MONETARY COMMITTEE

OF THE EUROPEAN COMMUNITIES

TWENTY-FIFTH REPORT ON THE ACTIVITIES

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I. Introduction

1. The world economic scene brightened up during 1983 and the major industrial economies returned to a path of real growth. Economic activity in the United States recovered first and grew strongly. In Europe too, expansionary forces gradually gained strength although with differentiation among countries.

2. The slightly faster pace of activity in Europe was spurred principally by the improvement achieved in the underlying domestic conditions for growth in certain countries. It was also supported to some extent by the expansion in the United States. However, for the EEC as a whole during 1983, the recovery remained well below that in the US and did not halt the further rise in unemployment.

3. For the Community as a whole in 1983, GDP grew by about 1.0% in real terms. This growth performance and the divergences within the Community reflected the staggered introduction of adjustment policies. The Member States whose corrective policies were most advanced registered the first signs of economic recovery. The main external factor influencing the Community's performance was the improvement in world trade, to which the US made a substantial contribution.

4. The Community was confronted during the whole of 1983 with difficult external and internal problems. World-wide interest rates began to rise again from their already very high levels and presented a grave danger for the development of balanced and sustainable growth. Although they did not prevent the revival of economic activity, they constituted a serious burden and a risk for the continuation of the recovery. Internally the Community countries strove to improve their fiscal performance in order to strengthen the groundwork for lasting economic growth.

5. Within the Community and especially among EMS countries, the orientations, particularly of monetary policy, in Member States became increasingly convergent; in most Community countries, measures were pursued to correct the imbalances on the external account, budget positions and inflation. Among the most encouraging developments in 1983 was the continuing fall in inflation. Every EMS country with an external deficit had an improvement in its current account during 1983 and, for most, the improvement was substantial. The aggregate budget deficit for the Community as a whole fell slightly as a percentage of GDP in 1983 as some Member States made important progress in consolidating their public finances.

6. Monetary policy in several Community countries was easier than in 1982 and was also easier — especially in the first half of 1983 — than originally expected. This development was associated with improving performance of fundamental economic variables. However, in a number of countries the continued heavy recourse to foreign borrowing to cover internal and external disequilibria, the high level of domestic credit expansion and, in certain countries notably credit to the public sector, or the risk of overshooting the quantitative monetary objectives, remained a factor of concern. In the second half of 1983 monetary expansion decelerated so that for the year as a whole most countries met, or only slightly exceeded, their targets.

7. As a whole 1983 saw a strengthening of the EMS, although the exchange rate mechanism again underwent severe temporary strains. Indeed the economic adjustment policies applied up until then proved to be insufficient to achieve lasting convergence in the economic fundamentals of the EMS countries. This led to the general realignment of 21 March 1983, resulting in a shift between the extreme currencies of about 9%, compared with about 10% in June 1982. The realignment was accompanied by additional stabilization measures: in particular the French Government reinforced its adjustment package so as to consolidate the new EMS parities. The resulting convergence in policy orientations in a more favourable external environment progressively strengthened the EMS during the remainder of the year. In general, the EMS has continued to contribute to intra-European exchange rate stability during a period of international monetary turbulence and to more equilibrated balance of payments situations.

II. Community actions and the activities of the Committee

8. Against this general economic and monetary background and with a view to achieving more monetary stability through the smooth functioning of the EMS and through other forms of international cooperation, the Committee organized its work around the following main themes: the monitoring of general economic developments and the examination of monetary and financial policies in the Community with a view to encouraging further convergence of economic performances; the analysis of the international monetary environment and of the effects of the economic policies implemented by the Community's main partners, especially in the area of exchange rates; common Community positions with regard to the activities of international organizations.

