

EUROPEAN ECONOMIC COMMUNITY

– MONETARY COMMITTEE –

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

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Brussels, 26 April 1968

INTRODUCTION

The purpose of this report is to give a brief account of the activities of the Monetary Committee of the European Economic Community during the past year. Apart from the tasks assigned to it by the Treaty, in particular that of following the monetary and financial situations in the Member States, the Committee this year addressed itself mainly to matters concerning the reform of the international monetary system.

In the course of the year, the Committee held fifteen meetings and the working parties met on several occasions. A list of members of the Committee is appended to this report. The report covers the period to 26 April 1968 and does not take into account economic developments or measures adopted after that date, whether in the Community or elsewhere.

Chapter I

GENERAL CONSIDERATIONS

1. As in previous years, the Committee discussed the monetary and financial situation in the member countries of the Community. In so doing they found that the economic trends varied considerably from country to country both as regards industrial production, prices, employment, and the balance of payments. The conclusions reached by the Committee are set out in Chapter II of this report.

2. The growth achieved in the Community during 1967 is the lowest since the Common Market was established; the rate of expansion amounted to 3% in real terms, whereas a rate of 4% had been reached in each of the two previous years. However, there was a progressive recovery in business activity during the second half of the year.

Prices rose less than in 1966, though the implicit price index of Community GNP rose by just over 2%, while wage costs per unit of production continued to rise in most member countries, though more slowly than in previous years.

Owing to the more subdued trend of business activity in the Community, visible imports showed hardly any increase in 1967 over those for 1966, whereas the value of exports to non-member countries rose in 1967 by almost the same amount as in 1966 (7.5% compared with 8.5%); this trend reflects the maintenance of world demand at a relatively high level and the efforts of business undertakings to counteract the slackness in home demand by selling goods abroad.

There was consequently a surplus on the Community's current transactions of approximately \$4 200 m. compared with \$2 100 m. in 1966. This very large surplus was greatly offset by net outflows of long-term capital in the private and to a lesser extent in the public sector. Thus there has been an improvement in the structure of the balance of payments of the Community countries, the reversal of the trends which was observed in capital movements during 1965 and 1966 having been confirmed in 1967 on the lines indicated by the Committee in its previous reports. Accordingly, there was a surplus on the basic balance of the order of \$2 000 million. Owing to short-term capital movements, the overall surplus (net official reserves in gold and foreign exchange, net short-term external balances of the commercial banks, and net balance with the IMF) of EEC countries amounted to \$1 500 m. in 1967, against \$1 200 m. in 1966.

3. The inflationary trends observed during 1964 and 1965 in a number of member countries, particularly the Federal Republic of Germany and the

Netherlands, led to the adoption in these countries of measures aimed at restricting internal demand and limiting increases in prices and costs. This policy caused a slackening of activity at the end of 1966 and early in 1967 which even amounted to a recession in the Federal Republic of Germany.

The other Member States of the Community felt the effects of the economic developments in Germany. The rapid spread of this hesitant trend throughout most of the EEC countries confirms the tendency for events occurring in one country to affect developments in the other countries — a tendency already noted when the trend was in the opposite direction, towards inflationary pressure. It is a further demonstration of the way in which the economic situation in one country depends increasingly on the economic policies followed by its partners, particularly those which exert a greater influence by reason of the size of their economy.

4. The slackening of growth in 1967 was primarily due to the national policies followed during the preceding years with the object of controlling inflationary pressures. The policy mix was often imperfect, most countries having made excessive use of monetary measures. None the less, the Committee noted that some progress had been made in 1967 towards a better mix, notably in the Netherlands and the Federal Republic of Germany.

5. There are, however, still obstacles hindering the improvement of the methods of intervention. Owing to the present structure of budgets and of the legislation in force in Member States, the budgetary practice is in the short term seriously lacking in flexibility and the role of budget policy as an instrument of short-term economic policy is somewhat limited. It is true that in the longer term, particularly in connection with forecasts covering several years, budget policy could be made more flexible both structurally and in its relationship to the immediate economic situation.

But if budget policy is to play a more important part in influencing these conditions, the short-term flexibility of government finance and especially of taxation receipts must be improved. Since rapid changes often take place in the economic situation, it is desirable to reduce the interval between the time when changes in budget policy are adopted and the moment when their effects are felt. Governments should seek greater freedom to increase or reduce expenditure or revenue within certain limits during the course of the financial year; current legislative procedures are, generally speaking, too slow to allow such measures to achieve their full effect with sufficient speed. In this respect the law on the stabilization and expansion of the economy which was enacted in June 1967 in the Federal Republic of Germany marks an important step forward.

