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COUNCIL AND COMMISSION

FIFTEENTH REPORT ON THE ACTIVITIES OF THE MONETARY COMMITTEE

FOREWORD

The purpose of this report is to give a brief account of the activities of the Monetary Committee during 1973.

During this year, the Committee held 17 sessions and the working parties drawn from its own members or set up at its initiative met on occasions. A list of members as at 31 December 1973 is annexed.

As a result of the accession of Denmark, Ireland and the United Kingdom to the European Communities on 1 January 1973, the delegates from these countries became full members of the Monetary Committee.

INTRODUCTION

In 1973 the Community encountered serious difficulties in its efforts to harmonize economic policies mainly on account of severe disruptions on the foreign exchange markets and the consequences of persistent inflation in the world, particularly in the Community.

The pattern of exchange rate relationships between the majority of the industrialized countries changed drastically. However, developments on the foreign exchange markets remained subject to many factors of uncertainty, due to the oil crisis at the end of the year.

In addition, the pace of inflation accelerated further throughout the Community, despite a significant improvement in the terms of trade in some member countries resulting from modifications of exchange rate relationships, the spectacular fall in the external deficit of the United States and the restrictive measures instituted by almost all the national authorities. Although it was possible in 1973 to make progress towards the goal of economic and monetary union, existing and newly created monetary and economic machinery worked under increasingly difficult conditions.

The first chapter reviews events on the foreign exchange markets, and the second chapter gives an account of the institutional progress towards the establishment of economic and monetary union, and the policy measures introduced to combat inflation. The third chapter is devoted to a review of the economic and financial trend in the Community, and the fourth summarizes the Committee's activities in the monetary field, both in a Community and an international context.

CHAPTER I

THE FOREIGN EXCHANGE MARKETS IN 1973

1. In 1973 the persistent instability of the international monetary system led to erratic movements on the foreign exchange markets. Speculative, monetary, economic and even political

factors forced many countries to take measures of exchange rate policy, so that in the course of the year a completely new pattern of exchange rates evolved, as the dollar, the pound, the lira, the yen and the Swiss franc were allowed to float independently and at the same time six Community currencies floated jointly in relation to all other currencies. In most countries these measures were accompanied by new restrictions on the international movement of capital. All these measures, together with the improvement in the external position of the United States, which became apparent from the beginning of the autumn and resulted in a gradual return of confidence in the dollar, restored some quiet to most foreign exchange markets in the closing months of 1973.

2. The institution of a two-tier exchange market in Italy to put a brake on the outflow of capital (22 January 1973) and the decision by the Swiss authorities to cease intervening on the foreign exchange market so as to discourage the inflow of foreign capital (23 January 1973) marked the beginning of one of the largest waves of speculation that the international monetary system has ever known. The latent lack of confidence in international monetary relations, particularly in the dollar, provoked a flood of capital to most of the Community countries, especially Germany, and Japan. Administrative measures to control capital movements, such as those adopted by Germany on 5 February, proved ineffective against the highly speculative nature of these flows, the result being that between 1 and 9 February over $ 10 000 million were converted into other currencies. This caused most industrialized countries, including all Community countries, to close their foreign exchange markets. After a series of consultations and bilateral and multilateral conferences, of which the main result was a decision to devalue the dollar by 10 %, taken on 12 February by the United States Government [1], all the foreign exchange markets reopened on 14 February. Earlier, on 13 February, Italy had decided to allow the commercial lira, like the financial lira, to float while continuing to operate the two-tier exchange market. As with the United Kingdom in June 1972, Italy thus ceased to participate in the agreement on the narrowing of margins between EEC currencies. Finally, on 14 February Japan decided to allow its currency to float. These last two measures led to a gradual depreciation of the commercial lira and an appreciation of the yen on the foreign exchange markets.

3. But the foreign exchange markets were only granted a brief respite. Lack of confidence in the new pattern of exchange rates quickly reappeared and again gave rise to large-scale movements of capital. As a consequence, on 1 March several countries which had continued to maintain their exchange rates within fixed limits once again experienced an enormous inflow of capital. Germany was the main victim: in one day alone it absorbed the record amount of $ 2 800 million. This situation led to many of the industrialized countries closing their foreign exchange markets on 1 or 2 March.

After several conferences between the Community countries at first, and then between a larger number of countries (the enlarged Group of Ten), this crisis was resolved by the decision of the six Member States of the EEC [2] to adapt the existing Community exchange rate scheme, maintaining the 2·25 % spread between the respective currencies (the 'snake') but ceasing to intervene to maintain fixed margins against the dollar (the 'tunnel'). These Council Decisions of 11 and 12 March, with which Norway and Sweden associated themselves on 14 March, came into force with the reopening of the exchange markets on 19 March. The same day Germany revalued the DM by 3 %. Further, several Community countries tightened the measures they had taken to ward off inflows of capital.

4. The joint float of several Community currencies and the accompanying measures taken by certain participating countries initially brought an easing of the international situation. Exchange rate movements within the Community bloc were fairly orderly, but the snake gradually left the old tunnel, in that the currencies of the participating countries appreciated against the dollar.

Towards the end of June, the monetary climate abruptly deteriorated again. The immediate cause of this crisis, which was much less serious than that of spring 1973, was again the US dollar, which suffered a large fall in its rate, resulting from massive capital outflows. Demand centred mainly on the DM. This situation obliged the German monetary authorities and those of other countries participating in the joint float to intervene massively in German marks and led to an inflow of unwanted liquidity into Germany. For this reason the German Government, after consulting with its EEC partners, decided to

(1) The devaluation of the US dollar, which raised the official price of gold from $ 38 to $ 42·22 per ounce of fine gold, was officially proposed to the IMF on 18 October 1973 and was approved the same day.

(2) Belgium, Denmark, Germany, France, the Netherlands and Luxembourg. The United Kingdom, Ireland and Italy continued to allow their currencies to float independently (cf. para. 9).

revalue the DM by 5·5 % with effect from 29 June, while maintaining the 2·25 % margin of fluctuation in relation to other currencies in the 'snake', based on the new intra-Community parities deriving from this revaluation.

5. At the beginning of July, the dollar rate fell to a level about 15 % lower than its nominal parity against the currencies within the Community snake. After a meeting of the governors of the principal central banks at the Bank for International Settlements on 8 July 1973, concerted action by the US monetary authorities and certain central banks helped to halt the depreciation of the dollar and even to initiate a reverse movement. The action took the form of intervention to support the dollar and of improved harmonization of interest rate policies at the international level, particularly on the part of the United States.

6. After a 5 % revaluation of the Dutch florin on 17 September, which was justified by the strength of the Dutch balance of payments and which was also part of a programme intended to control domestic inflation, a sense of uncertainty once again developed in the foreign exchange markets. Speculation was particularly directed towards the French and Belgian currencies, in the expectation of a possible revaluation of the Belgian franc and a possible devaluation of the French franc. However, the markets quickly returned to normal after the monetary authorities concerned had intervened massively and had, in particular, adapted their interest rate structure.

7. The beginning of November saw a major reversal in the situation on the international exchange markets. News of the extremely favourable US trade figures for September confirming a trend that had already been discernible, brought about a considerable improvement in the position of the dollar. This movement received additional impetus from the oil crisis, since the feeling on the markets was clearly that the economic and monetary consequences of the new energy situation would be less serious for the USA than for most of the other industrialized countries. Thus the 'third' dollar devaluation which had occurred in the exchange markets between February and July was completely reversed in a few weeks. By the end of the year, the dollar rate was back at its nominal parity against the group of currencies in the Community snake.

CHAPTER II

ECONOMIC AND MONETARY UNION

8. At their meeting on 19 and 20 October 1972, the Heads of State or of Government declared that 'the necessary decisions should be taken in the course of 1973 so as to allow the transition to the second stage of economic and monetary union on 1 January 1974'. Although the successive monetary crises have brought about unusual difficulties, it was possible to take some decisions in this connection.

9. On 11 March 1973, the Council decided to adapt the Community exchange rate system: by this decision the fluctuation margin between the German mark, the Danish krone, the Dutch guilder, the Belgian franc, the Luxembourg franc and the French franc was maintained at 2·25 % and the central banks were no longer required to intervene *vis-à-vis* the United States dollar. To protect this Community scheme, which is designed to maintain orderly exchange rate relations, the Council further agreed that the Directive of 21 March 1972 would be more effectively enforced by Member States in order to prevent disruptive capital movements.

10. Pursuant to the declaration of the summit conference of 19 and 20 October 1972, the Regulation establishing a European Monetary Cooperation Fund (1) was adopted by the Council on 3 April 1973 after prior examination by the Committee of Governors of Central Banks, the Monetary Committee and the conference of the Ministers of Finance. This Fund, which commenced operation on 1 June, and intended to be integrated at a later stage into a Community organization of central banks, is, within the limits of its powers, to promote:

— the proper functioning of the progressive narrowing of the margins of fluctuation of the Community currencies against each other;

— interventions in Community currencies on the exchange markets;

(1) OJ No L 89, 5. 4. 1973.

— settlements between central banks leading to a concerted policy on reserves.

In the first stage of its functions, the Fund is to be responsible for:

— the concerted action necessary for the proper functioning of the Community exchange system;

— the multilateralization of positions resulting from interventions by central banks in Community currencies and the multilateralization of intra-Community settlements;

— the administration of the very short-term financing provided for by the Agreement between the central banks of the enlarged Community of 10 April 1972 and of the short-term monetary support provided for in the Agreement between the central banks of the Community of 9 February 1970, to which the central banks of Denmark, Ireland and the United Kingdom acceded with effect from 8 January 1973, with the regroupment of these mechanisms in a renewed mechanism.

11. In order to prepare the transition to the second stage of economic and monetary union, the Commission took several steps in the economic and monetary spheres during the period under review. On 19 April 1973, it adopted a communication 'on the progress achieved in the first stage of economic and monetary union, on the allocation of powers and responsibilities among the Community institutions and the Member States essential to the proper functioning of economic and monetary union, and on the measures to be taken in the second stage of economic and monetary union'. In this report, drawn up in accordance with the Council resolution of 22 March 1971 and the communiqué issued at the Paris summit conference, the Commission reviewed the progress achieved in the first stage and drew the following conclusions: the actions included in this first stage should be consolidated and rigorously applied, particularly those concerning economic policies; structural and regional problems should receive prior attention; in certain important fields effective responsibility must be exercised at Community level; the Community must constitute a single monetary zone as soon as possible; the principle economic and social groups should be more and more associated with the European enterprise. In addition, this communication from the Commission set out a programme of action for a second stage which was to start on 1 January 1974.

Further, on 27 June 1973 the Commission presented a 'report on the adjustment of short-term monetary support and the conditions for the progressive pooling of reserves' as requested by the Council on 4 February 1973. In this report, the Commission proposed that more important tasks be entrusted to the European Monetary Cooperation Fund. It believes that the reorganization of the credit system and the pooling of reserves should go together and be undertaken without delay. According to these proposals, the Member States should have begun to pool their reserves and to improve Community credit mechanisms on 1 January 1974.

12. In the light of the discussion of these reports on 14 and 15 May and on 28 June 1973 in the Council, and in view of the opinions expressed by the Committee of Governors of Central Banks and by the Monetary Committee on 14 November 1973, the Commission adopted a document entitled 'work on economic and monetary union [1]', which contained a number of legal instruments intended to make possible the transition to a second stage of economic and monetary union.

On the first perusal of these proposals, the Council decided at its session of 3 and 4 December 1973 to separate the adjustment of short-term monetary support from the progressive pooling of reserves. It called on the Monetary Committee, the Committee of Governors of Central Banks and the Board of Governors of the European Monetary Cooperation Fund to submit, by 31 March 1974 reports on the still outstanding technical problems inherent in the pooling of reserves, and invited the Commission to amend its proposals by 30 April 1974 in the light of these reports. The Council stated that it intended to examine the Commission's revised proposal at the latest by 30 June 1974. The Commission was further invited to prepare a new proposal for the adjustment of short-term monetary support to be discussed by the Council before the end of 1973.

