Recent Economic Policy Measures in Industrial Countries Abroad

The stern austerity program implemented by the United Kingdom in July was the major economic policy development abroad during the last six months.[1] At the same time, a number of other countries—including Canada, Germany, the Netherlands, Belgium, Sweden, and Switzerland—have also maintained or intensified policies of restraint. It now appears that the restraining measures have cut into aggregate demand in these countries, and price pressures have moderated somewhat (see Chart I). On the other hand, economic policy in France, Italy, and Japan has continued to be expansionary. The remaining slack in their domestic economies has provided for strong—although recently diminishing—surpluses on external current account. Italy and Japan, however, have experienced rising capital outflows, partly in connection with the relative liquidity of their domestic money and capital markets.

THE UNITED KINGDOM

Early in the summer, when Britain was apparently making little progress in solving its basic economic problems—excess demand, inadequate growth of productivity, price and wage inflation, and a stubborn payments deficit—the pound sterling was again subject to heavy selling pressure in the exchange markets. The British authorities responded in July with a far-reaching austerity program, which included measures (such as the price and wage standstill) seldom applied in a democratic society during peacetime. The program was essentially designed to reduce excessive domestic demand. It was hoped that the new measures, in combination with those already in force, would instill confidence in the pound and provide a basis for longer term internal and external adjustments. These adjustments would come through redeployment of labor and an increase of industrial efficiency and productivity. Recent evidence shows that the program has been effective: demand pressures have been waning, and the pound has had a healthier look in the exchange markets.

In the first half of 1966, gross domestic product in Britain rose by only 0.5 per cent over the second half of last year (on a seasonally adjusted basis). Industrial production had leveled off, as had private investment. At the same time, British industry was operating near full capacity, with the unemployment rate reaching a low of 1.2 per cent of the labor force. The continued rise in demand (coming from both the household and public sectors) was pushing up prices and spilling into imports at an increasing rate. In addition, some sizable wage settlements suggested that further spiraling of costs and prices would be forthcoming. The May budget,[2] the major impact of which was to come in the fall, was a step toward relieving the underlying demand pressures in the British economy, but events in the exchange markets did not allow the time needed for these measures to become effective.

The basic balance-of-payments deficit deepened in the

[1] For a discussion of foreign economic policy measures in 1965 and early 1966, see "Recent Monetary and Financial Policies Abroad", this *Review* (November 1965), pages 239-45, and "Recent Economic Policy Measures in Industrial Countries Abroad", *ibid.* (June 1966), pages 144-49.

[2] Described in this *Review* (June 1966), page 146.

first half of 1966 on a seasonally adjusted basis. The current account deteriorated, reflecting particularly the accelerated rise in imports and a slight fall in exports in the half year as a whole, partly attributable to the seamen's strike which started in May and lasted for seven weeks. Moreover, the uncertainties of the Rhodesian crisis, together with tight money conditions in overseas centers, were damaging to the pound in the exchange markets. In July, a new attack on sterling developed and the British government moved quickly to assemble an even more severe series of restraining measures, most of which were announced on July 20. The various measures put into effect since June can be divided into three groups: monetary and fiscal measures, a price and income standstill, and measures directly affecting the balance of payments.

CHANGES IN SELECTED FOREIGN CENTRAL BANK DISCOUNT RATES, 1966

In per cent

Country	Date	New rate	Change
Belgium	June 2	5¼	+½
Canada	March 14	5¼	+½
Germany	May 27	5	+1
Netherlands	May 2	5	+½
Sweden	June 10	6	+½
Switzerland	July 6	3½	+1
United Kingdom	July 14	7	+1