6. In the past, the absence of an appropriate budget policy has meant that the task of restoring internal equilibrium has been left largely to monetary policy, with the consequent risk of checking the growth of private invest-

ment. Moreover, the effectiveness of this policy has often been reduced, if not entirely blunted, by developments on the international capital market, particularly the Euro-dollar market. The consequent delay in achieving the expected result has made it necessary to apply still more stringent measures; but owing to the impossibility of gauging exactly what new measures were required without knowing when the previous measures would take effect, it has often proved necessary to apply the brakes too sharply and too late, with consequent damage to the harmonious long-term development of the national economy.

7. The first objective of national policy at the present time should be to provide a rate of growth sufficiently rapid to ensure optimum use of productive resources. The measures recently adopted or announced by Great Britain and the United States could however induce a trend towards a tightening of the international money markets with a consequent rise in interest rates on those markets.

In this connection the Finance and Economics Ministers of the member countries, at the close of their meeting in Rome at the end of February 1968, emphasized their firm determination to "keep interest rates stable in their respective countries by means of concerted action". Such an attitude reflects their anxiety not to put a brake on the recovery of private investment, which is expected to continue in the coming months. The financial authorities should also be careful, as far as considerations of internal stability allow, to avoid causing pressure on the capital markets as a result of the methods used to cover public expenditure.

8. Action of this kind constitutes a new step towards the closer co-ordination of economic policies involved in passing from a customs union to an economic union. It is essential that this co-ordination should be steadily strengthened; it might take the form of a decision to consult together before a Member State takes any important measure which could have a considerable impact on its partners in the Community; the Monetary Committee intends to examine this problem and put forward proposals on the subject.

9. Such a harmonization of policies can best be achieved in the committees set up to discuss the various aspects of short-term policy. Thus, on the institutional side, it would be desirable to strengthen the close links that already exist between these committees and to increase their contacts with those bodies on which the Finance and Economics Ministers of the Member States sit.

Such a development should make it easier for these Ministers — who meet periodically — to discuss the problems facing the Community. At the same time the Commission, which is involved in the work at both levels, would be in a better position to carry out its mandate and submit to the Council of Ministers of the European Communities draft recommendations designed to ward off any threatened disequilibrium.

10. On the practical side, this harmonization calls for an improved flow of information to provide more up-to-date and accurate data on the latest developments in the various Member States.

As regards the movements of capital in the Community, for instance, the Monetary Committee has found it necessary to undertake a more intensive study of the situation of the security markets within the Community. For this purpose, it has set up a working group whose first task will be to examine the instruments and procedures by which Member States maintain a balance between supply and demand on their capital markets.

The Committee also intends to bring up to date the study made in 1962 on the "Instruments of Monetary Policy in the Countries of the European Economic Community".

Furthermore, the Monetary Committee and the Short-Term Economic Policy Committee have jointly requested a group of experts to undertake an experimental study of the possibility of working out a system of criteria and indices which would enable critical economic situations to be identified, so that serious disequilibria could be detected in good time.

Finally, attention must be drawn to the importance of improving the available statistics in Member States, of harmonizing definitions and data and, above all, of shortening the time taken to transmit statistics. In this connection, the Committee wishes to draw attention to the recommendation which the Council sent to Member States on 28 July 1966 urging that deficiencies in the statistical machinery should be remedied.

11. The year 1967 saw a worsening of the imbalance of international payments. This tendency was shown most clearly in a deterioration of the balances of the key currency countries. The United States deficit, on a liquidity basis, amounted to approximately \$ 3 600 m. in 1967 (an increase of \$ 2 200 m.), while the United Kingdom had a deficit on current transactions and long-term capital of the order of £ 540 m. (an increase of £ 400 m.). Meanwhile the overall balance of payments surplus of the EEC increased (see paragraph 2) and the external situation of the developing countries improved, their monetary reserves growing by more than \$ 800 m. in 1967. The monetary reserves of the developed countries other than those mentioned above showed a slight fall.

12. The worsening of the imbalance of international payments gave rise to a lack of confidence which had a sporadic but increasingly serious effect on the international gold and foreign exchange market. The growing disequilibrium between the reserves and short-term obligations of the key currency countries led to several unusually strong waves of speculation

which threatened the very existence of the international monetary system in its present form.

As a result of these developments, those countries which were still active members of the gold pool decided on 17 March 1968 to suspend their operations on the London market.

13. The reserve currency countries found it necessary to take, or prepare to take, strong measures to bring their balance of payments back into equilibrium. In November 1967, the United Kingdom decided to devalue the pound by 14.3 %, and some other countries followed suit. In accordance with the agreed procedure, prior consultations were held on several occasions between EEC member countries, particularly in the Monetary Committee. These consultations played an important part in the decision taken by these countries not to alter the parity of their currencies.

