

**EUROPEAN ECONOMIC COMMUNITY**

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

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**Brussels, 12 February 1965**

## INTRODUCTION

*The purpose of this report is to give a general picture of the activities of the Monetary Committee of the European Economic Community. The Committee itself held twelve meetings in 1964, while the Committee of Alternates and the working parties set up by the main Committee during the year to examine the monetary and financial situations of the member countries also met on a number of occasions.*

*Article 7 of its Statute provides that: "The Committee shall elect from among its members, by majorities comprising not less than eight votes, a chairman and two vice-chairmen for a term of two years." These officers of the Committee having completed their term, the Committee unanimously elected jonkbeer Mr. E. van Lennep, Treasurer-General in the Netherlands Ministry of Finance, as chairman and M. B. Clappier, second Vice-Governor of the Bank of France, and Dr. O. Emminger, a member of the Bundesbank Direktorium, as vice-chairmen. A list of members is appended to this Report.*

*In 1964 the Committee co-operated even more closely than in the past with the other Community committees and authorities. The chairman attended or was represented at all the meetings of the Short-term Economic Policy Committee, and the chairmen of these two Committees took part in the periodic meetings of the Ministers of Finance. The chairman also participated in the discussions in the EEC Council devoted to the Council's Recommendation for measures to be taken to restore the internal and external economic equilibrium of the Community.*

*This report was completed on 1 February 1965. It therefore does not take into account economic developments or measures adopted after that date, whether within the Community or, for example, in the United States.*

## Chapter I

### GENERAL CONSIDERATIONS ON THE CO-ORDINATION OF MONETARY POLICIES

1. Although 1964 was not a year of spectacular developments, the gradual process of monetary integration within the European Economic Community advanced in a number of fields. The monetary authorities made every endeavour, when implementing their domestic policies and when taking decisions or fixing their attitudes on matters more concerned with the international sphere, to carry economic union between the six Member States a stage further. The co-ordination of their activity in this direction is one of the main tasks of the Committee; it must also see that integration develops in a climate of economic and monetary stability within the Community and of constructive co-operation with the outside world.

2. The general economic development of the Community – with the imbalances that appeared in 1963 and began to recede towards the end of 1964 – has illuminated the considerable degree of interdependence already reached by the economies of the Member States. Inflationary pressures originating in certain member countries spread very rapidly to the other countries of the Community, impairing the internal balance of these countries also. The problem of financing the deficits has not been critical in the Community, since it disposes of ample foreign exchange reserves. In the circumstances, the right solution to the "contamination" problem lay in the implementation of adjustment policies designed to remedy the causes of imbalance.

When on 15 April 1964 the Council adopted, on a proposal from the Commission, a common and generalized anti-inflation programme – the implementation of which it is now watching – it showed a correct appreciation of what the situation required. The Committee, which helped elaborate the Recommendation put forward by the Council and is closely associated with its implementation, attaches the greatest importance to this first joint decision on the main lines of the economic and financial policy to be pursued by the competent authorities of the Community member countries.

3. Discussions on international monetary problems, in which the member countries have taken an active part, have also shown how necessary it is to secure close co-ordination between the policies followed by these countries. In accordance with the practice introduced some years ago and to which the Council's decision of 8 May 1964 gave a formal basis, the Committee has done everything in its power to promote such co-ordination. One example is its work in connection with the preparation of the study on the general functioning of the international monetary system and on international liquidity problems, which was published in 1964 by the "Group of Ten", and another is its action when certain

questions arose relating to the International Monetary Fund, such as the provision of additional resources for this institution and the IMF's call on the "General Arrangements to Borrow" when the United Kingdom made a drawing on the IMF.

4. In 1964 the Committee also discussed the monetary problems involved in the working out of a common agricultural policy – to be applied from July 1967 onwards – notably in the fixing of common farm prices. The Committee has consequently had to express their views on the monetary implications of the fixing of common farm prices and whether these prices should be expressed in units of accounts or otherwise.

5. Developments in the three fields referred to above are discussed in more detail below.

6. At regular intervals the Committee has examined the economic and monetary situation in the member countries, and the results of these examinations will be outlined in Chapter II. It should be recalled here that early in 1964 both France and Italy were suffering from clearly inflationary movements and that strains had grown severer in the Benelux countries, while the Federal Republic of Germany was enjoying conditions of near stability; a very heavy deficit on current account in Italy contrasted with a considerable surplus in the Federal Republic : in the first quarter of 1964 the surplus in the Federal Republic was \$425 million. Gross gold and foreign exchange reserves of the Bank of Italy had dwindled by \$235 million in the same period.

The main source of these payments disequilibria was intra-Community trade. In the first quarter of 1964, for example, the Federal Republic's surplus on trade with the other Community countries was nearly \$200 million higher than in the same quarter of 1963, while in Italy the deficit on trade with the other EEC countries was nearly \$70 million heavier than a year before.

7. These facts not only indicated that economic trends in the various member countries were out of phase, but – and this is more important – that by a contamination process excess demand was spreading from one country to another. This was a threat to the internal stability of the economies of all member countries and might have meant that inflationary strain had come to stay in all six countries, thus undermining the Community's external position. The new trend also raised a series of political problems, since if balance-of-payments difficulties had got out of hand they might have endangered the internal cohesion of the Community.

8. When carrying out its periodic examination of the economic situation in the member countries, the Committee had drawn the attention of the Council and of the Commission to the need for the Member States to co-ordinate their policies and to strengthen the measures adopted to adjust these trends and to bring inflation under control. It had, in particular, emphasized the direct impact of any serious strains in one country on the economy of the entire Community. It was the development of such strains, on a scale which had been particularly pronounced in the

case of Italy, which had led the Commission to initiate, in agreement with the Italian authorities, the procedure laid down in Article 108 of the Treaty. In accordance with the provisions of this article, the Community authorities recommended the adoption of an adjustment policy aimed at the prompt and effective correction of inflationary tendencies.

