EUROPEAN COMMUNITIES
MONETARY COMMITTEE

TWELFTH REPORT ON THE ACTIVITIES OF THE MONETARY COMMITTEE

Brussels, 30 June 1970

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INTRODUCTION

The purpose of this report is to give a brief account of the activities of the Monetary Committee during the period from 15 May 1969 to 30 June 1970.

During this period, the Committee held nineteen meetings and its working parties met on many occasions.

Following the departure of Jonkheer Mr. E. van Lennep, appointed Secretary-General of OECD, the Committee, at its meeting of 9 and 10 January 1970, unanimously elected as Chairman M. B. Clappier, Deputy Governor of the Banque de France, for the remainder of M. van Lennep's term of office, and as Vice-Chairman Professor W. Drees, Treasurer-General in the Netherlands Ministry of Finance, for the remainder of M. Clappier's term. A list of the members of the Committee is annexed.

The report was adopted on 30 June 1970. It takes no account of subsequent monetary and financial trends or measures in or outside the Community.

1. In the period reviewed in this report, the inflationary tendencies discernible in the Community since 1968 persisted and indeed strengthened in varying degree, while the balance of payments disequilibrium deteriorated, leading to exchange rate adjustments in France and Germany. These developments and the various measures taken by the member coutries to cope with them largely determined the nature of the tasks carried out by the Committee, which on several occasions held prior consultation meetings in conformity with current Community rules.

The Committee also continued its work on fuller co-ordination of economic and monetary policy within the Community. In particular, it had occasion to render Opinions on the appropriate prior consultation procedures, in line with the Council decision of 17 July 1969 on the co-ordination of short-term economic policies of the Member States, and on the implementing procedures for a Community system of medium-term financial aid.

In the field of international monetary relations, a number of important decisions were taken; here, the Committee helped to harmonize the positions to be adopted by the Six in more general international negotiations; the subjects dealt with in consultations included the creation of special drawing rights and the five-yearly revision of the quotas in the International Monetary Fund.

2. The pressure of work on current problems and the allocation of additional tasks forced the Committee to spend less time on the periodical examination of the monetary and financial situation of the member countries. Regular reviews and special examinations at consultation meetings replaced in some measure the traditional systematic studies. It is also clear that in future the Committee will have to devote more and more of its time to international monetary policies of the member countries. This is in line with the objectives set out in the Hague communiqué concerning the establishment by stages of an economic and monetary union among the Six.

I – GENERAL SURVEY OF ECONOMIC AND MONETARY DEVELOPMENTS IN THE COMMUNITY AND MAJOR NON-MEMBER COUNTRIES

3. The period of boom business conditions which had started in the Community in 1968 continued throughout 1969, and in most member countries, indeed, there were unmistakable signs of strain. Real gross Community product rose by 7·1% in 1969, a record since the inception of the Common Market. Growth was particularly rapid in Germany, France and Luxembourg. It was also lively in Belgium and satisfactory, though a little slower than in 1968, in Italy and the Netherlands.

4. This development was, however, accompanied by inflationary pressures which strengthened in most member countries in the period under review. Although production again showed a surprising degree of elasticity, particularly in the first half of 1969, potential overall demand gradually moved ahead of overall supply and cost increases outstripped productivity gains, mainly because various raw materials were in short supply and because there was an increasing number of bottlenecks on the labour markets of most member countries. In the course of the year, the price trend in the Community was, in general, mounting vigorously both at the production stage and at the various stages of distribution; consumer prices rose by 4·8%, the sharpest increase since the Common Market was set up.

The following table shows clearly how the inflationary process gathered speed.

Growth of GNP in the member countries and the Community in 1968 and 1969

(% change on preceding year)

	Value		Prices		Volume	
	1968	1969	1968	1969	1968	1969
Germany	8.9	11.6	1.6	3.3	7.2	8.0
Italy	7.6	9.2	1.5	4.0	6.0	5.0
Netherlands	10.1	11.7	3.7	6.3	6.2	5.0
Belgium	6.3	10.4	2.4	4.0	3.8	6.2
Luxembourg	7.1	15.0	3.0	7.5	4.0	7.0
EEC[1]	8.7	11.4	2.8	4.0	5.7	7.1

[1] Value : calculated on the basis of the official exchange rates, account being taken of the parity changes made in 1969 in France and Germany.

Volume: calculated on the basis of the official exchange rates in force in 1963.

5. In the Community, faster growth in 1969 was the result of an expansion of external and internal demand. The strength of Community exports remained satisfactory. In terms of value, visible exports to non-member countries were 11% higher than in the previous year. There was also a very distinct rise in internal demand. Gross fixed asset formation expanded sharply while private consumers' expenditure gathered momentum under the influence of a rapid rise in disposable incomes of households. The very lively upswing in internal demand was matched by exceptionally vigorous expansion in the field of intra-Community trade and imports from non-member countries. In terms of value, visible trade between the member countries went up by almost 30% while visible imports by the Community from non-member countries were 17% higher than in 1968.