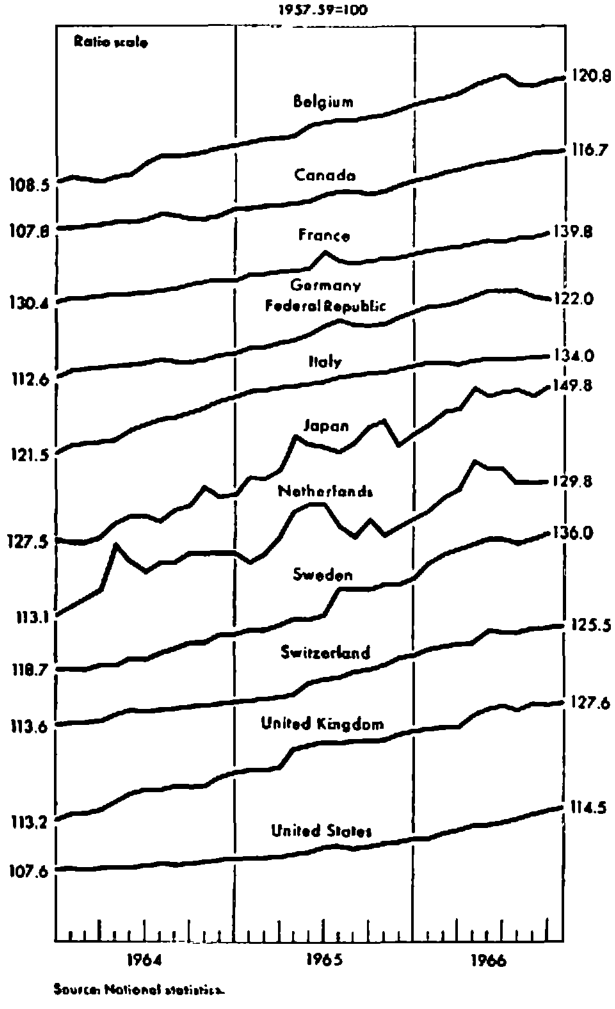


Chart I
CONSUMER PRICES IN MAJOR COUNTRIES
1957-59=100

Source: National statistics.

MONETARY AND FISCAL MEASURES. On July 12 it was announced that the ceiling on bank advances—105 per cent of the March 1965 level—would be continued until at least March 1967, and thereafter until further notice. Furthermore, it was announced that monetary policy would not be eased to offset any tightness resulting from the initial payments of the Selective Employment Tax introduced in the May budget. (Such payments began in September. Refunds to those industries which qualify for them and premium payments to manufacturing industries will begin early next year.) Two days later the Bank of England raised its discount rate to 7 per cent (see table) from the 6 per cent in effect since June 1965. At the same time, the special deposits that the banks must hold with the central bank were doubled, thus mopping up some $280 million equivalent of liquidity. On July 20, instalment credit downpayments were raised and maximum repayment periods shortened. This measure was expected to reduce consumer expenditures by about $450 million a year.

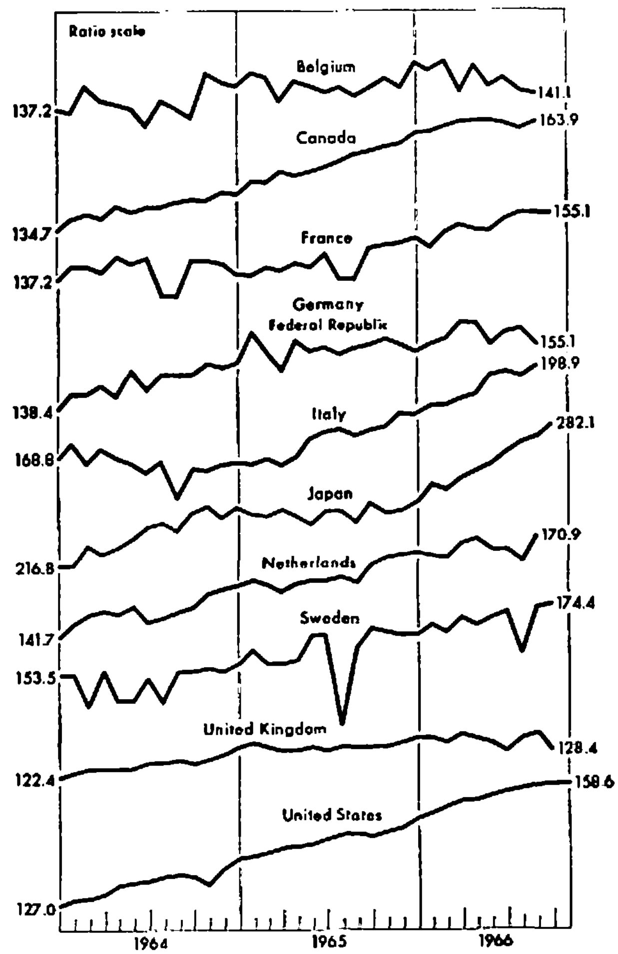
On July 20, fiscal measures were also introduced, providing for increased taxes and cuts in planned expenditures. The taxes payable on alcoholic beverages, gasoline, and a broad range of other consumer products were increased by 10 per cent. Postal and telephone charges were raised as well. These measures are expected to yield some $475 million annually in additional revenue. On the expenditures side, it was announced that spending by the central and local governments and by nationalized industries in 1967-68 is to be reduced by some $420 million from planned levels.