13. At its session of 17 December 1973, the Council and the representatives of the Governments of the Member States agreed in principle on a resolution on the implementation of a second stage of economic and monetary union in the Community. This resolution lists the objectives to be achieved during a second stage, from 1 January 1974 to 31 December 1976, as a prerequisite for the establishment of full economic and monetary union.

(1) OJ No C 114, 27. 12. 1973.

However, the resolution could not be formally adopted, pending the solution of problems with regard to the Regional Development Fund. During the same meeting the Council reached an agreement in principle with regard to a number of important instruments to strengthen economic and monetary union.

These instruments which were formally adopted on 18 February 1974, are as follows:

— a Directive [1] concerning stability, growth and full employment in the Community, whereby Member States undertake to enlarge the range of their economic policy instruments, thus fulfilling an essential condition for more effective coordination of their economic policies at Community level;

— a Decision [1] concerning the achievement of a high degree of convergence of the economic policies pursued by the Member States of the EEC; this decision aims at substantially strengthening and improving consultation procedures in the economic and monetary field within all competent Community bodies (Council, Committee of Governors of Central Banks, Monetary Committee, and Coordination Group);

— a Decision [1] setting up an Economic Policy Committee; by this Decision the Budgetary Policy Committee, the Conjunctural Policy Committee and the Medium-term Economic Policy Committee are merged to form a single Economic Policy Committee, thus ensuring greater effectiveness when it has to examine Community problems or, as a consultative body, to deliver technical opinions on specific problems;

— a resolution on short-term monetary support which requests the Board of Governors of the European Monetary Cooperation Fund to amend the short-term monetary support mechanism by doubling the debtor quotas, quadrupling the creditor quotas and increasing the extensions beyond the debtor and creditor quotas to 1 500 million units of account each.

14. In application of the Council resolution of 5 December 1972, the Member States took a series of anti-inflationary measures (cf. paragraph 26). However, the efficacy of these measures appears to have been limited: in 1973 inflation in the Community continued and even increased at a faster rate than in previous years. Although the influences from outside the Community should not be underestimated, the inflationary process in member countries was probably largely due to factors of internal origin.

It is clear that the persistence of a high rate of inflation in member countries constitutes a grave threat to the maintenance of a satisfactory equilibrium growth rate and the achievement of economic and monetary union. Under these circumstances, Member States therefore devoted considerable attention during the year to examining measures that might be taken to combat inflation and to coordinate their policies in this field.

15. On 22 March, on the basis of a Commission communication concerning the adjustment of the economic policy guidelines for 1973, the Council undertook, in accordance with Article 2 of the Council Decision of 22 March 1971 on the strengthening of coordination of short-term economic policies of the Member States, a first examination of the economic situation for 1973. After studying the results of the anti-inflationary action programme laid down in its resolution of 5 December 1972, the Council invited the Coordination Group on Short-term Economic and Financial Policies, the Monetary Committee, the Conjunctural Policy Committee and the Budgetary Policy Committee, to submit by 1 June 1973, reports on methods of supervising trends in prices and incomes, the implementation of national budgets and the trend of the money supply.

16. In the light of these reports, the Commission drafted a communication as a preparation for the second examination of the economic situation in the Community, which the Council carried out at its session on 28 June 1973. In view of the persistent rise in prices, the Council adopted at that meeting, on the proposal of the Commission, a resolution [2] on further measures to be taken against inflation.

17. Similarly, at the third examination of the economic situation of the Community by the Council on 9 November 1973, the problem of inflation was central to the discussion. At that session, the Council examined the measures taken by Member States pursuant to the resolution of 14 September 1973 [3], and on the Commission's proposal, adopted the annual report on the economic situation in the Community. It also agreed on the economic policy guidelines for 1974 set out in the report and decided, mainly on

[1] OJ No L 63, 5. 3. 1974.

[2] This resolution was only formally adopted on 14 September 1973 (OJ No C 75, 19. 9. 1973).

[3] OJ No C 107, 8. 12. 1973.

account of the new situation arising from the energy crisis, to lay down at its meeting of 3 and 4 December additional measures to combat inflation in the coming months.

18. On a Commission proposal, the Council set out these additional measures on 3 and 4 December in the 'resolution [1] on measures to be taken against rising prices and the maintenance of a high level of employment in the Community'. The programme of action which is to be implemented immediately and in parallel in the various countries of the Community covers measures in the fields of budgetary policy, monetary and credit policy, prices and incomes policy, agricultural policy and commercial policy.

[1] This resolution is dated 17 December 1973 (OJ No C 116, 29. 12. 1973).

CHAPTER III

ECONOMIC AND MONETARY DEVELOPMENTS IN THE COMMUNITY

19. The developments on the foreign exchange markets in 1973 did not have any perceptible adverse effects on international trade. There was in fact a sharp upswing in international trade, stimulated by an appreciable acceleration in economic growth in the industrialized countries, especially during the first half of the year. Whereas economic growth in the United States continued at much the same rapid pace as during the preceding year (6 %), Japan and the other OECD countries which are not members of the Community achieved growth rates which were distinctly higher than 1972. The considerably increased proceeds from the sale of raw materials also helped to boost economic expansion in many developing countries. These various factors gave a strong impetus to international trade which rose by some 13 % in volume. The expansion of world trade was however accompanied by an upsurge in prices which reached record proportions in almost every country.

20. All the Member States of the Community experienced boom conditions in 1973. Economic activity expanded at a very rapid pace especially during the first half of the year; it was not until the second half of the year that certain differences in trend between countries and between sectors of activity led to an overall slowdown in growth.

The growth rate of the Community's gross product in real terms in 1973 was nevertheless higher than in 1972 (plus 5 % against 3·7 %). Year on year, expansion speeded up in almost all the Member States: in France, Germany, Ireland, Luxembourg, Italy and the United Kingdom.

21. In general, export demand was a major factor in growth throughout the year; in Denmark and Italy, however, the volume of exports rose more slowly than in 1972. Domestic demand also expanded at a very rapid pace in most countries, although indications of deceleration were apparent in the second half of the year. While public investment showed only moderate growth or no growth at all, the pace of private investment quickened appreciably in France, Belgium, Denmark, Ireland, Italy and the United Kingdom.

The sharp rise in household money incomes, the persistence of inflationary expectations and, in certain countries, the effects of a decline in the propensity to save, which became particularly noticeable during the final months of the year, stimulated private consumption expenditure, which climbed particularly steeply in Ireland and Italy. The rate of growth of public current expenditure in money terms slackened a little in France, Belgium and Ireland, but accelerated in Germany and Italy. In the Netherlands, this expenditure stopped falling in real terms.

Finally, the continued upsurge in the prices of a large number of raw materials and the expectation of further increases contributed to a rise in stocks which was sometimes considerable.

22. The high level of economic activity led to a rise in employment in all countries until the end of the autumn. The improvement was particularly marked in Italy and the United Kingdom. However, labour market trends were relatively disappointing in Belgium and the Netherlands, where the unemployment rate was almost as high as during the previous year. In these countries, as in some others, in some of which a large number of foreign workers are employed, residual unemployment is due in part to structural causes. Towards the end of the year unemployment rose again in most countries and there was an increase — quite considerable in some cases — in the number of persons on short time, principally because of the repercussions of the energy crisis.

23. The boom in the Community was accompanied by very heavy inflationary pressures throughout the year. While in some countries the upward movement of prices slackened a little at the beginning of the summer, inflation in all member countries accelerated again during the final months. Consumer prices in the Community as a whole showed an increase in December 1973 of more than 8 % on December of the previous year. In Denmark, Ireland, Italy and the United Kingdom the rise in the cost of living even exceeded 10 % over this period.

This trend was due to the particularly sharp rise in the cost of raw materials and to an increase in labour costs which largely exceeded the growth of productivity. The vigorous expansion in domestic and export demand in most countries led to a high degree of capacity utilization from the beginning of the year. Even in countries such as Italy, where there still had been a certain amount of spare capacity at the beginning of the period, the speeding-up of economic activity gave rise to bottlenecks which soon impeded the growth of production in some sectors. Moreover, towards the end of the year, the situation deteriorated still further as a result of the massive increase in the price of oil and the strengthening of the dollar on the foreign exchange markets.

24. The domestic demand boom in the Member States, together with the appreciable increase in the cost of imports, entailed a considerable deterioration in the Community's balance of payments on current account, the surplus falling from $ 6 700 million in 1972 to $ 700 million in 1973.

Within this overall result the trends differed very sharply from one member country to another. There was a very marked deterioration in the balance of payments on current account in Italy and the United Kingdom — notably as a result of the adverse swing in their terms of trade — and in Denmark. In the United Kingdom, the 1973 trade balance closed with a deficit of £ 2 375 million and the current account showed a deficit of £ 1 468 million, compared with a surplus of £ 69 million in 1972; in Italy the trade deficit totalled Lit 3 366 000 million in 1973 and the current account deficit Lit 2 352 000 million; in Denmark the deficit on current account also rose sharply, principally because of the deterioration in the trade balance. In Germany, on the other hand, where the deterioration in the terms of trade was relatively moderate owing to the effects on import prices of the revaluation of the German mark, the trade surplus reached the record figure of DM 33 000 million, while the balance of payments on current account closed with a surplus of DM 12 400 million (compared to DM 3 300 million in 1972).

25. This generally poor trend in the Community's balance of payments on current account contrasts with a spectacular improvement in the United States' foreign trade position. After very heavy deficits during the first half of 1973, the US balance of payments on official settlements basis (less SDRs) showed surpluses of $ 2 100 million and $ 2 700 million in the third and fourth quarters respectively (seasonally adjusted), bringing the deficit for 1973 as a whole to $ 5 300 million, compared to $ 11 000 million in 1972. This turnaround was due mainly to the trend in the trade balance (fob), which after recording a deficit in 1972 of $ 6 400 million moved into a surplus in 1973 of £ 1 700 million (fob). The basic balance closed with a surplus of $ 1 200 million following a deficit of $ 9 800 million in 1972. This development enabled the US authorities to relax the restrictions on outflows of capital in November.

26. Faced with alarming price increases, all the Member States implemented restrictive economic policies at the beginning of the year, although Italy, which had suffered from a period of stagnation during the two previous years did not do so until the end of the second quarter. In order to combat inflation they employed a wide range of instruments, ranging from monetary and fiscal policy to prices and incomes policies.

The policy of restricting liquidity, initiated in 1972 in most Member States, was tightened repeatedly during the year in order to limit supply and curb demand. Implementation of this policy was helped by the floating of the dollar and by increases in interest rates on the principal foreign markets and on the international market generally, which afforded the monetary authorities more room to manoeuvre.

Most countries restricted access to central bank finance and implemented general or selective increases in compulsory reserve ratios, relating either to banks' liabilities or to their assets and liabilities. Some countries also introduced or strengthened arrangements for setting quantitative ceilings on lending. In order to protect their domestic economies from external influences and to lessen the impact of such influences on the Community's exchange rate system, capital movements were subjected to restrictive measures bearing on commercial banks' net external positions; non-residents' balances or foreign borrowing by non-bank institutions. The monetary authorities of all the Member States raised the cost of rediscounting with the central bank by putting up official discount rates several times. Discount rates in almost all the Member States therefore reached new record levels at the end of the year. These measures led to a considerable increase in the rates on the money market, and, except in Italy, to an appreciable rise in long-term interest rates.

Except in Italy and the Netherlands, the use of monetary policy, sometimes intensively, resulted in a marked slowdown in the expansion of the money supply. But, with regard to a total liquidity, including short-term saving, the slowdown was more moderate; in some countries there was even an increase. This trend is mainly due to the continuation of bank lending at a high level.

Moreover, monetary policy in countries with demand pressures was not always backed up sufficiently by fiscal policy. Only three countries (France, Germany and Denmark) had large budget surpluses, as a result of the use of budgetary measures in the fight against inflation. In the United Kingdom measures to restrict public expenditure were taken at the end of the year, but the effect of these will not be felt until 1974. The budgetary policies pursued by the other countries were neutral, but more often than not stimulated the expansion of liquidity, especially in Italy and, to a lesser extent, in Belgium.

