Recent Economic Policy Measures in Industrial Countries Abroad

Economic policy abroad moved in mixed directions over the past six months.[1] A number of countries pursued monetary restraint to deal with balance-of-payments deficits and inflationary threats. In the United Kingdom, restrictive measures were adopted primarily as a means of correcting a serious balance-of-payments deficit. As this article went to press, the government in a stringent April budget announced new measures, including substantial tax increases designed to curb internal demand and restore external balance. This action underlined Prime Minister Wilson's strong reaffirmation of his government's commitment to preserve the sterling parity.

In Germany, Austria, and Sweden, new restraints were primarily a response to domestic price and cost pressures. Meanwhile, Switzerland and the Netherlands held firm to the anti-inflationary policies adopted early in 1964. On the other hand, there were also several countries that moved toward relaxation of previous restraints. Italy and Japan cautiously began to ease their stabilization measures, and France was apparently beginning to lean in that direction as well. In Canada, monetary policy continued to be engaged in the exacting task of stimulating domestic activity while maintaining an improved external position.

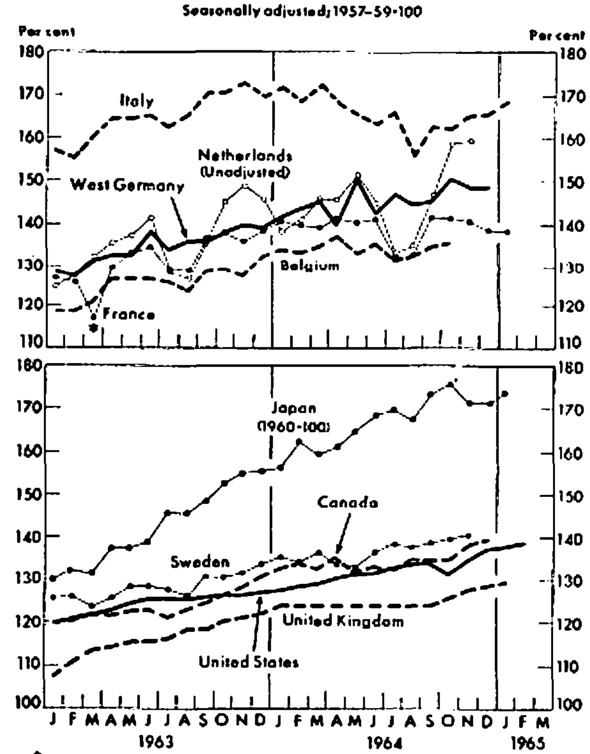
A comparison with a year earlier shows that in many countries the rapid rate of growth which had contributed to inflationary pressures tended to decline as production reached capacity limits (see Chart I). In several cases, however, price increases were also to some extent moderated (see Chart II), partly because enlarged imports helped to absorb excess demand and partly because the restrictive policies themselves have shown signs of achieving their goals. In a few countries—Italy, France, and Japan, in particular—these policies were a force tending to check the growth of production and income, although the ultimate aim of the stabilization efforts of course remained in all cases that of assuring a high and sustainable rate of growth over the long run.

In recognition of the increased interdependence of national economies, efforts continued to be made by authorities of major industrial countries toward ensuring the stability of the world economy. The most dramatic example of this cooperation was the $4 billion of credits provided by eleven countries, the Bank for International

Chart I

INDUSTRIAL PRODUCTION IN MAJOR COUNTRIES

Seasonally adjusted; 1957-59=100



* Affected by widespread strike in the public sector.