14. In the view of the Monetary Committee, the courageous decisions taken by the British Government will help to restore the United Kingdom's external payments situation. Devaluation and the supplementary measures designed to reduce internal demand, particularly those contained in the budget laid before Parliament on 19 March, should slow down the flow of imports and at the same time free the productive resources required to bring about a fundamental improvement in the balance of trade. But the measures taken to restrict expenditure and increase public sector receipts will have to be accompanied by an effective incomes policy if the new competitive conditions resulting from the change in the parity of the pound are to have a lasting influence. The scale of the burdens which the United Kingdom will have to assume during the next few years in repaying its external debts, combined with the need to restore the confidence of the holders of sterling balances, call for the maintenance of substantial payments surpluses over a long period.

15. At the beginning of this year, the President of the United States announced a programme for restoring the balance of payments of his country. In view of its scope and its possible effects on the external payments situation and on economic developments in the rest of the world — and particularly in the EEC — this programme is of outstanding importance. The main emphasis of these measures was on reducing the deficit on capital account, a course which, incidentally, had been recommended on several occasions by the Monetary Committee in its activity reports. But if it is to be successful and if the United States is to achieve its aim, additional measures to combat internal inflation must be taken. These measures should be aimed at mopping up excess home demand by making more use of budget policy reinforced by appropriate measures in the monetary field.

16. The endeavours of the United Kingdom and the United States to improve their balance of payments position will be facilitated by the expan-

sionary policy of the Community countries, a policy which is desirable in any case. Thus the Council's recommendation to Member States on the economic policy to be followed in 1968 emphasized the importance in existing circumstances of concerted action by the budgetary and monetary authorities both nationally and at Community level.

The problem is to find the right policy mix to offset the negative effects of the measures taken by the United States and the United Kingdom on international capital markets and consequently on the internal economic situation in the EEC, and so to maintain or even improve the conditions required for a reflation of economic activity sufficient to ensure satisfactory utilization of the available resources.

17. While it is for countries with an external deficit to take the necessary steps to bring their external payments situation into balance again, the other industrialized countries must take care not to pursue policies which would hinder their efforts.

There is still some underemployment of the productive resources of most member countries, and a number of countries have balance of payments surpluses, some of them large.

If the latter continue their present expansionary policy, and even intensify it where such a step is compatible with their internal stability, this would contribute towards an improvement of the international balance of payments. It is desirable that those countries whose payments are approximately in balance should continue their policy of economic reflation even if this should lead to a small deficit in their external payments, so long as the internal stability of their economy is not jeopardized.

18. During the period under review, the Monetary Committee devoted much of its attention to a study of how the international monetary system works and how it could be improved. In so doing, the Committee was carrying out one of its essential functions. There were two reasons why it undertook the study of these problems: first, it is a logical extension of the co-ordination of monetary policies within the EEC that member countries should concert their attitudes to international monetary problems; secondly, the trend of international payments during the last decade has given rise to widespread discussion about the working of the international monetary system and, in view of the important part played by the member countries of the EEC in this system, it was proper that the Monetary Committee should take an active part in this discussion.

19. In 1961, following a request by the Finance and Economics Ministers of the Six, the Monetary Committee set up a working group under the chairmanship of M. Emminger to study international liquidity problems. One of

the proposals put forward in the report which this group submitted in July of that year was that a "second line of defence" should be set up in the form of special credits to be available through the international institutions; the General Arrangements to Borrow constituting this "second line of defence" were concluded in December 1961.

20. In order to strengthen the co-ordination of the external monetary policies of Member States, the Council of the EEC, in a decision dated 8 May 1964, gave an official stamp to what had already been done in the Monetary Committee by giving it the task of co-ordinating the attitudes of the Six towards international monetary relations. In particular, it gave the Committee authority to undertake preliminary consultation concerning:

- (a) The working of the international monetary system in general;
- (b) Calls by a Member State on resources which could be made available under international agreements;
- (c) The participation of one or more Member States in large monetary operations in support of third countries.

21. The decision taken at the Hague on 16 and 17 January 1967 by the Finance Ministers and the governors of the banks of issue in Member States gave fresh emphasis to efforts to co-ordinate the policies of the EEC countries in respect of international monetary problems: the Monetary Committee was instructed "to devote particular attention to the improvement of international credit procedures while continuing to investigate the projects previously under discussion".

