Recent Economic Policy Measures Abroad

During the closing months of 1963 and in the early part of this year inflationary pressures intensified in a number of industrial countries abroad.[1] In the face of rapid increases in prices and wages which were threatening both domestic and external equilibrium, some countries adopted comprehensive stabilization programs while others relied on selective restraint measures. International consultation on these national financial policies continued through the established channels of cooperation.

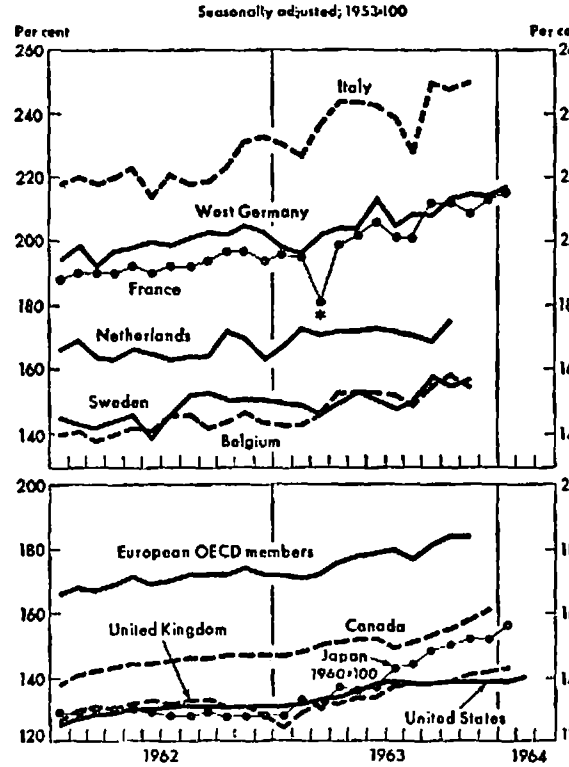
GENERAL ECONOMIC BACKGROUND

In virtually all major industrial countries abroad, the pace of economic activity has quickened since the summer of 1963 (see Chart I), making for impressive gains in production and output for last year as a whole. Thus, industrial production in 1963 increased by close to 10 per cent in France and the United Kingdom, by over 8 per cent in Italy, and by over 5 per cent in Germany. For the entire European Economic Community (EEC), gross national product grew by an estimated 4 per cent (in real terms) and is expected to rise by about 4.5 per cent this year.

In fact, public and private demand for goods and services has expanded at a rate which, in the second half of 1963, caused consumer prices—shown in Chart II—and wholesale prices to turn up sharply in many Continental countries. Moreover, labor has become so scarce that increases in wage costs have tended to accelerate. These boom conditions have generated stresses in a number of Continental countries that have tended to spread beyond national frontiers. Although it is admittedly difficult, if not impossible, to single out factors of special importance in each country, private consumption expenditures and construction activity appeared to be dominant in France, Italy, and Switzerland. Booming exports and construction expenditures emerged as the most significant factors contributing to the further rise in domestic activity in West Germany.

Among the major industrial countries outside the European continent, strength in the construction sector and in consumer expenditures on durable goods was recorded in the United Kingdom and led to fairly full utilization of resources. But there was little evidence of inflation, with