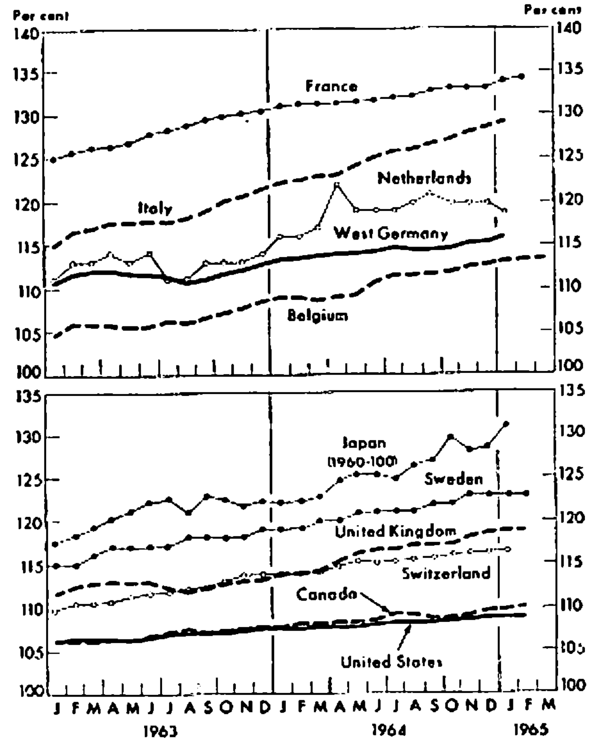
Sources: Organization for Economic Cooperation and Development, monthly statistical bulletins; national statistics.

[1] For a discussion of foreign economic policy measures in 1963 and early 1964, see "Recent Economic Policy Measures Abroad", this *Review*, April 1964, pp. 74-78, and "International and Monetary and Financial Developments", *ibid.*, October 1964, pp. 196-201.

Chart II

CONSUMER PRICES IN MAJOR COUNTRIES

1957-59=100



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

Settlements, and the International Monetary Fund (IMF) to the United Kingdom at the height of the sterling crisis late in 1964.[2] In another development of great long-run significance, the executive directors of the IMF proposed a general 25 per cent increase in Fund member quotas and additional selective quota increases for sixteen member countries.[3] These proposed quota increases—which appear to be almost certain of approval by the necessary majority of the Fund's members—are designed to increase the IMF's gold and foreign exchange resources by about $5 billion, and member borrowing potential by about $6 billion.[4] These concrete manifestations of mutual support and cooperation will further strengthen the present international payments system.

UNITED KINGDOM, GERMANY, AUSTRIA, AND SWEDEN

Soon after taking office in October, the Labor government in Britain was faced with an acute confidence problem in the sterling exchange market. This problem was superimposed on a serious balance-of-payments deficit which had developed over previous months—a deficit about equally divided between the capital and the current accounts. Since the ensuing sterling crisis has been described in last month's *Review*, the focus here is on the measures taken by the British authorities to restore external balance and to bring about improvement in the country's competitive position. Late in October, the government announced a surcharge of 15 per cent on almost all manufactured and semimanufactured imports, coupled with rebates of indirect taxes—averaging about 2 per cent—on the value of exports. Furthermore, a special budget in November increased customs and excise taxes on certain fuels and oils and outlined additional measures for inclusion in the April 1965 budget. The latter measures included an increase in the income tax and a broadening of the coverage of the capital gains tax. Substantial increases in social benefit payments were also presented, mostly effective from the end of March, but the greater part of these expenditures will be financed from higher payroll contributions.

On November 23 the Bank of England raised its discount rate by 2 percentage points to 7 per cent (see table) in an effort to stem the speculative tide against sterling. This hike in the discount rate (the second in 1964, giving Britain the highest such rate among major central banks) demonstrated Britain's firm resolution to achieve external balance even at the cost of considerable monetary stringency at home. In addition, the Bank of England asked the banks and other financial institutions to give priority, within a more slowly increasing total of credit, to credits for exports and productive investments at the expense of consumer and real estate loans. Also, to assist the ex-

[2] For a detailed discussion, see Charles A. Coombs, "Treasury and Federal Reserve Foreign Exchange Operations", this *Review*, March 1965, pp. 43-45.

[3] For details, see "Increases in Quotas of Fund Members: Fourth Quinquennial Review" (Report of Executive Directors to Board of Governors), Supplement to *International Financial News Survey*, March 5, 1965.