9. The Committee's work concentrated as a matter of priority on the economic and monetary trends and policies both in the individual Member States and at Community level. In early 1983 severe tensions arose within the EMS exchange rate mechanism, due to the continued large differences in cost and price developments, which were reflected in heavy pressures on weaker currencies, especially the French franc, calling temporarily for massive intervention. After strenuous negotiations a general realignment took place on 21 March 1983. The realignment of the French franc was accompanied by a programme of internal economic adjustment designed by the

French Government to correct the current account of the balance of payments and reduce inflation, so as to break out of the vicious circle of devaluation and inflation. The programme adopted by the French authorities was also in the interest of the Community since it strengthened the cohesion of the EMS and accorded with the view, strongly held by the Monetary Committee, that it is in principle desirable that new EMS parities be supported by internal adjustment measures towards monetary stability; indeed such practice has become more frequent in the recent past. On 16 May 1983 the Community granted France a loan of 4 000 million ECU as support towards correcting its balance of payments difficulties. These adjustment measures and those taken by other Community member countries helped the balance of payments and other economic fundamentals during 1983 to become basically more favourable for an extended period of exchange rate stability within the EMS.

10. An important task of the Committee every year consists in examining the economic and financial situations in the Member States. This allows members to take into account each other's economic and monetary experience and thus indirectly influence policy decisions in the individual member countries. The Committee's work in these areas contributes to the coherence of economic and monetary policies and hence to the convergence towards monetary stability in Europe. The object of these examinations is to identify both potential economic or monetary problems in order to discuss possible remedies.

11. As usual, the Committee held an *ex-ante* exchange of views towards the end of the year on the targets which the monetary authorities of the Member States adopt and it followed closely the actual development of monetary aggregates. Monetary policy continued to be a key element in the policy mix of the Member States' economic policies. There was some easing of monetary conditions in the majority of EEC countries in the early part of 1983 when monetary and credit growth was rapid and sometimes volatile. During the second half of the year, however, there was a slight firming of monetary policy, though this only partly compensated for the evolutions earlier in the year. The developments in the first part of 1983 can be traced essentially to domestic factors, although speculative capital movements before and after the EMS realignment in March contributed to the uneven and volatile growth profile of the monetary variables. By mid-year there was a progressive deceleration in monetary expansion in most EEC countries, strengthened by action from monetary authorities, so that the money supply or credit targets set in the large EC countries for 1983 were attained or slightly overshot.

12. The country examinations and the discussions on member countries' monetary policies are important catalysts for coordination within the EMS. In such a way a consensus forms on the diagnosis of the problems and on the general direction of economic and monetary policy required. The points of reference for the orientation of national monetary policies are the developments in the counterparts of the money supply in member countries. A schematic view of the circumstances in 1983 brought out two aspects of particular interest to the Committee:

(i) In countries with large deficits in the balance of payments on current account, it is not enough to ensure that the rate of monetary expansion is apparently consistent with the guidelines; the expansion of domestic credit and the external counterpart of monetary creation must also be closely monitored. A strong expansion of domestic credit reinforcing the trade deficit and supporting outflows of capital is incompatible with a balanced development of the economy.

(ii) In countries where public sector borrowing is the main source of monetary creation, the achievement of monetary expansion consistent with stability represents a very difficult problem: the choice is between, on the one hand, reducing credit to the private sector substantially and, on the other, accepting excessive domestic credit expansion while continuing to tolerate the destruction of liquidity by external transactions; indeed, both alternatives may be adopted simultaneously. More intensive recourse to non-monetary financing for the public sector is a first step towards putting things right; by putting upward pressure on long-term interest rates this course reveals clearly the fact that the financial demands of the public and private sectors are in competition for the limited supply of savings. In the final analysis, the only solution will be to reduce the public deficit.

13. The Community's aggregate current account improved further in 1983. This was due mainly to the success of some EEC deficit countries in reducing external imbalances under the impact of improved competitiveness and lower domestic demand resulting from the adjustment measures taken. Accordingly, there was a welcome convergence in developments on Member States' current accounts, also reflecting, in part, changes in countries' cyclical positions. In 1983 organized borrowing abroad by EEC deficit countries was smaller in volume than in 1982, although sometimes remaining heavy and well in excess of current account deficits.

14. In view of the unstable and unbalanced world-wide pattern of exchange rates experienced in 1983, the Committee devoted considerable attention to analysing the reasons for these developments and their consequences for the Community, in particular with respect to the US dollar, whose rise was viewed with concern. Exchange rates which do not reflect fundamental economic factors will have a negative effect on the production and allocation of resources and on trade flows and will also increase the danger of protectionism. Moreover, balanced economic policies geared towards a non-inflationary and lasting growth lead to benefits both domestically and for the rest of the world. This is especially relevant for the US authorities, the impact of whose policies is of such dominating importance for the monetary and economic situation of other countries, in particular those countries which are heavily in debt. The Committee was particularly worried by the continued high US budget deficit and the prospect that it will continue to go uncorrected despite widespread agreement, even in the United States, on the necessity for a substantial reduction in the deficit.