Chart I
INDUSTRIAL PRODUCTION IN MAJOR COUNTRIES
Seasonally adjusted; 1953=100

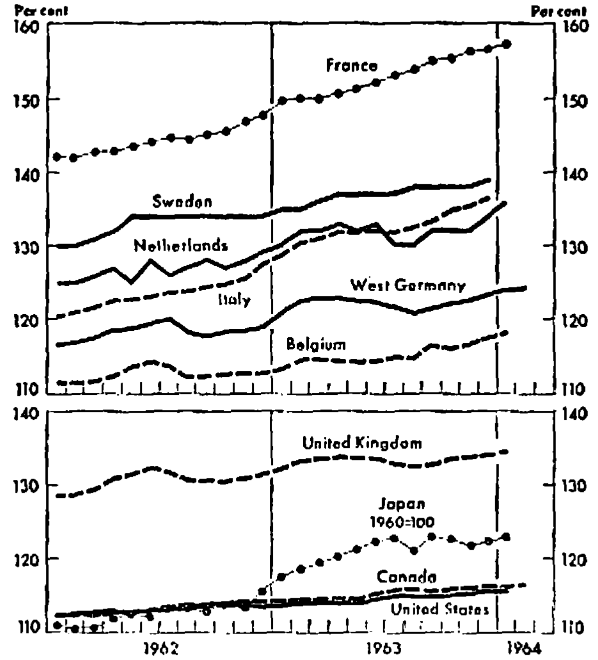


* Affected by widespread strike in the public sector.

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

[1] For a discussion of foreign economic and financial developments in January-August 1963, see "Recent Financial Policy Measures Abroad", this *Review*, September 1963, pp. 131-36.

Chart II
CONSUMER PRICES IN MAJOR COUNTRIES
1953=100



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

retail and wholesale prices advancing modestly between 1962 and 1963. Nevertheless, by the end of last year output was growing at a more rapid pace than the 4 per cent annual rate that the authorities consider a sustainable target. In addition, wage increases were frequently exceeding the official guideline of 3½ per cent per annum. Canada's economy also was operating at a high level by the year end. In December, industrial production set a record and unemployment fell below 5 per cent for the first time since mid-1957. However, with capacity still ample, price increases have tended to be very modest. Japan's growth again topped that of all other countries last year, with the increase in industrial production accelerating to 18 per cent.

Buoyant economic activity often led to substantial increases in imports, which tended to weaken the current-account positions of several major foreign industrial countries. In addition, varying degrees of inflation on the Continent have tended to move the surplus and deficit positions of individual countries somewhat further apart. The deterioration in Italy's current account—leading to a large over-all deficit last year—and the sharp contraction in the French current-account surplus stand in marked contrast (and may be partly related) to the increasing strength of Germany's external position. In the United Kingdom, rising incomes led to an expansion of imports—partly for inventories—in the second half of 1963 that exceeded the growth of exports, thus widening the trade deficit. As a result, the British current-account surplus contracted sharply toward the end of the year. On the other hand, Canada, helped by grain sales to the U.S.S.R., last year recorded a trade surplus for the third year in succession and the largest since 1952. Canada's current-account deficit in 1963 was cut by one third from 1962.

Against this general background of high-level economic activity and rising prices, a number of countries—including France, Italy, and the Netherlands—introduced a broad range of monetary, fiscal, and direct measures. Other countries adopted more selective and specific measures in their fight against domestic and external disequilibrium.

FRANCE, ITALY, AND THE NETHERLANDS

In France, the authorities extended and reinforced the monetary restraints—including curbs on borrowing abroad by French residents—that had been introduced earlier last year. In September, the ceilings on permissible annual increases in bank credit were again lowered—from 12 per cent to 10 per cent for March 1963-February 1964. Moreover, minimum downpayments for instalment purchases of a number of durable goods were raised. In the case of cars, the minimum downpayment is now 30 per cent, compared with 25 per cent previously, while the maximum repayment period has been lowered to twenty-one from twenty-four months. In November, the Bank of France raised its basic discount rate to 4 per cent from the 3½ per cent level that had been in effect since October 1960. In a follow-up early this year, the Bank of France raised (also to 4 per cent from the previous 3 per cent) its rate on thirty-day advances against short-term government paper and, in addition, extended to March-September the credit ceilings that were scheduled to expire in February.

