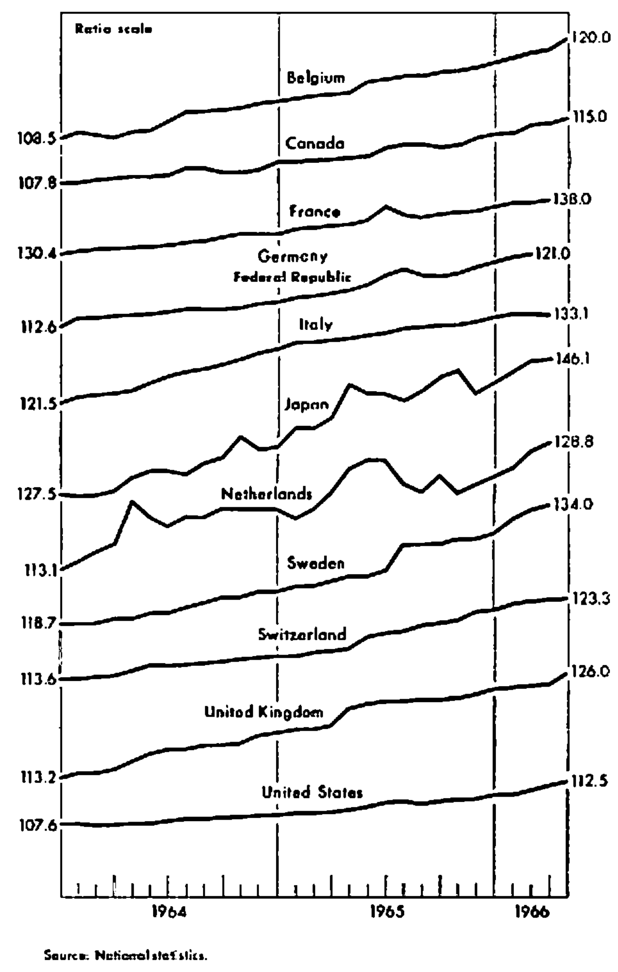
Recent Economic Policy Measures In Industrial Countries Abroad

Most of the major industrial countries abroad maintained or tightened restrictive policies during the November 1965-May 1966 period, either in response to mounting inflationary pressures or to unsatisfactory balance-of-payments positions.[1] The United Kingdom has introduced additional measures to reduce aggregate demand as wage pressures and the external deficit have yielded more slowly than anticipated to earlier restraints. At the same time, the authorities have taken a number of steps designed to effect longer term structural improvements in the British economy. Concern with price increases (see Chart I) has led Canada and Belgium to adopt monetary restraints in an effort to curb excess demand. The Canadian authorities have supplemented monetary restrictions with tax increases and reduced public expenditures, while the Belgians have exercised price controls. The Netherlands too has imposed monetary and fiscal restraints, but its actions were in part prompted by a deterioration in its external trade balance. Germany has tightened its monetary policy to limit wage and price increases even though industrial production has leveled off (see Chart II). While economic policy in Switzerland and Sweden has not changed markedly, the authorities have generally maintained an attitude of restraint in both countries. In contrast, France, Italy, and Japan, which all have strong payments positions and some margin of unused capacity, continued to pursue expansionary policies.

UNITED KINGDOM

The United Kingdom made substantial progress during 1965 in overcoming the difficulties that had produced a series of speculative assaults on sterling between November 1964 and September 1965. Most notably, the balance-of-payments deficit was reduced by more than one half:

Chart I
CONSUMER PRICES IN MAJOR COUNTRIES
1957-59=100



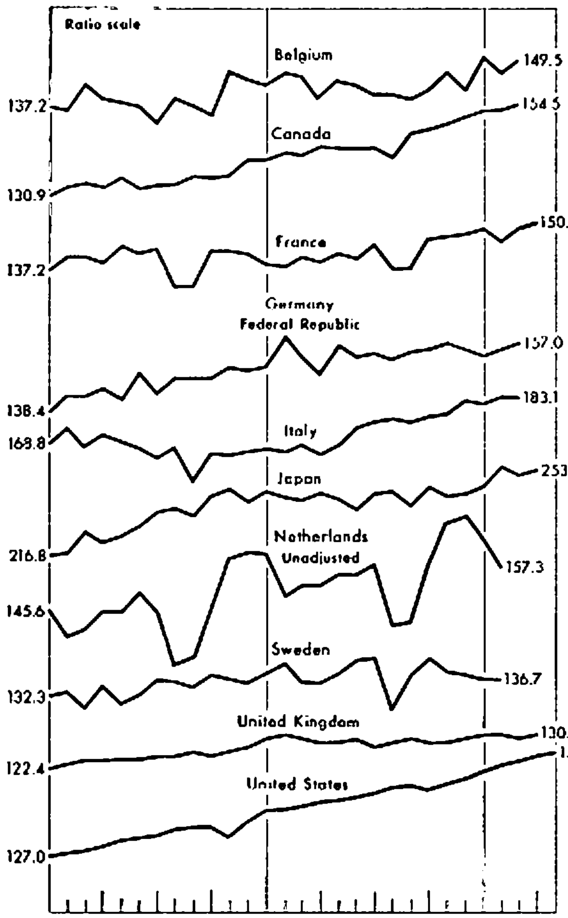
Source: National statistics.

[1] For a discussion of foreign economic policy measures earlier in 1965 and late in 1964, see "Recent Monetary and Financial Policies Abroad", this *Review* (November 1965), pages 239-45 and "Recent Economic Policy Measures in Industrial Countries Abroad", this *Review* (April 1965), pages 74-78.

Chart II

INDUSTRIAL PRODUCTION IN MAJOR COUNTRIES

Seasonally adjusted; 1957-59=100



Sources: National statistics; Organization for Economic Cooperation and Development, monthly statistical bulletins.

exports rose nearly 7 per cent, the growth of imports was held to less than 1 per cent, and the long-term capital outflow was reduced substantially. While real national output increased only 2 per cent last year, gross fixed investment (at constant prices) grew more than 3.5 per cent, and the growth of real consumption was held to 1.5 per cent. Nevertheless, retail prices rose by 4.5 per cent during 1965, and wholesale prices of manufactured goods increased by 3.9 per cent.

During the first four months of 1966, both exports and imports were up 5 per cent at seasonally adjusted annual rates. The current seamen's strike can hardly help Britain's external trading position. Domestically, industrial production does not seem to have risen above the December 1965 level so far this year, and yet the labor shortage has not eased significantly. Indeed, the number of unemployed hit a ten-year low in March, and during 1966 hourly wages have been increasing at a rate in excess of the 6.8 per cent rise in 1965.

Thus in the months from November through May, the British authorities have had to combine measures aimed at promptly curbing demand pressures and improving the balance of payments with policies designed for a longer term recovery. Their basic approach—reflected in a program of investment incentives, the government's incomes policy, and the recent budget—is to bring about a structural shift in the economy that will speed the growth of productivity while holding down prices and wages and avoiding large-scale unemployment. In this way the authorities hope to bolster the pound, strengthen Britain's international competitive position, and enhance the possibility of uninterrupted economic growth.

To provide short-term assistance to the balance of payments, the government in November 1965 requested (and subsequently obtained) Parliamentary authorization to retain the 10 per cent import surcharge until November 1966. In his recent budget message, the Chancellor of the Exchequer announced that the surcharge will be abolished when this authorization expires in November. On the export side, the authorities have moved to stimulate sales abroad by liberalizing the terms of export credit guarantees. In March of this year, the minimum size limitation was abolished for government guarantees on export credits of two years and longer. Moreover, negotiations with the banks led to the implementation of an arrangement under which thirty-day to two-year export financing will receive an unconditional guarantee at a reduced rate of interest.