The EEC Council, faced with the threatening situation in the Community, adopted a Recommendation, dated 15 April 1964, which calls on the Member States to take action with a view to the re-establishment of the internal and external equilibrium of the Community. The Council adopted in this document the principle of giving stability of prices and costs priority over all other economic policy objectives. The Recommendation specifies the means to be employed, and lays down in particular that the expansion of public expenditure should not exceed 5% per annum. What is significant is that here, for the first time, a decision was taken establishing a scale of priorities and giving rules backed by figures. This joint decision on the main lines of the economic and financial policies to be pursued in the member countries of the Community also gave the authorities in each of the countries considerable additional support in their fight against inflation.

9. In general the policies pursued by the Member States have been in line with the Recommendation. Among the measures adopted, the following may be noted: in France, maintenance of the action initiated early in 1963 to contain the expansion of credit, and curbing of the expansion in public expenditure, thanks to which budget transactions yielded a surplus in 1964; in Italy, the implementation of a restrictive monetary policy during the first half of 1963, the increasing of a number of indirect taxes and the limitation of the growth of central government expenditure; in the Federal Republic, the curtailing of the expansion of central government expenditure, steps taken by the Bundesbank to encourage exports of short-term capital as part of a more restrictive monetary policy, the advance reduction of rates of duty on imports from Community countries and the announcement of the decision to levy a tax on securities held by non-residents; in the Netherlands, the increasing of certain indirect taxes, the spreading over a longer period of public works programmes, the application of a restrictive monetary policy, and the limitation of the expenditure of local authorities; in Belgium, the strengthening of price supervision, the introduction of credit restrictions, the spreading over a longer period of public investment expenditure, the curbing of the increase in overall central government expenditure and the introduction of more stringent terms for the granting of loans for building and for hire-purchase sales.

10. The total effect of the measures taken by the Member States was a gradual move back towards equilibrium.

The deficit on the Community's trade balance, which was still growing at the beginning of 1964, started to decline towards the middle of the year. Trade between the member countries developed on appreciably more balanced lines: the surplus on the Federal Republic's trade, which had been running at nearly \$400 million in the fourth quarter of 1963, fell to about \$40 million in the last quarter of 1964. At the same time, the heavy deficit of \$200 million on Italy's trade was replaced by

a surplus of \$70 million, and the Netherlands deficit fell appreciably (\$25 million in the last quarter of 1964, against \$130 million in the fourth quarter of 1963). For the full year 1964 the Community as a whole had a surplus on current account somewhere between \$200 million and \$500 million. Monetary reserves (i.e. net gold and foreign exchange holdings of the banking system plus claims on the IMF) rose sharply; the increase was about \$1500 million. The increase in the monetary reserves of the Community countries was therefore largely due to net imports of capital.

11. In the Benelux countries, and to a lesser extent in Italy, the upward thrust of consumer prices eased as the year wore on, while in the Federal Republic and France it was relatively mild from the start. There was also a tendency for the rise in unit production costs to level out.

It should, however, be observed that the upward price movement has not yet been brought to a halt; in 1965, an increase of some 3-4% for the Community as a whole is to be feared.

Experience in the past year has shown that inflationary trends cannot successfully be fought unless a wide range of instruments is available to those responsible for monetary policy, public finance policy and wage policy. It would seem that in some member countries the means used were not sufficiently diversified and that too much emphasis was consequently placed on monetary measures.

12. That inflationary tendencies within the Community should have coincided with an increase in monetary reserves raises the question how far strains occurring in the Community can be put down to "imported inflation", i.e. the transmission of inflationary pressures through the balance of payments. Now, an increase in short-term claims on abroad is apt to lead to an increase in money supply at home. However, the authorities are not entirely helpless in the face of this phenomenon, for by using the various instruments available to them they can put a brake on the formation of domestic liquidity.

But the contraction of domestic liquidity is no easy task when the payments surplus affects domestic demand directly, as it does when it derives from a surplus on current account or from a net inflow of capital for certain kinds of direct investment. In principle, a policy of neutralizing inflationary forces from abroad will encounter fewer obstacles when the surplus stems from purely financial transactions, although beyond certain limits its implementation becomes increasingly difficult. In any case, as long as the accumulation of gold and foreign exchange reserves continues, it is not easy to convince public opinion of the need to accept some degree of discipline.

Although inflation in the Community was in the past due in part to the effects of developments abroad, it should be noted that more recently, and especially during the last two years, the pressure from outside has eased. Inflation is now due mainly to trends originating in the member countries themselves, and it must be fought with domestic measures.

13. Apart from the effects of the recent speculation against the pound sterling, the main counterparts in 1964, as in previous years, of the surpluses of the EEC countries were the continuing deficits of the United States balance of payments, and more especially US exports of capital. This problem is being studied in various quarters, and there have been a number of suggestions on how it should be remedied.

The suggestions sometimes lay emphasis on weaknesses in the organization of certain European capital markets; it is argued that if the markets were operated more efficiently, a better equilibrium in international movements of capital could be achieved. It is true that such adjustments are indispensable in the interests of the harmonious development of the Community itself, given that some of these markets are still suffering from the disturbances and in particular from the inflation by which they were beset in the two postwar periods. But even if such structural improvements had, in the near future, all the hoped-for effects, they would make only a limited contribution to solving the problem posed by the Community's need to step up its exports of capital, particularly to the developing countries. The Community's role as net exporter of capital is particularly important at the present time in view of the persistent net inflow of capital.

