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Legislation

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(Acts whose publication is not obligatory)

COUNCIL

COUNCIL DECISION

of 22 November 1976

adopting the annual report on the economic situation in the Community and laying down the economic policy guidelines for 1977

(76/916/EEC)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Decision 74/120/EEC of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community ⁽¹⁾, as amended by Council Decision 75/787/EEC ⁽²⁾ and in particular Article 4 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament ⁽³⁾,

Having regard to the opinion of the Economic and Social Committee ⁽⁴⁾,

Whereas, in adopting Council Decision 76/646/EEC of 26 July 1976 ⁽⁵⁾, the Council approved the analysis of the economic situation set out in the Commission communication of 23 June 1976 concerning in particular the preparation of the public budgets for 1977; whereas in accordance with that Decision, the Member States shall pursue economic policies in conformity with the guidelines on the preparation of the public budgets for 1977 which are specified in the Annex to the said Decision;

Whereas the tripartite conference held in Luxembourg on 24 June 1976 discussed in depth the problem of employment and stability in the Community, its conclusions being set out in a joint statement ⁽⁶⁾,

HAS ADOPTED THIS DECISION:

Article 1

The Council hereby adopts the annual report on the economic situation in the Community as contained in Sections I, II and III of the Annex and lays down the guidelines to be followed by each Member State in its economic policy for 1977, as shown in Sections IV and V of the Annex.

Article 2

This Decision is addressed to the Member States.

Done at Brussels, 22 November 1976.

For the Council

The President

W. F. DUISENBERG

⁽¹⁾ OJ No L 63, 5. 3. 1974, p. 16.

⁽²⁾ OJ No L 330, 24. 12. 1975, p. 52.

⁽³⁾ OJ No C 293, 13. 12. 1976, p. 46.

⁽⁴⁾ OJ No C 297, 16. 12. 1976, p. 3.

⁽⁵⁾ OJ No L 229, 20. 8. 1976, p. 1.

⁽⁶⁾ OJ No C 173, 28. 7. 1976, p. 1.

ANNEX

ANNUAL REPORT

ON THE ECONOMIC SITUATION IN THE COMMUNITY AND ECONOMIC
POLICY GUIDELINES FOR 1977

FOREWORD

Under Article 4 of its Decision 74/120/EEC of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community, as amended by its Decision 75/787/EEC of 18 December 1975, the Council, acting on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, is required, during the fourth quarter, to adopt an annual report on the economic situation in the Community and to set the economic policy guidelines to be followed by each Member State in the following year. Once the report has been adopted by the Council, the respective Governments must bring it to the attention of their national parliaments so that it may be taken into account in budget debates.

The guidelines contained in this report may have to be adjusted to take account of economic developments when the Council carries out its annual examination of the economic situation in future.

I. THE SCALE OF THE RECOVERY IN 1976 AND THE CURRENT ECONOMIC SITUATION

Recovery under way, but imbalances continue

1.1. The most severe post-war recession reached its lowest point in the second half of 1975. Since then, the efforts made within the Community and in coordination with other industrialized countries to revive domestic demand have been supported by spontaneous expansionary factors, by increased confidence on the part of individuals and firms, and by a vigorous expansion in international world trade. The growth of trade has helped to consolidate the recovery, especially because the Community and the other industrialized countries, contrary to what many had feared, in general avoided protectionist measures or 'beggar-my-neighbour' policies during the world recession.

The increase in demand and production has not, however, enabled the differences in price and cost trends in Member States to be narrowed to a sufficient extent, nor has it prevented the reappearance of balance of payments imbalances in a number of countries. The recent signs of an almost general slackening in the upward movement of labour costs are indeed encouraging, but it is not certain that this improvement will continue. Besides, underlying inflation still remains too strong. As for the situation on the labour market, it is improving only slowly and in only a few of the Member States, while continuing to deteriorate in many countries in comparison with last year.

Slowing in rate of expansion

1.2. The upturn in economic activity occurred towards the middle of 1975. Until the spring of 1976, industrial production rose very rapidly in almost all Member States. But since then, however, its rate of expansion has lost a good deal of momentum, and even become stagnant in some cases. This pause can be partly explained by a dampening of a number of dynamic factors, such as movement of stocks and demand in the motor vehicle industry, but is also due to the slow growth of private consumption and the continued weakness of fixed investment.

Divergent developments from one sector to another

The rate of recovery in industrial production has differed from one sector to another. Growth has been buoyant in the case of raw materials, intermediate goods, and consumer goods but has been weak for capital goods ⁽¹⁾. Overall, industrial production in the Community in August 1976 was 10½ % up on its lowest level recorded during the recession. However, it is still about 4 % below the record level of 1974.

Growth rate of 5 % in 1976

Compared with the preceding six months, and expressed as an annual rate, the Community's real gross domestic product rose by approximately 2½ % in the second half of 1975 and by 6½ % in the first half of 1976; it will probably show an increase in the region of 4 % in the second half of the year. For 1976 as a whole, the growth rate is expected to be some 5 % compared with a reduction of 2½ % in 1975.