To aid Britain's capital-account position, a voluntary program to curb long-term capital outflows to Australia, New Zealand, South Africa, and Ireland was also introduced with the budget. This measure will be administered by the Bank of England. Under it, British residents are requested to refrain from investing in these four countries unless the capital expenditure will be returned within two or three years or unless the outlay can be financed from funds obtained abroad.

In order further to assist the balance of payments by retarding the advance of prices and costs, the Bank of England has continued to limit the growth of credit, and the government intends to present a bill in Parliament establishing a statutory basis for the incomes policy. Although the discount rate remained unchanged at 6 per cent throughout the period under consideration (see accompanying table), on February 1 the Governor of the Bank

CHANGES IN SELECTED FOREIGN CENTRAL BANK DISCOUNT RATES, 1965-66

In per cent

Country	Date	New rate	Change
Belgium	1966: June 2	5¼	+½
Canada	1965: December 6	4¾	+½
	1966: March 14	5¼	+½
France	1965: April 8	3½	−½
Germany	1965: January 22	3½	+½
	August 13	4	+½
	1966: May 27	5	+1
Japan	1965: January 9	6.205	−0.365
	April 3	5.84	−0.365
	June 26	5.475	−0.365
Netherlands	1966: May 2	5	+½
South Africa	1965: March 5	5	+½
Sweden	1965: April 9	5½	+½
United Kingdom	1965: June 3	6	−1

of England requested that the banks and other financial institutions extend no additional credit once the existing allowance—a 5 per cent expansion over the level outstanding in mid-March 1965—had been utilized. With most institutions at or near their credit ceilings by April 1966, there is virtually no room for further credit expansion. Also during February, the terms of instalment credit purchases were tightened to reinforce the restrictions imposed in June and July of last year.

Under the government's bill establishing a statutory basis for its incomes policy, the National Board for Prices and Incomes would gain authority to collect evidence on expected price and wage increases. The bill would also enable the authorities to delay such increases for up to four months, but not to prohibit them. A provision is included that would compel employers and unions to notify the Board of wage claims and settlements and of proposed price increases. Notification is now voluntary, and this section would be implemented, at the government's discretion, only if the voluntary arrangements were found unsatisfactory.

In a special effort to raise the long-run productivity of industries believed likely to produce exports or import substitutes, the government announced in January a revision and expansion of its investment incentives; in May it bolstered this move by introducing a bill for the creation of an Industrial Reorganization Corporation (IRC). The new incentives replace special depreciation allowances with cash grants in "development areas", where labor and other resources are available, and in the manufacturing and mining industries. Firms not eligible for the new incentives, such as those in the service and construction industries, will continue to qualify for benefits under the former program. With funds obtained from the Exchequer, the IRC will purchase an interest in and combine firms too small to compete successfully in international markets; its interest in these firms will be sold when the continuation of profits is assured and their international competitive ability is established.

Although consistent with the Labor government's previous policies, the budget presented in May for fiscal 1966-67 constitutes a novel departure in British fiscal planning. The outstanding feature is a Selective Employment Tax (SET), designed both to achieve a short-run reduction in domestic purchasing power and in the long run to encourage the transfer of labor from the service and construction industries into manufacturing. This measure will not substantially alter the costs of manufacturers, but employers in most other private industries will be taxed for each individual on their payrolls. The SET, like the investment incentive program described above, favors manufacturing in order to encourage production of exports and import substitutes.

While the SET will contribute to the anticipated $3 billion expansion in the central government's revenues, current spending is scheduled to rise by about $2 billion, with the largest increases representing social service expenditures and grants to nationalized industries. At the same time, government lending for capital expenditures will expand by about $200 million. The net outcome of all changes in revenues and expenditures is expected to reduce the government's budget deficit to $804 million, or half the deficit in the last fiscal year.

As for the United Kingdom's external obligations, the government recently confirmed its intention to pay the first $1 billion instalment on Britain's debt to the International Monetary Fund when due in November 1967 rather than attempt to refinance or reschedule this payment; moreover, repayments may be initiated ahead of schedule.