CHAPTER IV

THE ACTIVITIES OF THE MONETARY COMMITTEE

27. The Monetary Committee devoted most of its time to considering problems arising from events in the monetary field, to examining measures connected with the progressive establishment of economic and monetary union and to preparing the work, at Community level, on the reform of the international monetary system.

28. When the monetary crisis broke out in February, the committee discussed the consequences of the United States Government's decision to devalue the dollar and of the Italian Government's decision to let the commercial lira float. It also examined the measures taken by Germany on 5 February 1973 to stem the inflow of foreign capital. In this connection it was noted in particular that the derogations from the Directives implementing Article 67 of the EEC Treaty, which such measures involved, could be justified by invoking the safeguard clause provided for in Article 109.

29. The monetary events in March and the resolution of the ensuing crisis involved the Monetary Committee on several occasions. To begin with, in preparation for the Council session of 4 March, it discussed in particular an oral communication from the Commission concerning 'the creation of a Community exchange system'. In accordance with the brief it had received from the Council, it then analysed the proposals which the Commission had put to the Council on 4 March and the various suggestions for overcoming the crisis made at that session. The committee recorded the results of this discussion in two documents. The first, concerning the implementation of a Community exchange rate scheme, was the basis of the Council's work at its session of 11 and 12 March, during which it decided to introduce a joint float of certain Community currencies. The second, concerning international cooperation measures for the protection of exchange parities on a world level, formed the basis of the Community's position at the international consultations in the enlarged Group of Ten on 9 March.

30. As part of the work on the establishment of economic and monetary union, the committee, at its meeting of 6 and 7 March, adopted an Opinion [1] on a proposal for a Decision establishing a European Monetary Cooperation Fund. The committee further drew up an Opinion [2] on the monetary aspects of the Commission communication to the Council of 19 April 1973 on the 'progress achieved in the first stage of economic and monetary union, and on the measures to be taken in the second stage'. Finally, in accordance with the brief it had received from the Council on 18 June 1973, it examined, at its meetings of 10 and 19 October 1973, the 'report from the Commission to the Council on the adjustment of short-term monetary support arrangements and the conditions for the progressive pooling of reserves', and adopted an Opinion [3] on it.

(1) See Annex I.
(2) See Annex II.
(3) See Annex III.

In preparation for the move to the second stage of economic and monetary union, the committee analysed the monetary aspects of the proposal for a Council Decision concerning the achievement of a high degree of convergence of the economic policies pursued by the Member States of the EEC, and on the Council resolution concerning short-term monetary support. As a result of this preparatory work, carried out jointly with the Committee of Central Bank Governors, the Council reached an agreement in principle on these proposals on 17 December 1973.

31. On account of the continued instability of the international monetary situation and pursuant to Council Regulation No 129, the committee had, on several occasions, to examine the problems concerning the unit of account and its conversion into national currencies for the purpose of the common agricultural policy and to prepare oral or written opinions on the matter. The consultations principally concerned the conversion rates of the British pound, the Irish pound, the Dutch guilder and the Italian lira to be used in the common agricultural policy and the establishment of a new method of calculating levies and monetary compensatory amounts by reference to the joint float rather than the dollar.

32. The Monetary Committee also continued to keep the monetary and financial situation in the Member States regularly under review. Pursuant to Article III of the Agreement between the Community central banks on short-term monetary support, it held special consultations at its meeting on 19 and 20 July 1973, on the situation in Italy, following the decision to make support facilities available to that country in June. The conclusions of the consultations were set out in a report which was transmitted to the President of the Commission, the President-in-office of the Council, the Chairman of the Committee of Governors of Central Banks and of the Board of Governors of the European Monetary Cooperation Fund, and to the Italian Finance Minister. When the period of support was extended, the committee re-examined the situation in Italy with particular reference to the economic measures adopted by the Italian authorities in the meantime.

Finally, the committee discussed in depth the monetary implications of the energy crisis for the Community. In this context the committee stated its intention to keep developments under review, particularly the monetary measures which the Member States might adopt to mitigate the effects of the crisis.

33. At its meeting on 6 and 7 February the Monetary Committee broadened the terms of reference of the Working Party on Short-term Capital Movements (see section 20 of the fourteenth report on the activities of the Monetary Committee). It instructed the working party to examine the possibility of harmonizing the existing restrictions on the free movement of capital and to find out what exceptions could be made for transactions between Member States.

On 9 October 1973 the working party presented the committee with a report on both parts of these terms of reference. With regard to the second part, it pointed out, that it would not be possible to harmonize exchange control instruments and to introduce a preferential system for Community transactions until a political stimulus had been given to the solution of certain problems which did not fall within its competence. It emphasized in particular that technical studies concerning the harmonization of controls and exceptions to be made for transactions between the Member States could not proceed any faster than economic and monetary union itself. The working party suggested to the Monetary Committee a three-stage procedure for any further work on harmonization beginning with a first stage instituting a forum for centralizing and exchanging technical information on various measures on exchange control.

34. The Working Party on Securities Markets continued to examine developments in the capital markets of the Member States, in the international capital market and in capital marked policies. It presented a report (1) on its activities, the conclusions of which were approved by the Monetary Committee.

35. The Monetary Committee and the Committee of Central Bank Governors had already been called upon in the Council resolution and the representatives of the Governments of the Member States of 22 March 1971 on the establishment by stages of economic and monetary union (point III.5), to continue 'their work on the harmonization of the instruments of monetary policy in close collaboration with each other'. In accordance with this mandate, the two committees had set up a Joint Working Party on the Harmonization of Monetary Policy Instruments, which, for technical reasons, had not been able to begin its work. In agreement with the Committee of Central Bank Governors, the Monetary Committee decided to entrust a new

(1) See Annex V.

mandate to this working party, which should commence work very soon.

Finally, in accordance with the Council resolution of 14 September 1973 concerning additional measures to be taken in the fight against inflation, the Monetary Committee, an the Committee of Central Bank Governors requested the group of experts 'trends in the money supply' presided by Mr Bastiaanse to prepare a report on the results obtained in the field of monetary policy under the requirements of this resolution.

36. The work of the Monetary Committee in the field of international monetary reform was mainly concerned with the preparation at Community level of the meetings of the Committee of Twenty and of its deputies, the latter committee having been set the task of preparing proposals for the reform of the international monetary system. This enabled the Community to adopt a common position on certain important points connected with reform at the meetings of the Committee of Twenty in March and July and at the annual meeting of the IMF in September.

After adopting a document entitled 'process of adjustment — use of quantitative indicators' (see section 25 of the fourteenth annual report), the Committee was able to reach a common position, at its meeting of 1 May, on the problem of 'reserve assets and convertibility', and to make a statement before the deputies of the Committee of Twenty (1). Furthermore, this body was presented with a report on a 'system of multiple currency intervention', drawn up by the group of experts under the chairmanship of Mr Théron, at the request of the Monetary Committee and the Committee of Central Bank Governors.

Other problems, such as the future structure of the IMF, the consolidation of dollar balances, the choice of a 'numéraire', the role of gold, the definition of the SDRs and the question of the special interests of the developing countries have not yet been definitively dealt with by the Monetary Committee, although opinions on certain points have moved appreciably closer.

Finally, the committee had to deal on several occasions with the question of the value of SDRs, i.e. the problem of converting SDRs into national currencies. The application of the 'equal value principle' and of rule 0.3 to Special Drawing Rights resulted, especially when the rate of the dollar had depreciated sharply on the foreign exchange markets, in SDRs being less and less suitable for use in intra-Community settlements. As a result of the work done together with the Committee of Central Bank Governors, a provisional solution was found and was approved by the Executive Board of the International Monetary Fund at the beginning of November. It permits the settlement of debts between Members of the European Monetary Cooperation Fund at a rate of one SDR for one European monetary unit of account (EMUA). The application of the IMF rules on this matter has been suspended until 31 October 1974 at the latest.

(1) Document given in Annex IV.

LIST OF THE MEMBERS OF THE MONETARY COMMITTEE

Chairman	
B. Clappier (until 31. 12. 1973)	Sous-gouverneur de la Banque de France (Paris)
Vice-chairmen	
Dr. O. Emminger	Vizepräsident der Deutschen Bundesbank (Frankfurt/Main)
Prof. Dr. C. J. Oort	Thesaurier-generaal bij het Ministerie van Financiën (The Hague)
Members	
S. Andersen	Gouverneur, Danmarks Nationalbank (Copenhagen)
F. Boyer de la Giroday	Director in the Directorate-General for Economic and Financial Affairs — Commission of the European Communities (Brussels)
B. J. Breen	Central Bank of Ireland (Dublin)
M. D'Haeze	Directeur général de l'administration de la trésorerie et de la dette publique — Ministère des finances (Brussels)
C. de Strycker	Vice-gouverneur de la Banque Nationale de Belgique (Brussels)
C. W. Fogarty	H. M. Treasury (London)
J.-Y. Haberer (from 19. 10. 1973)	Chef du service des affaires internationales à la direction du trésor — Ministère de l'économie et des finances (Paris)
K. Hansen	Director general — Det Økonomiske Sekretariat (Copenhagen)
Dr. D. Hiss (until 31. 12. 1973)	Ministerialdirektor — Bundesministerium der Finanzen (Bonn)
C. Lamboray	Directeur adjoint de la Caisse d'épargne de l'État (Luxembourg)
A. W. R. Baron Mackay (until 31. 12. 1972)	Directeur van de Nederlandsche Bank N.V. (Amsterdam)
C. W. McMahon	Director — Bank of England (London)
Prof. G. Miconi	Direttore generale del Tesoro — Ministero del Tesoro (Rome)
Dott. U. Mosca	Director General for Economic and Financial Affairs — Commission of the European Communities (Brussels)
S. F. Murray	Department of Finance (Dublin)
Dott. R. Ossola	Vicedirettore generale della Banca d'Italia (Rome)
C. Pierre-Brossolette (until 19. 10. 1973)	Directeur du trésor au ministère de l'économie et des finances (Paris)
J. Schmitz	Conseiller de gouvernement au ministère des finances (Luxemburg)
Drs. A. Szasz	Directeur van de Nederlandsche Bank N.V. (Amsterdam)
Chairman of the alternate members	
Prof. Dr. J. Mertens de Wilmars	Conseiller économique de la Banque Nationale de Belgique (Brussels)
Alternate members	
M. J. Balfour	Bank of England (London)

J.-M. Bloch-Lainé (from 19. 10. 1973)	Sous-directeur à la direction du trésor — Ministère de l'économie et des finances (Paris)
Drs. D. H. Boot (from 1. 1. 1973)	Onderdirecteur van de Nederlandsche Bank N.V. (Amsterdam)
H. Dalgaard	Head of Division — Danmarks Nationalbank (Copenhagen)
J. de Larosière (until 19. 10. 1973)	Chef du service des affaires internationales à la direction du trésor — Ministère de l'économie et des finances (Paris)
Drs. G. de Man	Ministerie van Financiën (The Hague)
A. Dondelinger	Commissaire au contrôle des banques (Luxemburg)
Dr. W. Flandorffer (from 1. 3. 1973)	Ministerialrat — Bundesministerium für Wirtschaft (Bonn)
Dott. L. Fronzoni (until 31. 12. 1973)	S.A.D.I.B.A. (Perugia)
Dott. D. Gagliardi (until 1. 2. 1973)	Ispettore — Ministero del commercio estero (Rome)
G. Jennemann	Bankdirektor — Deutsche Bundesbank (Frankfurt/Main)
H. Koch	Directeur général des études à la Banque de France (Paris)
J. G. Littler	H. M. Treasury (London)
D. Lynch	Department of Finance (Dublin)
D. McCormack	Central Bank of Ireland (Dublin)
M. Meulemans (until 31. 12. 1973)	Conseiller à l'administration de la trésorerie et de la dette publique — Ministère des finances (Brussels)
Dr. B. Molitor	Director in the Directorate General for Economic and Financial Affairs — Commission of the European Communities (Brussels)
J. E. Nash (from 15. 6. 1973)	Director in the Directorate General for Economic and Financial Affairs — Commission of the European Communities (Brussels)
Dott. S. Palumbo (from 1. 2. 1973)	Dirigente generale al ministero del tesoro (Rome)
M. Schmitt	Inspecteur des finances (Luxembourg)
N. Ussing	Head of Division — Det Økonomiske Sekretariat (Copenhagen)
Dr. G. Willman (until 28. 2. 1973)	Regierungsdirektorin — Bundesministerium der Finanzen (Bonn)
G. Wissels (until 31. 3. 1973)	Director in the Directorate General for Economic and Financial Affairs — Commission of the European Communities (Brussels)

Secretariat

G. Morelli

G. Lermen

ANNEX I

OPINION OF THE MONETARY COMMITTEE ON THE EUROPEAN FUND FOR MONETARY COOPERATION

The Commission has asked for the Monetary Committee's Opinion on the proposed Decision to establish a European Monetary Cooperation Fund which it must present to the Council. At its meeting of 6 and 7 March 1973, the committee examined this proposal and it was, in general, favourably received, subject to the following comments:

It has been suggested by certain members that the grounds should be shortened and simplified, while at the same time preserving the essential elements, in order to emphasize the solemn nature of the act establishing the Fund in accordance with the Summit communiqué.