In conformity with this instruction, the Committee worked out the basis for a common attitude to be adopted by the EEC countries when discussing in other international bodies the establishment of additional credit instruments and the concomitant modification of some of the rules and procedures of the IMF, steps which were being considered mainly with an eye to the numerous and far-reaching changes which have occurred since the Bretton Woods agreements were drafted. The conclusions drawn from the Committee's work in this field were set down in a report dated 11 April 1967 which was approved by the Finance and Economics Ministers of the EEC countries during a conference held in Munich on 17 and 18 April 1967.

At this conference it was agreed that Member States would consult with one another in the Monetary Committee on any problems outstanding in connection with the suggested reform, so as to reach as far as possible a uniform position on all these matters.

22. In arriving at a common attitude during these consultations, the EEC countries were making an important contribution to the agreement reached by the Group of Ten in London on 26 August 1967 on certain principles enabling facilities to be set up in the form of special drawing rights on the

IMF; these principles were approved at the end of September by the annual assembly of the International Monetary Fund at Rio de Janeiro.

23. The creation of fresh liquidity in this way cannot be envisaged until such time as Member States of the IMF agree that there is a world shortage of reserves. Moreover, a prior requirement is that there should be a better balance in international financial transactions and a likelihood that the process of adjustment will work better; the creation of new liquidity must not be based on the balance of payments requirements of certain countries.

Hence an adequate balance of payments policy is an essential feature of any lasting improvement in the international monetary system. This is true of all countries, and of none more than the United States, whose prolonged deficit is at present imparting an increasing degree of uncertainty to the world monetary system. The importance that the Six attach to this question has often been stressed by the Finance and Economics Ministers of the Community.

24. As a result, then, of the work done in the Monetary Committee, it has been possible to ensure co-ordination of the positions of the Member States throughout all the negotiations on the reform of the international monetary system.

As regards the reform of the procedures and practices of the IMF, the common attitude adopted by members of the EEC strengthened their negotiating position in the meetings of the Group of Ten and with the Board of executive directors of the IMF, and most of the proposals made by the Monetary Committee were finally accepted.

In regard to the establishment of the system of special drawing rights, it proved possible to adopt a common position on a number of important points. Although at this stage it was not possible to reach an agreement on this system which was acceptable to all the Common Market countries, all these countries, as well as the other member countries of the Group of Ten, declared their intention of strengthening international monetary co-operation at the conference of Finance and Economics Ministers and Governors of the Group of Ten held at Stockholm on 25 and 30 March 1968. The Monetary Committee will continue its efforts to assist in the attainment of this objective.

Chapter II

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

FEDERAL REPUBLIC OF GERMANY

The lull, not to say incipient decline in activity, to be seen in the German economy at the end of 1966 was followed at the beginning of 1967 by a real recession. For the first six months of the year, industrial production was running more than 5 % below the corresponding level for the previous year. Unemployment increased, even though nearly one fifth of the foreign workers returned to their countries of origin. Although activity was supported by the substantial rise in exports and, from the end of spring onwards, by the start made with the first supplementary investment programme, the other factors of demand — capital investment by enterprises, housing construction and consumption — showed unmistakable signs of weakening. This trend was emphasized by the run-down of stocks due in part to anticipation of the coming into force of the tax on value added at the beginning of 1968.

At the same time there was an exceptionally vigorous display of the symptoms which usually accompany a reduction in the growth rate; the situation was one of stagnation, with a distinct slowdown in the pace at which wages were advancing, a progressive slackening of the rise in prices and of the cost of living, a sharp drop in imports of goods and services, and a decline, followed by total cessation, of borrowing by business houses, in spite of the measures to increase bank liquidity taken by the Bundesbank since the end of 1966.

From the summer onwards the German economy, reacting to the greater flow of investment by business houses that was promoted by tax measures and by an improvement in profits and also by the announcement and gradual implementation of two successive programmes of reflation through public investment, began to move upward once again. Indeed, industrial activity increased at an exceptional pace during the last months of 1967, causing a perceptible rise in imports, a slow fall in unemployment and impressive gains in productivity. At the same time, borrowing by business houses rose sharply. Replenishment of stocks was also encouraged by the announcement of additional tax reliefs for stocks held on 1 January 1968, when the tax on value added was introduced, and stock-building is likely to continue at a high level during 1968.

For the first time since the war, however, the gross national product in real terms for the full year showed no improvement on the previous year.

With imports almost at a standstill while exports continued to expand, there was a surplus of nearly DM16 000 m. on visible and invisible trade in 1967. Since there was little alteration in the deficit on transfer payments, the current account closed with a credit balance of DM9 700 m. After heavy net exports of non-monetary capital, the surplus on the overall balance of payments was DM3 600 m. This resulted in an increase of DM1 200 m. in net official gold and currency reserves, a reduction of DM800 000 m. in the net balance with the IMF and an improvement of DM3 200 m. in the net short-term external balances of the commercial banks.

