

EUROPEAN ECONOMIC COMMUNITY

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

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Brussels, 15 April 1964

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INTRODUCTION

The purpose of this report is to give a general picture of the activities of the Monetary Committee of the European Economic Community in 1963. The Committee held nine sessions in 1963 under the chairmanship of Jonkheer Mr. E. van Lennep, Treasurer-General in the Netherlands Ministry of Finance. A list of the members is attached to this report.

The Monetary Committee was set up under Article 105 (2) of the Treaty of Rome. Its function as laid down in the Treaty is to observe the monetary and financial policies and general payments systems of the Member States and, more generally, to promote the co-ordination of the Member States' monetary policies to the extent necessary for the efficient functioning of the Common Market.

During the early years the Committee concentrated mainly on reviewing the member countries' monetary and financial position. These reviews, which were carried out half yearly, enabled the Committee to gain a better insight into the member countries' economic structures, and the Committee made a point in this connection of supplementing the reviews by comparative studies of the instruments of monetary and financial policy available to the Member States.

Owing to the Committee's new functions, its regular reviews have gradually become less frequent with the passing years. Nevertheless, the Committee is still able to review the position of a member country at short notice if its economic situation calls for such action, as was recently the case with Italy. Furthermore, as in the past, views are exchanged at most meetings concerning the latest monetary and financial developments in the various member countries.

Apart from these reviews of the monetary and financial situation in member countries, the Committee's attention has been increasingly claimed by other problems. Firstly, the progress made in implementing the Common Market has necessitated much more frequent action by the Monetary Committee with a view to the formulation of opinions or preparation of surveys concerning problems arising either in the actual monetary and financial field or in other fields where decisions with monetary implications have had to be taken. Secondly, largely owing to the important part played by the European Community as a whole in world trade and, more generally, in the international monetary system, the Committee has been called upon to turn its attention more and more often to problems of international liquidity and, more recently, to the problems created by the trend of foreign payments of the countries of the Community. The matters with which the Committee has been concerned in this field are discussed in Chapter I of this report.

Thus other tasks have gradually been added to the functions specifically assigned to the Committee by the Rome Treaty or by directives of the Council. More frequent recourse than in the past to its alternates, whose proceedings have been of great assistance in preparing its sessions, has enabled the Committee to shoulder its new responsibilities without having to increase the number of its meetings. For, while it is essential that all the Committee members

should attend the meetings regularly, the positions which they hold in their national administrations and their commitments in other international bodies make it difficult to increase the frequency of the Committee's meetings, which, except in summer, are held monthly and usually last two days.

The future progress of economic integration, and, in particular, the new tasks which it will assume in accordance with the decisions of the Council reproduced in this report, will make its time-table even more crowded than hitherto. To cope with this situation, the closest possible co-ordination will be required between the Monetary Committee and the other committees. This is already provided by the ex officio attendance of the Chairman of the Monetary Committee at the meetings of the EEC Economic Policy Committee and by the fact that the Chairmen of both committees attend the Finance Ministers' conferences. It will be important to ensure that this co-ordination, which is the essential pre-requisite for an efficient division of labour, is extended to the bodies which the Council has decided to set up. The attendance of a representative of the Monetary Committee at the meetings of these new committees could, as in the case of the EEC Economic Policy Committee, be a step in the right direction.

Chapter I

GENERAL CONSIDERATIONS ON THE CO-ORDINATION OF MONETARY POLICIES

1. In earlier years the implementation of the Rome Treaty was facilitated by an exceptional combination of favourable factors. Economic expansion was rapid and continuous and the member countries' strong competitive position enabled the Community to show large surpluses in its current payments with non-Community countries. Gradually, however, this position has changed, with the result that since the end of 1962 the EEC has been faced with new problems.

2. The very length of the expansionary phase and the rapid rate of growth have given rise to inflationary pressures on some countries. Labour shortages have been making themselves felt for some time in almost all parts of the Community. The rise in wages, in some cases far in excess of the increase in productivity, have appreciably impaired the competitiveness of the Common Market countries. Thus all the member countries, and above all France and Italy, whose balances of payments have shown the sharpest deterioration in the past two years, have shown a marked elimination of their surplus on current account with non-Community countries, especially the United States.