6. In 1969, member countries' imports from the United States and, to a lesser degree, from the developing countries mounted sharply and the surplus on the Community's balance of trade ($1 200m. as against $3 200m. in 1968) therefore contracted. As the increase in the surplus on services was almost completely offset by a heavier deficit on transfer payments, the surplus on current account fell sharply ($1 600m. as against $3 500m. in 1968). There were also heavy net outflows of long-term capital, especially private capital, and the Community's basic balance therefore closed with a deficit of the order of $7 000m. (as against $1 700m. in 1968). Including all other items (short-term capital movements, errors and omissions), the total payments deficit was $6 700m. Of this, $4 450m. was financed by a reduction in net official gold and foreign exchange reserves (including the net position with the IMF) and $2 260m. by a deterioration in the net short-term external position of the banking sector.

7. In Germany, demand built up vigorously in 1969. There was a particularly rapid rise in investment and exports, but from the autumn onwards, private consumers' expenditure was also gathering distinct momentum.

The labour market came under increasing strain. Production expanded considerably, thanks to a fresh and significant improvement in productivity and the recruitment of more foreign workers. In terms of volume, GNP was 8% higher than in 1968 while industrial production advanced by about 13%.

The upward thrust of prices gathered distinct momentum from the autumn onwards, notably as a result of major wage awards in a large number of industries.

On current account, the balance of payments showed a heavy surplus, but long-term capital exports easily offset this. Until the autumn, inflows of speculative short-term capital boosted gold and foreign exchange reserves. The period of relative calm which followed the wave of speculation of May 1969 was of short duration. During September 1969, inflows of short-term capital reached alarming proportions and forced the Bundesbank to intervene on a very large scale. In the circumstances, the Government decided to close the foreign exchange markets in Germany from 24 September 1969. On 30 September, immediately following the elections, the authorities decided to allow the mark to float, i.e. to discontinue, until further notice, intervention on the exchange market to keep the exchange rate within the limits fixed under the Bretton Woods agreements.

This measure and even more the decision to revalue the mark by 9·29%, taken on 27 October 1969, triggered off a rapid outflow of short-term capital, so that the situation on the exchange markets reverted to normal. The reserves of various countries which had run into difficulties because of the speculation on the mark now built up again.

Although at the beginning of 1970 exports returned to a more normal level, overall demand in Germany is still very buoyant. Production rose again considerably, but there was also a very appreciable rise in prices.

8. In France, the internal and external disequilibria which had developed after the strikes of May and June 1968 persisted and indeed grew worse during the greater part of 1969. The uncertainties connected with political or social deadlines and the international monetary situation influenced the behaviour of producers, dealers and consumers. As a result, the restrictive measures adopted at the end of 1968, including the credit restrictions, which were intensified the following spring, took longer to "bite" than would

otherwise have been the case. For a fairly long period demand outstripped production capacities, curbing exports and entailing a sharp rise in imports. The cost of living continued to increase, the annual rate being about 6%. Maintenance of the exchange controls made it possible to avoid very heavy outflows of capital of the scale registered in May and November 1968. Nevertheless, in the first half of 1969 the balance of payments deficit, which had already touched \$3 200m. in 1968, was close on \$1 700m., partly because of a "leads and lags" effect.

At the beginning of August 1969, the Government decided to devalue the franc by 11·11%. This measure was to have an important psychological impact but this did not affect the need for a rigorous recovery programme in support. Fresh moves were made to eliminate the budget deficit gradually and ensure that in 1970 revenue and expenditure would be back in equilibrium. The limits placed on the expansion of credit to trade and industry were tightened and Bank rate was raised to 8%. Internal liquidity creation slowed down sharply and the rate of expansion of the money supply (including near-money) dropped to 6% from 11% in 1968 while the money supply in the narrow definition hardly increased at all.

From the autumn onwards the pressure of domestic demand gradually slackened, particularly in respect of private consumption. As there was first a reversal in the "leads and lags" effect and subsequently an improvement in the trade account, heavy surpluses replaced the previous deficits on foreign trade and payments; in the end, the payments deficit for the year as a whole was no heavier than it had been at the end of the first half of the year. In the spring of 1970, France was able to pay off the balance of its short-term debts contracted abroad while increasing its gross foreign exchange holdings.

Supported by a strong wave of investment and exports and by the drive to replenish stocks, growth remained very dynamic, both during the closing months of 1969 and in the early months of 1970. GNP for 1969 expanded by some 8% in volume terms and forecasts under the economic budget for 1970 have been revised upwards very appreciably. Although prices are still rising too rapidly, strain has eased in most industries.

9. In Italy, the phase of rapid expansion that began in the summer of 1968 came to an abrupt end in the last four months of 1969 because of a wave of strikes of unusual proportions. They cut back the growth of GNP at constant prices to 5% while there had been good reason to expect an expansion of 7% before the social disturbances started. For the year as a whole, however, all components of domestic demand gathered slight momentum, reflected in an extremely rapid expansion of imports.

At the beginning of 1970, the Italian economy entered a phase in which the economy was making good previous production losses, but this trend was hampered by further strikes. In the first quarter, industrial production was about 5% up on the level of a year earlier.

On the labour market, unemployment fell sharply and there was a shortage of skilled labour in some areas.

The upward thrust of prices gathered momentum throughout 1969, and in the first quarter of 1970 consumer prices were almost 5% higher than a year earlier, compared with an average increase of 2·8% in 1969. As for the balance of payments, there was a slight decline in the surplus on current account and a considerable rise in outflows of capital.