The improvement in the economic situation in the Community has varied in timing and strength from country to country. The annual rate of expansion in real gross domestic product between 1975 and 1976 ranges from about 3 % (Luxembourg and United Kingdom) to about 6 % (Federal Republic of Germany) ⁽²⁾. At the regional level these developments have resulted in a widening of the gap between the most prosperous and the poorest regions in the Community.

⁽¹⁾ See Table 2.

⁽²⁾ See Table 1.

1.3. In several Member States, the economic recovery has brought to a halt the deterioration on the employment front. Almost everywhere, short-time working has been largely eliminated, while the number of hours actually worked have increased in some sectors. By contrast, the scope for productivity gains available in the wake of the recession, and the substantial expansion in the labour force in several countries has tended to prevent any reduction in the number of wholly unemployed. The seasonally adjusted number of wholly unemployed, which stood at some five million at the end of last year, or 4.7 % of the labour force, fell slightly in the first half of the year, but it should be noted that this improvement is almost entirely attributable to developments in the Federal Republic of Germany and France. Since the spring, the number of wholly unemployed has risen with the arrival on the labour market of a large number of school-leavers, with the result that by August 4.9 million people were out of work, or 4.6 % of the available labour force (seasonally adjusted figures) ⁽¹⁾. The number of young people unemployed is at present (early autumn) estimated to be more than two million, which, in the United Kingdom and Italy, is a much higher figure than was recorded a year ago. In several Member States, there has also been a sharp increase in the number of women out of work in 1976, because one result of the recovery has been that persons made redundant during the recession, who had left the labour market, are now seeking jobs once again. In general, unemployment rates have remained substantially greater in the economically weak regions of the Community than in the more prosperous regions, although in the latter there has been in some cases a relatively marked increase in unemployment.

Slowing in private consumption

1.4. After making a substantial contribution at an initial stage to the reversal in the cyclical trends within the Community, private consumption has been expanding at a more moderate rate since the beginning of the year. It is still being maintained by a fall in the rate of savings, which has returned to its long-term level in several countries. By contrast, the slower growth in real disposable income has, in most Member States, had a dampening effect on personal spending. In almost all countries the slackening in the rate of increase in wages has not been entirely offset by the rise in the total number of hours worked. In addition, there has been a less rapid expansion in transfer incomes. For 1976 as a whole, France will probably show the greatest improvement in real gross income per person in paid employment; in Ireland, the Netherlands, Luxembourg and United Kingdom no increase or even a slight fall is expected.

Although personal spending has still been boosted by replacement needs built up during the recession, particularly of motor cars, their impact is bound to have lessened during the year.

Following the high level reached at the beginning of the year, private consumption in the Community is expected to expand in real terms during 1976 by more than 3 %, as against just over 1.5 % in 1975.

Investment climate still lukewarm

1.5. In spite of the incentives introduced and the general tendency for the ratio of wages to gross domestic product to be reduced, the propensity to invest has remained weak in most Member States. In fact, the improvement in profits has mostly been only gradual and has mainly been used to reduce the short-term indebtedness of undertakings. Moreover, in most industries production capacity is still not being used fully, and there is uncertainty as to the general business outlook. For the year as a whole, real gross fixed capital formation is expected to rise only in Denmark, the Federal Republic of Germany and France, i.e. generally in those countries where investment in building and construction has picked up. In most other Member States, the volume of fixed investment is expected to remain below last year's level, so that the Community as a whole will record a modest growth in this demand component of 1.5 % in 1976, following a decline of 5.5 % in 1975.

Recent slackening in the rate of inflation

1.6. The dual tendency, first apparent in 1975, for inflation to slacken and for the economic development of the Community to be more harmonious was abruptly checked last winter. The increase in the prices of imported agricultural goods and raw materials,

⁽¹⁾ See Table 3.

to which currency depreciation has in some cases contributed, was a key factor in the upsurge in both producer and consumer prices in several Member States. Since April, however, the combined impact of more fundamental factors — primarily the slowdown, significant in some countries, in the rate of increase in labour costs and favourable seasonal factors — has greatly helped, in some cases, to reduce the rate of increase of consumer prices.

In the Community as a whole it went down to about 8 % per annum from April to August 1976, compared with a rise of about 14 % from December 1975 to April 1976. It must however be assumed that this improvement will not continue during the final months of the year, given the rise in wholesale prices. For the full year, the increase in consumer prices in the Community can be estimated at over 10 % as against 12.2 % in 1975. The forecast of a 5 % rise in the Federal Republic of Germany compares with a 16 % increase in the United Kingdom and from about 17 % to 18 % in Ireland and Italy, with increases of between 9 % and 10 % for the other Member States ⁽¹⁾.

Sharp recovery in the world economy

1.7. In the early months of 1976, the United States' economy continued to expand briskly and the economic upturn in Japan became more firmly established. In most of the non-member countries in Europe the recovery lagged several months behind the larger economies; it was boosted by the expansion in sales by these countries to the Community. During the spring and summer months, output continued to rise almost everywhere; however, the rate of this expansion proved to be less sustained than at the beginning of the year, particularly in the United States and Japan. Since, in 1976, the rate of growth in real gross product will exceed 6.5 % in the United States ⁽²⁾, it could well reach about 5.5 % for the developed countries as a whole.

... and in international trade ...