When the Monetary Committee discussed the monetary and financial situation of the Federal Republic of Germany at its meeting on 18 and 19 March 1968, it reached the conclusion that conflicting trends were still in evidence in the German economy. It therefore expressed the opinion that the German authorities should keep very careful watch on economic developments so as to be able, at the end of the first half of the year, to draw more definite conclusions regarding the way the economy is going than can be drawn at present. In the view of the Monetary Committee, if there were at that time any doubt as to the ability of the German economy to achieve a growth rate for 1968 which would gradually enable optimum use to be made of productive capacity, the Government of the Federal Republic of Germany should without further delay make flexible use of the various means available to it under the law on the stabilization and expansion of the economy which was passed last June. This watch on developments is particularly necessary because the policy of reflation can be expected to help reduce the very large surplus on the trade account. Since there might even so be a large surplus on current account for the remainder of 1968, the Committee considered that the large net outflows of long-term capital recorded in 1967 could with advantage be continued.

Since the restrictions on credit were abolished at the end of 1966, the Bundesbank has been pursuing an expansionary policy in support of the objectives of the Federal Government. The Central Bank has extended the range of its operations by supporting the financial market by its open market operations and by action to facilitate the placing of bills issued by the public authorities. The Committee, while recognizing that in present circumstances this policy is correct from the point of view of both internal and external equilibrium, is nevertheless conscious of the dangers that may in the longer term be implicit in a large-scale expansion of bank liquidity.

Finally, the Committee noted that in 1967 the German authorities had achieved a better mix of the instruments of budget and monetary policy. It expressed the hope that the German authorities will in future show equal skill in utilizing these various instruments in accordance with the requirements of the economy.

FRANCE

Expansion slowed down during the first eight months of the year, but from the autumn onwards there was a gradual recovery. Demand from abroad played an important part in these developments. The slowdown in visible exports which had begun in mid-1966 continued during the first few months of 1967. There has been a distinct revival since the autumn. For the full year sales showed an increase of a little over 4 % by volume.

The volume of consumption increased at the relatively moderate rate of 4.2 %, that is to say more slowly than in the preceding year, during which it had expanded at the rate of 4.6 %. It was affected by the unsatisfactory trend in the employment situation with unemployment showing a slow but steady increase over the year from 1.6 % to 2.2 % of the total working population.

Gross fixed capital formation, however, was fairly buoyant throughout the year, increasing by 6.3 %, or slightly more than the 5.8 % achieved in 1966.

During the first half of the year the growth of production was held back by a weakening of household demand and of demand from abroad. But after the summer holidays industrial activity rose again and this, coupled with the good results in agriculture, which showed an increase of 6 % over the preceding year, led to an increase of at least 4.2 % at constant prices in the gross national product — only half a point behind the rate of growth for 1966, even though stock-building was distinctly weaker than the year before.

Notwithstanding the lull in the economy and the easier situation in the labour market, the cost of living continued to rise at a rate which, though moderate, was practically unchanged. During the second half of the year some exceptional factors tending to increase this cost came into play when the tariff structures of the public services were readjusted and measures were taken to wipe out the deficit on social security account. The average rise in consumer prices for the year was rather more than 2.8 %, the same as in 1966.

Imports were greatly affected by the sluggishness of the economy. Their rate of expansion did not slacken until the spring, but it then continued at a very low level until the end of the year; not until December did the effects of the revival begin to affect purchases abroad, and then only to a limited extent. For the full year, imports increased by a little more than 4 % by volume, compared with 12 % in 1966.

In 1967 the balance of payments was almost in equilibrium. There was a small deficit on current operations due to some worsening under the heading of services. Since movements of non-monetary capital, trade with the

French overseas possessions and the errors and omissions taken together were approximately in balance, the overall balance showed a deficit of FF 163 m. This was made up of an increase of FF 2 163 m. in net official reserves in gold and foreign currency, a worsening of the net short-term external position of the bank sector by FF 1 823 m. and a reduction of FF 503 m. in the net balance with the IMF.

There was a fairly marked increase in public spending, largely due to the measures taken in support of business activity; but owing to the listlessness of the economy, receipts increased at a slower rate. The deficit on Treasury operations (excluding debt redemption) amounted to approximately FF 6 200 m., against FF 2 000 m. in the previous year.

The slightly higher rate at which domestic liquidity expanded in 1967 was due mainly to increased borrowing by business houses. The monetary authorities countered the slowdown in expansion by lifting the last of the restrictions on bank credits and by more flexible intervention on the money market by the Bank of France.