The overall deficit reached \$1 400m., compared with a surplus of \$600m. in 1968. Despite this deterioration, the net official gold and foreign exchange reserves fell only slightly, mainly because of heavy imports of short-term funds by the banks.

10. In the Netherlands, economic expansion remained rapid in 1969. The lively growth of overall demand was supported by faster export growth. The expansion of fixed investment, by contrast, slowed down and the growth of private consumers' expenditure slackened distinctly in terms of volume. Although the growth of world trade has tended to weaken since the beginning of 1970, there are no important signs of the business trend in the Netherlands weakening.

Under the persistent pressure of demand and despite mounting strains on the labour market, domestic supply was remarquably elastic. Industrial production rose by 12·5%, as against 11% in 1968, while GNP in real terms expanded by 5%, following a rise of 6·2% in 1968.

In the early months of 1969, the price climate deteriorated appreciably, not only because factors in the business trend forcing up prices were strengthening but also because of the repercussions of the introduction of VAT. In 1969, consumer prices went up by 7·5%, the sharpest increase since 1951. In the first quarter of 1970, the year-to-year rise was only 3·4%.

The current account deteriorated in 1969. However, if stocks are included, the external position is seen to have improved appreciably.

With funds flowing in from abroad, particularly after revaluation of the mark, and the authorities making considerable use of the money market because tax receipts fell short of estimates, the tightening of liquidity was not as pronounced as had been expected. For these reasons the restrictive policy was reinforced to some extent in 1970.

11. In Belgium the rising phase of the trend, which began about the end of 1967, continued throughout 1969, and it was not until the beginning of 1970 that it showed signs of slackening. The vigorous contributions came from the usually rapid expansion of export demand as the other member countries purchased much more and from the strong recovery in gross fixed asset formation. Private consumers' expenditure also rose sharply.

The rise in production gathered appreciable momentum: at constant prices, value added by industry went up by 9·5% in 1969, as against 5·6% the previous year. With activity in the other sectors also expanding appreciably, GNP at constant prices rose by 6·2%, as against 3·8% in 1968.

As a result of the slowdown in productivity gains, there was a tendency for the improvement in the employment situation become more marked. The decline in unemployment continued and even gathered momentum at the beginning of 1970, leading to general strains on the labour market.

The business upswing entailed increasing pressure on the level of domestic prices. The rise in consumer prices was 3·75% in 1969 and rose to 4·3% in January-April 1970 above the price level for January-April 1969.

While the overall balance of payments for the first nine months of 1969 closed with a deficit of BF400m., it produced a surplus of BF23 000m. in the period October 1969-

February 1970, this being mainly a matter of "leads and lags" after the revaluation of the mark.

12. In Luxembourg, the economic upswing strengthened significantly in 1969, borne up mainly by exports and fixed investment. In terms of volume, the growth of GNP in 1969 may be estimated at 7%, as against 4% in 1968. Since the beginning of 1970 the pace of growth has, however, slowed down because export demand for iron and steel products has advanced at a less lively pace and several industries have been running at capacity.

The faster expansion of production is due not only to major productivity gains but also to a significant rise in the numbers in paid employment. Strain on the labour market grew in the course of the year.

Until the summer, the price trend was calm; in the second half of the year, prices were rising somewhat more rapidly, particularly because the cost of imported manufactures and services went up. For the full year, the consumer price index went up by 2·3%. At the beginning of 1970, the index rose appreciably because of the switch to the VAT. The policy pursued by the Government, however, helped to avoid excessive increases such as could have resulted from the reform in a period of boom business conditions.

13. The economic trend in the Community in 1969 differed appreciably from the trend in the United States, where expansion slackened sharply during this period without, however, there being any easing in the pressure on prices. The trend in the Community also contrasts with the rather sluggish revival of economic activity in the United Kingdom.

Under the contraints imposed in monetary and budget matters, the American economy tended to mark time. From August onwards, the index of industrial production declined. Inflation none the less remained very rapid throughout the year (about 5·8% in annual average terms), especially under the pressure of private investment and an increase in costs, due largely to wage increases running well ahead of productivity gains.

14. On a liquidity basis, the United States balance of payments for 1969 closed with the record deficit of about $7 000m. By contrast, the balance on an official reserve transactions basis showed the heaviest surplus in many years ($2 700m.). [1]

The very sharp deterioration in the liquidity balance, which in 1968 was still virtually in equilibrium, is mainly due to a trend reversal for special financial transactions (a deficit of $900m. compared to a surplus of $2 300m.) and to a major increase in non-recorded exports of capital, reflected in a swollen "errors and omissions" item. Net exports of private long-term capital accounted for $1 600m. of the deterioration in the external position, this being partly due to a relaxation of the Johnson programme on capital exports. There was no major change in the current account from one year to the other, despite an appreciable slackening of economic expansion and despite the anti-inflationary policy of the American authorities.

[1] The US balance of payments is defined in a number of different ways and this gives rise to some problems of interpretation. It should be noted that none of the concepts used by the American authorities matches the definition of the overall balance of payments used in the Community.

Given the role played by the dollar in the international monetary system, it is clear that the persistence of a heavy deficit on the US balance of payments is liable to disrupt the international monetary order.

15. During 1969 the United Kingdom made considerable progress on the road to stabilizing its external position, while the state of internal equilibrium deteriorated.