1.8. As production recovered, the volume of the industrialized countries' imports has risen strongly since mid-1975. Stock rebuilding in these countries has triggered off a greater demand for raw materials. Purchases of oil, particularly by the United States, have begun to increase once again; this has further boosted the current account surpluses of the OPEC countries, whose own imports have risen much more slowly since mid-1975. The non-oil-producing developing countries are themselves reaping the benefits of a recovery in export demand and the rise in raw materials prices. Nevertheless, in spite of this improvement, they are still running substantial current account deficits which prevent any increase in their imports. Lastly, the purchases of State-trading countries would seem to be marking time. Overall, the volume of world imports — excluding the Community's imports — will probably grow by around 9 % in 1976 (—2 % in 1975).

... triggering off a recovery in exports

1.9. Export demand has played an important role in the short-term development of the economies of the Community during both the recession and the recovery. According to Commission estimates of the net impact of exports on the growth of gross domestic product, taking into account the effects of both domestic and international trade multipliers, almost half of the fall in the Community's real gross domestic product in 1975 can be attributed to the simultaneous contraction of trade among the industrialized countries while almost a third of the estimated expansion in 1976 is expected to be accounted for by the growth in exports. In both 1975 and 1976, intra-Community trade for each of the Member States has been slightly higher in volume than demand from the other OECD countries.

⁽¹⁾ See Table 4.

⁽²⁾ See Table 7.

Deterioration in the payments balances of all the deficit countries

1.10. The Community's trade deficit continued to increase during the first half of 1976 ⁽¹⁾. However, the deficit is now increasing more slowly with the weakening of the initial surge of imports, and the reduction in the rate of deterioration of the terms of trade. The Community's current account deficit has been seriously affected by the drought in 1976, and is expected to rise to about £ 7 000 million compared with a surplus of £ 600 million in 1975 ⁽²⁾.

This overall development hides considerable underlying differences between countries. For most of the deficit countries, differences in the development of prices and costs have been reflected, since the beginning of the year, in a deterioration in exchange rates, the short-term adverse effects of which have again in some cases aggravated external difficulties. In fact, the expected deterioration in the Community's current account balance between 1975 and 1976 will be mainly attributable to the deficit countries, whose combined deficit is likely to have roughly doubled.

II. THE ECONOMIC POLICIES IMPLEMENTED IN 1976

Changes in short-term economic policy ...

2.1. The problem of the direction and intensity of short-term economic policy has become more difficult in 1976. The recovery has concealed only temporarily the serious nature of the underlying questions still to be solved. Since the beginning of the year the differences persisting between countries in price, cost and balance of payments trends have constantly led to further strain on the foreign exchange market which, despite the insufficient reduction in unemployment, obliged several Member States to tighten their short-term economic policies.

... to contain the increasing public deficits

2.2. In August and September 1975, important measures for supporting economic activity were introduced by five Member States. Early in 1976, similar limited measures in the budgetary field were again taken in the Community. Since March the emphasis has, however, been on decisions aimed at containing public deficits. Ireland and Italy in particular have been led to limit their budget deficits as part of the action to promote financial solidarity introduced by the Community. Measures to restrain expenditure have also been taken in the United Kingdom. The economic upswing has in general helped to slow down the growth of public expenditure, in some cases appreciably, and to increase revenue more rapidly than in 1975. As a proportion of national income, budget deficits in all the Member States, except the Netherlands, will be lower than in the previous year. France and the Federal Republic of Germany are, however, the only countries where the deficits will be really substantially reduced ⁽³⁾.

More cautious monetary policy

2.3. In the autumn of 1975, when the tentative signs of economic recovery had been confirmed, the deliberately expansionist character of monetary policy was changed to one of caution. Since last spring, monetary policy has followed a more restrictive course in most of the Member States.

Still rapid growth of liquidity

At the beginning of the recovery, the money supply had increased at a rapid rate as a result of heavy budget deficits. Despite the introduction of a more cautious monetary policy and the reduction in the public sector borrowing requirement, the expansion has only slowed in a small number of cases. Until now demand for personal credit has shown an appreciable recovery, mainly in the Federal Republic of Germany and, more recently, in the United Kingdom.

Recovery of interest rates

Short-term interest rates fell in the Community in 1975, but this development generally ended in the closing months of the year. The monetary unrest then contributed to reversing the course of interest rates. In Denmark, Italy and the United Kingdom short-term interest rates reached record levels at the beginning of the autumn. Long-term interest rates have slightly increased since last spring.

⁽¹⁾ See Table 5.

⁽²⁾ See Table 1.

⁽³⁾ See Table 6.

Strains on the foreign exchange markets

2.4. The relative stability of exchange rates recorded during the recession came to an abrupt end early in 1976. Despite subsequent adjustments to short-term economic policy in the Member States whose currencies were tending to depreciate, the situation remained difficult throughout the summer. Only the lira, following the deposit requirement imposed on purchases of foreign currency and other measures which brought a rise in interest rates, became firmer temporarily, but it was then subjected to a further downward movement. The significance of exchange rate strains is all the greater in that they occurred despite large-scale central bank support measures. During the first half of 1976 exchange rates between the dollar and the currencies within the Community exchange rate system displayed relative stability. Since then the latter have shown a tendency to appreciate.