More recently overall demand has become excessive in various member countries. This pressure of demand, differing greatly from country to country, has led to divergent trends in the balance of payments of the different countries and has created strains within the Community.

3. An examination of payments on current account emphasizes the reversal which has occurred in the course of a few years in the external position of the Community, as is clearly shown by the following table :

(in '000 million dollars)

	Annual average		
	1958-61	1962	1963
1. Balance of trade (fob-fob)	+ 1.7	+ 0.9	+ 0.1
2. Balance of services and transfers	+ 0.9	- 0.1	- 0.1
3. Current balance	+ 2.6	+ 0.8	0

This movement was entirely due to merchandise transactions. As is shown by Table I annexed to this report, all the member countries except the Federal Republic of Germany contributed to a greater or lesser extent to the worsening of the EEC's trade balance with non-Community countries. This was due to a number of causes. The high degree of

employment of productive capacities had the effect of slowing down exports and stimulating imports; the rise in production costs, as a result of a faster increase in wages than in productivity, led to a deterioration in the competitive position of the EEC countries in relation to the other industrialized countries, particularly the United States; and the growth in personal incomes, and thus in the demand for consumer goods, was reflected in larger imports, especially of foodstuffs. Furthermore, during this period the member countries pursued an increasingly liberal trade policy, and two of them adopted measures — the revaluation of the DM and the guilder — to reduce the very substantial surpluses which they had had during the early years of the implementation of the Treaty.

4. For all these reasons the whole of the increase in the Community's official reserves in 1963 was attributable to inflows of funds from non-Community countries, in most cases on the initiative of the latter. The rate of increase in official reserves recorded in 1963 does not reflect the deterioration analyzed above. Member States' official gold and foreign exchange reserves went up by some \$1500 million in 1963, against \$600 million in 1962 and \$1200 million in 1961. This increase does not, however, represent either a rise in or even the maintenance of the level of the Community's surplus with the rest of the world, the influence of which on the imbalance of international payments had received special attention from the Monetary Committee in earlier years. Indeed, if allowance is made for the extraordinary transactions which took place during this period, and particularly the advance redemptions of debt which were much larger in 1961 and 1962 than in 1963, and also for a net deterioration in the external position of the commercial banks, mainly attributable to the indebtedness of the Italian banks in the Euro-dollar market, it will be seen that the adjusted increase in the Community's gold and foreign exchange reserves amounted to only \$537 million in 1963, compared with \$755 million in 1962 and about \$3 000 million in 1961.

5. The persistence of the trends which have affected the pattern of the Community's balance of payments in recent years could not, in the longer run, be regarded as either normal or desirable. The reduction in the very large surpluses on goods and services account, while it did help to restore a better balance of international payments, was accompanied by a considerable rise in costs within the Community. If this process, which has entailed the sacrifice of internal stability by the member countries, were to continue, there would be a danger of its overshooting the desired objective, namely the restoration of external equilibrium.

For a group of industrialized countries such as those composing the EEC it is not possible for the balance on current account to remain in a state of persistent deficit involving, as a normal and more or less permanent feature, a net import of capital or a fall in reserves which could not be tolerated in the long run. On the contrary, and mainly in the interests of the developing countries, the Community's role would appear to be rather that of a net exporter of capital.

The experience of recent years, during which there have been large net inflows of private capital into the Community, raises the question

whether such an aim can be achieved in the near future. An analysis of these capital movements reveals, however, that there is a definite connection between the inflows of capital into the EEC and the capital outflows from the United States. In view of the worsening of the Community's competitive position, the faster rate of expansion in the United States, the adoption of certain measures in July 1963 by the U.S. monetary authorities and the announcement of other measures, there is likely to be a net reduction in the outflows of funds from the United States.

If the countries of the Community are ultimately to become net exporters of capital, an improvement in the functioning of their capital markets is essential in order to render them more easily accessible to foreign borrowers and make it possible to lessen or offset the inflationary effects which large capital inflows could produce on the economies of the member countries.

6. Owing to the fact that costs, wages, prices and domestic demand increased considerably faster in some member countries than in others, the year 1963 witnessed the development of strains in intra-Community relations which became more pronounced during the year.

These phenomena of "over-heating", which first became apparent in France and Italy in 1962, have since manifested themselves in the Netherlands and are now tending to affect Belgium. In 1963 they became particularly acute in Italy, where they were reflected in a drastic deterioration in the overall balance of payments, a state of approximate equilibrium in 1962 having been followed by a deficit of some \$1 200 million in 1963.