The restrictive measures taken under the budget bit into consumer demand and enabled some real resources to be switched to exports. Compared with the previous year, the growth of gross domestic product slackened distinctly and was down to 2%, after 3·5% in 1968. Although economic activity was thus not very dynamic, the rise in prices persisted and indeed gathered momentum.

16. The balance of payments staged a remarkable recovery in 1969. United Kingdom exports, favoured by the slackening of domestic demand and the extremely lively expansion of world trade, grew appreciably faster than imports (14% in terms of value as against 5%). In the circumstances, the trade deficit fell sharply, from £643m. in 1968 to £158m. in 1969.

The surplus on services also rose further so that the current account produced a surplus of £415m. The basic balance showed a surplus of £398m., the best performance in many years. The changes in its external position enabled the United Kingdom to repay, sometimes ahead of schedule, a substantial part of its external debts.

17. During 1969, interest rates were rising throughout the world and movements of short-term capital expanded at an unusual pace.

Inflationary pressure, varying in strength from country to country in the Community, led the national monetary authorities to tighten restrictions and this made a progressive contribution to the rise in interest rates.

This tendency was strengthened by the monetary policy pursued by the US authorities. As credit demand remained strong, official policy entailed a distinct rise in interest rates, first on the American market and then for Eurodollars when American banks turned to the Eurodollar market. The interest rates prevailing in the Community were inevitably affected; some Member States were forced to follow the trend on the Eurodollar market in order to avoid very heavy outflows of capital.

In the closing months of the year, short-term interest rates, which are particularly sensitive to credit policy, reached their highest point in most member countries and have since been running at very high levels although there have been signs of a decline in the United States and on the Eurodollar market. Long-term interest rates, by contrast, appear to be still rising in many countries. The policies pursued to restore equilibrium have failed to prevent private individuals from acting on the assumption that the inflationary process would continue: this has made the demand for credit very inflexible, so that inflation has itself become an inflationary factor.

Although in this period there was no conflict between outside influences and the requirements arising from the internal situation in the Community, it is not certain that this pattern will last or will again emerge in the future. Member countries therefore examined ways of preventing US monetary policy hampering their own policies. In this context, the Committee discussed the trend of interest rates on several occasions. These discussions enabled a large measure of agreement to be reached among the Six and this harmonized attitude played an important role in discussions held at other levels.

18. The exceptional scale of short-term capital movements is mainly attributable to two factors: firstly, there was the disparity which developed for a time between interest rates on the national money markets and interest rates on the Eurodollar market and, secondly, there was the prospect of parity changes, mainly for the French franc and the mark.

For a time, interest rate escalation in the United States and also on the Eurodollar market entailed major disparities between the yields on these markets and yields on the markets of most other industrialized countries. This induced the banks and private individuals in Europe to step up their holdings of securities denominated in dollars. To meet their finance and liquidity needs, the satisfaction of which was hampered by the restrictive monetary policy adopted by the United States, American companies and banks had to repatriate a large part of the funds held with their subsidiaries abroad. These two factors led in some cases to a heavy drain on the reserves of certain member countries, which were consequently compelled to take safeguard measures by raising their Bank rates and/or imposing requirements with respect to the external position of their commercial banks.

The effects which the likelihood of parity changes had on movements of short-term capital were referred to in Sections 7 and 8 above.

II – PARITY CHANGES: CONSULTATIONS IN THE COMMITTEE

19. In accordance with the rules, prior consultations were held within the Committee on the parity changes made in the Community in 1969. Before an outline is given of the conditions in which these consultations were held, it may be useful to recapitulate the provisions which are the institutional basis of the consultations.

In accordance with Article 107 of the Treaty of Rome, which provides that "each Member State shall treat its policy with regard to exchange rates as a matter of common interest", the representatives of the Governments of the Member States meeting in the Council adopted, on 8 May 1964, a declaration confirming their intention to consult each other prior to any change in the parities of their currencies. In conformity with instructions received pursuant to this declaration, the Committee worked out the procedure for these consultations.

20. Council Regulation No. 129 of 23 October 1962 requires that the common agricultural prices are to be expressed in units of account, and Council Regulation No. 653/68/CEE of May 1968 lays down the rules governing changes in the value of the unit of account as used for this purpose. So as to facilitate the preparation of the decisions to be taken by the Council in the event of a change in a Member State's parity, the Committee has to render an opinion on the desirability of changing the value of the unit of account and/or certain agricultural prices. Where such changes are made it is also incumbent on the Committee to examine the situation created in the relevant fields, render an opinion on the economic and monetary implications of the automatic adjustment of the prices expressed in national currencies and state its views as to whether it is desirable for the Member State concerned to make arrangements temporarily mitigating the impact of these automatic adjustments.

21. These rules were applied for the first time when Community countries decided to change their parities in 1969: in connection with the devaluation of the French franc, prior consultations were held during the meeting of the Committee of 10 August 1969, while in respect of the revaluation of the mark the rules were applied in two stages:

(i) The decision by the German Government to allow the rate of exchange of the mark to float led, on the occasion of the annual IMF meeting in Washington, to a meeting of the Committee and a meeting of the Ministers of Finance of the Six on 29 September;

(ii) Prior consultations were held on the definitive fixing of the new parity for the mark at the meetings of the Committee of 8 October and 24 and 25 October 1969.