Articles of the Decision

Article 4

The members draw attention to the fact that the wording at the beginning of this Article contains a grammatical illogicality (it is hard to see how 'the provisions contained in the Agreements.... shall replace those Agreements') and offers certain other ambiguities. A wording to make the text clearer could be arranged by replacing 'and' in the second line by 'which'. Certain members advocate the following wording: 'The Fund shall apply, in its administration, the provisions appearing in the Agreements mentioned in Article 3, third indent (the rest unchanged).

On the other hand, the members wonder what procedure will be adopted for making possible amendments to the decision and statutes as a result of the evolutive nature of the Fund.

Statutes

Article 1

One member suggests that it would be desirable to grant a right of veto to the Commission member taking part in the deliberations of the Board of Directors with a view to ensuring respect for the Community interest.

Article 2

Various amendments to the wording in the first paragraph of this Article are suggested: one group of members feels that it would be sufficient to reproduce the terms of the Summit communiqué. The following wording would be equally acceptable to these and certain other members: 'The Board of Directors, with a view to achieving the Fund's objectives, shall act within the framework of general economic policy guidelines drawn up under the terms of the Treaty by the Council (of Ministers) and *in accordance with the guidelines concerning the Fund's principles of administration recommended by it*'.

Another group of members recommends the wording: 'The Board of Directors, with a view to achieving the Fund's objectives, shall act . . . . by the Council (of Ministers) and *in accordance with the Directives the latter may issue whenever it considers necessary*'.

Members in favour of one or other of the above versions also consider that it would be advisable, under these conditions, to lay down the procedure to be followed by the Council of Ministers in this matter.

Lastly, a third group of members recommends the retention of the text drawn up by the Commission, with the exception of the following words: '. . . in accordance with the procedures laid down under Article 103 of the Treaty'.

Article 3

The members suggest that the words 'and represent it in law' be added to this first paragraph.

Article 4, second paragraph

The members consider that it is premature to introduce provisions into the statutes concerning allocations of any profits that may accrue.

Article 5

Certain members consider that the wording of this Article satisfies the requirements in respect of the Fund's tasks for the first stage. It could therefore be retained provisionally on the understanding that, as provided for in the last paragraph, the political authorities would reserve the right to redefine the unit of account at any time.

Other members feel that it would be preferable, in the prevailing circumstances, if the definition of the unit of account and of the procedures to be adopted in the event of a redefinition were to appear in the annex and were to be adopted provisionally.

Then again, there are other members who emphasize that they are not yet in a position to express an opinion, since the committee has not had the opportunity to examine the problem in sufficient depth. As far as they are concerned, it would be perfectly feasible to set up the Fund prior to a settlement of the problem of the unit of account, while embarking as soon as possible on a study based mainly on the technical report just completed by an expert group.

In addition, the majority of the members drew attention to the desirability of including in the last paragraph a reference to the Board of Directors of the Fund.

Article 6

The members suggest that this Article be supplemented in so far as the Fund's legal capacity is concerned. They would insert after the words 'immoveable or moveable', 'to open accounts with the Community central banks and conclude agreements with the latter'.

Articles 7, 8 and 9

The Committee has not examined in depth the legal problems raised by these Articles nor the question of the financial supervision of the Fund.

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* *

Finally, some proposals for amendments to the wording are set out below:

— One member considers that the beginning of the third ground should read as follows: 'Whereas the report "on the organization, functions and statutes of an EFMC" of the Monetary Council and the Council of Governors of the Central Banks as well as their Opinions of 5 and 11 September 1972 have been referred to the Council and whereas the meeting of the Heads of Government . . .' (the rest unchanged).

— The Agreement between the Community central banks on short-term currency support bears the date 9 February 1970 (fourth ground and Article 3 of the Decision).

— The second indent in Article 2 of the Decision should read as follows: '— interventions in Community currencies on the exchange markets'.

— In the German text of Article 1 (3) of the Statutes, the words 'of the Grand Duchy of Luxembourg' should be replaced with 'of the Luxembourg monetary authorities', in accordance with the French text.

— The figure 1 to be deleted each time it appears after the word 'Annex'.

— In order to avoid any confusion, the word 'Council' should, if necessary, be clarified to show whether it is the 'Council of Ministers' or the 'Board of Directors of the Fund' that is meant.

ANNEX II

OPINION ON THE COMMUNICATION FROM THE COMMISSION TO THE COUNCIL OF 19 APRIL 1973

The Monetary Committee, at its meeting on 21 and 22 June 1973 examined the communication from the Commission to the Council of 19 April 1973 which related to the progress made during the first stage of Economic and Monetary Union; to the distribution of powers and responsibility between the institutions of the Community and the Member States, which is necessary for the proper functioning of economic and monetary union, and to the measures to be adopted during the second stage of this union.

In accordance with the powers rested in it, the committee reviewed all the monetary questions raised by this document. The committee, without defining its position on all of the individual suggestions which appear in the Commission's document, wishes to formulate a number of observations, in the same order as the Commission's proposals. They can be summarized as follows.

I. REVIEW OF THE FIRST STAGE OF EMU

On the whole, the Committee agreed with the analysis made in the document regarding the results obtained during the first stage. Some members, however, would like the causes for failures in various fields to be analysed in greater depth. Finally other members pointed out that while reviewing the first stage, it was advisable to keep in mind the exceptional nature of this period, due to the successive crisis in the international monetary system. In spite of the difficulties during this delicate period, it had been possible to make some definite progress, in particular:

— intervention in Community currencies as part of the system of reduced margins of fluctuation;

— common position towards the dollar;

— creation of a European Monetary Cooperation Fund.

The Committee would like all the Member States to become involved in all these matters as soon as possible, since they constitute an important advance for the Community, in accordance with the resolutions regarding the first stage and with the Council Decisions of 11 March 1973.

II. THE ACTION PROGRAMME FOR THE SECOND STAGE

1. General remarks

The committee was also in agreement with the basic concept of the proposals made by the Commission. These aimed towards a sufficiently balanced group of actions covering both the monetary and economic fields.

However the committee reiterated the need, in carrying out this action programme, to bear in mind the principle of parallel progress both in monetary policy, and in principle economic policy in general, which was recognized by the Council resolution of 22 March 1971.

Taking into account the limited progress made during the first stage regarding the effective coordination of internal economic and monetary policies, this principle of parallelism implies that the Community should pay full attention to the effort which remains to be made in this field, while at the same time continuing with its progress in the field of external monetary policy.

2. Specific proposals in the monetary field

(a) *Financing of budget deficits*

The Committee considered it to be very important to coordinate the policies relating to the financing of budget deficits.

It suggested that coordination in this field should be concerned with the size of the budget deficits, and on the means by which they are financed, rather than with prior consultation on each loan.

In fact the committee considered that prior consultation on the issuing of any national loan would not be easy to achieve, since it was very difficult to ensure the necessary secrecy regarding the date and the terms of such loans. This was especially true in some countries, where the system of financing budget deficits prevented any prior consultation from taking place. Moreover, the committee expressed a reservation regarding the Commission's suggestion of fixing 'ceilings' for the short-term financing of budget deficits. Since cash requirements vary so greatly from time to time, since it is so difficult to make rigorous provisions for these variations, and since the monetary consequences of the different types of short-term indebtedness are so diverse, it appears to be more realistic to submit the problem of financing budgetary balances to periodic and concerted examination.

(b) *Coordination of monetary policies*

In the committee's opinion, the coordination of monetary and credit policy within the Community, and the stepping-up of the efforts made towards a harmonization of the machinery for implementing this policy, were extremely important. This harmonization should enable a whole range of machinery to be defined, from which the monetary authorities in the Member States would be able to choose that best corresponding to the circumstances at the time.

At the present stage in the development of the EMU, the committee considered that it would be neither useful nor advisable to establish uniform rules for national monetary policy. They believed that the right procedure to take would be to determine, by common agreement, the monetary factors to be taken into account and to establish norms for this purpose which make allowance for the various situations in the Member States.

The Committee realized that the Community must pay particular attention to reaching a common position on international monetary relations, to be expressed where appropriate by a single spokesman. Some members pointed in this connection that it was agreed at the Paris summit conference, that the Member States would aim to contribute to the reform of the international monetary system, by adopting a common position, and that they should be in a position to put forward modified opinions where necessary.

(c) *The exchange system and the European Monetary Cooperation Fund*

The Commission rightly stressed how important it was for the currencies of all Member States to participate in the Community exchange system. However, in order to ensure that this system had a stable basis and avoid the changes of new failures, it was vital that economic conditions should be favourable to it and that there should be effective policy coordination at Community level. The same considerations would apply also to any narrowing of the margins of fluctuation at a later date. A European Monetary Cooperation Fund working efficiently would help solve the problems which are likely to arise in this field.

The committee reserved the right to decide on the appropriation for the European Monetary Cooperation Fund and on the possibility of creating a European unit of account when the Commission submits the report on the adjustment of short-term monetary support and the progressive pooling of reserves.

The Council resolution of 22 March 1971 lays down that the Fund will eventually have to be integrated in the Community system of central banks. The Fund should be equipped with the functions of a central bank only gradually, and these would be extended subsequently.

The need for effective control of unsettling capital movements had been amply demonstrated by the recent monetary crises. The committee therefore endorsed the Commission's proposal on this matter. However, it would stress that the harmonization of national control mechanism and their variants in intra- and extra-Community relations should take account of the structural conditions in the various Member States and of differing opinions on economic policy.

The committee approved the principle advanced by the Commission whereby the Community would have the right to supervise adjustments in exchange ratios. However, it noted that the Commission proposal raised a number of delicate institutional and practical problems. In any event, the committee considered that the proposal did not in any way change the existing situation where the final decision on parity continued to rest with the Member States concerned, since any other solution could only be considered at a later stage in the development of economic and monetary union.

(d) *The capital market*

If a common market presupposed a common external strategy, the latter did not necessarily involve restricting capital movements from and to third countries. Certain committee members felt that the Community's obligation under the EEC Treaty to adopt as liberal a policy on the matter as circumstances allowed was not given sufficient weight in the observations on the document.

Moreover, the retention of controls for certain types of capital movement, even within the Community, could prove necessary under the international monetary system in its existing form. The committee was aware, however, that such exceptional cases should be restricted to a minimum.

(e) *The Community budget*

The Commission proposed that under the coming system for the Community's own resources, the Community could well be authorized to finance short-term Community budget deficits by drawing on the money market. Rules and procedures would have to drawn up to prevent excessive relaxation of the restraints on the Community's budgetary policies and to ensure that monetary equilibrium in general and money market stability in particular were not disturbed. Indeed, certain members considered that the raising of Community loans was neither necessary nor progress.