15. In accordance with its general responsibilities, the Monetary Committee continued its task of coordinating the policies of Member States in the field of international monetary relations. It examined in 1983 in particular the monetary and financial questions raised during the preparation of Unctad VI and, in this context, emphasized the important role of the Bretton Woods institutions, the IMF and the World Bank, without which the international monetary problems cannot be solved. As to the general problem of indebtedness, a long-term remedy to excessive indebtedness can only be found by applying sound domestic policies notably under the auspices of the IMF and by creating the conditions for a stable world-wide recovery. In particular there is no ground for revising the principle of case-by-case treatment of debt difficulties, for example within the Paris Club, whose effectiveness has been widely demonstrated.

16. As in past years the Committee contributed to the formation of common Community positions for the spring and autumn meetings of the Interim Committee of the (IMF) and for the annual meetings of the Fund and the World Bank. In preparing the statements to be made at these meetings on behalf of the Community, the Monetary Committee stressed that the viability of the world financial system is linked to the freedom of world trade. The Community remains firmly committed to an open multilateral trading system, and despite the present international difficulties it will continue to pursue a trade policy that ensures the openness of its markets.

17. The IMF has an important role to play in strengthening efforts to ensure a world recovery and a return to economic stability through surveillance of exchange rate policies and as a source of temporary financing. This temporary financing should aim to promote adjustment and serve as a catalyst for complementary financial flows from other official and private sources. The Committee reaffirmed that the Fund's primary source of financing should continue to be quota subscriptions, and that the revolving character of its balance of payments support should be preserved.

18. The Committee welcomed the solutions and the generally satisfactory compromises found in 1983 for many of the problems concerning the activities and financing of the Fund, in particular concerning the eighth review of quotas and the GAB. The solution to the Fund's financing problems by means of new credit lines arranged mainly under the aegis of the BIS found support. In this context Saudi Arabia's contribution was welcomed. At the same time it was regretted that not all industrial countries considered it possible to take part in the joint effort.

19. The Committee stressed the importance of an adequate transfer of resources to less developed countries and in this context it is important that the International Development Association be provided with a sufficient level of funding in order to enable the Association satisfactorily to continue its action in support of the poorest countries. The efforts made by the management of the IDA to mobilize additional resources were followed with special interest.

20. Finally by the end of 1983 it was noticeable that remarkable and effective adjustment measures were being taken in many developing countries in conjunction with the Fund. Continued support from the international community, including the

Fund and the World Bank, is needed to ensure that these countries will be able to adjust in a way enabling them to regain the momentum of growth and development. Support is critical, in particular for those least developed countries which have limited production potential and few basic resources.

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M.F. Doyle (since 16. 12. 1983)	Secretary, Department of Finance (Dublin)
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European Communities — Washington, 10 February 1983

Statement by Mr G. Stoltenberg, President of the Council of the European Communities, to the IMF Interim Committee meeting

1. Since the Federal Republic of Germany is at present exercising the Presidency of the Council of the European Communities, I have the honour of presenting to you the Community's views on the economic outlook and on Fund issues.

2. The global economic picture is becoming more differentiated. The current setting remains critical and unemployment has reached intolerable levels. Nevertheless the underlying conditions have improved in some important respects and, with appropriate policies, there is a reasonable hope that, during the year, business activity will gradually improve, and that, over the medium term, a more satisfactory, sustainable rate of growth may be resumed.

3. The economic climate is still one of widespread uncertainty. Uncertainty has been created by repeatedly disappointed hopes for economic revival, by the tremors in the international financial system, by pressures for protectionism and by the behaviour of exchange and interest rates. The rigours of economic adjustment are straining the social and political fabric of societies. Particular hardship is involved for the developing countries which are beset with the multiple problems arising from weak demand for their exports, deterioration of their terms of trade and increased financial strain.