These consultations enabled the other Member States to obtain detailed information on the measures envisaged and to express their views. Experience has shown, however, that this procedure could be improved: it is important to ensure that the consultations are held **before** any important measure, for their efficacy is largely a function of their timing.

22. The meetings of the Committee on 10 August and 24 and 25 October were devoted mainly to an examination of the impact of the parity changes on the functioning of the common market in agriculture: despite the unit-of-account technique adopted, a change in exchange rates is necessarily a threat to price uniformity for farm products in the common market. The Committee had to express its views on the advisability of changing the value of the unit of account or the agricultural prices. In both cases, i.e. on the occasion of the devaluation of the French franc and the revaluation of the mark, the Committee came out against changes of this kind.

Normal application of the unit of account would have meant that when the French franc was devalued, the agricultural prices expressed in French francs would have gone up automatically in proportion to the rate of devaluation. The success of the devaluation would therefore have been jeopardized from the outset because higher farm prices would strengthen inflationary tendencies in France.

Conversely, the revaluation of the mark would have entailed an automatic cut in agricultural prices when expressed in marks. Unless modified, this arrangement would have entailed an immediate and appreciable fall in farm incomes in Germany.

These considerations led the Committee to express the view that the two governments should be able to take temporary and degressive measures to cushion the impact of an automatic adjustment of the agricultural prices in terms of national currencies, it being understood that these measures should comprise no impediments to free trade in the Community.

III – CONSULTATIONS ON INTERNATIONAL MONETARY PROBLEMS

23. In the period under review, two important decisions were taken in this field. At the general meeting of 3 October 1969, the Board of Governors of the IMF decided to create special drawing rights (SDRs). At the beginning of 1970 it was decided, in accordance with the Articles of Agreement of the IMF under which the quotas of the members are

to be reviewed every five years, to increase these quotas. When these decisions were being prepared, consultations were held on them within the Committee.

24. When policies on the creation of the SDRs were being agreed, the Committee had in particular to express its views on the desirability of activating the scheme, on the amounts of the SDRs to be created and the duration of the commitments to be entered into. The position adopted by the Six on these three points following the consultations went far to enable general agreement to be reached within the IMF and made it possible, during the negotiations, to bring more ambitious proposals back to a level acceptable to the Community.

The decision taken provides for the creation of SDRs as from 1 January 1970 in amounts of $3 500m. and of $3 000m. for each of the years 1971 and 1972. This arrangement was based on certain assumptions concerning the trend in other sources of international liquidity, particularly the balance of payments of the United States. It is evident that increased caution would have to be exercised in this field if these assumptions proved unfounded in the years to come.

25. The decision to increase the quotas, taken under the rule providing for a review at intervals of five years and scheduled to take effect in the autumn of this year, will also strengthen the means of action available to the IMF. Negotiations on this subject proved particularly difficult at international level. The consultations within the Committee brought out in detail the views held, making it easier for the Six to align progressively the attitudes which they were to adopt in the discussions held in a wider international context. From 30 October 1970, the sum total of the quotas of the members of the IMF is to be raised from $21 300m. to $28 900m., which is an increase of about 36%, while the share of the Community countries will go up from $3 771m. to $5 474m., lifting the Community's share in the total from 17·7% to 18·9%. The increase decided upon is the result of an across-the-board adjustment in the quotas of the order of 25% and of selective increases intended to take into account the changes that have taken place in the economic and financial stature of certain members of the IMF.

Although the rate of increase may appear to be substantial, it should be recalled that the liquidities involved are conditional in nature, i.e. they are intended to help finance temporary deficits and recourse to them is made subject to stipulations concerning economic policy.

IV – CLOSER CO-ORDINATION OF ECONOMIC AND MONETARY POLICIES

26. The Memorandum on the co-ordination of economic policies and monetary co-operation within the Community which the Commission had sent to the Council on 12 February 1969 contained proposals on which the Committee stated its views in its Opinion of 10 May 1969. [1] These proposals, the underlying principle of which was endorsed by the Council, served as a starting point for further progress in the co-ordination of economic policy and towards monetary solidarity.

27. In the field of economic policy, the joint establishment of medium-term objectives was, in the first instance, a matter for the Medium-term Economic Policy Committee.

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[1] See annex to the Eleventh Report on the Activities of the Monetary Committee.

In this connection, the Monetary Committee noted that at its meeting of 26 January 1970 the Council adopted preliminary broad guidelines. The Committee had been closely associated with the implementation of the proposals on the concerting of short-term policies. These proposals were given concrete form in the Council decision of 17 July 1969. which puts Member States under the obligation to hold prior consultations on any short-term policy decision which would have a substantial impact on the economies of the other member countries or which would depart from the medium-term objectives established jointly. A safeguard clause dispenses the Member States from holding **prior** consultations, in emergency circumstances.

A further decision, of 16 February 1970, laid down procedural requirements, established by the Commission in co-operation with the Short-term Economic Policy Committee.

28. Several consultations took place in 1969, in accordance with the rules laid down by the decision of 17 July 1969. Immediately following the devaluation of the French franc, the Committee had to examine the French stabilization programme before it was finally adopted. The Belgian project to postpone the introduction of VAT was also discussed in the Committee. Lastly, in October a consultation was held on the suspension, by the German Government, of export levies and import refunds. This consultation, by the nature of the subject and in view of the background against which it was held, necessarily resulted in an exchange of views on the fixing of a new parity for the mark.