14. For it must not be forgotten that capital movements towards the Community countries are encouraged by the continued availability of relatively ample funds on the American capital market. The question therefore arises as to what should be the attitude of the Community countries towards the recurrent deficits on the United States balance of payments. This problem has since 1960 been the subject of many international discussions at which the American authorities have presented programmes designed to bring their balance of payments into equilibrium. The execution of these programmes has achieved appreciable results; the surplus on current account last year is thought to have been of the order of \$8 000 million. It is doubtful whether it will be wise or desirable to work towards a further increase in a surplus of this magnitude. Between 1960 and 1964 the balance of all transactions on current account and of government transactions of all kinds showed a net improvement of about \$3 000 million. But during the same period the balance of capital transactions deteriorated by about \$2 000 million net.

15. There is therefore no doubt that capital transactions are the item which calls for attention if the American deficit is to be corrected. It is hard to see how this can be done as long as the American capital markets enjoy their present ample supplies of funds. Accordingly it is pertinent to inquire how far it is right for the Member States to contribute, through the accumulation of short-term claims on the United States, to the financing of a payments deficit due at least in part to an outflow of capital which, because much of it finds its way into the Community, is liable to hamper the stabilization drive in the six countries.

16. In this respect it should be noted that in 1964 the American deficit was financed largely through the holding of dollars by developing countries, which can be expected to use part of these increased funds in 1965 to step up their purchases. If and in so far as the dollar holdings of the developing countries are transferred to Community countries, which usually

hold a large share of their reserves in gold, the United States might find itself required to cope not only with the problem of financing the 1965 deficit, but also with the need to refinance that of 1964.

17. Last year the Committee exchanged views on a number of occasions in connection with the decision to place special resources at the disposal of the IMF under the General Arrangements to Borrow.

The General Arrangements were called into play because the United Kingdom — faced with a 1964 payments deficit of some £800 million, or more than \$2200 million — drew \$1000 million on the IMF. Since the assistance rendered under the General Arrangements comes largely from the Community countries (\$335 million out of a total of \$405 million) and since the Central Banks of these countries also contributed a large share of the international assistance which it subsequently proved necessary to afford the Bank of England, consultations are still needed within the Monetary Committee on the attitude to be adopted by Member States in their talks with the United Kingdom authorities and in the IMF.

18. The Member States of the Community have a direct interest in the pursuit by the British authorities of a policy ensuring the re-establishment of equilibrium in the United Kingdom balance of payments. This is because this account must be brought back into balance if serious disturbances in the international monetary system are to be avoided, and also because the United Kingdom deficits add to the inflationary pressures that still persist in the Community. Moreover if the freedom of international trade built up at the price of considerable effort since the end of the second world war is to be maintained, the UK import surcharge must be dropped in the near future.

19. Consultations have also been held in the Committee concerning the general raising of IMF quotas. It has examined the details of this operation and more particularly the measures that might be taken to reduce the drain on United States and United Kingdom reserves that may result from the gold payments made to the Fund: those countries holding the greater part of their reserves in dollars or in sterling might find it necessary, because of the raising of their quotas, to convert reserve currency holdings into gold so as to be able to discharge their obligations to the Fund.

20. The general raising of quotas, possibly accompanied by an additional increase in the quotas of certain Community countries, would further swell the resources which Member States are already placing at the disposal of the IMF. At the end of 1964, outstanding drawings on the IMF totalled \$2622 million. Of this total, \$857 million was financed by IMF sales of gold, while of the balance of \$1765 million, \$1473 million — more than 80% — was in the form of drawings on Community currencies.

21. The Committee continued its consultations on the general working of the international monetary system. A study was published last year by the group of ten countries which had concluded the General Arrangements to

Borrow with the IMF. As part of the General Arrangements they have undertaken to procure special resources for the Fund in specific situations; consultation in the Committee has meant that certain opinions held within the Community have been aired in discussions in the Group of Ten.

22. The Committee welcomes the agreement reached in the Group of Ten on the usefulness of participating, through the international institutions which are already concerned with these problems, in a "multilateral surveillance" of the ways and means of financing the balance-of-payments disequilibria. Such surveillance is designed to help the monetary authorities to avoid excesses or shortages in the means of financing surpluses or deficits in the balance of payments, as well as to discuss measures appropriate for each country in accordance with the general economic outlook.

The Committee also regards as noteworthy the conclusion reached by the Group of Ten that the smooth functioning of the international monetary system depends on the avoidance of major and persistent international imbalances and on the effective use of appropriate policies by national governments to correct them when they occur.

Lastly, the Committee feels it must stress the importance it attaches to the constitution of a study group to examine various proposals regarding the creation of reserve assets either through the IMF or otherwise. It feels that this study is all the more important since there is no immediate prospect of a currency of one of the six countries assuming the functioning of an international reserve currency. Indeed, at the present junction such a development could raise problems without substantially strengthening the international monetary system.

23. On 15 December 1964, the Council adopted certain decisions concerning the implementation of the common agricultural policy. The Committee has examined the implications in the monetary field of the adoption of common farm prices and the question of how these common prices should be expressed.

24. The common agricultural market in its final stage, which should be reached in 1967, involves the removal of all intra-Community obstacles to the movement of farm produce, and the unity of the market will mean a permanent arrangement for common prices throughout the Community. The Committee has concluded that of the two methods of expressing prices - in national currencies or in units of account - the unit-of-account method is to be preferred, since it would afford an automatic price safeguard in the event of any change in the cross rates between member countries and would more firmly secure the working of the markets at Community level, particularly from the point of view of relations with the outside world.

But the existence of common prices and their expression in units of account would mean that any such change, especially if it were on an appreciable scale, could have major economic repercussions, since prices of agricultural commodities would change automatically and

immediately, and these changes would affect both farmers' incomes and consumer prices.

25. The Committee therefore went into the question whether the adoption of the unit of account would mean that the member countries must forgo their freedom to devalue or revalue their currencies – an important instrument of monetary policy. It concluded that progressive integration within the EEC, and particularly the tendency for the respective prices of a growing number of products to settle at much the same level throughout the Community, will make devaluation or revaluation increasingly difficult and unlikely. The establishment of a single agricultural market will strengthen this trend. However, the Committee considered that even so it would still be possible for a State to adjust the exchange rate of its currency, should this prove necessary in order to safeguard, for example, the smooth working of the Common Market itself.