ANNEX III

OPINION ON THE REPORT FROM THE COMMISSION TO THE COUNCIL OF 27 JUNE 1973

At its meetings of 10 and 19 October 1973, the Monetary Committee as requested on 28 June 1973 by the Council of the European Communities examined the 'report from the Commission to the Council on the adjustment of short-term monetary support arrangements and the conditions for the progressive pooling of reserves'.

I. General remarks

The report of the Commission includes proposals aimed at establishing important elements of the basic structure for economic and monetary union. It answers the request made by the heads of State or Government meeting in Paris on 19 and 20 October 1972 that two reports be prepared: before 30 September 1973 on the reorganization of the short-term monetary support scheme and before 31 December 1973 on the conditions for a progressive pooling of reserves. At its meeting of 14 February 1973 the Council asked the Commission to submit only one report on both questions before 30 June 1973. A single report permits a global view of the two problems, which, although quite distinct, are interrelated.

Thus the report submitted by the Commission is within the framework of the three objectives stated under Point I of the resolution of 22 March 1971.

Despite the unfavourable circumstances within the Community and outside, it has been possible to create a Community foreign exchange system and establish the European Monetary Cooperation Fund. The Community must pursue and direct its efforts towards improvement in the coordination of economic and monetary policies, amongst others, interest-rate policies and the control of destabilizing capital movements. In this field, special emphasis should be placed on faster and more substantial progress. Community efforts must equally be directed towards the maintenance and reinforcement of the Community exchange rate system, so that new progress can be achieved in keeping stable the ratios between the exchange rates of the Member States' currencies. The Commission is endeavouring to meet both these objectives in the report which is the subject of this opinion.

In this present opinion, the Committee has not examined in detail the technical problems raised in the Commission's report; they have already been dealt with in the Opinion of the Committee of the Governors of the Central Banks of the Member States of the Community and the Council of Administration of the EMCF.

II. Reorganization of credit facilities

The system envisaged by the Commission (cf. Annex), would substantially increase the potential amount of credit that could be given simultaneously as of right to all Member States because the amount that could be drawn, as of right, by any Member State, would be unaffected by the granting of support to other member countries, in contrast to the present system where a single country can exhaust most of the available resources. Within the framework of the actions to be carried out in order to safeguard and strengthen the Community foreign exchange system, it is essential that existing credit mechanisms should be improved. The Committee thinks that an increase in available credit facilities is justified in appropriate circumstances. Opinions verge, however, on the importance of changes to be made in the volume of available credits, their maturity and the degree to which they are automatically available.

Certain members think that the increase in debtor quotas suggested by the Commission should be less, due to the risks of inflation inherent in a substantial increase in credit facilities, and the need for a better control over the creation of liquidity in any future international monetary system. Furthermore, an increase in automatic facilities might weaken the element of integration inherent in the Community exchange rate system. According to these members it is also necessary to avoid the risk of a single country having to carry the whole burden of financing. The other members accept the increase in facilities proposed by the Commission, taking into account the importance of destabilizing capital flows between member countries and of the financing requirements which stem from them. They point out that if the close link between the adaptation of the credit arrangements and reserve pooling which the Commission suggest were accepted, the result would be that the financing of credits would be undertaken by the EMCF itself and therefore, in effect, spread amongst all the Member States holding claims on the Fund.

The extension of credit maturities within the short-term monetary support scheme from a maximum of six months to 12 months as proposed by the Commission is equally considered by certain members as desirable, while others think that the present maturities are satisfactory.

Finally, the Committee's members are divided as to the extent to which automatic availability is acceptable for the granting of credits. Certain members can accept the suggestions of the Commission such as they stand and believe that the proposed consultation procedure is satisfactory. Furthermore, they consider that it would be useful to study the means and conditions under which the short-term facility could, in appropriate circumstances, be extended into medium-term support. The others consider that any reorganization of the system ought to be based primarily on an assumption that credits would be conditional, in order to contribute better to the coordination of economic policies.

III. Pooling of reserves

The pooling of reserves is an important element of economic and monetary union. It cannot, however, be conceived in isolation, because parallel progress must be achieved in other fields.

Three important issues arise: the nature of the pooling operation, the moment at which it should begin and the rhythm it should follow.

In the Commission's view the reorganization of the credit system and the pooling of reserves are clearly linked and should be undertaken to start without delay. The pooling of reserves, they say, does not mean that each Member State makes over to the Community without compensation, such part of it's reserves that it pools, but that it exchanges it's pooled reserves for a European reserve asset created by the EMCF. The Community system which the Commission advocates would make it possible in their view, to overcome present settlements difficulties, to strengthen the multilateral character of the system and to develop the role of the fund as the tool for monetary cooperation, as well as the role of the European monetary unit of account.

Certain members do not share the Commission's view. They consider that the pooling of reserves is not justified given the present position in the coordination of economic policies; indeed it is not necessarily an instrument capable of reinforcing coordination, but might even weaken it; moreover, they consider that the reorganization of the credit facilities does not imply pooling of reserves. They point out, on the other hand, that certain technical factors make it difficult at present to transfer certain reserve assets to the Fund (cf. Opinion of the Committee of Governors of the Central Banks and of the Council of Administration of the Fund, section II § 1).

The majority of members, not all of whom think that the reorganization of credit facilities is necessarily a precondition for starting to pool reserves, agree in principle with the Opinion of the Commission and consider that, particularly for psychological and political reasons, a start, albeit modest, should be made in pooling reserves as quickly as possible. These members consider that the method of pooling suggested by the Commission marks a useful step towards the end objective, and does not run ahead of the principles of parallelism between economic and monetary progress to which they too subscribe. They think, moreover, that solutions could be worked out to the abovementioned technical difficulties, provided that a decision in principle is taken at the political level. Finally, the establishment of common reserves could further the objective of giving the Community an autonomous monetary personality.

IV. Capital of the fund

The committee recognizes the usefulness of endowing the fund with capital. The Commission suggests that it should be underwritten in national currencies by the Member States through a budgetary allocation. If certain members could bring themselves to agree to the suggestion, however, the great majority think that the capital should be underwritten by the central banks. Taking account of the fact that any returns on the capital are intended to cover the fund's operating costs, the committee thinks that to begin with, only a small part of the capital will be required. Thereafter, the capital could be paid in simultaneously with the development of the fund's activities.

Annex

The comparison shown below between present and proposed credit arrangements is only provided for the sake of illustration and does not purport to cover all situations.

1. Amounts available, in millions of units of account:

	Short-term monetary support arrangements (a)		Commission proposals (b)
	Automatic quotas (i)	Total non-automatic extensions (ii)	
Deutsche Bundesbank	300	1 362·5	1 800
Banque de France	300		1 800
Bank of England	300		1 800
Banca d'Italia	200		1 200
Banque Nationale de Belgique	100		600
Nederlandsche Bank	100		600
Danmarks National Bank	45		270
Central Bank of Ireland	17·5		105

Under the present system of short-term monetary support arrangements the amount shown in column (a) (ii) is the maximum extension available for a single country; the sum total of extensions outstanding at one time cannot exceed this amount. Creditor countries are not obliged to extend credit beyond the amount of their creditor quota.

Under the proposed system, this limitation would no longer apply.

2. Duration of credit.

— Present system:

(i) under Basle arrangements: automatic credit, one and a half months plus three months extension under bilateral agreement;

(ii) short-term monetary support arrangements: three plus three months (consultation on first drawing).

— Proposed system:

(i) under Basle arrangements: automatic credit one and a half months;

(ii) short-term credit: six plus six months (consultation on renewal).

ANNEX IV

RESERVE ASSETS AND CONVERTIBILITY

1. Introduction

The countries of the European Economic Community consider the future system of international reserves to be one of the major aspects of international monetary reform. The monetary crises that have repeatedly plagued the world in the recent past have in no small measure been due to the uncontrolled growth of currency reserves. This has added significantly to inflationary pressures in the world, and has built up tensions in the system that have tended to explode whenever doubts began to arise on the sustainibility of the exchange rates of reserve centres.

We have stated at various occasions that in our view the role of reserve currencies should be reduced and that of the SDR should be enhanced. In the final stage, reserve currencies should be completely phased out except in their function of normal working balances.

Because we consider these matters central to the reform of the international monetary system, representatives of our countries have made various suggestions with regard to the problems of reserve assets and convertibility. In an attempt to make a further contribution to progress in this area, we have agreed on a common proposal which we hereby submit to the Committee of Twenty.

The memorandum does not go into problems of transition. In particular, it does not deal with the consolidation of existing reserve currency balances through bilateral funding and/or through a substitution facility in the IMF. We realize, however, that this question is intimately related with convertibility and that it is, indeed, an essential precondition for the proper function of the reformed system. We intend to make proposals on this important matter in a separate note.

2. Objectives

We suggest that the proposals for a future system of reserve assets and convertibility should be judged with reference to the following primary objectives, which are largely inspired by what we believe to be the major faults of the present system.

In addition to these primary objectives, there are a number of other considerations which we shall not mention explicitly. An example is the desire of countries to remain free in the composition of their official reserves. Since we believe that this freedom must be limited in the interest of stability, we have not entered this as one of our objectives. We recognize, however, that it is a valid goal to minimize the constraints on national freedom of action to the extent that this is compatible with the primary objectives of the reform.

(a) *Balance of payments deficits and surpluses should be reflected in reserve movements*

Unlike other countries, reserve centres are able to finance their deficits by incurring liquid liabilities in their own currency. To the extent that foreign holders cannot or do not convert additional reserve currency balances either into their own currency or into primary assets, the system operates in an asymmetrical manner and tends to mask the need for fundamental balance of payments adjustment in certain cases. In order to eliminate the asymmetry and to prevent the instability, caused by delayed adjustment action and by an excessive build-up of currency reserves, reserve centres should not finance their balance of payments deficits by incurring liquid liabilities in their own currency. Conversely the system should ensure that reserve centres earn reserve assets when in surplus.

(b) *International control over the global volume of world reserves*

In the past, world liquidity has increased in a completely uncontrolled manner as a result of payments deficits of the reserve centres. This has provided an additional and very unwelcome stimulus to world inflation; it has enlarged the quantity of potentially volatile international capital; and it has left a legacy of excessive official liquidity in the world. Reserve creation in the future system should take place only on the basis of international decisions, based on the criterion of global need for additional reserves. As stated in the introduction, the manner in which excess international liquidity can be eliminated will not be considered at this point.

(c) *The instability due to shifts in the composition of official reserves should be eliminated*

Shifts in the composition of official reserves between primary reserves and reserve currencies as well as between different reserve currencies (including various new reserve currencies) have compounded the problem of excessive international liquidity creation and have produced large flows of capital that have tended to interfere with an orderly system of exchange rates.

As we mentioned in the introduction, we believe that these problems should be mainly solved by reducing the role of reserve currencies and by enhancing that of the SDR. The ultimate goal should be to reduce the amounts of reserve currencies held by the non-reserve countries to normal working balances.

3. Multilateral asset settlement

Even before the convertibility of the US dollar was suspended, the existing system was clearly deficient in various respects. The primary reserves of reserve centres did not systematically change in response to balance of payments deficits or surpluses, since other countries could and did settle their collective surpluses or deficits *viz-à-viz* the reserve centre by adding to or drawing upon their holdings of currency reserves. For the same reason, global reserves could increase or decrease, not as a result of an international decision, but as the unplanned consequence of deficits or surpluses of the reserve centres and of the uncoordinated decisions by other countries to accumulate surpluses in the form of reserve currencies or to change the composition of their reserves in favour of currency reserves.

Asset settlement aims to correct these shortcomings of the existing system by requiring that reserve centres settle their balance of payments deficits in primary reserve assets, while it should also ensure that reserve centres receive primary assets when they are in surplus. Interpreted in this sense, asset settlement clearly satisfy the objectives (a) and (b) of the reformed system.