29. On monetary solidarity, the Memorandum of 12 February 1969 included the proposal to create mechanisms for giving short-term monetary support and medium-term financial assistance. The Council instructed the Committee of Governors of Central Banks to work out an agreement setting up between the Central Banks of the Member States a system of short-term monetary support. This agreement, which entered into force on 9 February 1970, assigns to each participating bank a quota that determines the level of support which it may ask for and the level of support which it agrees to finance; the assistance arrangements cover a total of $1 000m., with the possibility of their being extended by a further $1 000m. at most. Recourse to the system is automatically, and within the shortest possible period, followed by special consultation on the economic situation of the beneficiary country. Under the decision of 16 February 1970, consultation must take place within the Committee.

30. The Council invited the Committee to put forward its views on the implementing procedures for a Community system of medium-term financial assistance. These views were given in a report of 10 April 1970, which outlines the objectives of such a system and the conditions in which it could be set up.

In the report, the Committee states that medium-term financial assistance is the co-operation machinery by means of which the Member States grant each other the financial assistance provided for under Article 108(2 c) of the Treaty (mutual assistance). The fact that the progressive establishment of economic and monetary union may temporarily have an unfavourable impact on the balance of payments equilibrium of the Member States is one of the reasons why this machinery is needed. The reciprocal granting of financial aid among the countries of the Common Market would therefore demonstrate their solidarity in a way that would alleviate or partly remedy the difficulties that may arise within individual countries.

The chief aims of such assistance would be:

(i) To contribute to the smooth functioning of the common market by reducing the risk of a Member State invoking the safeguard clauses of the Treaty;

(ii) To accelerate the process of economic integration by promoting the harmonization of short- and medium-term policies (notably through the economic policy stipulations imposed when assistance is granted) and by preparing the establishment of economic and monetary union among the Six.

As for the mechanism itself, the Committee studied procedural rules, links with the IMF, funds committed, the distribution of the ceilings on the commitments, and the duration of assistance; special attention was given to the problem of the liquidity of the claims.

Given the importance that would attach to the institution of this system, particularly from the angle of the establishment of economic and monetary union, the Committee has thought it expedient to publish this report as an annex.

31. As part of the drive to strengthen co-ordination of monetary policies, the Council and the Commission invited the Committee to render an opinion on the Commission Memorandum to the Council of 5 March 1969 on "Capital movements: the case for action, procedures to be adopted". This Memorandum recommends measures to help advance the liberalization of capital movements, reduce discrimination, and harmonize the organization of domestic markets and the tax rules liable to affect capital movements.

In its Opinion of 30 June 1970 the Committee stated that "there is a need to bring the authorities supervising the capital markets to concert all their policies in respect of these markets. The concerting of policies should go hand in hand with the efforts to harmonize monetary and credit policies. It would in particular facilitate the pursuit of two important objectives, namely:

"(i) Greater convergence of the measures adopted at national level with a view to strengthening the markets of the Member States and improving the conditions in which they operate;

"(ii) A more systematic search for common attitudes on developments covering a wider area than the common market, such as the trends in interest rates or on the international capital markets."

Lastly, the Committee examined Part II of the Report from the Working Party on Securities Markets giving an account of Member States' policies with regard to their fixed-interest securities markets from 1966 to 1969. It decided to publish this Report and keep the Working Party in being, extending its responsibilities to cover all capital market problems. A main task for the Working Party will be to seek out ways and means of promoting and facilitating progressive integration of the capital markets.

ANNEX I

REPORT TO THE COUNCIL AND THE COMMISSION

In accordance with instructions adopted by the Council on 17 July 1969, the Committee submitted to the Council of Ministers, on 17 January 1970, its interim report on the conclusions it had arrived at with regard to certain aspects of the establishment within the Community of a system of medium-term financial assistance.

The present report sums up the Committee's views on the problem seen as a whole.

1. Objectives of the system

The system of medium-term financial assistance is the co-operation machinery by means of which Member States grant each other the financial assistance provided for under Article 108(2 c) of the Treaty (mutual assistance). The fact that the progressive establishment of economic and monetary union may temporarily have an unfavourable impact on the balance of payments equilibrium of the Member States is one of the reasons why this machinery is needed. The reciprocal granting of financial aid among the countries of the Common Market would thus demonstrate their solidarity in a way that would alleviate, or partly remedy, the difficulties that may arise within individual countries.

The chief aims of medium-term financial assistance are:

(a) To contribute to the smooth functioning of the Common Market by reducing the risk of a Member State invoking the safeguard clauses of the Treaty;

(b) To accelerate the process of economic integration by promoting the harmonization of short- and medium-term policies (notably through the economic policy stipulations imposed when assistance is granted) and by preparing the establishment of economic and monetary union among the Six.

Medium-term financial assistance must not be looked upon as the consolidation of short-term aid granted by the banks of issue. Short-term aid does not necessarily lead to medium-term aid. Medium-term support may very well be granted to a country which has not already used short-term aid at all.

2. Procedural rules

On the question of the creation of the machinery, the obligation for each Member State to supply funds up to a specified ceiling should flow from a Council decision adopted unanimously and approved by the Parliaments of the individual Member States. This obligation should cover a period of several years, for instance five years, renewable by tacit agreement. Every Member State would have the right to notify, at the latest six months before the end of the period, its intention to withdraw.