Apart from these moves to raise the cost and reduce the availability of credit, the French authorities also continued their earlier efforts to channel more resources into the longer term market. Thus the authorities reduced the portion of the commercial banks' over-all liquidity ratio that has to be held in Treasury bills, thereby permitting the banks to put a larger part of their earning assets into medium-term credit. In a parallel move designed to increase the flow of investment funds to savings institutions, the maximum savings deposit which individuals may hold was raised from 10,000 to 15,000 francs ($2,000 to $3,000), while the rates on competing three-year government securities were reduced. These savings deposits are administered by the official Caisse des Dépôts et Consignations, which normally invests them in mortgage loans, public securities, and loans to various public agencies and entities. With the government having a strong voice in the management of these resources, it was anticipated that long-term funds would become more readily available to finance government-sponsored capital projects. In the fiscal field, the planned over-all deficit for calendar year 1964 was cut back by close to 2 billion francs below last year's nearly 6 billion, mainly as a result of downward revisions in spending plans.

To reduce pressures on consumer prices, the French government last September temporarily lowered customs duties on a large number of manufactured goods and foodstuffs imported from both the EEC and other countries.[2] In addition, the government canceled scheduled rent increases, froze the prices of manufactured goods and of a wide range of foodstuffs, and in some cases even rolled back prices. In order to cope with the pressure of wages on prices, the government formed within the High Planning Council (Commissariat au Plan) a committee to prepare the gradual introduction of policies designed to keep income growth within a range supportable by productivity increases, and in the meantime has limited wage and salary increases in the public sector to 4 per cent per annum.

Italy experienced an estimated over-all balance-of-payments deficit of some $1.2 billion equivalent last year, largely as a result of the rapid business expansion. In late summer, the Bank of Italy acted to curb the growth of liquidity. Therefore, the bank instructed the Italian commercial banks authorized to operate in foreign exchange to keep their foreign borrowing to the August level and, if possible, to reduce it. Such borrowing—mainly in the Euro-dollar market—had increased by over $760 million in the first eight months of last year and had supported a rapid increase in bank lending. As the Italian banks began to reduce their foreign borrowing, their liquidity position came under some strain. Moreover, Italy's international reserves began to reflect more fully the country's deteriorating balance-of-payments position. Between August 1963 and February of this year, official reserves fell by $751 million. To buttress Italy's external position, the authorities in mid-March obtained approximately $1 billion in credit facilities from the United States and from European central banks. In an official statement, the Italian government declared that these credits were

> immediately available to supplement the official holdings of the Bank of Italy and the Foreign Exchange Office to the extent necessary to meet whatever requirements may occur in 1964—the period during which Italy's program to correct its balance of payments is expected to become fully effective.

Shortly after obtaining these credits, Italy also drew from the International Monetary Fund (IMF) $225 million equivalent in eight currencies (other than United States dollars).

Prior to arranging for this assistance, the Italian authorities had already taken a number of anti-inflationary measures, mainly in the fiscal field. In September, the government reduced the planned deficit for fiscal 1963-64 to substantially below the level of the original estimate. This cut is to be achieved mainly through reductions in government spending and increases in sales taxes on a number of luxury goods. On the other hand, in an effort to stimulate the growth of productive capacity, the government program provided for more liberal tax treatment of business investment. In March, the government obtained legislative authority for a tax increase on gasoline and fuel oil, a new tax on cars and pleasure craft, and a reform of dividend taxes. The sales tax on cars is expected to have a significant effect on car purchases, particularly of foreign cars, which have bulked large in the recent rise in Italian imports. Mainly to discourage capital flight and help restore the flow of private savings to the investment market, the government also modified the regulations governing the tax on dividends. Up to March, dividends were subject to a 15 per cent withholding tax and could be paid out only if stock ownership was disclosed to the authorities. The withholding tax has now been reduced to 5 per cent provided investors declare their holdings; on the other hand, failure to reveal ownership will result in a withholding rate of 30 per cent. The authorities have also proposed the fixing of minimum downpayments and maximum repayment periods for consumer instalment credit, which would be the first instance of such controls for Italy.

The Dutch authorities, concerned over the large wage increases under recent wage negotiations, likewise adopted a broad range of restraint measures. Early in January, the

[2] In the case of EEC imports, the reductions were 15-20 per cent, while for other countries the reduction amounted to 50 per cent of the difference between present rates and the future EEC common external tariff.