26. Should this happen, it would be desirable for machinery to be available which could be used to soften the impact of the change.

The arrangement could be as follows: while the appropriate EEC authorities examined as rapidly as possible the situation created by devaluation or revaluation in the Community from both the agricultural and monetary points of view and took the necessary decisions – which could, if this were deemed desirable, involve an adjustment to Community prices – interim measures might be taken to cushion the impact of the automatic changes in farm prices in the Member States concerned.

27. Although revaluation and devaluation within EEC have become more difficult and unlikely, circumstances could still render the one or the other unavoidable. Because of the common interest of Member States in this sphere, suitable procedures must be agreed. For this reason the Member States meeting in Council agreed in 1964 on the need for consultation prior to any alteration in the rate of exchange of a Member State's currency, and that the Commission should take part in the discussions.

28. The prospects opened by the implementation of the common agricultural policy and experience gained in the last two years in the fight against inflation have brought out more clearly than before the nature of the evolutionary process of economic integration in the Community. As integration gains ground, changes in overall demand, costs and prices in one or more member countries make themselves felt with increasing speed throughout the Community. Given that the economic situation in each member country depends on economic development in the Community as a whole, it is becoming increasingly difficult for the authorities of a Member State to influence their own economic development in isolation by pursuing independent monetary, fiscal or incomes policies or by altering their exchange rates. Should the internal balance of one or more Member States be severely impaired, the stability of the Community as a whole is more and more likely to be threatened. The overall development of the six Community countries between 1963 and 1964 shows how far they have already travelled along the road to complete interdependence.

De facto monetary integration is indeed constantly progressing, although the process is not always immediately obvious.

29. Certain conclusions are to be drawn.

In the first place, the co-ordination of the policies pursued in the member countries must be intensified so that economic and financial developments in each of the Community countries will stem from joint decisions rather than be the fortuitous result of unco-ordinated decisions or chance events in the Community. The Council's Recommendation of 15 April 1964, the first recommendation common to all the countries, is, with its "5% rule" governing the annual increase in public spending, of particular significance in this context. The application of this technique to the other components of economic equilibrium could now be contemplated. The main lines of the policy to be pursued in the Member States – not only in the field of public finance but also in other fields, such as those of monetary policy and incomes policy – should as far as possible be backed up with actual figures in the recommendations. If this were done, common standards would be bound to emerge.

30. While it has been proving increasingly necessary to co-ordinate the economic policies of Member States within the Community, harmonization of their attitudes to external problems has also been acquiring fresh urgency. The fact that in recent years Member States have shouldered almost the entire burden of financing IMF operations highlights the need to solve these problems, and although in the past consultation has not yielded agreement on every occasion, the passage of time is rendering the need for prior agreement on issues among the EEC countries steadily greater.

There is no shortage of examples to illustrate this need. Should, for instance, the current influx of capital into the Community persist, it might lead to further payments surpluses and so engender inflationary pressure, making it necessary to seek out suitable ways and means of encouraging capital exports and of neutralizing the effect of capital imports on internal liquidity. Compensatory measures of this kind can never be completely effective, and it is therefore of overriding importance to put a brake on excess imports of capital from non-member countries, especially as the size and composition of the monetary reserves held by the Member States are already a problem which would undoubtedly be made even more acute by such a development.

Another important task for the Committee will be that of securing close co-ordination when the Group of Ten's report on the creation of fresh reserves is presented and when the ministers and the governors of the Central Banks of these ten countries are deciding on the most appropriate solution to the problem of providing the world with monetary reserves.

## Chapter II

### POSITION IN THE INDIVIDUAL MEMBER COUNTRIES AND MAIN FINDINGS OF THE COMMITTEE

#### FEDERAL REPUBLIC OF GERMANY

Generally speaking 1964 was, despite the very rapid pace of economic expansion, a year in which relative stability was maintained within the Federal Republic of Germany and equilibrium was restored in its external balance of payments.

Expansion was sustained by the very high level of exports and, more recently, by the upsurge in domestic demand, notably investment demand; the gross investment of enterprises rose 9% (volume), compared with 2.1% in 1963. Private consumers' expenditure also grew more rapidly (5.3% in volume), though its progress, like that of public consumption, lagged behind the increase in GNP which, at constant prices, expanded much faster than in 1963: the figures are 6.5% and 3.2% respectively.

The maintenance of relative stability was mainly due to the successful economic policy pursued by the Federal authorities. It was facilitated by the action taken in certain member countries to combat inflationary pressure, as this reduced the demand for goods and services from the Federal Republic. It also owed something to the very marked increase in saving and to the very rapid gains in productivity achieved until quite recently.

None the less strains persisted, and in certain industries these have for some time been growing more serious. Although more than a million foreign workers are now employed in Germany and the number is still rising, severe shortages persist on the labour market; production capacity is almost fully extended throughout the economy, and this tends to increase the difficulty of expanding domestic supply; and the moderate upward movement in prices that has already been recorded may well continue.

The Bundesbank has therefore taken certain steps to curb the expansion of the liquidity of the banking system and, more generally, to moderate the growth of overall demand: from 1 August 1964 onwards, the minimum reserves required of credit institutions were raised by 10% and Bank rate was increased from 3 to 3 1/2% on 22 January 1965. The Bundesbank has also adopted a number of measures to prevent an influx of short-term foreign capital and any additional borrowing abroad by the banks. The reduction in the surplus on the overall balance of payments has underpinned this moderately restrictive policy; the net gold and foreign exchange reserves of the Bundesbank have remained practically unchanged. In 1964, the main features of the balance of payments were a slightly lower surplus on current account than that achieved in 1963 and

a reversal in the net flow of capital. This reversal was due mainly to the announcement that a tax on income from securities held by non-residents was to be imposed, but an increase in the export of capital also played a part. All in all, the basic balance of payments (i.e. the current account plus long-term capital transactions) showed a deficit of DM 642 million, compared with a surplus of DM 2833 million for 1963.