The discount rate was not changed, but it had not been raised at the time when most central banks were raising their rates. Rates on the financial market also remained virtually unaltered; but as a result of deliberate government policy these too had risen only very slowly during the preceding phase of economic strain in 1966, when rates in other countries were advancing rapidly.

As the temporary factors making for a slowdown in economic activity began to lose strength during the second half of the year, the Monetary Committee when discussing the monetary and financial system in France last September considered that no additional measures for the stimulation of activity were called for; it felt, however, that if the expected upturn did not materialize, the situation should be reviewed, since the fact that the balance of payments was not in surplus was no obstacle to the adoption, if need be, of fresh measures of stimulation. The Monetary Committee welcomed the agreement by the French authorities that a temporary worsening of the external balance of payments could be accepted in view of the state of the monetary reserves. The need to avoid aggravating the rise in costs and prices nevertheless called for care and skill in deciding upon the mix of any reflationary measures that might be used. In the event, such measures were brought into play at the end of January, when it became apparent that prices were rising only moderately after the reform of the tax on value added.

ITALY

The Italian economy expanded rapidly during 1967 notwithstanding the lull that occurred in mid-year. Gross national product at constant prices rose

by 5.9% compared with 5.7% in 1966. Whereas in 1966 the growth of production had been due mainly to exports, in 1967 it was home demand, and particularly investment, that gave the greatest impetus.

The growth of production was accompanied by a noticeable increase in employment (the number of wage-earners rose by 2.2%, against a fall of 1.1% in 1966) and by a drop in unemployment. Wages again rose more than productivity and unit wage costs increased by 3% in 1967 compared with 1.2% in 1966. This trend was largely responsible for the rise in prices. The implicit price index of the GNP rose by 2.6% in 1967 compared with 2.2% in the previous year. Foreign trade expanded more slowly. The rate of growth in imports of goods and services declined in the summer; for the full year the rise was 10.5%, compared with 13.7% in 1966. Exports rose by only 6% in real terms, compared with 13.2% a year earlier.

The surplus on the balance of payments, though still large, was therefore considerably smaller in 1967, amounting to Lit. 1076 000 m. compared with Lit. 1323 000 m. in 1966. There was again a heavy deficit on capital movements, largely because there was still a considerable gap between interest rates in Italy and abroad. The overall balance of payments closed with a surplus of Lit. 202 000 m. Official net reserves rose by Lit. 351 000 m., net balances with the IMF fell by Lit. 27 000 m. and the short-term external position of the commercial banks worsened by Lit. 122 000 m.

The faster rate of increase in lending by the banks and the slower rate of formation of deposits caused the banks to borrow more from abroad and expand their borrowings from the Central Bank, which released large amounts of money through them in order to counteract the diminished creation of liquidity due both to a fall in the balance of payments surplus and to the reduction in monetary financing by the Treasury. Nevertheless, bank liquidity was lower both in absolute terms and in relation to the amount of deposits. The liquidity of the economy increased at a slower annual rate than in 1966, though still at about 13%.

When the Monetary Committee examined the monetary and financial situation of Italy in December 1967 it found that the public sector deficit had decreased and that a smaller fraction of the Government's budget deficit was being financed by monetary means. Thus budget policy was in line with the recommendations made by the Monetary Committee in its 1966 report on the situation in Italy. But the Committee noted that the comparatively favourable trend of disbursements is largely due to the increase in credits carried over (*residui passivi*), which were already too high. These might be turned into expenditure at an unfavourable moment from the standpoint of economic management, and so provide a threat to economic equilibrium in the next few years. Efforts to prevent a further growth of the carryover of credits should therefore be intensified. In the Committee's view, special attention should also be paid to local authorities and to social security institutions; it would seem that the task of putting their financial management on a sound footing is urgent.

Monetary policy has succeeded in making available to the business community the volume of credits essential to a rapid but balanced expansion of production. It has also served to keep long-term interest rates at a relatively low level and so to encourage investment financing and the placing of public issues, of which there are still a large number. Meanwhile the Central Bank has been able to strengthen its control over the credit potential of the banks by limiting their liquidity ratios.

The Committee found that, at least in the field of monetary policy, these measures had created the necessary conditions for combating any overheating of the economy with the required speed. It was gratified to note that the monetary authorities have initiated a policy whereby cyclical factors in the expansion of the economy can be controlled, and it has recommended that this line of policy should be continued, since comparatively large price increases are still to be expected in 1968.

This being so, the Committee considered that the Government should intensify its endeavours to introduce an incomes policy which would be "neutral" as regards prices, and would also circumvent the danger of the upsurge of investment being compromised by the trend of costs.