Netherlands Bank raised the discount rate to 4 per cent from the 3½ per cent rate that had been in effect for an entire year (see table). In addition, the ceilings on the expansion of bank credit to the private sector, which had been established for September-December, were retained for the first four months of this year, although the permissible rate of expansion was increased slightly. In the consumer credit field, the minimum downpayment for durable goods was raised by 5 percentage points, and banks were asked to refrain from advertising such loan facilities. To reduce the budget deficit, the Dutch government has postponed certain investment expenditures and suspended both investment allowances for industrial buildings and accelerated depreciation allowances in general. In addition, the government apparently intends to allow the share of tax revenues in national income to rise and to refrain from tax cuts designed to keep this share constant, as had been the stated policy previously.

In another move—to cope directly with wage and price pressures—the Dutch authorities early this year gave warning to both unions and employers that the government might use its power to limit any future wage agreements that provide for increases substantially in excess of the recently negotiated 10 per cent. The authorities have also asked for the power to control "undue" price increases of individual enterprises, in addition to existing powers to control prices in whole sectors of industry. Finally, the sanction of law for retail price maintenance is to be withdrawn for some goods.

CHANGES IN FOREIGN CENTRAL BANK DISCOUNT RATES, 1963-64
In per cent

Country	Date	New rate	Change
Austria	1963: June 27	4½	−½
Belgium	1963: July 18	4	+½
	October 31	4¼	+¼
Canada	1963: May 6	3½	−½
	August 12	4	+½
Denmark	1963: August 19	6	−½
	November 13	5½	−½
France	1963: November 14	4	+½
Greece	1963: January 17	5½	−½
Japan	1963: March 20	6.205	−0.365
	April 20	5.84	−0.365
	1964: March 18	6.57	+0.730
Netherlands	1963: January 8	3½	−½
	1964: January 6	4	+½
Sweden	1963: January 18	3½	−½
	June 14	4	+½
	1964: January 31	4½	+½
United Kingdom	1963: January 3	4	−½
	1964: February 27	5	+1

ANTI-INFLATIONARY MEASURES IN OTHER COUNTRIES

In raising the discount rate from 4 per cent to 5 per cent in February, the Bank of England made the first major move toward restraint since the British authorities began to relax their policy in the wake of the July 1961 crisis measures. The authorities stated that their purpose was to "steady" the pace of expansion in the economy. While it is true that the rapid expansion of economic activity in the United Kingdom in the latter part of 1963 was not accompanied by any excessive increase in bank credit, consumer instalment credit and construction activity have been buoyant. In addition, bank lending rose to a new peak in the quarter through mid-February, with manufacturers, retailers, and nonbank financial institutions the principal borrowers. The Bank of England's action effectively curbed the pressure on sterling that had developed toward the end of February in the wake of January's poor trade results. However, the authorities stressed that the move was not intended to attract funds from abroad, but rather to bring rates in the United Kingdom into alignment with short-term rates in other countries.

Belgium and Sweden also moved to restrain the rapid growth of domestic credit. The Belgian authorities suggested to the commercial banks the conclusion of a "gentleman's agreement" to reduce bank loans to 85-90 per cent of the average outstanding in 1963, with the cut slated to fall mainly on construction credit. In addition, downpayments on instalment purchases of consumer durables were raised and repayment periods shortened. These measures supplement the boost in the Belgian National Bank's basic discount rate from 4 per cent to 4¼ per cent last September and the subsequent sharper increases in money market rates in general. The Bank of Sweden, after raising its discount rate from 4 per cent to 4½ per cent last January, subsequently imposed a penalty rate of 9 per cent on discounts in excess of half of each commercial bank's own capital. To reduce over-all liquidity, the Swedish authorities in March successfully floated a three-year government loan issue, carrying a 6 per cent coupon (the highest since 1921).