PRICE AND INCOME STANDSTILL. As set forth on July 20, and as detailed in a white paper on July 29, the freeze

Chart II

INDUSTRIAL PRODUCTION IN MAJOR COUNTRIES

Seasonally adjusted; 1957-59=100



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

of prices, wages, and other forms of income was intended to be a voluntary program. It quickly became evident, however, that an entirely voluntary approach would not work, and the Prices and Incomes Act (passed in August) gave the government twelve-month standby authority, which it has already invoked, to issue orders to prevent specific price and wage increases and to roll back increases already made. Until the end of this year, the freeze applies generally to prices, rents, employment income for workers and management (in both the private and the public sectors), fees of the self-employed, and company dividends.

The July 29 document stated also that the first half of 1967 will be regarded as a period of severe restraint, and a second white paper, issued on November 21, spelled out the new guidelines. From January 1 through June 30, 1967, wage increases will be allowed only for workers in firms having clearly demonstrated productivity gains, for workers who had obtained a definite commitment before July 20 for a pay raise during the second half of 1966, and for those in the lowest pay brackets. As regards prices, some increases will be permitted for firms which, in the opinion of the government, have made a genuine attempt, but have been unable, to absorb increases in costs.

EXTERNAL MEASURES. On July 20, the government pledged to reduce its overseas expenditure by at least $280 million in 1967; the basic allowance for travel outside the sterling area and that for cash gifts to nonsterling-area residents were each slashed to $140 (from $700) per person per year; and the provisions for emigrants taking funds out of the United Kingdom were severely tightened. To restrict the outflow of short-term funds, the Bank of England on August 3, effective August 30, partially reduced the ceiling on foreign exchange positions that licensed dealers are permitted to carry.

Since the July measures, there has been considerable evidence of dampening of pressures in the domestic economy. From mid-July to mid-November seasonally adjusted advances by London clearing banks to private borrowers fell by about 3½ per cent. The unemployment rate has risen, reaching 1.8 per cent of the labor force (seasonally adjusted) in mid-November. Retail sales have been declining. Industrial production rose slightly in July and August, but plummeted in September to the level of June 1965 (see Chart II), and new orders have been declining. British business has now substantially cut back plant and equipment spending plans for the next twelve months. However, to prevent too great a sag in investment, the British authorities in early December decided to increase investment allowances.

Externally, despite some distortions in the aftermath of the seamen's strike, British trade figures have begun to improve, with exports starting to rise faster than imports. Indeed, for the first time since last December, a trade surplus was registered in October (on a seasonally adjusted basis). The slowdown in imports may have been partly due to the deferral of purchases from abroad until the removal of the 10 per cent import surcharge on November 30. Nevertheless, the generally firmer tone of sterling in exchange markets in recent months is testimony to the improvement in confidence that has taken place.

RESTRAINT IN OTHER COUNTRIES

A resurgence of inflationary pressures in Canada has prompted the Canadian authorities to apply further restraint through fiscal policy, while the tight posture of monetary policy has been maintained. After an unusually strong advance in the first quarter of 1966, GNP growth slowed considerably in the second quarter. From its peak in April, industrial production declined through July, and a rebound in August may well have been merely due to an earlier-than-usual start on new automobile production. New orders, residential construction, and automobile sales have also shown some softening. Recently, the current account deficit narrowed somewhat, primarily because exports rose more rapidly than imports. But even though the growth of aggregate demand has slowed, prices have continued to rise much more rapidly than last year. Labor negotiations have been particularly hard fought this year, and several wage settlements have been extremely large. Because of the persistence of this inflationary atmosphere, the Finance Minister announced in September a program calling for an immediate cutback in budget expenditures, which included the postponement until July 1968 of the Canadian medicare program and cuts in the defense budget and in Federal subsidies for forestry, research, and education. Also additional taxes, the amount of which is still undecided, will reportedly be provided in an interim budget to be submitted to Parliament before the end of January 1967.