7. Owing to the progress already made towards European economic integration, the strains in France and Italy had almost immediate repercussions on the rest of the Community. There was thus a substantial increase in the exports of the Federal Republic of Germany, Belgium and the Netherlands to France and, above all, to Italy.

Owing to the almost universal full employment, the shortage of skilled labour and the lack of available production capacity, this growth in external demand helped to revive inflationary tendencies in the other member countries. In addition, the monetary authorities in the countries subject to external pressures, especially the Federal Republic of Germany, were at the same time faced by substantial inflows of short-term and long-term capital, of which a larger proportion than hitherto came from other member countries. The growth in capital movements between Community countries is not so much attributable to divergences in interest rates, since the rates in the various countries have continued to move closer together, but rather to divergences in the methods of taxation, a study of which would appear to be urgently needed.

8. Unless sufficiently energetic joint action is taken in good time, there is a danger that the strains which have developed within the Community will spread. If allowed to continue too long, the imbalances which appeared in 1963 would inevitably have serious effects on the development of the Common Market. Furthermore, it would be impossible to avoid the danger of an excessive decline in the competitive power of the Community

in relation to the rest of the world. The member countries might then be faced with a fall in employment due to a marked slackening of external demand, and would have virtually no weapons available for combating such a trend.

9. In the opinion of the Monetary Committee, it is essential that, in order to curb the rise in costs and prices and prevent the present strains from becoming more acute, the measures taken or planned in the various member countries, especially France, Italy and the Netherlands, should be applied with all necessary vigour. The Committee considers that the use of selective measures alone to combat the present trends is no longer sufficient to re-establish equilibrium. The only way to achieve this aim is by overall measures designed to check the increase in demand and the rise in costs and prices. True, such a course will inevitably cause a temporary slowing-down in the rate of growth, but such a slackening is the prerequisite for preventing a permanent weakening of the Community's competitive power and giving a fresh start to balanced long-term expansion. It should be noted in this connection that all the countries possess economic instruments which would enable them to reintroduce expansion rapidly if external demand were to become too weak.

10. The continuation and strengthening of the monetary policy already being pursued in most member countries, mainly aimed at curbing credit expansion, is one of the essential conditions for the restoration of a better economic equilibrium. In this connection the Committee welcomed the introduction in France of new instruments for restraining credit expansion similar to those already existing in the Netherlands. In the Federal Republic of Germany the effectiveness of a restrictive credit policy is severely limited by the reappearance of the problem by which the monetary authorities have previously been faced as a result of very large capital inflows from abroad. This being so, it would be wiser, in order to prevent an excessive growth in domestic demand, to adopt specific measures, especially in the field of public finance.

11. The same applies to the other member countries, where the mere tightening of national monetary policies would not be sufficient to curb inflation. For success in this struggle a stricter budgetary policy is also necessary. The efforts made in Italy, France and Belgium to reduce the budget deficit will have to be continued and even intensified, and member countries ought also to check the growth in public expenditure. In any case, where government budgets still show a deficit, steps will have to be taken to ensure that cash outlays are covered by methods which do not have any inflationary effect on the economies of the countries concerned. Member States should also endeavour to curb demand in the building sector, which is a particularly active source of contagion in all the Community countries.

12. Lastly, it is desirable that the introduction of an incomes policy should be accelerated in the member countries. The Committee notes with regret that the Netherlands, the only country which has introduced a co-ordinated incomes policy, has recently been faced with serious difficulties in this field. These difficulties are primarily attributable to the extreme tightness which has long been a feature of the labour

market. In view of the fact that a similar state of imbalance exists, to a greater or lesser degree, in the other member countries, it would seem necessary first of all to re-establish conditions which will permit the implementation of this policy.

13. The ease with which efforts to restore stability can be successfully implemented will depend on the extent to which co-ordination of action among the member countries can be improved. The need for such co-ordination is all the more pressing in view of the fact that monetary policy must increasingly take into account the progress of economic integration, and especially the adoption of common policies or rules in certain sectors. As has been previously noted by the Monetary Committee, such co-operation cannot be confined merely to the measures taken by the Central Banks. It should also embrace the actions of the authorities responsible for financial policy, which exert a considerable influence on monetary developments, sometimes affecting them even more decisively than do central bank measures.