NETHERLANDS

The hesitancy in the economy which had appeared in the second quarter of 1966 continued until the spring of 1967, but during the second half of the year there was an upturn in economic activity as a result of which industrial production began to grow at a higher rate. The unemployment figures levelled out and have been fluctuating around a level slightly below the maximum reached in October-November. The exceptional results in agriculture and construction due to specially favourable weather conditions also contributed to a rise of 5% in GNP (by volume), compared with 2.5% in 1966.

Foreign demand continued to be relatively buoyant, mainly owing to visible exports which, after slowing down somewhat in the early part of 1967, showed a distinct increase, their rate of growth for the full year being 7.5% by volume compared with 6.5% in 1966. Home demand also continued to grow at a faster rate, reaching 5% in 1967 compared with 3.5% for 1966, owing largely to an appreciable increase in global expenditure on consumption amounting to 5% (by volume) compared with 2.5% in 1966, while gross fixed capital formation increased at just the same rate as in 1966.

Owing to a marked improvement in productivity and a falling off in the rate at which earnings rose, the pressure of wage costs fell off and the advance in consumer prices was much slower — 3%, compared with 6.2% in 1966.

A strong upturn in imports — in part fortuitous — at the end of the year, caused the improvement in the balance of current payments to be more limited than had been forecast; it closed with a deficit of Fl. 355 m. compared with Fl. 686 m. in 1966. Although net exports of long-term capital were more than offset, in particular by unrecorded foreign commercial credits, the final result for the overall balance of payments was a small deficit of Fl. 76 m. This was made up of an increase in net official reserves in gold and foreign currency of Fl. 839 m., a worsening of Fl. 693 m. in the net short-term external position of the commercial banks and a reduction of Fl. 222 m. in the net position with the IMF.

When the Monetary Committee examined the monetary and financial situation of the Netherlands at its meeting on 18 and 19 March 1968, it found that during 1967 economic policy had been skilfully adapted to developments in the economic situation. Restrictive measures in the monetary field, which had been eased in March, were lifted altogether in June, giving rise to a rapid increase in bank lending. In the field of budget policy, the increase in the Government's deficit between 1966 and 1967 was largely caused by the fall in tax receipts resulting from the economic situation and by expenditure on measures to combat unemployment in some regions of the country. The deficit was partly financed from monetary resources, and it was not considered advisable to consolidate the floating debt of the local authorities.

The Committee noted that the Netherlands Government intended to avoid action which might lead to an increase in overall demand during 1968. It considered that the Netherlands authorities were fully justified in taking this view, as the economy of the Netherlands was already on a course which would bring it back to its normal rate of economic growth. There are, moreover, problems connected with the balance of payments which are not only temporary but also structural, owing to the worsening in the services account.

It is very important to find the right mix of the various instruments of economic policy, and especially of monetary and budget policy, particularly in view of the more liberal turn recently given by the authorities to wages policy — although the Government is keeping in reserve certain means of intervention in this field. It appears from some of the discussions between the two sides of industry, concerning renewal of a number of annual wage agreements during the first quarter of 1968, that wage increases might be distinctly in excess of the recommendations made by the Central Planning Office. If productivity were to increase at an appreciably lower rate than wages, prices would tend to rise more quickly again and this could endanger the external balance. In this context the Committee welcomed the efforts made by the Netherlands authorities to adapt incomes policy to the requirements of the economic situation. Nevertheless, in view of the extreme sensitivity of the Netherlands economy to conditions prevailing in world markets, great vigilance is still called for concerning the trend of wage costs.

The Committee also stressed the importance of a suitable policy on Government finance. The draft budget for 1968 included a deficit of about the same size as the actual deficit for 1967, and it showed that Government saving would be maintained at quite a high level. There is, however, the possibility that it may not prove feasible to achieve this objective. Special efforts should be made to prevent any worsening in this sphere. The Committee noted in this connection that the Netherlands Government was anxious to prevent budgetary spending from outrunning the initial forecasts in 1968, as has happened in previous years. Finally, the Committee considers that partial financing of the budget deficit by monetary means appears to be still justified in 1968, but that the extent to which this should be done will depend on how the business situation develops.

BELGIUM

The rate of economic expansion was comparatively slow in Belgium during 1967. The increase of 2.7% in real terms of GNP, comparable to that of the previous year, was in the main due to exceptionally good harvests and deliberate Government intervention by such means as a considerable increase in public works. Private consumer demand remained hesitant, increasing by 2.5% in volume compared with 2.9% in 1966, while there was an appreciable slackening in the growth of fixed investment by enterprises and of investment in housing. Consequently, utilization of the available industrial production capacity fell somewhat, while the level of unemployment rose.