There are two possible ways in which asset settlement could be organized. One would be to impose the obligation on all members of the system to bilaterally convert any newly received currency reserves into primary assets at the country of issue. The other possibility is a system of multilateral asset settlement via a special settlement account in the Fund, its major feature being that reserve centres would undertake to sell primary assets to the Fund, or to buy primary assets from the Fund whenever they are in deficit or in surplus. Under the latter system, settlement is no longer a bilateral transaction, but is defined in terms of rights and obligations of reserve centres *viz-à-viz* the Fund on the one hand, and of rights and obligations of non-reserve centres *viz-à-viz* the Fund on the other hand. These two aspects of multilateral asset settlement will be taken up separately in the next sections.

We support the idea of *multilateral asset settlement.* It avoids the political and economic tensions inherent in the alternative system, that of obligatory bilateral conversion. Multilateral asset settlement also circumvents the difficult problem of distinguishing between 'old' and 'new' reserve currency balances, a problem that does arise under a system of obligatory bilateral conversion. If it is correctly defined and applied, multilateral asset settlement would indeed (a) cause the balance of payments position of the reserve centres to be reflected in changes of their primary assets and (b) prevent any unplanned increase in global reserves due to deficits of reserve centres.

Multilateral asset settlement would not, in itself, satisfy objective (c). It is necessary, therefore, to take special precautions against destabilizing shifts in the composition of reserves in particular by preventing the emergence of new reserve currencies.

4. Rights and obligations of reserve centres

Under multilateral asset settlement, a reserve centre would have the right to buy primary assets from the Fund when it has a balance of payments surplus, but only to the extent that the surplus is not already reflected in a rise in its primary reserves (resulting from other countries having settled their deficits with the reserve centre in primary assets).

Conversely, a reserve centre would have the obligation to sell primary assets to the Fund when it has a balance of payments deficit, but again only to the extent that the deficit is not already reflected in a fall of its primary reserves [1]. In both cases, the indicated restriction must be made in order to allow for voluntary bilateral settlement in primary reserve assets, which cannot and need not be prohibited under a system of multilateral asset settlement. The major advantage of multilateral asset settlement to the reserve centre is, however, that it cannot be confronted with demands for conversion resulting from past deficits: bilateral asset settlement by the reserve centre would be purely voluntary.

The choice of the specific settlement criterion (i.e. the definition of a reserve centre's balance of payment surplus or deficit) is of considerable importance. It is far more than a simple matter of definition, since it determines the essential characteristics of the whole system.

In the context of reserve creation, the logical definition of a reserve centre's deficit of surplus is that based on the *official settlements balance.* Multilateral asset settlement based on this definition implies that any increase of a reserve centre's liquid liabilities to foreign monetary authorities is to be settled in primary assets via the Fund. This rule would satisfy our second objective as well as the first, since global reserves could no longer grow as the result of countries accumulating currency reserves: any such accumulation of currency reserves would be fully offset by a loss of primary reserves on the part of the reserve centre via the mechanism of multilateral asset settlement [2].

Although multilateral asset settlement based on the official settlements balance provides a logically acceptable system, it has certain economic and practical drawbacks. Its economic drawbacks are that asset settlement by the reserve centre may be delayed whenever it incurs liquid liabilities, *not* to foreign monetary authorities but to non-official foreign holders (in practice: to foreign private banks).

As a result, a reserve centre may be forced to yield primary assets to the Fund at a later stage, not because of any fundamental factor relevant to the economic situation then prevailing, but because previously incurred liquid liabilities to non-official holders are converted into official reserves.

In order to eliminate this potential instability in the system, multilateral asset settlement could conceivably be based on the *liquidity balance* of the reserve centres, which includes changes in liquid liabilities not only to foreign monetary authorities, but to all foreign holders. However, it is difficult to see how such a system could work in practice, since non-official holdings of reserve currencies are not reserves, cannot be used in balance of payments settlement, and cannot be subject to designation by the Fund.

Whereas we cannot in practice utilize the economically more relevant concept of the liquidity balance in the system of multilateral asset settlement it, rather than the official settlements balance, should play a role in the adjustment process. Since they are relieved of asset

(1) These rules could, of course, be modified so as to deal with the special problems of the interim-period. In particular, the obligations of the reserve centres could be temporarily reduced during the interim-period. Since this paper concentrates on the reform of the system we shall not work out these ideas concerning the interim-period at this point.

(2) Except for placements in the Eurocurrency market. On this point see section 5.

settlement for their non-official liquid liabilities, the reserve centres have a special responsibility in this area, particularly in determining their internal policy mix such as to gear monetary policy more to external considerations. It is clear that other countries will also have to make a contribution in coordinating monetary policies with a view to preventing interest rate differentials from producing an excessive growth of non-official holdings of reserve currencies.

5. Rights and obligations of other countries

We believe that the proposals made in the previous section, dealing with the relationship between the reserve centres and the Fund, satisfy the first two objectives of the reform except in one important respect, namely the transformation of liabilities to official holders into private claims on the reserve centres via the Eurocurrency market. Official placements in the Eurocurrency market lead to an unplanned increase in global reserves to the extent that the claims on the reserve centres that are placed in the Eurocurrency market are acquired by other official holders. This loophole in the system should be closed by appropriate measures to contain the placement of official reserves in the Eurocurrency market.

Apart from this last problem, the first two objectives of the reform are satisfied by the proposals contained in the previous section. They do not, however, contribute necessarily to the attainment of the third objective, that of reducing the role of reserve currencies in the interest of stability. Obviously, this should apply to all reserve currencies, the traditional ones as well as others.

Currency reserves increase when reserve centres run a balance of payments deficit to the extent that it is financed by increasing liquid liabilities. Under the system of multilateral asset settlement, the additional reserve currency holdings are not converted bilaterally into primary reserve assets except to the extent that the reserve centre is willing to do so on a voluntary basis. In general, asset settlement will take place via the Fund, the reserve centre selling primary reserve to the Fund in the amount of its deficit.

In order to obtain the reserve currencies which the Fund requires to pay for the primary assets, one possible method is the designation procedure. This would lead to a substitution of SDRs for the newly created reserve currency balances and would fully serve the objective of preventing a renewed build-up of currency reserves (1).

The designation procedure could obviously be frustrated if countries could freely rebuild their reserve currency balances by using SDR. Consequently, balance of payments need should in principle be maintained as a criterion for the use of SDR, unless other means are found to make countries accept a limitation on reserve currency holdings.

(1) Since not all countries participate in the SDR system, problems could arise with the designation procedure when important surpluses accrue to non-participating countries. This problem will have to be seriously examined.

The rules of designation in a system of multilateral asset settlement would have to be worked out. A possible rule would be either to harmonize the composition of reserves or to designate in relation to newly acquired reserve currency holdings. It would also be possible to use the designation procedure only to the extent that voluntary transactions are not sufficient.

In order to be acceptable, designation should be made as little a burden as possible on the participating countries by making SDR holdings attractive relatively to reserve currency holdings. This would also serve to reduce the effective infringement on national freedom in the composition of official reserves. The position of the SDR should in any case be strengthened by raising the rate of interest on SDR, but it would obviously be impracticable as well as undesirable to make the rate at all times fully competitive with money market rates in the major reserve centres. The appropriate rate of interest on SDR holdings should be considered in relation to the provisions concerning its value and any possible disincentives to be introduced for holdings of reserve currencies.

While designation is entirely appropriate in the case of reserve centre deficits, the same does not hold for *surpluses,* at least until reserve currency holdings have been reduced to the level of normal working balances. When a reserve centre runs a surplus, it is entitled to buy SDR from the Fund. Given the objective to reduce the amount of reserve currency holdings in the system, it would be quite inappropriate to force the reserve currency which the Fund acquires onto the other participants of the system by a process of 'reverse designation'.

Instead, the Fund should fund these balances with the reserve centre. The debt thus incurred by the reserve centre should carry a SDR-exchange guarantee, since the asset settlement transaction implies that the reserve centre receives SDR-denominated liabilities.

6. Mobile capital flows

To the extent that mobile capitals flows are destabilizing, they are undesirable as such and should be prevented. The methods to achieve this are the subject of separate deliberations and will therefore not be considered in this paper. We shall deal only with the consequences of such flows, given that they occur, on the system of multilateral asset settlement.

It has been suggested that the system of multilateral asset settlement should be relaxed in the case of destabilizing capital outflows from a reserve centre, since full settlement would impose too much of a burden on the reserve centre and too much of a stress on the system as a whole. There is no doubt that the system should provide sufficient elasticity to deal with such cases. Such provisions already exist in the form of the 'General Agreement to Borrow', swap arrangements between central banks, etc. If necessary, these arrangements could be expanded. But it is not desirable that the general obligation to settle deficits in primary assets should be relaxed (except in so far as this is implied by the swap arrangements), or that this should be done exclusively for the benefit of reserve centres. It could easily become an important loophole in the system, since destabilizing capital flows are notoriously difficult to indentify with any degree of objective precision.

ANNEX V

REPORT OF THE WORKING PARTY ON SECURITIES MARKETS

During the period under review (fourth quarter 1972 to end 1973), the capital market trends in most Community countries were affected by a monetary policy which, because of the persistent inflationary tendencies, was given an increasingly restrictive bias, although there were notable exceptions. Action on interest rates played an important part among the means employed. This was facilitated by the attenuation of external constraints, due particularly to the joint floating of the principal Community currencies. The successive raising of official discount rates, which in most countries were standing at record levels at the end of the year, together with the measures to restrict bank liquidity led to a sharp rise in short-term interest rates, with money market rates — except in Luxembourg and Italy — following suit with a certain time lag to differing degrees. From October 1972 to the end of 1973 interest rates, measured by the stock market yield on public bonds, rose by less than 0·5 % in Italy and less than 1 % in Luxembourg and Belgium; in Germany, France and the Netherlands, the yield increased by between 1·4 and 1·9 %, while in Denmark, Ireland and the United Kingdom it rose by as much as 2·3 to 3 %.

The rise in interest rates was, generally speaking, continuous, the peaks being reached at the end of 1973. A notable exception was Germany, where the high point for the period was reached in July. As a result of these rises, interest rate differentials between the Community countries widened considerably. The gap between the highest rate and the lowest rate in the Community, which had been less than 3 % at the beginning of the period, reached 5·5 % at the end of the year. This was possible only because the majority of the member countries kept their markets isolated from each other and, in order to ensure sufficient room for manoeuvre for their monetary policy, even accentuated the division. In February 1973, for instance, the German authorities instituted an authorization procedure for the acquisition of domestic bonds by non-residents which was strictly enforced.

The trend in the volume of issues differed quite sharply from one member country to another. In France, Italy and Denmark the performance was distinctly better than in 1972. In Belgium the volume of issues was slightly up on the previous year, while the German capital market proved somewhat less receptive than in 1972 when admittedly the result had been exceptionally good. On the other hand the volume of issues was well down on the previous year's results in the United Kingdom and the Netherlands.

In virtually all the countries, however, this overall trend masks sharp variations in new issue activity during the year. In Denmark and the United Kingdom, for instance, the amount of capital raised in the first half of the year was so large that it more than offset the poor result for the subsequent period (Denmark) or limited the negative results for the year as a whole. In France, Italy and Germany highly productive periods alternated with times of market saturation. Towards the end of 1973 the German, French, United Kingdom and Danish markets in particular were proving to be insufficiently absorptive.

Borrowers and the monetary authorities reacted in different ways to market strains. Some countries insured market equilibrium in such situations by interrupting issues or spreading them over a longer period and/or adjusting interest rates. In Italy, on the other hand, where for economic policy reasons an increase in long-term interest rates was regarded as undesirable, the Banca d'Italia at times purchased large quantities of securities. The securities portfolio of the Issue Department of the Bank of England also increased appreciably at times.

Coordination of capital market policies was not achieved during this period; dissimilarities in the economic situations of member countries caused different objectives to be attributed to national economic policies. In addition, different views continue to be held on the role of interest rate policy.