Expansion in terms of volume is expected to continue in 1965, though at a slightly less lively pace than in 1964. One factor in the growth of demand is likely to be a more rapid development of consumption by households, whereas investment and exports are likely to move ahead rather more slowly. Moreover, prices may well increase more sharply than in 1964 unless steps are taken to counter current trends in demand and costs. The surplus on current account may be smaller than in 1964 or may vanish altogether; it can be hoped that the policy being pursued will enable net exports of capital to be maintained.

In these conditions the aim of economic policy should be to temper the disequilibrium between real supply and demand in monetary terms. The Committee is, however, aware that the scope for action by the Federal authorities in the field of incomes policy is very limited.

In pursuing their drive to maintain equilibrium in the balance of payments, the authorities should avoid any measure in the field of current payments which would encourage exports. Again, action to curb capital imports and especially to encourage capital exports should continue and even be reinforced. Equilibrium in the external balance of payments will facilitate the mild credit squeeze and any firmer measures that prove necessary. It might also be found useful to limit the sums available for the financing of building and construction, as the continued excess of demand in this field might, should it gain ground, imperil the balance of the Federal German economy.

The Committee believes that the continuing harmonious expansion of the Federal German economy will depend more than in the past on fiscal policy. In this respect it recalls the EEC Council's recommendation that public spending should not be allowed to grow more than 5% per year, and the wish expressed on this occasion that the "5% rule" should apply to the budgets of the Länder and of local authorities as well as to that of the Federal Government. Although as it now stands the Federal budget seems to comply broadly with the rule, the danger that expenditure will in fact rise above the ceiling is not to be ruled out since additional expenditure, mainly in the agricultural and social fields, has been decided on.

The development of spending by the Länder and the local authorities poses even graver problems, since growth is here well above 5% and since the Federal Government cannot, in view of the financial independence of the provincial and local authorities, at present implement a homogeneous and effective budgetary policy. The wisest course, therefore, is to pursue and step up measures to render tax and budgetary machinery more effective, though an adjustment of the legal situation should not be ruled out.

## FRANCE

In 1964 France made great progress towards the restoration of economic and financial equilibrium. The expansion of demand in monetary terms slowed down more – and sooner – than the growth of real supply. Gross national product at constant prices was up 5% on the 1963 figure, but this figure was a result of the high initial level of activity; throughout the year the tendency was in fact for the rise in industrial output to lose momentum.

Domestic demand expanded more slowly because of a more moderate growth in public consumption and in that of households. In volume, the former was 1.8% up on the 1963 figure, which had showed a 1.9% gain over 1962, but the growth rate of private consumption dropped from 6.3% for 1963 to 4.7% for 1964 <sup>(1)</sup> – and in terms of value the slackening was even more marked. This lower rate of growth of private consumption reflects a slower advance in the incomes of households and some strengthening of the propensity to save. All in all, the rate of growth of investment showed little variation in terms of volume from 1963 to 1964: productive investment by the public and private sectors lost a little momentum, while the growth rate for new housing was distinctly higher.

The upward price trend slowed down, partly as a result of government action and of direct administrative controls. From November 1963 to November 1964 consumer prices rose only 2.3%, compared with 5.3% for the corresponding period of 1962/63.

As in 1963, the growth rate of external demand was, in terms of value, about 10%. On the other hand, imports of goods and services rose sharply, at least up to and including the third quarter, so that the surplus on current account of more than FF 2500 million in 1963 fell to a small figure in 1964. None the less, there was still a heavy surplus on the overall balance for 1964. The maintenance of this large overall surplus despite the reduced surplus on current account is explained by the size of the surplus registered, as in 1963, by movements of long-term private capital, to which must be added the surplus achieved by the franc area in its dealings with the rest of the world, and the absence of advance repayments of public debts such as were made in 1963. Official gold and foreign exchange reserves increased by FF 3 210 million, compared with an increase of FF 4 160 million in 1963.

The slightly smaller contribution of liquidity from outside, together with the restrictive pressure exerted by credit policy and especially by the transactions of the Treasury, helped to slow down appreciably the expansion of money and near-money supply, which in the first 11 months of 1964 rose only 6.4%, compared with 9% in the same period of 1963. The sum of short- and medium-term bank advances increased by 7.8% from January to November 1964, compared with 8.2% in the same months of 1963, whereas commitments by the Treasury to the banking system and to the economy declined by 2.5%, where in 1963 they had risen by 12.2%.

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<sup>(1)</sup> August-September estimate.

The budget deficit resulting from the implementation of the finance acts and the amortization of the public debt was FF 60 million for the first 11 months of 1964, compared with FF 7 700 million for the same period of 1963.

The lull in economic activity is expected to persist in 1965, at least in the early months of the year. The economic budget envisages an increase of 4% — compared with 5% in 1964 — in the gross national product. This assumes a moderate recovery of foreign demand, a growth rate in public and private consumption comparable with that of 1964 and, from the spring onwards, a definite improvement in private investment and in industrial activity.

The French authorities still aim at narrowing the gap which may persist between real supply and demand in monetary terms. Budgetary policy has an essential role to play in this stabilization drive. The Committee notes with satisfaction that in elaborating its budget for 1965 the French Government has kept very close to the EEC Council's Recommendation of 15 April 1964.

Short-term stabilization measures should, however, be supplemented by efforts to improve the structure of the economy and thus to eliminate those factors in its structure which force up costs and prices. A point the Committee wishes to stress is the importance of establishing an incomes policy. In the monetary and financial field the action being taken to reform the organization of the money market and gradually to place the public debt on a longer-term footing should be pursued; consideration should also be given to measures which would further encourage private saving and adapt it better to the financing requirements of industry. Lastly, in view of the persistence of a heavy surplus on the overall balance of payments, largely due to net capital imports, the French authorities should endeavour to step up exports of capital on an appropriate scale.