In the interests of greater flexibility, provision should, however, be made for a procedure making it possible, under the conditions mentioned above, to modify the implementing details and the amount involved even before the first period of five years has expired. This procedure could be set in motion by a Member State or by the Commission after consultation with the Committee.

Any decision on the granting of medium-term financial assistance should be taken by the Council by a qualified majority vote and should include the economic policy stipulations governing the grant of assistance. In this respect it would appear that the conditions imposed in the event of recourse to the Community system should be as stringent as those deriving from the rules and practices of the IMF.

As a general rule, any drawing made under the Community system would have to be financed by the creditor countries proportionally to the size of their commitments.

Any Member State invoking balance of payments difficulties and/or a deterioration in its reserve position would be given the benefit of the doubt and could refrain from helping to finance a financial support scheme.

3. Links with the IMF

All appropriate links should be established between a Community system of medium-term financial assistance and the monetary co-operation machinery established under the International Monetary Fund. Arrangements should be made allowing of the greatest measure of flexibility when decisions are to be taken in such cases. Depending on the circumstances, it might therefore be appropriate to confine intervention either to the Community system or to the Fund, or to arrange fcr assistance involving a combination of the two systems. This is why a general clause is needed requiring that any recourse by a member country to international medium-term credit facilities must be preceded by consultation in the Committee, no matter what the circumstances.

An exchange of information and appropriate contacts between the IMF and the EEC would facilitate the necessary co-ordination of financial aid under the International Monetary Fund and medium-term financial assistance from the EEC.

Two members consider it essential that a procedure should be established in advance for co-operation between the Community and the IMF. The aim of co-operation would be to establish, case by case, with due regard to the nature of the deficit and the location of its counterpart, whether the IMF machinery and that of the Community should be used together or the Community machinery used alone. Where applicable, efforts should in particular be made to seek agreement on the economic and monetary policy stipulations to be accepted by the member country which is granted the facilities, and on methods of refinancing with the IMF, if necessary, the credit facilities granted under this mechanism. In this connection the Council should, at an early date, take the decisions necessary for arranging appropriate consultations with the IMF.

4. Level of the Funds

The scale of the system should be comparable to the one agreed upon by the Governors of the Central Banks of the EEC in the agreement establishing short-term monetary support.

The maximum level of the financial commitment to which each Member State may be asked to subscribe would be fixed by the Council under the procedure outlined above under Section 2, first paragraph. The ceiling on total commitments could initially be fixed at 2 000 million units of account. [1]

Consideration could be given to placing an individual limit from the outset on the debts contracted by each Member State. It may, however, be held that it must be for the Council to fix in each individual case the limits on indebtedness, which would enable it to regulate intervention according to the circumstances. Under such a procedure it would, however, be particularly important to ensure that the claims built up within the system remain sufficiently liquid (see Section 9 below) and to prevent excessive use being made of the facilities available under the system.

5. Proportion of allocation of commitments

The scale fixing the commitments could be modelled on the scale for Member States' IMF quotas. The percentages laid down for short-term monetary support could also be used for the system of medium-term financial assistance, which would yield the following pattern:

	Maximum commitment
Germany	30%
Belgium-Luxembourg	10%
France	30%
Italy	20%
Netherlands	10%

6. Duration of credit facilities

Facilities granted under the system should normally run for two to five years. However, in order to ensure a higher level of liquidity at the beginning, consideration should be given to limiting facilities to two to three years during an initial period of no more than three years from the date the system actually started to operate.

7. Interest rates

Some members of the Committee feel that the rate of interest for credit facilities granted under this system should be similar to those charged by the IMF (at the moment averaging 2 to 3·5%, varying with the duration and level of indebtedness). Other members consider that interest rates should run at a level close to the current market rate.

By way of compromise, the members of the Committee would contemplate a rate half-way between the market rates and the rates charged by the IMF.

[1] Some members feel that this amount is not high enough while others would have preferred it to be lower.

A similar problem arose in respect of arrangements to refinance the claims built up under the system. The Committee agreed that there should be no change in the level of the interest rate if the facility is refinanced within the system. Where refinancing would be taking place outside the system, however, the extra cost involved could be borne by the debtor country or could be shared out, according to a scale to be established, among all countries participating in this system; the Committee has, however, not arrived at a final conclusion on this point.

8. **Currency denomination of claims**

The credit facilities granted under the system could be denominated in a Community unit of account to be defined. [1] Should it prove necessary to refinance an outstanding credit by calling on institutions from outside (BIS and/or capital markets), the debtor country would have to accept that the currency in which its debt was originally denominated be replaced by the currency of the refinancing operation.

9. **Liquidity of claims**

As a general rule, the debtor country should be required to repay the whole or part of the credit ahead of schedule in the event of a balance of payments improvement to be defined according to certain criteria yet to be fixed.

Should the creditor country itself run into balance of payments difficulties and should the external position of the debtor country fail to improve sufficiently, there is the problem of the liquidity of the claims since the creditor would have to be able to mobilize his claim at any moment. Two possibilities must be envisaged here:

1. Claims may be transferred to other Member States within the ceiling on their commitments, due regard being paid to the exceptions provided for under Section 2, fifth paragraph, concerning the balance of payments trend and the reserve position.
2. There can be no such transfer as the ceilings on the commitments of the other Member States have already been reached or cannot be taken advantage of because the waiver of Section 2, fifth paragraph, applies.