Search for a social consensus to overcome inflation

2.5. The efforts made by the member Governments to moderate the rise in income and prices benefited in some Member States from the support and cooperation of both sides of industry; in others, however, more or less mandatory measures proved unavoidable. After several years in which wages had moved up sharply, there has been a distinct slowdown in the trend in 1976, except in France and Italy.

Active policy on the labour market

2.6. Most Member States have resorted to a very wide range of employment policy measures so as to make up for the lapse of time before the economic recovery affects the labour market. In general terms, policy has continued to favour the protection of incomes of those unemployed, the prevention of large scale redundancies and the selective granting of employment subsidies, rather than the improvement of professional training and of labour mobility.

III. ECONOMIC POLICY PROBLEMS AND THE ECONOMIC OUTLOOK FOR 1977

3.1. The very rapid expansion which characterized the initial phase of the recovery in the Community has been succeeded during the past few months by more moderate economic activity, owing to the disappearance of certain stimuli.

This moderation suggests that the risks of a boom in the domestic and raw materials markets have been avoided, creating an improved basis for stable growth. On the other hand, there are factors which make it difficult to assess future developments.

3.2. A number of factors suggest that the economic upswing will continue:

- the most recent EEC surveys have confirmed that consumer confidence has increased;
- industrial conflicts have become substantially less acute, while the cooperation of both sides of industry is beginning to bear fruit;
- the rise in prices and in labour costs has become less rapid, except in certain special cases;
- the productivity and profits of undertakings have improved in a number of industrial sectors; as a result of this, the likelihood of an industry-based recovery in demand has improved;

— the improvement in world trade is continuing. Most Member States are at present benefiting from the strong expansion in world imports.

3.3. The slowdown seen in recent months could thus be only temporary; however, a more confident assessment of the prospects for a continuation of the growth phase into 1977 will depend on the trends which emerge during the autumn. In any case, it is unanimously accepted within the Community that greater stability of prices, a reduction in balance of payments deficits and a halt to the deterioration in exchange rates are key conditions for the achievement of durable growth.

Several Member States have recently introduced — partly to contend with growing balance of payments deficits — programmes to fight inflation and rising costs, and also restrictive measures in the monetary field. These decisions carry with them the risk of curbing the expansion of domestic demand and therefore of economic activity. It is not yet possible to evaluate the effect which these stabilization programmes, or actions of this kind yet to be introduced, will have on short-term economic developments in the countries involved and in the other Member States. The fragility of the expansion

has its source essentially in the uncertain development of investment demand. Fears of new monetary disturbances and of a further rise in raw materials prices produce uncertainty which could undermine the confidence of business executives and the growth of international trade. Lastly, balance of payments difficulties, often linked with a high level of unemployment, have increased the risk of import restrictions, the effect of which would be to slow down the development of world trade.

3.4. In present circumstances, the growth rate of real gross domestic product on average in the Community might attain 4 % in 1977, providing the favourable influences continue at work. The volume of private consumption should continue to grow, given that the increase in incomes and the slowing of price increases reinforce consumer confidence. In most Member States, investment in equipment could begin to rise gradually and to an extent which will vary from country to country and from one industry to another. Construction, both of industrial and commercial buildings and of dwellings, will also continue to expand. On the other hand, stock formation will, only briefly, continue to stimulate output. In the majority of the Community countries, external trade is expected to impart the greatest stimulus to activity. Exports to non-member countries could increase in volume at the same rate as intra-Community trade, that is by about 9 %.

3.5. In the developed countries outside the Community, the rate of growth of production in 1977 should be slightly above the longer-term average. In the United States, economic expansion is likely to continue next year but at a slower rate. A recovery of activity is expected in Japan as well as in most of the smaller economies, in which the beginning of the recovery was hesitant. A rate of growth of 5 % to 5.5 % of real gross domestic product for the developed countries outside the Community can be estimated for 1977, as against 5.5 % in 1976. Most of the developed countries, with the exception of the United States, can be expected to experience a more rapid growth in the volume of their imports next year. The gradual improvement in the export revenues of the non-oil-producing developing countries should bring about an increase in their purchases. In total, the volume of world imports (excluding EEC imports but including those of the east European countries) should increase by about 8 % in 1977 ⁽¹⁾. Moreover, one should expect further price increases for industrial raw materials in

1977, as a result of the continued upswing in world economic activity. In most regions in the world, with the exception of those European countries hit by the drought, the harvests of the principal crops appear to be relatively good. The size of food price increases within the Community will thus largely depend on the decisions taken under the agricultural policy.

3.6. Given the reserves of capacity which still exist in most Member States, together with further additions to capacity, the growth of total production in the Community, estimated at about 4 %, would lead to only a slight increase in employment in 1977. The unemployment rate in the Community could fall to a little below 4 % of the labour force which, for most of the Member States, would not represent a good enough improvement. The number of wholly unemployed in the Community would still be at least as high as in 1975.

The outlook for the rate of inflation depends essentially on the success of economic policy and the attitude of both sides of industry. In the absence of determined action by the Member States, already taken in certain cases, it is to be feared that in 1977 the rise in consumer prices for the Community as a whole will scarcely be less than the rate recorded for this year. The effects of the drought on agriculture and any future currency depreciations and import price increases could accentuate this problem.