The balance of payments position of the various members exhibited very different trends throughout the period: sharp deterioration for some, distinct or even significant improvement for others. Because of this, deficit countries were forced to take measures to control capital exports to avoid an eventual reduction in their external balance, while the surplus countries took various measures restricting capital imports and/or encouraging capital exports to prevent inflows of capital which would counteract their monetary policy. Together, these measures constitute a set-back to progress in the liberalization of capital movements.

The share markets in all the countries were affected — especially in the second half of the year — by anti-inflation measures, and at the end of the period, by uncertainty as to the effects of the energy crisis on the pattern of firms' costs and on future economic growth. At the end of the year share prices on all stock exchanges without exception were down, and in some cases considerably so, on the level at the beginning of the period under review.

In *Germany* the major feature has been the effect on the capital markets of the credit policy of the central bank.

Over the year as a whole, the volume of issues was fairly high, although there was a slight fall from the volume of 1972 which had, however, been an exceptional year. As in previous years, purchases by the non-bank sector, and especially households, contributed much to this satisfactory result concerning the volume.

The fall in the volume of issues in the fourth quarter of 1972 was attributed to the effectiveness of the restrictive monetary policy, and expectations of a further rise in interest rates.

There was a further decline in issues in the second quarter of 1973 after a very high volume in the first quarter, and this was accompanied by a steady rise in yields until July, as issuers made concessions to subscribers in order to ensure placing. At the same time, further conjunctural measures taken by the authorities in the second quarter of 1973 to restrain inflation pushed nominal interest rates up to the record level of 10 %, and yields to more than 10 %. As this high level of interest again attracted investors to the bond market, and in order to keep the rates high as a measure to counter inflation, the authorities encouraged a high volume of issues. Towards the end of the third quarter, however, the cyclical demand for capital had fallen sufficiently to permit interest rates and yields to decline slightly to about 9·5 %.

There was a distinct decline in the volume of foreign issues in DM after the second quarter, and the total volume was some 20 to 25 % inferior to that of the previous year (DM 2 200 million in 1973 compared to DM 2 716 million in 1972).

As in previous years, the totality of foreign issues was subscribed to by non-residents, there being no net exports of long-term capital. In addition, the government reinforced and extended existing measures preventing foreigners from buying German securities. Yields on international DM bonds issued by non-residents were stable at around 7 % until mid-year when they were about 3 % below the level of internal issues. Subsequently they moved gradually and, by the end of the year, sharply, upwards to attain a level superior to the yield of domestic bonds.

The share market had a bad year. Weakened at the end of 1972 after Bundestag elections, it recovered at the beginning of the year to resist the monetary disturbances of March 1973 only to become pessimistic again in July. The volume of issues over the year as a whole did not show a very large fall, being about DM 2 000 million in 1973 compared to DM 2 400 million in 1972. But the share price index (end 1965 = 100) which had been 149 at the end of 1972 and rose to 168 in March, had fallen to 123 by December 1973.

On the *French* securities markets, the volume of gross issues was greater in 1973 than in 1972 by 35 %, private enterprises and financial institutions again being the principal borrowers on this market. During the first quarter the market was uneven, due to the issue of a State loan and a certain saturation of the market. Measures were taken by the authorities to combat this, however, by making smaller issues less often and increasing interest rates and yields, and the volume of issues reached a record level in the first six months. Later in the year, there was a certain slowdown in the volume of issues, in the third quarter, compared with the corresponding quarter of 1972, followed by a strong recovery in October and November before the market once again showed signs of saturation in December.

Much of the evolution in the bond market can be illustrated by the movement of yields. At the beginning of 1973 yields of around 8·35 % had appeared sufficiently attractive, particularly to institutional investors. There was a large increase to about 9 % in mid-year which was the price of an increase in issues. In the third quarter, however, there was a further rise in yields, despite the slow-down in the volume of issues. In December, yields rose even further to end the year at over 9·75 %.

In addition to the bond market, private enterprises also increased their use of the share market as a source of funds this year. Share issues increased in every quarter, producing a global expansion of 20 % over 1972. The share price index rose steadily up to April 1973 but by the end of the year had declined to about five points below the level at the beginning of the year. Fears of a sharp slowdown in the growth rate and difficulties in financing due to the oil crisis were apparently the strongest factors in this evolution, as was the case in most other countries.

The combination of a large balance of payments deficit, a rapid rise in consumer prices and a recovery of industrial production caused the *Italian* authorities to take a series of restrictive measures in mid-1973, in contrast to the previous expansionist policy. These aimed to establish selective credit controls, make short-term credits more expensive, to reduce capital inflows notably by means of introducing a non-interest bearing deposit of 50 % on purchases of foreign securities by residents, and to oblige the banks to invest more and more on the bond markets, thus providing direct and indirect influence on the capital markets.

Issues were distinctly greater in 1973 than in the previous year. In the first and second quarters of 1973, issues of domestic bonds were slightly lower than in 1972 due to reluctance by investors, but issues on the international market over-compensated for this after encouragement by the Banca d'Italia. In the third and fourth quarters of 1973 there was a sharp increase both in domestic issues and Euro-issues. Gross domestic issues were Lit 8 874 000 million in 1973 compared with Lit 5 879 000 million in 1972, and Euro-issues were Lit 1 900 000 million in 1973 compared with Lit 448 000 million in 1972.

Interest rates remained stable at around 7 % and yields at 7·5 % as a result of government policy to encourage investment and to increase industrial production. The authorities, relying on measures against capital outflows (see above), succeeded in keeping interest rates at such a low level compared with conditions abroad, thus virtually separating the Italian bond market from the rest of the world.

At the end of 1972 and the beginning of 1973 there was an increase in the volume of share issues, and this level was maintained in the rest of the period, an increasing part of the capital going to companies quoted on the official market.

Share prices steadily increased until mid-1973 as industrial production and business profits recovered. It was also felt that equities would provide a hedge against inflation. However, in the third and fourth quarters of 1973, these hopes were disappointed and stock market quotations dropped as a result of a shrinking in the volume of available credit and government anti-inflationary policy.

At the end of 1972, the United Kingdom markets were quiet, with over half the activity involving British Government securities. At the beginning of 1973, however, the authorities made large net sales of stock and sold even higher amounts in the second quarter. In the following quarter the market was generally quiet and official sales of stock were small. As a result of the economic situation, the market was generally weak in the fourth quarter, although sizeable amounts of Government Stock were sold in October and around mid-December. Activity in most other fixed-interest securities was more consistent, until December when the amount of transactions was substantially smaller.

Yields on British Government securities, like those in the parallel money markets, increased sharply in the second half of the year from just around 10 % in June to rather more than 11 % in October and about 12·5 % in December. This was mainly in response to a tightening of monetary policy in July (when the minimum lending rate rose to 11·5 %) and again during November (when the minimum lending rate rose to 13 % and there was a call for a further 2 % of special deposits). The yields on other fixed-interest securities also rose sharply.

The equity market was also unsettled during the year, with domestic capital issues well below those in 1972 (138 million in 1973 compared with 680 million in 1972), and the share price index fell by over 30 % during the course of the year, from 505 to 344, touching 306 in mid-December, just before the announcement of new deflationary measures.

The particular characteristic of the *Irish* capital market is its close dependence on the United Kingdom capital market, especially in terms of interest rates. This is due to the fact that there is freedom of movement of capital between the two countries, the difference in the size of the two markets, and (recently) the merging of the United Kingdom and Irish Stock Exchanges.

Interest rates followed closely those in the United Kingdom, partly through market forces and partly through action by the authorities to avoid large capital outflows. There was a sharp rise at the beginning of 1973, and short-term money rates reached a peak under the influence of the parallel money markets in the United Kingdom towards the end of the year. Yields on government securities followed the same pattern, reaching an historical high level of 10 % in February 1973, easing off in mid-year to reach a new high of 12·5 % in December.

There was a rise in issues in the second quarter of 1973, so that banks could maintain their secondary liquidity reserve ratios, and despite a fall in issues in the third quarter, when the volume of redemptions exceeded the volume of issues, there was a renewed demand in the fourth quarter when nominal sales were £ 24 million compared with £ 12 million for the fourth quarter 1972; although again this demand was mainly from the banks and confined to shorter maturities.

A structural feature of the *Danish* capital market is that 90 % of bond issues are made by the mortgage credit institutions. This means that the markets are most heavily influenced by, and government measures concentrated on, developments in the housing sector.

The absorptive capacity of the market proved to be very strong at the beginning of the period (fourth quarter 1972) with issues remaining at a high level of around 30 % over the corresponding period of 1971. At the beginning of 1973, however, bond prices came under heavy pressure as a result of a large issue of mortgage bonds, despite some support by the national bank. In the face of this situation, the mortgage institutions after consultation with the authorities, imposed ceilings on mortgage borrowings in order to restrain the rise in demand for capital and alleviate the disparity between investment in the housing market and investment for industrial development. The volume of issues which had been very high in early 1973 declined in the third and fourth quarters of 1973 to a level some 15 % above 1972, producing a total for 1973 of 25 % above that for 1972.

The distinct increase in bond prices which occurred after the referendum of 2 October 1972 on the accession to the EEC was followed in November by a decline which continued until mid-March: due to this, the average yield increased by at least 1 %. Following a recovery in April which compensated for a small part of the previous losses, there was a further sudden fall in prices in July and August; it was only in December that a certain stabilization manifested itself, given that prices only decreased slightly. The average bond yield at the end of the year reached around 13·5 %, exceeding therefore the level of 2·5 % at the end of 1972 and that of 3·5 % at the end of November 1972. The increase in yields was, however, smaller for certain high-interest bonds.

The share market, traditionally an unimportant source of funds, experienced a new lease of life after Denmark's entry into the Community. In the first half of 1973 foreign demand for Danish shares, although restricted by quotas, was at a high level, and both issues and prices increased, although demand and issues fell back to a more 'normal' level in the second half of the year, when foreign net purchases of Danish shares fell to zero, and later suffered net repatriations. The share price index rose up to the end of August 1973, but later fell, in line with activity on the market, to end the year at 177 compared with 217 in August.

On the *Dutch* capital market, after a continuous decline in the first six months, the volume of new issues stabilized during the second half of the year at the level of the previous year.

At the end of 1972, the increase in short-term rates had caused a contraction of the capital market due to the withdrawal of certain funds from this market, notably by the banks. Furthermore, the institutional investors, expecting a rise in long-term rates, preferred to wait. During the first part of 1973, due to the development of the exchange markets, which produced an easy money market, borrowers preferred to have recourse to this market and obtain their financing by short-term capital. During the second half of the year, the high level of short-term interest rates and the continuing preference of investors for liquidity, necessitated an upwards adjustment in the long-term interest rate: only when yields on privately contracted loans reached 9 % (at the beginning of September) did the institutional investors return to the capital market.

But this recovery was only temporary; the market suffered a further setback as a result of the oil crisis and by the end of the year yields were at around the level already achieved (9·5 to 9·75 %). On the whole, activity was quiet and the drying-up of issues which occurred during the year clearly reflected the reluctance of investors.

The authorities took a number of monetary policy measures to combat inflation; they were led to increase the rate of discount on several occasions in order to avoid too large discrepancies in relation to the rate in other countries. Monetary policy during the year was moderately restrictive, principally aiming to prevent a large increase in the liquidity of both banks and individuals; the trend in unemployment and the relative weakness of industrial investment prevented a more severe policy from being implemented.

Despite liberalizing measures taken in January, (now permitting residents to purchase by subscription 'guilder notes' issued by residents), the market for these notes was quiet throughout the period. During the second half of 1973, issues almost completely ceased, while yields exceeded 10 % on the secondary market.

There were traditionally few issues of shares over the period. The share price index rose at first from 130 at the end of 1972 to 144 in April, then falling back to 101 in December 1973.

The volume of gross issues on the *Belgian* securities market was slightly higher for the whole of 1973 than for 1972 (Bfrs 267 000 million in 1973 compared with Bfrs 238 000 million in 1972). Borrowers had no great difficulty in placing issues laid down in the schedule, although during the course of the year two public issues were delayed in order to ensure an even flow of new issues on the market.