14. The Committee welcomes the Council's decisions aimed at increasing the co-ordination already achieved, especially in the Monetary Committee. These decisions, which are annexed to this report, meet the wishes expressed by the Committee in the past, particularly in its Fifth Annual Report.

The Community procedures for which provision has thus been made cover all action on the part of the monetary authorities which is likely to have major internal or external repercussions. Such action must as far as possible be discussed in advance at the preparatory stage. This co-ordination will be made close and effective by the presence on the various committee of representatives of the authorities responsible for the shaping and implementation of decisions. True, these arrangements are still no more than consultative procedures which will not commit the member countries' governments; the experience gained, however, will make it possible subsequently to envisage the creation of institutional procedures capable of leading to Community action.

15. The Monetary Committee takes note of the specific tasks assigned to it in two respects by these decisions. Giving institutional form to the co-operation which the Committee is already practising in the form of frequent exchanges of views, the decisions provide, firstly, for regular prior consultation on all matters arising in the field of international monetary relations: the operation of the international monetary system, recourse by Member States to resources which can be drawn upon under international agreements, and the participation of one or more Member States in any major measures to provide monetary support to non-Community countries.

The Council's decisions also provide for prior consultation in the event of alterations in the rate of exchange of the currency of one or more Member States. In this connection, owing to the difficulty of holding such consultations in view of the need for speed and secrecy, the Committee has been instructed to work out a procedure for effective action.

16. More generally, owing to the importance of the EEC's trade with the rest of the world and the part played by its members' currencies, the proper functioning of the international monetary system is of vital importance to the six countries of the European Economic Community. The Monetary Committee therefore welcomed the establishment of the Working Group of the Ten Countries participating in the General Borrowing Arrangements of the International Monetary Fund; it should provide useful assistance in finding solutions to the problems connected with international liquidity to which the Monetary Committee has drawn attention since its 1961 "Report on current problems of international liquidity". The studies which the Monetary Committee has been carrying out in this field for some years, and the important contributions, both theoretical and practical, which some of its members have made on this subject, have given it a deeper understanding and clearer view of the present problems. In particular it has been examining to what extent it would be possible to arrange the international monetary system in a way more suited both to the attainment of the short-term aim of restoring a better balance in international payments and to the satisfactory achievement of the long-term purpose of meeting the liquidity requirements of the international monetary system.

Chapter II

INTERNAL AND EXTERNAL POSITION OF THE MEMBER STATES

Section I

GENERAL

In its previous report, the Monetary Committee expressed the opinion that a continuing rise in prices and production costs would jeopardize the balanced growth of the Community. Increasing strains did in fact become apparent in 1963 and, in order to combat them, several member countries introduced stabilization programmes.

In terms of volume, the Community's growth rate for the year was about 4%. It was thus lower than the rates for the preceding years, namely 5% in 1962 and 5.3% in 1961. This slackening, however, is more apparent than real, since it was in fact due to the severe cold spells in the early months of the year. After this exceptional period, activity rose again to high levels.

Although the increase in purchases by non-Community countries contributed more than in 1962 to the growth in overall demand (exports of goods increased by 4.5%, against 1% in 1962), domestic demand, especially for consumer goods, remained the main driving force behind the expansion. As domestic supply did not expand as fast as nominal demand, prices continued to rise and imports increased. Goods imports from non-member countries thus went up by 10.5% in both value and volume, against 8% in 1962.

The trade deficit therefore worsened, the adverse balance amounting, according to customs statistics, to about \$2 800 million, which represents a deterioration of some \$4 000 million compared with 1959. There was a similar movement, although less marked, in the current balance of payments, which, after showing a surplus of \$2 800 million in 1959, was close to equilibrium in 1963. The Community's overall balance of payments, however, remained positive, owing to large inflows of private capital.

The member countries' official gold and foreign exchange holdings increased by about \$1 500 million, against \$600 million in 1962, while there was a substantial fall in the net external assets of the commercial banks.

Intra-Community trade increased in 1963 by 16%, against 14% in 1962. This increase was attributable both to the gradual achievement of economic union and to the effect on merchandise trade of the growing divergence of the business trends in the various member countries.