In Switzerland and West Germany, the authorities' task of maintaining stable credit conditions has been complicated by the heavy influx of funds from abroad. To limit these inflows the Swiss authorities previously had relied exclusively on voluntary agreements concluded with the commercial banks. Under the terms of these agreements, the banks were to accept new foreign deposits only on a time basis, with a three-month minimum, pay no interest on larger new foreign deposits, and refrain from purchases of Swiss securities, real estate, and mortgages for foreign accounts. In addition, the banks were to observe ceilings on over-all credit expansion, and the authorities recommended that loans be granted only for essential activities. This year, the Swiss federal government sought and obtained from parliament the power to compel both commercial banks and other financial intermediaries to observe such restraints in accepting foreign funds. Moreover, the government now can ask financial institutions to deposit with the central bank funds that have been received since January 1 and have not been invested abroad. In addition, the authorities were given the power to establish broad credit ceilings and to regulate the flow of new domestic securities issues. The legislation also provided for closer controls over construction. An explicit permit will be required for all construction except maintenance work, publicly subsidized housing, and construction costing under 250,000 francs (about $58,000).

Concerned with the threat to stability posed by the renewed strength of the German balance of payments, the German authorities also have taken a number of steps to curb the inflow of foreign funds. The federal government lowered the coupon rate on two recent bond issues of public agencies and, moreover, permitted foreign subscriptions only after a week during which the books had been open to residents. In March, the German Federal Bank offered to provide commercial banks, through direct swap facilities, with forward cover for investments in United States Treasury bills; and as of April 1 the bank banned interest payments on foreign-owned time deposits, while imposing the maximum statutory reserve requirements of 30, 20, and 10 per cent, respectively, against foreign-owned sight, time, and savings deposits. (Domestic deposits currently are subject to reserve ratios ranging from 5 to 13 per cent.) In addition, the authorities have proposed a 25 per cent withholding tax on interest paid on German bonds held by nonresidents. However, the impact of this measure would be softened considerably by the fact that a tax credit against their domestic tax liability could be claimed by residents of countries with which Germany has concluded double-taxation agreements; moreover, the tax would not apply to income from foreign issues floated in Germany.

In December, Japan took several steps to ease the pressure on the country's external position resulting from the rapid pace of domestic expansion. Reserve requirements were doubled for all commercial bank demand and savings deposits, as well as for savings deposits with larger mutual loan and savings banks and credit associations. The Bank of Japan also advised the commercial banks to limit their credit expansion during January-March to 90 per cent of the expansion permitted during the corresponding period of 1963. In addition, the Bank of Japan in mid-March raised its discount rate to 6.57 per cent, the highest since November 1962. In the foreign exchange field, authorized banks were permitted to raise rates on Euro-dollar deposits; however, the banks will have to adhere to ceilings on foreign exchange loans and guarantees extended to overseas branches of Japanese firms. Also in March, the Japanese authorities obtained a $305 million stand-by agreement from the IMF; this assistance was linked in part to Japan's making the yen fully convertible for current-account transactions on April 1.[8]

The Canadian authorities have taken steps to prevent the country's strengthening current-account position and rising domestic activity from producing inflationary effects. In addition to the increase in the Bank of Canada's discount rate last August, the budget for fiscal 1964-65 provides for a deficit significantly lower than that of the previous year. Canada has also taken advantage of its favorable balance-of-payments position to reduce further its indebtedness to the IMF under the $300 million drawing of June 1962. Furthermore—in a move reflecting in part a more gradual approach toward limiting foreign ownership of Canadian industry—the Finance Minister withdrew the proposed increase from 15 per cent to 20 per cent in the withholding tax on dividends paid to foreigners by companies with less than 25 per cent of Canadian ownership.

[8] By so doing, Japan accepted the full obligations of currency convertibility under Article VIII of the IMF Articles of Agreement—the twenty-fifth country to do so. Thus, Japan will no longer be able to make use of the transitional arrangements under Article XIV of the Fund Agreement, which allow a country to maintain and adopt exchange restrictions on current-account transactions without prior approval of the Fund.