Continued inflation of this magnitude would be unacceptable. Not only would it undermine the economic recovery, but it would threaten the cohesion of the Community and would prolong the differences in the development of prices and costs within the Community.

3.7. The continuation of the economic recovery, the worsening of the terms of trade and the delayed effects of the 1976 drought will be reflected again in 1977 by a deficit in the balance of payments on current account of the Community. This deficit will only be smaller than in the previous year if import demand in the deficit countries tends to slow and if world demand remains buoyant. The current account surplus of the OPEC countries may grow larger in 1977, while the deficits of the non-oil-producing developing countries and the State-trading countries will tend to decline. In these circumstances the developed countries of the western world must accept for 1977 as a whole a current account deficit greater

⁽¹⁾ See Table 7.

than in 1976, if stagnation of world trade, which would affect the Community in particular, is to be avoided. The efforts made by most Member States to reduce their balance of payments deficits could thus meet with success only if the other Community countries reduce their surpluses, and if developed countries outside the Community, more particularly the United States and Japan, accept corresponding deficits. In the interests of Community solidarity therefore, the process of adjustment within the Community should be eased by:

- the coordination of aggregate demand management, with a view to restraining the growth of consumption in the deficit countries and strongly increasing import demand in the surplus countries;
- the raising of the necessary financial means if the adjustment process within the Community were to appear too slow, or if the other developed countries were not prepared to accept large deficits.

IV. THE GUIDELINES FOR ECONOMIC POLICY

A. General guidelines

4.1. At the end of June 1976, the Governments of the Member States, and representatives of unions and employers' organizations, together with the Commission, resolved to implement a common strategy with the aim of reaching the following medium-term targets ⁽¹⁾:

- the simultaneous restoration of full employment and stability as a matter of priority;
- an annual rate of real growth of the domestic product of the Community averaging around 5 % in the period from 1976 to 1980;
- full employment by 1980;
- the gradual reduction in all Member States of the annual rate of inflation to between 4 % and 5 % by 1980.

4.2. The medium-term guidelines corresponding to these targets were the subject of the fourth medium-term economic policy programme, recently submitted to the Council. The Community must establish, for 1977, an economic policy which is compatible with these medium-term targets and attempts to reduce the wide disparities in the rate of increase of costs and prices between Member States.

4.3. In 1976, Member States were able to register some initial success in their struggle against the world-wide recession. It is, however, to be deplored that the position in the labour market has improved

only very slowly, that the rate of inflation has scarcely fallen, and that the differences in price and cost trends in the Community have hardly lessened.

As things stand at present, the economic outlook for 1977 suggests that the rate of growth, in real terms, of gross domestic product of the Community will be somewhat below the medium-term growth target.

The experience of the initial stage of the recovery has served to highlight, in several Member States, the persistent nature of inflationary expectation, of rising costs and external imbalances, and the handicaps which these factors impose on the growth of total demand. It is to be feared that in 1977 certain Member States, will experience a conflict between the need to reduce the rate of inflation and the balance of payments deficit, and the need to strengthen the economic recovery and to improve the employment situation. If the present weakness in economic growth happened to coincide with the effects of stabilization programmes introduced in Member States the result could be cumulative contraction of internal demand. It would, however, be just as mistaken, in present circumstances, to expect that some stimulus to demand and production would produce quick results in the battle against unemployment. It is highly unlikely that the risks inherent in a policy of economic 'stop-go' and in a worsening of the overall economic equilibrium would be compensated for by the short-term advantages of a forced expansion of demand. Eventually, every Member State could be affected by spreading 'stagflation', as the example of the world recession of 1974 to 1975 has shown.

If, in the present situation, it becomes impossible to avoid the impending conflict between objectives, the difficulties may nevertheless be reduced by:

- overall coordinated intervention both on a Community and world-wide scale;

⁽¹⁾ Joint statement adopted at the conclusion of the Tripartite Conference on employment and stability in the Community, held on 24 June 1976 (OJ No C 173, 28. 7. 1976, p. 1).

- a better appreciation, by both sides of industry, of macro-economic potential;
- an active employment policy combined with measures to promote structural change.

4.4. The overall approach to the Community economy in 1977 must be to ensure that no obstacle is put in the way of the expansion in domestic demand, in those Member States where there are no external economic constraints and where a further slowdown in price increases is likely. This could necessitate a rather cautious reduction in the budget deficits of the countries concerned and also the use of specific measures for job creation and the provision of training places especially if, contrary to expectations, investment demand fails to pick up reasonably vigorously in the months ahead ⁽¹⁾.

In those Member States faced with high underlying rates of inflation, sizable trade deficits, and the threat of a vicious circle of monetary depreciation and rising prices, economic policy must be used to impose some constraints on consumer demand and to make the most of the stimuli provided by export demand. The stronger export demand proves to be and the quicker the reduction in the rate of price and cost inflation is achieved, the more possible it will be to make domestic economic policy less restrictive. Nonetheless, it would be dangerous for all the Member States to consider the expansion of their exports as the principal factor supporting economic activity in 1977.

