October 1977. The Council invited the Monetary Committee to pursue its examination so as to enable it to reach a decision on the matter at its meeting on 21 November 1977.

2. The Committee is of the opinion that the general considerations and the outline of the divergences in present positions set out in Section A of its report of 12 October cannot usefully be taken much further. Furthermore, the various technical aspects of the Commission proposal were examined in Section B of the report and there have been no new elements since then to shed light on the uncertainties which persist.

3. Consequently, the Committee considers that a basic political question must be settled by the Council: supposing that there is agreement on boosting investment through Community action, is it necessary and desirable to have recourse to a new instrument instead of making use of the EIB, whose capital, the Board of Governors has decided, is to be increased substantially in 1978? Assuming the Council's answer to this question is in the affirmative, the Committee has discussed the general

lines of a possible compromise which, while departing from the Commission proposal, lies mid-way between the positions adopted by the Member States on the proposal.

4. This compromise solution could be based on the following arrangements:

- (a) the Commission would borrow up to a maximum of EUA 1 000 million, preferably on external financial markets;
- (b) borrowing operations would be carried out in such a way as to satisfy the following objectives:
 - the dates and amounts of issues would be fixed so as to obtain the best terms on the market,
 - other issues by the Community and member countries would not be disrupted,
 - issues would be made only for projects which had been sufficiently examined;
- (c) a guarantee would be provided by the Community budget ⁽¹⁾;
- (d) the funds would be handed over to the EIB and, if necessary, temporarily invested;

⁽¹⁾ Some members doubt whether a budget guarantee would, in all circumstances, be considered sufficient by the markets.

- (e) the EIB would examine loan requests in sectors and for types of operation decided on by the Council on a proposal from the Commission (e.g. energy, infrastructure and redevelopment). The EIB would apply its usual criteria to these operations ⁽¹⁾;
- (f) projects would be submitted in accordance with the procedures laid down in the Statutes of the EIB and loans would be approved by the Board of Directors of the EIB, following an opinion from the Commission ⁽²⁾ ⁽³⁾. Particular attention would have to be given to projects which would help to reduce unemployment;
- (g) the exchange risk would be borne entirely by the borrower. There would be no interest rate subsidy ⁽⁴⁾;
- (h) loan terms would be fixed at cost price, on the basis of the borrowing terms obtained by the Commission, while ensuring that all the costs incurred are covered. The terms would not necessarily be the same for all the projects approved;
- (i) the funds paid back to the EIB (capital and interest) would allow the Commission to repay the money it borrowed.
5. While accepting the compromise solution set out above, some members consider that the setting up of a new Community loan instrument could be even more useful if it formed part of a wider context based on regional, sectoral and structural policies drawn up at Community level to promote the integration of the economies of the Member States.

⁽¹⁾ Some members feel that new criteria suited to the structural and economic situation in the Community should be adopted by the Council for these operations.

⁽²⁾ Some members feel that Council approval of projects should be unanimous. Other members feel that it is the Commission which should approve the projects.

⁽³⁾ Some members are of the opinion that the funds made available under loans should be paid to governments acting as intermediaries.

⁽⁴⁾ Some members cannot exclude *a priori* the principle of an interest rate subsidy or an exchange guarantee.