In Germany, the restrictive measures taken in the first half of the year, including a discount rate increase in May, have begun to show some effect. Although economic activity remains at a high level, some signs of easing have appeared. Industrial production has fluctuated below the peak recorded in April. The rise in consumer prices has moderated; the increase in the cost-of-living index from January to September was only 1.6 per cent, compared with a 3 per cent rise in the same period last year. Labor market pressures have also eased somewhat, and wage increases appear to be smaller this year than last. A further slackening of domestic demand was indicated by the growing trade surplus in the first nine months of the year, as exports rose rapidly and import growth slowed somewhat. German monetary policy remained firmly on the side of restraint until early December, when a slight easing took place through a modest reduction in reserve requirements.

The Netherlands has also continued the restraining measures put into effect earlier. These included a central bank discount rate increase, the trimming of budgetary expenditures, and a ceiling on wage increases of 7 per cent under 1966 labor contracts. (Some unions were pressing for wage increases up to 10 per cent.) These restraints had been prompted by the fact that the economy had become generally overheated, with demand pressures showing up in sharply rising prices and wages and in a clear deterioration of the trade balance. Some easing in price and labor market pressures has now become evident. The budget for calendar 1967 to be presented to Parliament by the new Prime Minister, Professor Zijlstra, is reported to be considerably more restrained than the one which brought down the previous cabinet in October. The new budget will reportedly attempt to reduce the size of the deficit by speeding up by six months, to January 1, 1967, sales and turnover taxes already planned, and postponing for six months, to July 1, 1967, planned cuts in income taxes.

Belgium adopted a series of stabilization measures last May and June, including a discount rate hike, quantitative limits on bank credit expansion, and direct price controls. Since then, conditions in the skilled labor market have eased slightly, though wage pressures are still generally strong. Industrial production has drifted below the previous high levels. The rise in consumer prices has been checked, partly as the result of the price freeze decreed in May, and wholesale prices have edged slightly downward. Partly in recognition of these developments, the government on September 5 rescinded the price freeze, reintroducing until the year-end a former system of requiring official approval for any proposed price increase. The ordinary budget proposed for the fiscal year beginning April 1, 1967 is to be in equilibrium after two consecutive years of deficit; however, a sizable increase in capital expenditures is expected to bring the overall deficit to about the same size as that estimated for the current fiscal year.

The Swedish economy has continued to operate close to full capacity. Industrial production has been rising at a slower rate than last year. During the first half of this year, the consumer price level continued on an upward course and the current-account deficit widened. With domestic credit demand holding strong and with interest rates rising rapidly abroad, market rates in Sweden also moved upward in the first six months of the year. Thus, for internal and external reasons, on June 10 Sweden's central bank raised its discount rate to 6 per cent from 5½ per cent, the rate in effect since April 1965. Since early summer, price, unemployment, and import trends have indicated some easing of tensions in the economy.

In the period under review, Switzerland maintained a policy of cautious restraint. In the first half of 1966 internal demand was on the rise, partly on the basis of expanding central and cantonal government expenditures, and this was reflected in increased credit demand. Foreign demand for funds was also strong and, with interest rates generally higher abroad, a capital outflow from Switzerland developed. Against this background, the Swiss National Bank increased its discount rate on July 6 by 1 percentage point to 3½ per cent and raised its rate on advances on securities by ½ percentage point to 4 per cent (the first change in these rates since July 1964). Available data for the third quarter seem to indicate some easing of tensions in the economy, particularly in the investment and construction sectors, as well as some moderation in price and wage increases. There are also indications that the capital outflow has been reduced or reversed. In measures designed to liberalize capital movements, the Swiss Federal Council in June eased its regulations so that nonresidents could invest in domestic bond issues. In October, nonresidents were also allowed to purchase Swiss shares and investment trust certificates.