4.5. In almost all Member States, the return to price stability should have high priority. As far as the United Kingdom is concerned, it is envisaged that the present phase of incomes policy will continue to slow down the rise in prices, in so far as this policy is not thwarted by further non-economic disturbances. In France, the implementation of the stabilization programme decided last September should lead to a significant reduction in the rate of inflation. If Member States made the necessary effort, the annual rate of increase in consumer prices, on average for the Community as a whole, could be reduced to a rate of 7 % to 8 % in 1977 and the difference between rates of inflation in individual Member States could be significantly reduced. In fact, however, the deceleration of price inflation is likely to be less sharp than this, as indirect taxes and charges for public services are to be raised in certain Member States.

⁽¹⁾ It is appropriate to recall, in this context, the obligations of Member States to set five-year public-investment programmes (see Article 6 of Council Directive 74/121/EEC of 18 February 1974 concerning stability, growth and full employment in the Community).

4.6. Monetary policy must play a central role in the steps to be taken to reduce inflationary expectations and to moderate cost and price increases. In almost all Member States, the growth of the money supply remains much too fast to be consistent with the target of reducing the annual rate of price increase to between 4 % and 5 % by 1980. The prior notification by the Member States of targets for the growth of the money supply should exert a stabilizing influence on companies and households in particular with regard to their production, investment and savings decisions and on the behaviour of both sides of industry. For each Member State, the following common criteria for the expansion of the money supply in 1977 should be adopted, over and above the expected changes in the speed at which the money circulates:

- a real rate of growth, consistent with medium-term targets, that would allow a more satisfactory utilization of capacity;
- a rate of price increase that would allow the rate of inflation to be gradually reduced to an annual rate of between 4 % to 5 % by 1980.

As each country's situation is different, these quantitative guidelines will necessarily also differ and should be defined in relation to the various instruments of monetary policy that are available in the various Member States (control of the monetary base, M_2 or M_3 , or total credit). The Governments and central banks must work closely together to ensure that their budgetary and monetary policies and the growth targets for the money supply correspond as closely as possible to each other. The continuous and gradual alignment of the money supply growth targets for the various Member States could contribute significantly towards stabilizing both present and anticipated exchange rate movements.

4.7. The policy on competition is a necessary instrument in the fight against inflation. The Commission proposal concerning the more systematic control of major mergers in the Community ⁽²⁾, should be discussed and implemented as soon as possible. It is also a suitable time to intensify efforts to improve the transparency of the market and the process of price determination particularly through consumer information.

4.8. In order to be able to reduce the large budget deficits in some Member States, it is necessary to increase indirect taxation, as is already foreseen in some Member States, and, in certain cases, to allow

⁽²⁾ Proposal for a Council Regulation on the control of mergers. Doc. COM(73) 1210 fin., 18. 7. 1973.

an adjustment of public sector charges to reflect the increases in costs already sustained. The effect of these measures on prices — at least those which represent higher indirect fiscal charges — should not be compensated for in wage and salary increases. This implies changes in the indexation provisions for wages and other incomes in certain countries.

4.9. The recovery of investment is, for all the Member States, the main problem as far as the strengthening of domestic demand in 1977, and the creation of employment opportunities, are concerned. Government measures in this area can only have a limited scope and effect. An adequate improvement in the profitability of undertakings and in sales, both immediately and in the future, can alone ensure a continued expansion of fixed investment. The investment climate will be determined by the attitudes of both sides of industry when collective agreements come up for renewal. The room for manoeuvre for macro-economic policy will be the greater since both sides of industry will have taken macro-economic requirements into account. Wage and salary agreements should be reached on the basis not of past rates, but rather of the target rates of inflation. Income policies should include elements of a policy on the distribution of wealth.

4.10. The employment situation should improve as a result of increased capacity utilization. However, at a later stage in economic development, this improvement will be hindered by the effect of certain factors. In all Member States, the working population will grow at a faster rate than previously, due to demographic changes. On the other hand, in the present phase of the recovery, the hiring of workers is adversely affected by the uncertainties which surround the economic outlook and by the unfavourable effects of measures designed to make the shedding of labour more difficult. As the use of general budgetary measures to stimulate the economy carries too great a risk of inflation, improvements in the employment situation must be sought mainly through re-channelling Government expenditure into areas conducive to the direct or indirect stimulation, as selective as possible, of job-creating investment. The creation of new jobs and of training places could be temporarily encouraged by employment premiums adjusted to take account of the regional situation. But it would be mistaken to seek to counter the required adjustments by means of subsidies or protectionist measures. All Member States should develop employment policy (retraining assistance, professional training, labour mobility, etc.) in order to gradually reduce structural unemployment and help workers in certain occupations and in certain age groups to adapt to the changes that have occurred.

4.11. Overall adjustment measures are in themselves no longer adequate for fighting both inflation and unemployment, at the same time as bringing about the numerous necessary structural changes. These changes have become more and more necessary in the last few years. In countries with deficits, the redistribution of resources in favour of exports must be continued. In virtually all the countries of the Community, the long-term trend towards a weakening of private sector investment should be reversed at the expense of consumer expenditure and it will be necessary to reduce the relative growth of public expenditure and wage costs which have risen excessively. The structural changes will be needed within the Community, in the relationships with countries which supply raw materials and with the developing countries. The solution to the problems of energy and of the environment, the fundamental changes in the relationship of prices and exchange rates, as well as the basic conditions of the world economy will call for a high degree of regional and sectoral factor mobility. Structural policy will have the task of stimulating transfers from structurally weak to strong sectors, while the onus on the Community Institutions will be to facilitate these transfers at a Community level and to ensure that they are coordinated. The fourth medium-term economic policy programme of the Community should constitute the framework for the realization of structural and social reform in Member States.