The rise in retail prices, which speeded up for a time during the first half of the year, largely owing to the relaxation of the dampening measures previously introduced by the Government, was 2.8% for the full year, compared with 4.2% in 1966. Wage costs at first continued on their upward trend at the same pace as previously, but slowed down progressively during the rest of the year.

The stabilization of visible imports, due to the way the economic situation was developing, explains why the trade balance of the Belgo-Luxembourg Economic Union improved considerably in 1967 despite the moderate expansion of exports. There was a surplus of nearly Bfrs. 11 000 m. compared with a deficit of nearly Bfrs. 5 000 m. in 1966. Moreover, the steep rise in imports of private capital, largely due to direct foreign investment, made it possible to offset the considerable increase in net outgoings that stemmed from public sector operations (part of the foreign indebtedness was repaid). The overall balance of payments of the Belgo-Luxembourg Economic Union closed with a surplus of Bfrs. 13 300 m. This corresponded to an increase of Bfrs. 12 400 m. in net official reserves, a reduction of Bfrs. 2 000 m. in the net balance with the IMF and an increase of Bfrs. 900 000 in the net foreign assets of financial organizations other

than the National Bank and in the foreign commercial credits refinanced by the market.

During 1967 the monetary authorities took a number of measures designed to stimulate reflation of the economy; these included several reductions in the discount rate, the lifting of credit restrictions and authorization of some financing of public works by monetary means. In view of the level of foreign interest rates this policy had, however, only a limited effect on the cost of long-term credit. Another measure aimed at strengthening the revival of economic activity taken by the Belgian authorities was the adoption in January 1968 of a number of additional measures of various kinds representing expenditure of the order of Bfrs. 4 000 m., designed particularly to increase public investment and expand private construction activities.

When examining the monetary and financial system of Belgium in February 1968, the Monetary Committee stressed the need for the Belgian Government to safeguard the structural objective of putting Government finance on a sound footing, while at the same time using appropriate budgetary measures to bring about a satisfactory resumption of economic activity.

The Monetary Committee shared the Belgian Government's view that a revival in the economy, which can be expected to cause a reduction in the balance of payments surplus, has at the present time priority among the aims of economic policy. All the instruments adopted should lead to the achievement of this aim. If, however, it became apparent during the next few months that activity was increasing at too slow a rate to enable all available production capacity to be fully used, the Government would have to examine the feasibility of further temporary and reversible measures for stimulating home demand without causing pressure on prices and costs. Lastly, the Committee found that the measures approved under the law of 31 March 1967 on "special powers" designed to increase the flexibility of the financial markets, are likely to bring about a considerable improvement in the conditions under which investment can be financed and therefore to stimulate economic revival. Possibly further steps in this direction could be taken with the object of giving an additional stimulus to the formation of risk capital.

GRAND DUCHY OF LUXEMBOURG

Economic growth in Luxembourg showed a slight improvement during 1967. The gross national product at constant prices increased by 2%, against 1% in 1966. This trend is due to a slight revival of foreign demand for iron and steel products and to increased sales by the new industries. But home

demand fell, largely owing to a net drop in expenditure on gross fixed capital formation, which was 15 % by volume below the level for 1966.

The hesitancy of the economic trend explains why the easier situation that had developed on the employment market persisted or even became more marked. Production costs, which had been rising during previous years, settled down, owing in the main to a slowdown in the rate of wage increases. Prices continued to increase, but at a lower rate than the previous year (2.2 % in 1967 compared with 3.3 % in 1966); this trend largely reflects the extent to which the Luxembourg market depends on the movement of foreign prices of consumer durables and current consumption goods.

When the Monetary Committee examined the monetary and financial situation of Luxembourg last February it was glad to note that the Government is endeavouring to put the structure of public expenditure on a sound footing by reducing the rate at which current expenditure is growing and by increasing the rate of investment expenditure. None the less the Government of Luxembourg should, without compromising the attainment of the structural aim, do everything possible to support the revival of home demand, for example by making use as far as possible of additional investment programmes. In this connection the Committee found that the tax reform which came into force in 1968 is already having a noticeable countercyclical effect.

Nevertheless there could be obstacles in the way of measures designed to stimulate home demand, obstacles connected with the financing problems which the Luxembourg authorities may meet in 1968. There would be limits to what could be done through short-term financing on the money market in Luxembourg or by means of a loan from abroad, while too extensive recourse to the capital market would inevitably make it more difficult and more costly to meet the requirements of the private sector.

A N N E X

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