[4] In general, IMF members can borrow up to 125 per cent of their quota. Thus, the proposed increase of about $5 billion in Fund quotas means that members' total potential claims on Fund resources would rise by 125 per cent of the increase, or by about $6 billion. However, it must be remembered that, to obtain these rights, members in the aggregate will have to pay to the Fund some $1.2 billion, or 25 per cent of their quota increase, in gold.

CHANGES IN CENTRAL BANK DISCOUNT RATES IN MAJOR INDUSTRIAL COUNTRIES ABROAD SINCE OCTOBER 1, 1964

In per cent

Country	Date	New rate	Change
Canada	November 24	4¼	+¼
Germany	January 22	3½	+½
Japan	January 9 April 3	6.205 5.84	−0.365 −0.365
Sweden	November 6	5	+½
United Kingdom	November 23	7	+2

port effort, the Board of Trade in January announced a wide range of new measures involving marketing assistance and government credit guarantees for exports; at the same time, the Bank of England improved refinancing facilities for commercial bank export credits. In the three months of December through February, there was considerable improvement in the British trade position. In particular, the seasonally adjusted trade deficit was well below that of the previous three months. On February 22 the government announced that, effective April 27, the import surcharge would be lowered to 10 per cent.

Meanwhile the government pressed forward with steps to insure long-term growth without inflation. On December 16 a Declaration of Intent was signed by the government and representatives of labor and management. The government asked the cooperation of labor and management in an attempt to keep price and wage increases within the range deemed to be in the national interest. It also made clear its intention to use sterner enforcement measures if voluntary compliance fails. Under this program, wage and price increases will be kept under surveillance by a National Board for Prices and Incomes. Representatives of important labor groups have reportedly already given tentative approval to the Board's 3 to 3½ per cent norm for wage increases. The government has also continued efforts to reduce the effect on domestic prices of restrictive practices in industry. Taken together, the various measures adopted by Britain during the past six months demonstrated the government's determination to deal effectively with the country's international payments problems.

Germany's restraining measures were more of a precautionary than of a corrective nature. Part of the recent expansionary thrust to the German economy had stemmed from a renewal of large current-account surpluses since early 1963. This surplus declined in the second half of 1964, as policy measures taken by Germany's European Economic Community partners slowed the growth of German exports and as Germany's own import demand increased markedly. A further increase in disposable income is anticipated in 1965—partly as a result of a long-anticipated income tax cut in January and partly as a reflection of higher wages and salaries that have resulted from recent labor negotiations. To counteract the inflationary potential of these developments, the German Federal Bank raised its discount rate to 3½ per cent on January 22 from the 3 per cent rate that had been in effect since May 1961. At the same time, the bank raised by a similar amount the rate at which it stands ready to sell money market paper to the banks. Also, the government enacted in February the 25 per cent withholding tax on interest earned by nonresidents on German securities. This tax had first been proposed in March of last year to stem the inflow of funds from abroad and thus curb the balance-of-payments surplus.

Austria adopted a restrictive monetary policy last fall when rapid growth of demand was placing increased strain on domestic resources. Effective October 31, minimum required reserves were raised from 10 per cent to 11.5 per cent on demand and time deposits and from 8 per cent to 9.5 per cent on saving deposits in large banks, with comparable adjustments for small banks. At the same time, the existing credit ceiling (the maximum ratio of credit to selected liabilities) was lowered from 70 per cent to 68 per cent of the banks' liabilities. In addition, the Austrian government early in 1965 authorized the use of 3 billion schillings ($115 million) of its debt held by the Austrian National Bank for initiating open market operations. Since a sizable balance-of-payments surplus was considered an important source of inflationary pressures, Austrian import restrictions were eased somewhat and the quota for foreign workers' entry to that country was raised. Also, the large banks early last September agreed not to repatriate 1.7 billion schillings ($65 million) of their foreign assets for a period of six months. This agreement was extended by another three months on March 1. It appears that some of these measures may have contributed to the emergence of a balance-of-payments deficit in the fourth quarter.