4.12. Given the fragile nature of the recovery and the need to reduce budget deficits, it is of the utmost importance that expenditure on regional development, as much at the national as at the Community level, be allocated in the most efficient way so as to induce investment which from the geographical viewpoint is most likely to resolve the problems of structural unemployment. So as to preserve the cohesion of the Community and to move on towards further integration in a situation of weak investment, Community regional policy should be strengthened, and its financial means and instruments of adjustment reinforced. The public expenditure policies of the Member States should be determined with greater reference to their likely impact on regional development and in such a way as to increase their effectiveness at the Community level.

B. The guidelines for Member States

In *Denmark*, the deterioration in the current balance of payments, with the deficit reaching 6 000 million kroner in the first half of the year, and the forthcoming renegotiation of wage and salary agreements have recently led the authorities to reinforce an already restrictive economic policy and

continue to maintain a strict incomes policy. The measures taken in August are intended basically to limit the growth in nominal incomes and costs for the next two years and give a strong brake to the expansion in consumer demand. Although a slowdown in imports and a growth in exports can be expected, the latter, which depends on the buoyancy of world trade, may not be sufficient to give an additional impetus to private investment. Thus growth may be held back, reaching at most 3 % for 1977 as a whole. For this reason the employment situation could tend to worsen.

Given that the increases in salaries and other incomes should not exceed 6 % for each of the next two years, such a framework will have additional moderating effects on consumer price increases, which for 1977 as a whole should be below 8 % (including changes in indirect taxation).

The budgetary policy, used as a supplementary instrument to incomes policy, relies principally on severe increases in indirect taxation as well as cutbacks in current and capital expenditure. However, conjunctural developments could lead to a reduction in tax revenue as well as to additional expenditure. Thus, for the deficit for the 1977/78 financial year not to exceed the norm of 11 500 million kroner fixed last June, the authorities must ensure that expenditure which is not automatically linked to conjunctural developments is maintained within the appropriate limits.

Monetary policy should endeavour to limit domestic liquidity creation with a view to ensuring the financing of the external current account. In this respect the ceiling on lending by banks and other credit institutions should be kept fairly tight so as to encourage undertakings to borrow abroad, and the central government borrowing requirement should be financed in a non-inflationary way. In addition, credit policy should be flexible and selective, priority being given to export sectors.

In the *Federal Republic of Germany* the economic revival, which has developed considerable momentum in the initial phase, has continued at a calmer pace in the past few months. After slowing down a little in the summer, investment demand has picked up again recently, and export demand has continued to provide a very vigorous stimulus.

Growth in private consumption, on the other hand, is still sluggish. Stock building too, has been less buoyant.

With expenditure on consumption likely to rise and export demand buoyant, expansionary forces will probably gather again in the near future. However if steady economic growth is to be maintained, it is essential that the distinct improvement in company profits be safeguarded, and, sustained by favourable sales prospects, be reflected in a sustained increase in investment activity. In the circumstances it should be possible for the gross domestic product in real terms, to grow by an average of at least 5 % in 1977. Even under relatively favourable conditions for growth, the structural problems on the labour market will ease only gradually, so that selective measures are still necessary to reduce imbalances in certain sections of the labour market. Despite a further rise in demand all groups involved in economic activity should continue their efforts to curb the upward movement of prices. An attempt should be made, on the basis of the stabilization achieved so far, to restrict the average increase in consumer prices in 1977 to around 4 % at the most. The growth in the value of the gross national product could be between 9 % and 10 %.

Monetary and credit policy should finance prospective growth, but should continue to ensure that the monetary scope for wage and price increases remains limited. Because of the increase in the velocity of circulation of money, and taking into account the expected level of liquidity in the economy at the end of 1976, the target for the expansion of the monetary base should in any case be below the rate of growth in value of the gross national product.

With the economy moving further ahead, the policy introduced in 1975 of reducing the heavy structural deficits of the public authorities, particularly the Federal Government and the 'Länder', should be continued cautiously, thus gradually creating more room for the expected increase in the private sector's financing requirements. In trying to improve the budget structure, care should also be taken to see that public investment in real terms does not go on falling, in particular, to enable the desired rate of growth to be attained, where necessary. The planned spending policy and the increase in revenue, mainly due to the economic upswing, should bring the combined Federal Government and Länder deficit — not including the planned increase in value-added tax — to well below the amount, some DM 50 000 million, expected for 1976.

In *France*, the major imbalances which appeared in the course of the past recession have not yet been eliminated. The continued search for higher real disposable income both by salary and non-salary earners, while the national product is growing less rapidly, is still generating rapid increases in costs. The rate of price rises no longer seems to be falling below its present unacceptable level. On external markets, the resulting deterioration in competitiveness, on top of certain exogenous factors, is aggravating the trade deficit and so putting pressure on the franc, thus reinforcing domestic inflationary pressures.