In this second case, it is essential to provide for the use of one or more of the following procedures, without the order in which they are listed being a guide to the order in which they should be used:

1. Refinancing by the BIS and/or on the capital markets.
2. Recourse by the debtor country to its unused drawing facilities with the IMF or to its reserves. In both cases, the debtor country could, under a gentleman's agreement concluded when the drawing is made, give an undertaking that it would not use, without the prior agreement of the creditor country or countries, a specified proportion of its facilities, this proportion to be fixed in relation to the amount of the drawing.

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[1] On this point it should be recalled that the Council, on the initiative of the Netherlands Minister of Finance, has requested that a study be made of ways and means of eliminating differences between the various units of account used in the European Communities.

3. Increasing the liquidity of the system by using the resources which the member countries would decide, when the time had come, to pool according to appropriate procedures.

Several members recall that in an Opinion of the Committee rendered on 10 May 1969 they had expressed the view that in order to give substance to the idea – put forward by the Commission in support of the proposals made in its Memorandum of 12 February 1969 – of providing a "forecourt" for the reception of new members, "those countries which have applied for membership of the Community should be informed of the proposals before a decision is taken, as this would allow them to express any views they might have on the subject."

ANNEX II

THE COMMITTEE: MEMBERS AND ALTERNATES

Chairman:

Jonkheer Mr. E. van LENNEP (until 30.9.69)	Thesaurier-generaal bij het Ministerie van Financiën (The Hague)
B. CLAPPIER (from 9.1.70)	Sous-gouverneur de la Banque de France (Paris)

Vice-chairmen:

B. CLAPPIER (until 9.1.70)	Sous-gouverneur de la Banque de France (Paris)
Prof. W. DREES (from 9.1.70)	Thesaurier-generaal bij het Ministerie van Financiën (The Hague)
Dr. O. EMMINGER	Vizepräsident der Deutschen Bundesbank (Frankfurt/Main)

Members:

P. BASTIAN (until 24.9.69)	Commissaire du gouvernement (Luxembourg)
F. BOYER de la GIRODAY	Director in the Directorate General for Economic and Financial Affairs—Commission of the European Communities (Brussels)
M. D'HAEZE	Directeur général de l'administration de la trésorerie et de la dette publique – ministère des finances (Brussels)
Prof. W. DREES (from 1.10.69)	Thesaurier-generaal bij het Ministerie van Financiën (The Hague)
C. de STRYCKER	Directeur de la Banque Nationale de Belgique (Brussels)

Dr. W. HANEMANN (until 31.1.70)	Ministerialdirigent — Bundesministerium für Wirtschaft (Bonn)
Dr. W. HANKEL (from 1.2.70)	Ministerialdirektor — Bundesministerium für Wirtschaft (Bonn)
R. LARRE	Directeur du Trésor — ministère de l'économie et des finances (Paris)
Mr. A.W.R. baron MACKAY	Directeur der Nederlandsche Bank NV (Amsterdam)
Dott. U. MOSCA	Director-General for Economic and Financial Affairs, Commission of the European Communities (Brussels)
Dott. R. OSSOLA	V. Direttore generale della Banca d'Italia (Rome)
J. SCHMITZ (from 24.9.69)	Conseiller de gouvernement au ministère du trésor (Luxembourg)
Prof. G. STAMMATI	Ragioniere generale dello Stato — Ministero del Tesoro (Rome)
R. WEBER	Membre du Comité de direction de la Caisse d'épargne de l'État (Luxembourg)

Chairman of the alternates:

Prof. J. MERTENS de WILMARS	Conseiller économique de la Banque Nationale de Belgique (Brussels)

Alternates:

D. DEGUEN	Directeur adjoint à la direction du Trésor — ministère de l'économie et des finances (Paris)
Dott. L. FRONZONI	Delegato della Banca d'Italia per il Benelux (Brussels)
Dott. D. GAGLIARDI	Ispettore — Ministero del commercio estero (Rome)
G. JENNEMANN (from 24.2.70)	Bankdirektor — Deutsche Bundesbank (Frankfurt/Main)
H. KOCH	Directeur général des études à la Banque de France (Paris)
M. MEULEMANS	Ministère des finances (Brussels)
Dr. B. MOLITOR	Director in the Directorate-General for Economic and Financial Affairs, Commission of the European Communities (Brussels)
N. ROLLMANN	Conseiller de direction à la Caisse d'épargne de l'État (Luxembourg)

Dr. H.O.Chr. R. RUDING	Ministerie van Financiën (The Hague)
Drs. A. SZASZ	Onderdirecteur, Nederlandsche Bank NV (Amsterdam)
M. SCHMIT	Inspecteur des finances (Luxembourg)
Dr. H. UNGERER (until 24.2.70)	Abteilungsleiter – Deutsche Bundesbank (Frankfurt/Main)
Dr. G. WILLMANN	Bundesministerium der Finanzen (Bonn)
G. WISSELS	Director in the Directorate-General for Economic and Financial Affairs, Commission of the European Communities (Brussels)

Secretariat:

R. de KERGORLAY
(until 24.7.69)

G. MORELLI
(from 24.7.69)

G. LERMEN

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