## ITALY

From the early spring of 1964 the Italian economy began to recover from the imbalances and strains that had beset it in the previous year. The balance of payments showed a considerable surplus and the rise in prices slackened. At the same time, however, production and investment stagnated.

The uncertain trend of domestic demand had the effect, despite the rapid expansion of demand from abroad, of limiting the real growth of GNP to about 2.5%, as against an increase of 4.8% in 1963.

While expenditure on consumption in 1963 had increased by 9% in volume, in 1964 it grew by only 3%. This development can be attributed to the slower growth of wage and transfer incomes and also, no doubt, to the weakening in the propensity to consume caused by the growing insecurity

of the employment situation. The growth rate of public spending on goods and services also slackened and was slightly below 4% by volume, as against 5.7% the year before. Lastly, gross fixed asset formation diminished appreciably in the course of the year, and in terms of volume the total for 1964 was considerably below the figure for 1963.

The favourable world business situation and the efforts made by businessmen to counter the uncertain trend of domestic demand by increasing sales abroad brought about a faster expansion of visible exports in 1964, growth by volume being 16% against 5.9% in 1963. The total rise in exports of goods and services was some 13% by volume, against 6.3% the previous year.

Agricultural production showed distinct improvement after the bad harvests of the previous two years, but industrial production seems to have made scarcely any progress in 1964 after the 8.6% expansion achieved in 1963; on the basis of seasonally adjusted indices it even showed something of a drop in 1964. The level of production at the end of 1964 was about 4% lower than at the close of 1963. Imports of goods and services barely reached the 1963 level in volume.

Prices continued to rise, though more slowly; for the first ten months the index of wholesale prices was about 3.5% and that of consumer prices some 5.9% up on the same period of the previous year. The trend of prices during the year, especially wholesale prices, showed a tendency to settle down.

The balance of payments was marked by two different trends during the year: in the first quarter there was a heavy deficit of over \$ 430 million, while during the rest of the year there was regularly a surplus, so that the year ended with an overall surplus of about \$ 750 million. This favourable trend in the balance of payments resulted from an improvement in both current payments and capital movements. Among current transactions, exports showed in the first quarter an advance of some 11% over the corresponding period of the previous year and about 17% during the last nine months, while imports showed a year-to-year advance of 18% in the first quarter and then fell some 10% for the rest of the year. Capital movements, which in the first quarter had resulted in a net outflow of \$ 9 million (compared with \$ 58 million in the same period of 1963), showed during the rest of the year a net surplus of more than \$ 300 million (compared with a deficit of some \$ 300 million in the same period of 1963).

The improvement in the balance of payments enabled Italy to build up its reserves again; it repaid to the International Monetary Fund the gold tranche drawn in March and paid up \$ 57 million of its increased quota to the Fund. The official gold and currency reserves went up by \$ 400 million in 1964, while the commercial banks reduced their foreign indebtedness considerably (by about \$ 420 million).

Since April, developments in the balance of payments and of Treasury operations have led to rather greater liquidity in the banking system. This the banks used primarily to reduce their indebtedness abroad and their commitments to the Central Bank. On the other hand, the expansion of advances to business and private customers ceased in 1964, and there

was even a slight drop. At the end of November 1964 the total of bank advances was 3% higher than a year earlier.

The monetary Committee notes the forecasts for the current year, which suggest that the continued expansion of demand from abroad and the growth of domestic demand will lead to some recovery in 1965. The trend of domestic demand seems to reflect a net increase in expenditure on gross fixed asset formation and on building and construction as a result of steps taken by the Italian authorities. In these circumstances the real gross national product may increase by 3%.

The Committee is glad to find that the stabilization measures taken by the Italian authorities have had certain favorable results during the past year. One of the major problems at present facing the Italian authorities is clearly the need to put a brake on the increase in labour costs, so that stability of prices can be re-established, a high level of employment maintained, and the revival of economic activity ensured.

Until there is a policy which limits the expansion of incomes to the growth of productivity, and unless considerable adjustments are made to the sliding-scale system, it may not prove possible to put an early stop to the rise in costs and prices.

The high degree of elasticity of production, the distinct improvement in the balance of payments, and the existence of substantial foreign currency reserves should make it possible for the authorities to take the measures that should counteract the recessive tendencies which have been observed for some time and which have been leading to shorter hours in some industries and some unemployment. The degree of success in encouraging investment will depend on how nearly they succeed in keeping public expenditure within the limits recommended by the Community's Council of Ministers. This being so, the Committee welcomes the fact that the Government's budget for 1965 respects the norms laid down by the Council in respect of the growth rate of public expenditure, the appropriations for public investment having been increased much more sharply than those for current expenditure on goods, services and transfers.

## NETHERLANDS

Internal economic stability in the Netherlands was subject to considerable pressure in 1964, mainly on account of the rise in income from wages.

Expansion was rapid: industrial production went up by 7.5% in volume, agricultural production by over 10%, and value added in the services sector by 7%. The growth of the gross national product at constant prices was 7%, as against 3.8% in 1963.

The growth of demand in money terms was however much more rapid than the expansion of supply, with domestic demand accelerated by the

exceptionally sharp increase in salaries and wages (17% in the private sector and 21% in the public sector) advancing even more rapidly than demand from abroad. The level of investment has not yet been impaired by the considerable rise in the wage level, gross fixed asset formation rising by some 15% in volume against 3.9% the year before; it must be noted, however, that this high figure is in part a result of the slowdown in investment during the particularly severe winter of 1963. Although the effect of the sharp increase in salaries and wages was attenuated by the increase of some 5.5% in overall productivity and the measures intended to contain prices were strictly enforced, price increases gathered speed. Wholesale prices rose by over 6% (2.2% the previous year), while consumer prices rose by 6.5%; the volume of private consumption went up by 6%, as in 1963.