OTHER COUNTRIES INTENSIFYING RESTRAINTS

Rising inflationary pressures have prompted Canadian efforts to restrain demand. The discount rate has been raised twice during the period under review, on December 6 and on March 14. The first increase, from 4¼ per cent to 4¾ per cent, followed a ½ per cent rise in the Federal Reserve discount rate, but the Canadian decision was also a response to changing credit conditions and market yields in that country. The second increase lifted the rate to 5¼ per cent and primarily reflected the view of the authorities that some moderation of the growth of aggregate demand was desirable.

Canada's monetary restraint has been reinforced by fiscal measures to restrain both private and public spending. In addition to a cut in public construction projects, government revenues will be supplemented by the withdrawal of most of last year's 10 per cent personal income tax reduction and by a sharp cut in depreciation allowances for various types of capital goods purchased during the next eighteen months. Two further measures have been introduced to encourage the temporary deferral of private investment expenditures. First, the sales tax on production machinery and equipment will be reduced in April 1967 and then abolished a year later. Secondly, under an interesting fiscal innovation, a refundable 5 per cent levy is to be placed on retained corporate profits and depreciation allowances. The amounts collected under this measure will earn interest at 5 per cent and will be refunded at the government's initiative after eighteen to thirty-six months, depending upon business conditions.

Belgian industrial production turned upward in the second half of 1965, apparently reversing the downswing that had persisted through the first six months of the year, but unemployment remains a problem in areas affected by coal-mine closings and lagging steel output. In recent months, bank credit has expanded rapidly and the upward movement of prices has accelerated. The planned government budget deficit for 1966 is substantial, although smaller than in 1965. In view of these developments, the National Bank of Belgium reinstituted quantitative limits on bank credit expansion in May; credits to private borrowers are to increase by no more than 12 per cent over the next year. If the rise in the first six months is more than 6 per cent, reserve requirements—removed last July—may be reimposed.[2] The Belgian authorities followed these measures with the imposition of direct price controls. Certain consumer prices will be reduced through negotiations with businessmen and through cuts in domestic taxes (requiring equivalent domestic price reductions). Prices of all goods not included under these arrangements are to be frozen for at least three months. On June 2, the National Bank reinforced these restraints by increasing its discount rate ½ of a percentage point to 5¼ per cent. This move undoubtedly reflected the desire to place an additional limitation on domestic credit expansion, but in view of the short-term capital outflow that occurred in the first quarter of this year, the Belgian decision was in part a response to rising interest rates abroad. The government has indicated that other general measures may be expected: these reportedly include a slowdown of government spending, strict application of the capital gains tax to curb speculation in real estate, and incentives to promote saving.

In the Netherlands, monetary and fiscal policy has been tightened following a deterioration of the external trade balance and continued increases in wages and prices. Although industrial production expanded by 7 per cent in 1965, wages and real consumption increased even more rapidly; the cost of living consequently rose 5 per cent. The impact of these developments on external transactions produced a rise in the seasonally adjusted trade deficit of more than 50 per cent from the first to the second half of 1965, and this trend has apparently continued. The Netherlands Bank has maintained the requirement that banks deposit with the central bank amounts equal to the excess of their loans over the established ceilings. The permissible expansion of bank credit during January through April was the same as that established for the last four months of 1965. To supplement these measures, the discount rate was raised on May 2 from 4½ per cent to 5 per cent. Even more recently the government intensified price and wage restraints: all firms will now be required to report each price increase, the guideline on annual wage raises specifying a 7 per cent maximum will be enforced by invalidating contracts awarding larger increases, a ban on government hiring has been imposed, and all new central government investment projects will be postponed for at least four months.