4. However, in some fields, considerable adjustment has taken place and further improvement is under way. Inflation, in a number of industrial countries, has markedly declined. Along with strengthening price performance, interest rates, though still very high in some instances, especially in real terms, have come down. Energy constraints have eased. At great sacrifice and in spite of the difficult international environment, substantial internal and external adjustment has also been achieved by developing countries.

5. Although the world debt problem remains a cause of real concern, the immediate, acute tensions have been reduced. An effective cooperation of governments, central banks and international financial institutions has contained the damage to the international financial system and the countries involved. And, with the assistance of the Fund, progress towards more lasting solutions has been initiated. This cooperation should be continued.

6. Economic recovery would go a long way towards easing present financial strains. An important prerequisite for sustained growth, however, is greater market confidence. To strengthen confidence and to improve expectations should be a key objective of policies. This hinges on appropriate policies in the fiscal, monetary and other fields, formulated in a medium-term perspective. It implies having regard to the international side-effects of domestic policy actions. And it requires persisting efforts to:

(i) improve conditions for productive investment and employment;
(ii) achieve lower interest rates;
(iii) reduce structural budget deficits while tolerating, as far as possible, deficits of a cyclical nature;
(iv) promote structural adjustment, domestically and externally; and
(v) secure orderly conditions in the exchange markets.

As the underlying circumstances improve, each country should fully utilize any additional scope to strengthen recovery in a non-inflationary way and to promote employment.

In order to enhance the prospects of success of these efforts, there must be reinforced cooperation among industrial countries on economic and financial policies.

7. The viability of the financial system is linked to the freedom of world trade. The harm that a relapse into defensive trade policies would do cannot be overstated. At its meeting in November 1982, the Council of the European Communities reaffirmed the Communities' determination to continue to combat protectionist tendencies in all their forms, including use of competitive devaluations.

8. The stability of the world economy continues to require an active role of the Fund as a promoter of adjustment, a source of temporary financing and a catalyst of complementary financial flows from other official and private sources. A substantial increase in the resources of the Fund is needed.

However, under any assumption, the Fund itself can provide only a part of the needed financing. Orderly adjustment requires that commercial banks, in the aggregate, maintain and even increase their exposure to countries willing to adjust. To encourage adequate financial flows from private sources, it is essential that private lenders can continue to rely on the capacity of the Fund to promote the required adjustment policies. In this connection, the Community welcomes the efforts made by the Managing Director to develop contact with leading commercial banks. With the necessary care and discretion, which he has shown, such contact provides an opportunity for valuable cooperation as a basis for all concerned to play an appropriate part.

9. Even with firm adjustment policies, many developing countries will continue to have only limited access to private sources of finance. This underlines the need for continuing and substantial official aid flows, particularly to the least developed countries.

10. The Community recognizes that quotas must remain the principal source of finance available to the Fund. Regarding the future size of quotas, it favours a substantial increase and considers an increase of at least 50% as appropriate.

11. The Community confirms its view that the overall increase should be structured so as to bring the quotas of individual members more into line with their relative positions in the world economy. On this issue, discussions in the executive board have brought about a convergence of views and the conditions are present for reaching an agreement.

The Community is of the view that the quota structure should be adjusted on the basis of a uniform method for all members. Moreover, a meaningful degree of adjustment should be achieved. This would enhance the liquidity of the Fund by tending to increase the amount of usable resources available to it. The Community's preference is for a major part of the overall increase to be distributed on the basis of members' shares in calculated quotas. The Community agrees that the remainder of the increase should be distributed equiproportionally, i.e. according to shares in actual quotas.

12. Regarding the mode of payment for the quota increase, 25% of the increase should be paid, at the option of members, in SDR or in currencies specified by the Fund.

As to the question whether a resumption of SDR allocations is justified, it is important, under present world economic and monetary conditions, that this issue should be kept under review in the Fund in the light of all relevant aspects.

13. Determined efforts should be made to advance the implementation date of the quota increase. The new quotas should become effective by the end of 1983. Thus, the increase in the financial leverage of the Fund would enter into force about two years earlier than originally envisaged. This would be a significant gain in the present period of increased demand for Fund lending.