The value of imported goods and services grew by 17.5%. As the corresponding exports rose only 14%, the current account closed with a deficit of some Fl. 750 million, while in 1963 there had been a surplus of Fl. 350 million. Capital transactions showed a surplus, particularly in the second half of the year. The overall balance of payments will consequently have closed with a slight surplus in 1964. The foreign currency held by the commercial banks fell, while official monetary reserves went up by Fl. 681 million.

In the first half of the year developments in the balance of payments contributed to a tightening of liquidity on the money and capital markets. Against this, the Treasury deficit and the increased short-term indebtedness of the local authorities helped slightly to increase liquidity. In 1964 short-term advances made by the banks to business and private customers went up by some 12%; this went beyond the 10% limit agreed between the Central Bank and the commercial banks. The Nederlandsche Bank raised Bank rate in two stages to 4.5%. Special measures were also taken to restrain the expansion of consumer credit.

The strain on the labour market will continue to be marked in 1965. As the wage agreement which has just been concluded, and which means a wage rise of at least 7% in 1965, will lead to a further increase in unit labour costs, prices may well rise further in 1965, though less steeply than in 1964. The balance of current transactions is likely to show a smaller deficit than in 1964, but there will none the less be a deficit. In real terms the GNP will increase by about 3.5%.

Reinforcement beyond certain limits of restrictive measures in the monetary and credit sphere could raise difficulties, since any further increase in interest rates risks being offset by inflows of capital. The Netherlands authorities would then have to ensure that there were corresponding exports of capital. In the Committee's view, anti-inflationary action should concentrate on budgetary policy and on measures to restrain demand in building and construction, for this is one point from which inflation can spread. Continuance of the present strains could, in the longer run, undermine the competitive position of those industries which are most dependent on exports and consequently their growth. The maintenance or even the reinforcement of a policy of restraint seems therefore to be in the interest of both internal and external equilibrium.

## BELGIUM

In Belgium the year 1964 was marked by increased strains, which led to a considerable rise in costs and prices. Gross national product went up 5% in volume (3.9% in 1963), there was a perceptible increase in gross public and private investment and a recovery in the public finances, and the capital market returned to more normal operation.

The gradual rundown of manpower reserves led to further strain on the market, at least until spring. The total wage bill rose more than 11% from 1963 to 1964, as against 8.2% from 1962 to 1963. As demand in money terms exceeded real supply, and both costs and the price of imports (particularly raw materials) increased, there was from the second half of 1963 onward a significant rise in prices — more than in most of the other industrialized countries. Though the upward trend slowed down in the second half of 1964, the retail price index rose more than 4% for the full year.

The rapid increase in household incomes brought about a market expansion of expenditure by private consumers: the growth rate was 10% in value and 5% in volume. Government expenditure on consumption also increased considerably, though not as quickly as private consumption. The most vigorous increase among the various elements of total demand was that in gross fixed asset formation, which rose about 10% in volume, compared with 1.6% in 1963. But in 1963 investment in housing had fallen off because of the exceptional length and severity of the winter. Foreign demand also increased sharply in 1964, though it did slow down during the second half of the year.

Transactions in goods and services showed a deficit of some Bfrs. 3 000 million in 1964, as against Bfrs. 4 200 million in 1963. Net imports of medium- and long-term capital by the public authorities were much the same as the year before, while imports of private capital were considerably higher. The overall balance of payments showed a surplus of about Bfrs. 8 000 million, after the 1963 deficit of Bfrs. 600 million. The net foreign assets of the Belgian monetary institutions totalled Bfrs. 82 300 million at the end of November 1964.

Increased strain in the economy led the Belgian authorities to introduce restrictive policies from the end of 1963, the effects of which have gradually been making themselves felt. This policy involves the spread of public investment expenditure over longer periods, some reinforcement of price controls and a credit squeeze. Attempts to put a brake on expansion of credits available to the economy made it possible to keep the growth rate of domestic liquidity well below that of 1963. The Government borrowed less from the banking system and the Central Bank, mainly because of the increase in tax revenue.

In 1963 the national debt had grown by Bfrs. 23 000 million — Bfrs. 10 700 million of funded debt and Bfrs. 12 300 million of floating debt. In 1964 it increased by Bfrs. 16 200 million; the funded debt having risen Bfrs. 18 100 million while the floating debt shrank by Bfrs. 1 900 million. The Monetary Committee has invited the Treasury and semi-official institu-

tions to avoid increasing their short- and medium-term commitments abroad, and suggested that the Treasury should continue its efforts to pay off or fund the floating external debt. In 1964 there had been a tendency for the imports of private capital to increase, and the Committee considers that if this tendency persisted the Belgian authorities would be well advised to offset it by increasing exports of capital. In this connection it would be well to recall the conclusions reached in earlier reports, in which the Committee pointed out that the structure of public expenditure needed to be altered and the methods of financing it reviewed. Although undoubted progress has been made in recent years, too great a proportion of budget expenditure in Belgium is still financed by borrowing. In order to provide the domestic savings needed to finance the desired expansion of the economy, the Belgian authorities should ensure surpluses on the ordinary budget to help finance the investments envisaged in the extraordinary budget.

The outlook for 1965 depends both on the extent to which domestic demand is affected by the policy of restraint and on developments in the world economic situation. Some slackening in the growth rate of exports — particularly to non-member countries — seems probable; gross fixed asset formation, too, will increase more slowly than in 1964. On the other hand, public and private expenditure on consumption will remain high. Gross national product may go up nearly 4% in volume, although the expansion of activity in some sectors has slackened of late. Although, then, there may be some slackening of demand, it is not certain that balance will be fully restored and there is still a risk that prices may increase further, though at a more moderate pace than in 1964.