Continued upward pressure on wages and prices in Germany has induced additional moves toward restraint. A moderate slowdown in the growth of aggregate demand has recently occurred, largely as the result of a reduced rate of industrial investment. Private consumption, on the other hand, has continued its rise and demand for labor has remained high. In a series of three steps between January 7 and March 4 the German Federal Bank raised its selling rates on open market paper by a total of ⅛ of a percentage point for maturities of three months or less and by ¾ of a percentage point for maturities of over three months to two years. To limit credit availability further, commercial bank rediscount quotas with the central bank were reduced by 12½ per cent as of May 1.[3]

[2] Reserve requirements are a comparatively recent innovation in Belgium and were first applied in mid-1964.

[3] This was the second half of the 25 per cent quota reduction originally scheduled for last October but then postponed.

A ceiling was also imposed on rediscounts of certain bank acceptances that had previously been eligible for discounting without limitation. Even more recently, the German central bank on May 27 raised its discount rate from 4 per cent to 5 per cent. At the same time, the official rate for advances on securities was increased by 1¼ percentage points, the selling rates on Treasury bills and stockpile financing paper were raised by 1 percentage point, and selling rates on other open market paper were increased by ½ of a percentage point. In an effort to prevent an excessive rise in already high long-term interest rates, however, which might induce unwanted capital inflows, discussions on the scheduling of loans have continued among all public borrowers. The federal government recently announced its intention not to borrow on the capital market this year, and the state governments and municipalities resolved early in May to float no new issues before June 30. As for wages, an important compromise was reached in February with workers in the metallurgical industry. While providing for wage increases of 6 per cent and 5 per cent in 1966 and 1967, respectively, a reduction in the workweek that had been previously agreed upon was postponed. It is hoped that this settlement will become a model for other industries.

COUNTRIES MAINTAINING RESTRAINTS

The rise in consumer prices in Switzerland accelerated toward the end of 1965, and the growth of industrial output, which slowed early in 1965, had speeded up somewhat by the year-end. Short-term interest rates have been moving upward since early 1965 in response to both domestic demand for funds and higher rates abroad. The Swiss federal budget for this year is expected to show a marginal surplus after a much larger surplus in 1965. In order to keep domestic credit expansion under rein, the Swiss parliament in March renewed for another year the 1964 temporary controls over inflows of foreign capital, securities flotations, and the expansion of bank credit. The permissible increase in bank advances to domestic borrowers during 1966 is equivalent to the total rise allowed last year. Thus most restraints have continued in force. However, because the construction industry is lagging, controls over its activity have been removed.

The government has recently proposed a bill, which will be submitted to parliament later this year, to expand the powers of the Swiss National Bank and, it is hoped, provide a substitute for the temporary controls which are scheduled to expire in 1967. Under this bill the Swiss National Bank would be able to issue its own interest-bearing notes (as the medium for expanded open market operations), to fix minimum reserve requirements for commercial banks, and to establish ceilings for the expansion of bank credit.

Monetary policy in Sweden has remained restrictive during the period under review, mainly as a response to inflationary pressures and an adverse trade balance. Recently, however, industrial production has turned down and unemployment has risen. In addition to maintaining the discount rate at a historically high level, the central bank has requested the banks and insurance companies to observe specified priorities in making new loans. The government budget for the 1966-67 fiscal year, in addition to an increased general turnover tax and a greater capital gains tax on the sale of stocks, includes higher taxes on wines and liquors, gasoline, and automobiles. While some public expenditures will be deferred, other scheduled increases in government spending and higher salaries for public employees are expected to produce a deficit substantially larger than the small deficit anticipated for the current fiscal year.