14. The Community supports the proposal submitted by the Group of Ten and Switzerland for a substantial enlargement of the GAB and it looks forward to this enlargement being supplemented by the resources that other countries may be willing to provide. It welcomes the fact that the proposed amendment of the GAB also provides for activation of GAB resources for the benefit of non-participants. The enlarged and revised GAB will contribute to greater confidence and should enable the Fund to meet legitimate requests for its financing even in the case of an exceptional situation in the international monetary system. It is desirable that the revised GAB, like the increase in quotas, comes into effect as soon as possible.

European Communities — Washington, 27 September 1983

Statement by Mr Gerasimos Arsenis, President of the Council of the European Communities to the IMF-IBRD annual meeting

I have the honour of addressing these meetings on behalf of the Member States of the European Communities.

Recent Developments

Since last September the world economic environment has become more differentiated. On the one hand, evidence of an economic upturn has grown consistently firmer over the last months in some industrial countries, especially in the United States, where recovery seems to be quite significant, and there are also prospects for a further abatement of inflationary pressures. The emerging recovery should help slow, if not reverse, the rise in unemployment, which has reached tragically high levels in many countries. On the other hand, high interest rates are hampering the investment necessary for a sustainable recovery. True, nominal interest rates have declined considerably from their peaks of 1982, but real interest rates remain high by historical standards.

As far as the Community is concerned, recovery is expected to be rather modest, although the prospects are very different from one Member State to another.

At the same time developing countries exhibit an unsatisfactory growth record, which is attributable to adverse external developments as well as to domestic factors. The Community is also concerned with the severe impact of these external developments on the payments situation of many developing countries, in particular, the effects of the past sharp deterioration in their terms of trade.

External indebtedness has continued to grow in a number of countries while debt servicing problems have been accentuated. This has been accompanied by a substantial slowdown in the growth of commercial bank lending to certain developing countries. Most of these countries have now recognized that adjustment of their own policies and performance is essential. We welcome the initiatives taken by the International Monetary Fund in providing and helping to mobilize support for these countries, conditional on effective measures of adjustment, and the efforts made by all parties concerned in bringing constructive solutions to individual cases of debt problems. We are also conscious that an orderly solution of debt problems will be greatly helped by an improving world economic environment.

This difficult situation, in both industrial and less developed countries, is further complicated by uncertainties over the future course of world interest rates, and by uncertainties linked to the volatility of the dollar, the recent rise of which has adversely affected the terms of trade of many countries. These developments are heavily influenced by financial policies in the United States.

All these difficulties may threaten the sustainability of the present recovery as well as its capacity to spread its benefits world-wide. The Community is endeavouring, in this context, to pursue policies designed to consolidate its incipient recovery.

Interdependence and economic policies

The various manifestations of the present difficulties have once again brought to our attention the growing interdependence of our economies and thus the international dimension of national policies.

We are all aware of the fact that the restoration of sustained and non-inflationary growth in the industrial countries is essential to complement and enhance the adjustment efforts of debtor countries. At the same time we cannot underrate the fact that debt servicing problems cause severe strains in the international financial system and that orderly solutions to these problems, and renewed growth in developing countries, will in turn strengthen the recovery in the industrial world.

It has been part of the European Community strategy to bring these issues to the attention of the world community and to underline the responsibility we all share in selecting our policies. In a period of increased uncertainty, the need for a coherent and harmonized approach to international economic policy is greater than ever.

Accordingly, we welcome the declaration by the Heads of State at the Williamsburg Summit, and in particular the recognition that the principal industrial countries must act together to pursue a balanced set of monetary and budgetary policies in order that the recovery may spread throughout the globe. Where the underlying circumstances have improved, a priority aim of policy should be to strengthen recovery in a non-inflationary way and to promote employment.

The cornerstones of international cooperation are effective policy coordination among industrial countries and adherence to our international commitments.

In designing our policies we should take a more global point of view by recognizing the greater interdependence among all economies: in particular, due consideration should be given to international repercussions of domestic economic policies. In the monetary field, the European Monetary System (EMS) has already demonstrated the potential benefits of such concerted efforts. It has encouraged more convergence in EEC member countries' economic policies and in the implementation of orderly adjustments. The introduction of the System has thus brought more monetary stability, and we hope that this stabilizing influence will spread to the exchange rates of other currencies that have close ties to EMS participants. The EEC Member States will, of course, play their full role in any discussions that may take place for the improvement of the international monetary system more generally.