In Sweden, strong domestic demand during 1964 put considerable pressure on productive capacity. Excess demand was evident in the labor market, and price pressures were expected to become stronger unless counteracted. The task of curbing price increases and a larger trade deficit has mainly been borne by monetary policy. Along with other efforts to hold the line on credit expansion—including a hike from 9 per cent to 10 per cent in the penalty interest rate for commercial banks not maintaining the required liquidity level—the Bank of Sweden raised its discount rate in November to 5 per cent from the 4½ per cent level posted the previous January.

SWITZERLAND AND THE NETHERLANDS

The Swiss stabilization program introduced last year was keyed largely to reducing demand and liquidity pressures from both internal and external sources, lest such pressures become too strong for an economy already operating in high gear. The program was approved by the Swiss electorate in a February 1965 national referendum and extended for a year; it can be prolonged for yet another year without another popular vote. One effect of this program was a sharp rise during 1964 in domestic interest rate levels for all maturities. In November, the large banks in Zurich increased by an average of ¼ percentage point the interest they pay on medium-term bank bonds (Kassenobligationen), and in December these banks increased their market discount rate on trade bills by ½ percentage point to 3 per cent. This marked the second rise of the latter rate in eight months, following a five-year period of stability preceding April 1964. The extensive controls on imports of foreign capital have been retained. Early in 1965, Swiss capital and money market rates declined from their 1964 peaks but continued above the levels prevailing a year earlier when the stabilization program was just initiated. While the rate of price increases was reduced, the labor shortage remained pressing. Further restrictions on hiring of foreign workers have nevertheless been imposed because of mounting concern about the social problems created by massive immigration of temporary laborers. Decrees effective last November and this March are designed to bring about a limitation in the number of foreigners in the labor force and a gradual reduction, about 10 per cent, by mid-1966.

In the Netherlands, anti-inflationary measures brought to a virtual halt last July the previous rise in consumer prices. In good part, this inflationary pressure had stemmed from the 1963 wage agreement which led to a 17 per cent rise in wages and salaries in 1964. Dutch wage negotiations for 1965—a major concern for the government—were settled in December, with wages and fringe benefits scheduled to rise by 8 to 9 per cent this year. To secure the labor unions' cooperation in restraining wage increases, the government advanced half of a scheduled income tax cut from January 1966 to July 1965. Output continued to expand through 1964, and the large trade deficit of early 1964 became smaller in the second half of the year. In the financial sphere, credit restraint resulted in substantial increases of short-term and long-term interest rates over 1963 levels. Commercial banks continued to exceed their permitted credit ceilings, and accepted the penalty of making interest-free deposits with the Netherlands Bank, meeting this penalty by repatriating foreign assets. Long-term capital has been attracted from abroad in large quantities, particularly since last summer when yields on new issues reached a peak of 6 per cent. Given the inflationary potential of such capital inflows, there has been increased discussion of the feasibility of reopening the Dutch capital market to new issues of foreign securities.

ITALY, JAPAN, FRANCE, BELGIUM, AND CANADA

In Italy, the stabilization program, introduced in the fall of 1963 and stiffened in early 1964, achieved its major objective of curbing the country's large balance-of-payments deficit. The payments balance swung into surplus in the spring of 1964 as the result of a considerable decline in imports, accompanied by export expansion and a net inflow (including reflows) of capital. The measures required to restore external balance apparently contributed to a falloff of production in 1964 in many sectors of the Italian economy and to an increase in unemployment. Consumer prices nevertheless continued to rise rapidly—by about 6 per cent last year. Since a broad range of wages is contractually linked to the cost of living, the interaction of rising wages and prices has not yet ceased.