NATIONS CONTINUING EXPANSIONARY POLICIES

French policy has remained oriented toward economic growth at a measured pace. The industrial expansion has become more firmly established, and the annual increase in consumer prices has remained below 3 per cent. But monthly balance-of-payments surpluses, which were particularly large earlier in 1965, have on average been smaller during the period under review. The government has continued its efforts to modernize French industry and to strengthen the French capital market. As a means of stimulating domestic investment, corporations will be allowed to deduct from their tax liabilities 10 per cent of the cost, after the permitted allowance for depreciation, of most large capital equipment orders placed between February 15 and the end of this year. The government in May embarked on a major effort to develop a national market for home mortgage loans, which have been negotiated locally at high rates and with maturities of only two or three years. Through a program to create a secondary market, the government hopes to bring about lower rates and terms possibly as long as twenty years. Several measures have been taken recently to increase the efficiency of the banking system: the distinction between commercial and investment banks has been reduced,[4] two of the four largest commercial banks, both nationalized, are being

[4] See the November 1965 issue of this *Review*, page 245.

merged, and minimum lending rates have been abolished. In a move to offer greater flexibility under the 1963 price freeze, still in effect, industrywide stability agreements have been supplemented by a system of agreements between individual firms and the government. Both types of agreement have the objective of allowing price changes while avoiding a general increase in price levels. The earlier program balanced price increases and declines in the same industry; in contrast, the newer plan offers the opportunity for price changes in exchange for submission to a comprehensive government review of business plans.

Italy's 1963-64 recession is now clearly in the past, and total production is continuing to expand beyond its former peak. However, the construction and investment goods sectors of the economy are still lagging. Recently prices have been stable, and unemployment is still declining but has not yet reached the pre-recession low. In 1965, the balance-of-payments surplus more than doubled and the growth of exports provided most of the stimulus for the domestic economy.

Policy in Italy has remained expansionary; the government cash budget showed a large deficit during 1965 in contrast to the previous year's virtual balance. The monetary authorities permitted the large external surplus and Treasury borrowing at the central bank to swell bank reserves. As the result of these actions and slack demand for credit, the banking system has recently attained the highest level of liquidity in years. To aid the construction sector, the terms of household mortgages have been eased, and commercial and savings banks have been permitted to hold a portion of their reserves in the form of mortgage certificates. Limitations on consumption have also been relaxed by abolishing restrictions on instalment purchases of certain durables.

In Japan, efforts to stimulate domestic economic recovery have continued. Although 1965 saw the first substantial external trade surplus of the postwar years, the domestic economy remained weak. To bolster activity the government decided that, instead of curtailing expenditures to achieve a balanced position, it would finance a shortfall in tax revenues during the second half of the fiscal year ended in March 1966 through a flotation of long-term bonds. Primarily to finance an expected budget deficit in the current financial year, the government plans to issue in 1966 domestic bonds worth the equivalent of about $2 billion. In addition, the government's extra-budgetary loan and investment program is being expanded by nearly 25 per cent. Since mid-1965 the Bank of Japan's discount rate has remained at 5.475 per cent, the lowest level since 1951. As a result of both policy measures and slack domestic demand for credit, interest rates have declined to levels more closely in line with those in the rest of the world. A consequent shift in trade financing from foreign sources to Japanese institutions contributed to a reversal in the direction of capital movements leading to net outflows. A number of measures have been taken to reduce these net outflows: the Bank of Japan has suspended its practice of granting low-cost import credits, a 40 per cent reduction has been permitted in the external assets that Japanese banks are required to hold as reserves against their short-term foreign exchange debts, the limit on banks' net long position in foreign exchange has been cut 10 per cent, and quantitative restrictions on the acceptance of Euro-currency and free-yen deposits have been relaxed.

CONCLUSION

Most of the major industrial countries abroad have responded to inflationary pressures with monetary restraints and, in several cases, with fiscal measures or direct controls as well. Interest rates have tended to rise in many of these countries, and to some extent national efforts to apply monetary restraint have been assisted by United States efforts to curtail capital outflows. Nevertheless, industrial production and aggregate output have generally continued to increase at satisfactory rates. The main problem has been, in fact, that aggregate demand has in most cases responded slowly to monetary restraints, suggesting the possibility that somewhat more emphasis on fiscal policy may be required. During the same period there has been some reduction in the major payments imbalances, the French surplus has diminished, while the United Kingdom has substantially curtailed its deficit.