COUNTRIES WITH POLICIES OF RELATIVE EASE

The French economy has continued to expand with no serious strains on wages and prices though with some reduction of the balance-of-payments surplus. Under the stimulus of growing domestic investment, and strong external demand in the first half of the year, industrial output has risen to considerably higher levels than last year. Even so, manpower reserves and growing productivity have kept labor costs within tolerable bounds. So far this year, prices, still subject to official controls, have risen at the same moderate annual rate as last year (somewhat less than 3 per cent). In recent months France's trade account has deteriorated as imports have risen faster than exports, and for the year so far the overall balance-of-payments surplus, though sizable, is smaller than last year's. Against this background, French economic policy has remained cautiously expansionary. Although French interest rates have been rising in response to rising rates elsewhere and increasing domestic demand, short-term rates have remained lower than in many European money markets. In order to hold the line on prices by more flexible means than direct controls, the Finance Minister has been empowered to enlarge import quotas for goods subject to very strong price pressures.

During the period under review, significant institutional reforms were made in France or were announced for implementation in the near future. Further steps were taken to develop a mortgage bond market. Several types of banking institutions are now authorized to issue marketable instruments against the mortgages they hold, and banks as well as insurance companies, pension funds, and other nonbanking financial intermediaries are allowed to hold, buy, and sell these instruments. The market will be supported by the government-sponsored Crédit Foncier, which will trade only in instruments of no less than ten-year maturity. In addition, the government proposed in November that minimum cash reserves for the banking system be substituted for the present liquidity coefficient (under which a proportion of a bank's assets must be held in the form of Treasury obligations, medium-term paper, and certain other obligations). The French authorities anticipate that the new system will prove more effective as a credit control mechanism.

On the international side, the French authorities took several steps in November to give commercial banks further flexibility in their foreign operations. A 1963 ordinance forbidding them to pay interest on nonresident accounts denominated in francs was rescinded, and they were allowed to make longer term loans to nonresidents and to engage in forward exchange operations of longer maturity. At the same time, the authorities stated that they would soon allow commercial banks to obtain central bank rediscount facilities on loans to finance French investments abroad. In November, it was announced also that international securities issues would be permitted in France, subject to the same Treasury control as domestic issues. French borrowers, too, would be freer to raise funds abroad through securities issues denominated in foreign currencies.

The Italian economy has been gathering momentum under the stimulus of domestic and foreign demand, and the expansion has spread to the formerly lagging capital equipment and construction sectors. Industrial production is strongly on the rise and unemployment has been declining. However, with ample available resources, wage pressures have been very moderate. From January to September, consumer prices rose by less than 1 per cent. The trade deficit has recently widened as imports have begun to rise more rapidly than exports. But, with a strong tourist account and increased worker remittances from abroad, the current-account surplus during the first nine months of this year was about the same as that of the same period in 1965. Within this context of a fairly balanced expansion, monetary policy has remained relatively easy. Banks still have ample liquidity, some of which they are placing in the Euro-dollar market. Longer term capital outflows have also developed in substantial volume, reflecting the rise of interest rates abroad as against the fairly steady rates in Italy. In October, the Italian Treasury was able to avail itself of domestic liquidity by floating a record $1.1 billion equivalent issue of nine-year bonds—$480 million of which was to refund maturing debt —which was eagerly subscribed by the public and the commercial banks. However, the destruction resulting from the almost unprecedented November floods may slow down the expansion. To meet the most pressing needs of relief, the government has ordered for one year an across-the-board 10 per cent increase in income and other direct taxes, a similar increase in gasoline taxes, and a reimposition (next January 1) of the requirement that certain employers pay social security contributions, which have been paid by the government since the 1963-64 recession.

In Japan, policy has remained on the side of cautious ease. Largely buoyed by booming exports, industrial production has been rising almost steadily since October 1965, when the downswing of the earlier part of 1965 was reversed. Industrial production during January-September 1966 was more than 10 per cent above that of the comparable period last year. Although consumer prices have not risen as steeply as last year, wholesale prices have recently begun climbing more rapidly. Japanese interest rates, which have moved down from previous high levels, are now more roughly in line with those of other countries, and the usual inflow of capital has been reversed by a large margin. To reduce short-term outflows without dampening domestic growth, the Japanese authorities have acted to prevent short-term rates from falling further while allowing long-term rates to continue on a downward trend. In July, all interest rate ceilings were removed on commercial banks' Euro-dollar borrowing. In August, in an effort to combat developing price pressures without tightening monetary policy, the government expanded import quotas in some sectors and restricted exports of some metals.