This ease of placing was especially useful in permitting the authorities to consolidate a part of its floating debt and to continue the redemption of the foreign currency debt to an amount of Bfrs 3·4 000 million.

The major characteristic of the capital market has been the stability of the rate of interest and yields, both only rising from 7 % to just below 8 % over the course of the year, despite the exceptionally high level in neighbouring countries.

The share market has been quiet; the volume of issues was not as high as in 1972, although a record number of new companies have requested quotations. There was a slight increase in the share price index up to the middle of the year, but a fall in the second half of the year to about the level at the beginning of the year.

In the *Grand Duchy of Luxembourg*, although the level of domestic issues was quite high at the end of 1972, it was reduced at the beginning of 1973 and later even suspended in order to avoid an influx of speculative capital.

During the two last quarters, the authorities reopened the market to borrowers willing to quickly convert and export the product of their borrowing.

Towards the end of the year, a certain shrinking of the market occurred, partly due to a desire to maintain a relatively stable interest rate in relation to the very high rates prevailing on the money market.

The total volume of issues was Lfrs 2 700 million compared with Lfrs 3 300 million in 1972.

The characteristics of the Lfrs 300 million State loan are interesting: it was available only for physical persons, bore no interest coupon and was redeemable at premium free from income tax.

Bond yields have remained fairly stable over the whole period, the maximum increase being of the order of 0·77 %.

In contrast to previous years, continuing monetary uncertainty in the past year had strong repercussions on the *international markets,* where the size and composition of the volume of issues, the distribution of issues by borrowing countries and the interest rate trend were all affected.

After reaching the record figure of 1 980 million EUR in the fourth quarter of 1972, the volume of issues fell appreciably in the first and second quarters of 1973 as a result of the monetary events in February and March and the drop in the dollar rate. After a further sharp dip in the third quarter to 616 million EUR there was a strong recovery in the final quarter, but even this quarterly result — as all the others in 1973 — was distinctly lower than the figures for the corresponding quarter of the previous year. This meant that between 1972 and 1973 the total volume of international issues dropped by 35 % to 4 556 million EUR. This decline affected issues in all currencies with the exception of the Swiss franc. Issues in this currency last year did in fact slightly exceed the high 1972 figure.

A breakdown by currencies of issue shows a slight fall in dollar issues (from 51 to 45 % of the total volume) and an appreciable increase in the share of DM and SwF issues (25 and 15 % in 1973 as against 20 and 10 % in 1972). The proportion of foreign DM issues in total issues denominated in currencies other than the dollar increased from 42 to 46 %, while the corresponding figure for SwF issues rose from 19 to a good 28 %. On the other hand there was a marked fall in international issues denominated in guilders and French francs; issues of these securities practically dried up in the second half of the year.

The share of issues denominated in units of account, insignificant in 1972, considerably increased in 1973, particularly due to the new 'Eurco' formula. The Eurco is a unit of account based on a basket of the nine Community currencies in fixed proportions. The value expressed in one of these nine currencies (or in any other currency) varies every day according to fluctuations in exchange rates and is the sum of the amounts obtained by converting the various currencies making up the whole into the desired currency. Two Community borrowers used this formula in autumn 1973 for an amount of 50 million Eurco.

Privately placed loans recorded in the statistics were again in 1973 of little significance (37 million EUR compared to 48 million EUR in 1972).

In contrast to the downward trend in the volume of issues, Eurodollar bank loans shot up: in 1973 they probably amounted to at least 24 000 million, an almost fourfold increase over 1972. This suggests that the sharp drop in the volume of issues was not due to a shortage of funds on the markets, but to the reluctance of issuers and investors to contract long-term debts in the present circumstances. Therefore, Euro-loans, which enable more capital to be raised at a time than bond issues, were favoured by borrowers.

There were also considerable shifts last year in the pattern of countries floating loans: while the EEC share jumped from 27 to 45 % (increase of 1973 on 1972), the US share dropped appreciably, from some 25 % in 1972 to less than 19 %.

Interest rates on the international capital market were particularly affected by the events on the foreign exchange markets. A slight drop in interest rates on dollar issues in the closing months of 1972 could be taken as a sign of renewed confidence in the dollar. One main consequence was that the gap between interest rates on the dollar issues market and some Euro-currency markets narrowed. But bouts of speculation in February and March and the heavy pressure on the dollar in the following months then led to a sharp increase in interest rates on dollar issues, although the volume of these issues was constantly declining; the peak was reached in July when the stock market yield was 9·25 %. Although the yield had fallen back to 8·75 % by the end of 1973, compared to the beginning of the period under review this represented an increase of more than 1·5 % in the real interest rate.

There was an even more substantial advance in the interest rates on foreign DM issues. After yields had fallen from 7·25 % in the final quarter of 1972 to 6·75 % at the beginning of March, a steady upward movement set in. With the German mark weakening on the foreign exchange markets the prices of foreign DM issues came under increasing pressure from October onwards, with the result that yields on these issues caught up with the yields on domestic issues by the end of November and a month later were almost 0·5 % higher. Over the entire period under review the yield on foreign DM issues increased by some 3 %.

The Swiss franc was the only major currency of issue to remain relatively unaffected by the rise in international interest rates. The yield at issue was mainly between 6 and 6·5 % throughout the period. As the yields on SwF bonds were already the lowest of all international issues, the gap between them and yields on issues in other currencies widened distinctly.

There were no major changes last year in the policies pursued by the monetary authorities of the member countries. The German authorities did, however, get the issuing banks to limit the volume of international DM loans — not counting the issues of international organizations — to DM 400 million to DM 500 million per month. In addition agreements were concluded on a time limit for the conversion and transfer of the proceeds of issues. The banks further entered into a gentleman's agreement not to sell foreign DM issues from their holdings to non-residents.

In the Netherlands, residents were authorized to subscribe to international guilder issues where the issuer was also a resident.

A kind of 'cash deposit' on exports of capital introduced by the Italian authorities in July 1973 meant that Italian subscribers withdrew almost completely from the international markets, except for loans floated by European institutions which could still be purchased on both the primary market and the secondary market without the cash deposit having to be made. At the same time, for balance of payments reasons, greater encouragement was given for importing capital, especially in the form of borrowing on international capital markets, by enterprises and financial institutions. The resulting net inflow of capital amounted to some $ 4 000 million in 1973.

In addition to the regular examination of trends on the national and international capital markets the working party began to look into how cooperation between the capital market authorities of the Member States could be stepped up. The working party takes the view that this work is in line with the provision of the Council resolution of 22 March 1971 requiring a procedure to be laid down for the progressive coordination of the Member States' policies with regard to capital markets. The discussions, which are still continuing, are on the possibilities of identifying the short-term objectives of capital market policy and the plans for structural reform essential to the capital market. From now on the working party has agreed in principle to exchange information on all measures which affect the capital market.

In addition, the working party started to look at the problems connected with protecting holders of fixed-interest securities from the fall in the value of money. The starting point for the discussions is the sharp and persistent rise in prices in virtually all member countries. Erosion of the value of money on such a scale could discourage saving through investment in bonds and be prejudicial to the efficiency of the bond market. The working party has studied several solutions, among others, which would compensate for losses sustained by savers and preserve the important source of finance for the private and public sectors, which the bond market represents: index-linking, higher interest rates, shorter periods of maturity and tax measures. This analysis gave special consideration to the fact that applying them in an uncoordinated manner could hamper efforts to merge the national markets into a European capital market. The working party hopes to conclude the study in the near future and to put the results before the Monetary Committee.

In conclusion, it may be noted that at a special meeting the working party examined the structure of the British capital market. Its studies of capital market structures will shortly be completed with an examination of the Irish and Danish markets.

Annex

LIST OF THE MEMBERS OF THE WORKING PARTY ON SECURITIES MARKETS

Chairman:	M. F. De Voghel, vice-gouverneur honoraire de la Banque nationale de Belgique, président de l'Institut de réescompte et de garantie, Brussels (until 15 February 1973).
	M. D'Haeze, Directeur général de l'administration de la trésorerie et de la dette publique, Brussels (from 15 May 1973).
GERMANY	Dr. K. Andreas, Leiter der Hauptabteilung Kredit, Deutsche Bundesbank, Frankfurt/Main.
	Ministerialrat Borgböhmer, Bundesministerium der Finanzen, Bonn.
	Ministerialrat G. Wetzler, Bundesministerium der Finanzen, Bonn (until 30 March 1973).
	Regierungsdirektor D. Thorand, Bundesministerium der Finanzen, Bonn (from 1 April 1973).
BELGIUM	M. D'Haeze, directeur général de l'administration de la trésorerie et de la dette publique, Brussels (until 15 May 1973).
	F. Junius, Banque nationale de Belgique, Brussels.

BELGIUM *(cont'd)*	E. Kestens. Inspecteur général au ministère des finances, Brussels. M. Esselens, Inspecteur général à l'administration de la trésorerie, Brussels (from 15 May 1973).
DENMARK	J. Kjaer, Kontorchef, Danmarks Nationalbank, Copenhagen. H. Olsen, Fuldægtig, Handelsministeriet, Copenhagen.
FRANCE	Y. Berger, conseiller auprès du gouverneur de la Banque de France, Paris. J. M. Block-Lainé, Sous-directeur des affaires multilatérales à la direction du trésor, ministère de l'économie et des finances, Paris (from 1 November 1973). Ph. Cosserat, Direction du trésor, ministère de l'économie et des finances, Paris (until 31 August 1973). J. de La motte de Broöns, Direction du trésor, ministère de l'économie et des finances, Paris (from 1 September 1973). P. de Larosière, Sous-directeur des affaires internationales à la direction du trésor, ministère de l'économie et des finances, Paris (until 31 October 1973). Mrs. L. Beauvais, Banque de France, Paris.
IRELAND	C. O'Carra, Department of Finance, Dublin. M. Coffey, Central Bank of Ireland, Dublin.
ITALY	Dott. B. Bianchi, Servizio studi, Banca d'Italia, Rome. Dott. G. Monterastelli, Condirettore centrale, Banca d'Italia, Rome. Dott. M. Napolitano, Ispettore generale, direzione generale del Tesoro, Ministero del Tesoro, Rome (until 31 March 1973). Dott. V. Platino, Ispettore capo del Tesoro, direzione generale del Tesoro, Ministero del Tesoro, Rome (from 1 April 1973).
LUXEMBOURG	A. Dondelinger, Commissaire au contrôle des banques, Luxembourg. E. Israel, Directeur à la Banque internationale, Luxembourg. Mrs. P. Weides, Conseiller adjoint au Commissariat au contrôle des banques, Luxembourg.
NETHERLANDS	Drs. M. M. Keyzer, Nederlandsche Bank N.V., Amsterdam. Drs. P. C. Timmerman, Onderdirecteur van de Nederlandsche Bank N.V., Amsterdam. Drs. J. Grooters, Directeur binnenlands geldwezen, Ministerie van Financiën, The Hague.
UNITED KINGDOM	Miss J. Kelley, Treasury Chambers, London. D. A. C. Nendick, Cashiers Department, Bank of England, London.
COMMISSION OF THE EUROPEAN COMMUNITIES	F. Boyer de la Giroday, Director for Monetary Matters in the Directorate General for Economic and Financial Affairs of the Commission of the European Communities, Brussels (until 30 June 1973). J. E. Nash, Director for Monetary Matters in the Directorate General for Economic and Financial Affairs of the Commission of the European Communities, Brussels (from 1 July 1973). M. Sarmet, Head of Division, Directorate General for Economic and Financial Affairs, Commission of the European Communities, Brussels (until 30 June 1973). A. Kees, Head of Division, Directorate General for Economic and Financial Affairs, Commission of the European Communities, Brussels (from 1 July 1973). M. Zucker, Directorate General for Economic and Financial Affairs, Commission of the European Communities, Brussels.
SECRETARIAT	G. Morelli, Secretary of the Monetary Committee, Brussels. G. Lermen, Brussels.