The authorities have therefore been cautious and selective in choosing measures to stimulate the economy. In October, the Italian authorities made arrangements with savings banks to purchase about 200 billion lire ($320 million) of Treasury paper held by these banks as part of their compulsory reserves. According to the agreement, the savings banks would use the proceeds to acquire bonds of public enterprises engaged in rail and highway modernization and other public investments. In November, in view of the depressed state of the automobile industry, the government repealed the special tax of 7 to 15 per cent on automobiles imposed in February 1964 as part of the stabilization program. In March 1965, the government moved more strongly to revive production. The Credit Consortium for Public Works (a semiofficial agency designed to supply funds to local authorities) was authorized to borrow $400 million equivalent, and the Post Office Savings Fund will contribute $600 million equivalent, for the financing of an extensive public works program. Also included in this group of measures were a one-year reduction in employer contributions to pension funds and a cut in taxes on real estate transactions.

Japan's industrial output grew less rapidly in 1964 than in 1963 and became virtually stationary in the last few months of the year. There were an increased number of business failures, and prices in the Tokyo stock market continued the decline begun in July 1963. To bolster confidence, the Bank of Japan provided substantial support to the stock market by extending loans to two government-sponsored intermediaries, with the proceeds to be used for purchases of securities. Monetary policy, which had been increasingly restrictive in 1963-64, was relaxed in December and January. In December the reserve requirement against demand deposits and against time deposits subject to call on two-week notice was lowered from 3.0 per cent to 1.5 per cent, and the Bank of Japan's discount rate was reduced by 0.365 percentage point each in January and in April. After the two adjustments, it stood at 5.84 per cent. As Euro-dollar rates moved generally upward in February and March, the Japanese authorities on several occasions raised the maximum rates that Japanese banks are permitted to pay on dollar deposits.

The French stabilization effort, in effect since September 1963, slowed the inflationary trend, and after mid-1964 may also have exerted a depressing effect upon production. Nevertheless, wages continued to advance, and in the fall of last year the upward drift of consumer prices again gathered momentum. Thus, new restraining measures were introduced in November; controls were placed on certain food and restaurant prices, and the scheduled increases in controlled rents were postponed from January to July 1965. Because of the price pressures, the authorities have proceeded very cautiously in relaxing the stabilization program, and positive measures to stimulate growth have been minor. In January, the National Credit Council reduced slightly some key commercial bank lending rates (without, however, any change in the Bank of France's discount rate). At the same time, in a move to improve housing finance, commercial banks were permitted to sell mortgage loans to insurance companies and retirement funds, a privilege already possessed by financial institutions specializing in mortgage loans.

Belgian monetary policy remained on the side of restraint as wage and price increases continued. In addition to the July 1964 boost in the National Bank's discount rate from 4¼ per cent to 4¾ per cent, a 1 per cent compulsory reserve ratio against commercial bank deposit liabilities was put into effect in August and renewed in November and again in February. With Belgium's industrial production virtually level since mid-1964, the Belgian authorities have recently suggested that selective easing action might be taken if warranted.

Canada has experienced prolonged economic expansion and has made progress in reducing unemployment. Monetary policy has generally been stimulative, but has been adjusted to maintain Canada's external position without at the same time aggravating the United States payments difficulties. When the British discount rate was raised by 2 percentage points on November 23 and the Federal Reserve Banks followed immediately with a ½ per cent rise, the Bank of Canada raised its rate by only ¼ per cent to 4¼ per cent. Canada's moderate reaction in this instance was consistent with both the needs of the domestic economy and the desire to limit short-term capital inflows from the United States. Similar considerations influenced the Bank of Canada's open market operations. The Canadian money market remained fairly liquid, even after President Johnson's balance-of-payments message in February and the subsequent measures to curb the flow of funds from the United States. Canadian Treasury bill yields—which over long periods have tended to be higher than United States yields—often moved below those on United States Treasury bills.

Economic policy abroad in the near future may face substantial adjustments, particularly in the monetary area, as the United States program to reduce capital outflows takes effect. (Several key documents relating to this program are reprinted in last month's and in this *Review*.) Recent developments, such as the sharp rise in Euro-dollar rates, suggest that the outflow of funds from this country has been reduced. In the absence of counteracting policies, there might be a tendency for credit conditions to tighten in several countries abroad. The authorities are of course aware of this problem, and there are already indications that policies are being adapted to the new conditions.