Coordinated policies should strive to:

(i) attain a more appropriate fiscal-monetary policy mix so as to counter inflation and permit a reduction in both nominal and real interest rates;
(ii) secure orderly conditions in exchange markets through the adoption of compatible economic policies, especially by key currency countries;
(iii) increase productive investment and to adopt positive adjustment policies that will foster the current recovery;
(iv) reverse protectionist trends, to relax restrictions, and to create conditions for the enhancement of world trade. In particular, it is necessary for developed countries to improve market access to the exports of developing countries. It is also necessary for the latter group to liberalize their own foreign trade as much as possible;
(v) strengthen the ability of multilateral financial institutions to assist member countries; and
(vi) secure continuing and substantial official aid as well as other financial flows to developing countries and the LLDCs (least developed countries) in particular.

The Community remains firmly committed to an open multilateral trading system, and despite the present international difficulties it will continue to pursue a trade policy that ensures the openness of its markets.

International Monetary Fund — Related issues

The IMF has an important role to play in strengthening our efforts to ensure a world recovery and a return to economic stability through surveillance of exchange rate policies and as a source of temporary financing. This temporary financing should aim to promote adjustment and serve as a catalyst of complementary financial flows from other official and private sources.

In spite of the increased efforts toward adjustment, the balance of payments deficits of many countries remain substantial while the means of financing them have contracted, essentially owing to the reduction in commercial bank lending, particularly to the developing countries. Thus, many of these countries have been confronted with liquidity strains and this has been reflected in the decline in world liquidity.

The demand for Fund credits has increased sharply while the liquidity of the Fund has deteriorated. We in the Community recognize the importance of the Fund being adequately provided with resources at this time of unusual strains in the world economy. The forthcoming quota increase and the enlargement of the General Arrangements to Borrow (GAB) will constitute a timely and needed strengthening of the resources available to the Fund. The Community Member States are taking all necessary steps to ensure that the revised GAB and the quota increase will come into effect in any event before the end of 1983, and we hope that other countries will do the same. We feel that the Fund should remain primarily quota-based, and that its revolving character should be preserved.

We are convinced that the successful implementation of Fund-supported adjustment programmes by countries that have been confronted with major disequilibria will progressively lead to a better balance of payments situation and smooth out the demand for Fund lending. Still, over the next years, there will clearly be a need to keep the adequacy of the Fund liquidity and the scale of Fund lending under close review. The Community urges all countries to assume their full responsibility in this context.

The countries of the Community contributed actively to the discussions which led to the conclusions of the Interim Committee regarding the continuation of the policy of enlarged access. Although current account imbalances have declined, the world payments situation still makes it appropriate to continue enlarged access for a further period. The conclusions reached take into account the liquidity position of the Fund. They also take into account the borrowing requirements of members and allow increased access depending on the seriousness of their balance of payments needs and on the strength of their adjustment effort.

Conditionality should continue to place adequate emphasis on the improvement of supply conditions and the strengthening of the productive base. The Fund should continue to take into account the economic and social priorities of the countries concerned. The Community endorses the current practice of the Fund as far as conditionality is concerned.

The Community will formulate its position on the advisability of an SDR allocation in the light of the present circumstances and of all relevant provisions of the Fund's Articles of Agreement. We are of the opinion that this is a matter of high priority.

The Community welcomes the steps taken by the Fund to strengthen its surveillance over members' exchange rate policies. It underlines the importance that it attaches to an active exercise of the surveillance function in order to promote sound and internationally compatible policies by member countries.

World Bank

The Community favours the World Bank's continuing to engage actively in cofinancing with public and private institutions and to cooperate with the IMF, *inter alia,* in its structural adjustment programmes. The Community welcomes the Special Assistance Programme agreed by the World Bank in February 1983, and notes the intention of the Bank management to propose expansion of the Bank's programme beginning in 1985.

Member States of the Community have shown their support for the International Development Association by supplementing its resources in the past, and favour an adequate level of Seventh Replenishment to enable the Association satisfactorily to continue its action in support of the poorest countries. The Community therefore urges governments to make every effort to ensure that the IDA replenishment becomes effective by 1 July 1984.

Monetary Committee of the European Communities

Twenty-fifth report on the activities

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The 25th report on the activities of the Monetary Committee gives an account of the chief areas of the Committee's work in 1983.