The Committee notes with satisfaction that in 1964 the Belgian authorities reinforced certain restrictive measures, particularly in the credit field, but it must be pointed out that such measures by themselves are not enough to ensure the balanced, long-term growth of the Belgian economy. Failing an incomes policy linking wage increases more closely to rises in productivity (this might mean making some adjustment to sliding-scale clauses), it is uncertain whether stabilization of costs and prices can be attained in the immediate future.

## LUXEMBOURG

After the negligible advance made in 1963, economic expansion in Luxembourg has since the beginning of 1964 been very rapid, though the pace has now eased. Reflecting the improvement on the world steel market, the vigorous recovery of steel production — which accounts for nearly two thirds of the country's total industrial output — led to a 6% increase in GNP in real terms, as against about 1% in 1963.

The growth of domestic demand also helped expansion; private consumption, particularly of durable goods and services, rose sharply as a result of the large increases in household incomes. In addition, expenditure under the 1964 budget will probably be some 15% up on actual expenditure in 1963.

These developments resulted in considerably heavier imports of raw materials and finished products. The strain on the labour market increased, and the consequent rise in costs (the sliding wage scale came into operation twice in the course of the year) helped to send prices up significantly, particularly in the services and construction sectors.

It is not yet certain whether domestic prices will tend to settle down in 1965. The Committee therefore underlines the need for vigilance, particularly as regards the movement of wages and prices. Luxembourg, because of its dependence on other countries, can hardly avoid the inflationary pressure that has been felt in the other countries of the Community, but a rise in public expenditure such as occurred in 1964 will inevitably have added to this pressure. The Committee notes with satisfaction that the 1965 budget, in accordance with the Recommendation put forward by the Council, is intended to restrict domestic demand and that the authorities will put a brake on the money that is made available for investment, particularly in the construction industry.

## ANNEX

### THE COMMITTEE MEMBERS AND ALTERNATES

#### Chairman :

Jonkheer Mr E. van LENNEP      Thesaurier-generaal bij het ministerie van Financiën  
(The Hague)

#### Vice-Chairmen :

M. B. CLAPPIER      Sous-gouverneur de la Banque de France (Paris)

Dr O. EMMINGER      Mitglied des Direktoriums der Deutschen Bundesbank  
(Frankfurt/Main)

#### Members :

M. P. BASTIAN      Commissaire du gouvernement (Luxembourg)

Dott. F. BOBBA      Director-General for Economic and Financial Affairs  
in the EEC Commission (Brussels)

M. A. de LATTRE      Directeur des finances extérieures (Paris)

M. F. DE VOGHEL      Vice-gouverneur de la Banque Nationale de Belgique  
(Brussels)

M. T. de VRIES      Director in the Directorate-General for Economic and  
(from 2 December 1964)      Financial Affairs in the EEC Commission (Brussels)

M. M. D'HAENZE      Directeur général de l'administration de la trésorerie  
et de la dette publique - ministère des finances  
(Brussels)

Dr R. GOCHT      Ministerialdirektor, Bundesministerium für Wirtschaft  
(Bonn)

M. J. HEINEN      Conseiller de direction à la Caisse d'épargne de  
l'Etat (Luxembourg)

Dott. R. OSSOLA      Capo del servizio studi di economia internazionale  
(from 26 November 1964)      della Banca d'Italia (Rome)

Prof. S. POSTHUMA      Directeur der Nederlandsche Bank NV (Amsterdam)  
(until 29 October 1964)

Prof. G. STAMMATI      Direttore generale del tesoro - Ministero del tesoro  
(Rome)

Mr J. H. O. graaf v. d. BOSCH      Directeur der Nederlandsche Bank NV (Amsterdam)  
(from 30 October 1964)

Dott. A. VERNUCCI      Direttore generale dell'Ufficio italiano dei cambi  
(until 25 November 1964)      (Rome)

**Chairman of the Alternates :**

Mr A. W. R. Baron MACKAY                      Onderdirecteur, Nederlandsche Bank NV (Amsterdam)

**Alternates :**

Dr. H. BONUS                                      Ministerialdirigent, Bundesministerium der Finanzen  
(Bonn)

M. F. BOYER de la GIRODAY                      Head of Division in the Directorate-General for  
Economic and Financial Affairs in the EEC Commis-  
sion (Brussels)

Dott. M. CARDINALI                              Ispettore generale delle valute - Ministero del  
commercio estero (Rome)

Drs. S. N. EISMA                                 Ministerie van Financiën (The Hague)

M. P. ESTEVA  
(until 7 September 1964)                      Directeur adjoint au ministère des finances (Paris)

M. H. FOURNIER                                 Directeur général des études et du crédit de la  
Banque de France (Paris)

Dott. L. FRONZONI  
(from 26 November 1964)                      Délégué de la Banca d'Italia pour le Benelux  
(Brussels)

M. R. LOMBA                                      Chef du service des relations financières avec  
l'étranger au ministère des finances (Brussels)

Prof. F. MASERA  
(until 25 November 1964)                      Capo del servizio studi di economia internazionale  
della Banca d'Italia (Rome)

Prof. J. MERTENS de WILMARS                      Onderdirecteur der Nationale bank van België  
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M. C. PIERRE-BROSSOLETTE                      Directeur adjoint à la direction des finances exté-  
rieures (Paris)

Dr G. SCHLEIMINGER                              Bankdirektor, Abteilungsleiter in der Deutschen  
Bundesbank (Frankfurt/Main)

M. M. SCHMIT                                    Chef du service du budget (Luxembourg)

Dr. H. STEFFE                                    Director in the Directorate-General for Economic and  
Financial Affairs in the EEC Commission (Brussels)

M. R. WEBER                                      Membre du comité de direction de la Caisse d'épargne  
de l'Etat (Luxembourg)

**Secretariat :**

M. R. de KERGORLAY

Dr H. BURGARD  
(until 30 November 1964)