The recovery in growth has not brought with it a solution to these problems. A cautious attitude has been generally evident: hesitancy in consumption and with regard to any rapid increase in cash savings, and sluggishness in investment being the most noticeable examples. Thus, a return to balanced and durable growth, particularly in areas of costs and employment, has necessitated a re-orientation of economic and social policy designed to encourage confidence, by cutting back price rises and restoring external equilibrium, and satisfying aspirations for a more just distribution of income.

The series of measures adopted recently may set the French economy towards a marked reduction in inflation and a re-establishment of external equilibrium. Indeed, they should enable:

- cost increases, currently the principal source of inflation, to be rapidly curbed by limiting the overall growth in incomes;
- investment to recover;
- a gradual return to be made to balancing the Government budget, at the same time allowing for a redirection of public expenditure and adjustments to the tax system for the purpose of sustaining economic activity;
- the financial position of the social security system to be improved;
- the rate of money creation to be regulated in such a way as to avoid any restrictive effect;
- imports to be limited by cutting back on oil purchases;
- a start to be made in the reorganization of the tax system in order to bear more heavily on higher incomes and begin (by a reduction) to bring the

rate of value added tax into line with the average applied in the Community as a whole.

Overall, these measures are likely to result in a less rapid rise in final internal demand: in this event the rate of increase in gross domestic product in real terms of 4.5 % sought by the French Government for 1977 will be more difficult to reach. The opportunities for a considerable reduction in the rate of increase of prices exist; the increase should not exceed 7 % to 8 % on an annual average basis, which is consistent with a 6.5 % increase in the course of the year. Finally, the improvement should be equally marked in the balance of payments on current account.

It is important that this plan be put into operation with determination and continuity. The effective increase in central government expenditure should not exceed 13 % and if necessary the appropriate measures should be implemented in order to prevent this figure being exceeded by the local authorities. The guidelines set for the monetary aggregates in 1977 (M_2 : + 12.5 %) should be respected. Finally, it will be essential to continue the reorganization of the tax system to produce greater equity.

In *Ireland*, growth should continue in the coming months, because of a relatively sustained increase in private consumption and exports and despite a persistently low level of private investment. For 1977 as a whole the real growth rate of gross domestic product could be around 3 %. The employment situation should therefore only improve slowly and the unemployment rate could remain high. Although diminishing in significance somewhat from the middle of the year, the factors behind the rise in prices will undoubtedly remain relatively important, the delayed effect of the depreciation of the pound adding to the growth in internal costs. Despite a slower increase in the volume of imports, the current balance of payments deficit is unlikely to be reduced.

Under these conditions and with the aim of improving employment in the longer term, economic policy will have to be directed primarily at the fundamental problem of cost increases. To this end a strict incomes policy should be implemented, with the aim of substantially curtailing the rise in wages, salaries and other incomes in the course of the year, so that it can be pegged in 1977 to 10 %, including the carry-over from 1976. Such a development would permit a reduction in the inflation rate for the year as a whole to around 13 % and to 10 % for the final quarter of the year. It will also be essential to begin preparing the basis of a more restrictive income agreement for 1978.

In this context, current budgetary policy will have to be restrictive and ensure notably that the net

borrowing requirement of the central government registers a further relative decline in 1977. This would mean that it should not exceed the figure contemplated in the budgetary outlook for 1976. This guideline implies a strict limitation in the rate of growth of expenditure, which should be below that of gross domestic product in value, or, should the occasion arise, further fiscal measures.

In order to help re-establish the basic balance in the economy, monetary policy should aim in 1977 at keeping the increase in the money supply, (M_3), below that expected for gross domestic product in value ($\pm 16\%$). Such a development would be facilitated by the less rapid growth in the public sector borrowing requirement, given that this requirement can to a sufficient extent be financed by non-monetary means.

In *Italy*, economic recovery was marked in the first half of the year and during the summer of 1976. Employment increased and capacity utilization was much higher. At the same time, however, prices have continued to soar and in the first half of the year the balance of payments suffered a very substantial deterioration. Although the balance of payments was again in surplus in July-August, principally due to seasonal factors, and the price momentum slowed down in the middle of the year, the external and internal equilibrium, as reflected in another lira crisis at the end of September/beginning of October, remained extremely fragile, while unemployment only fell slowly.

There is no doubt that, if free rein were given to the spontaneous growth of internal demand, strong pressures on the balance of payments might well recur. Taking into account the low level of official foreign exchange reserves, the balance of payments accordingly represents a powerful constraint on economic policy.

The policy should therefore be one of extreme caution and be aimed, by an appropriate series of conjunctural and structural measures, at keeping the growth of internal demand within narrow limits while at the same time encouraging investment and thus strengthening Italy's international competitiveness and reducing its dependence on imports. Such a policy would also have beneficial effects on the development of employment. In addition, investment

in housing, which is labour intensive and uses relatively few imports, should be maintained.

In order to lay the foundation for durable and balanced growth in production and employment, it is also essential to moderate the growth of unit production costs. In this context a policy should be implemented, with stability as its objective, for the purpose of adopting the present system of wage indexation.

In the area of public finance, the requirements of conjunctural policy as well as longer-term considerations, impose a particularly tight framework on budget management. It will be necessary firstly for the ceiling of 13 800 000 million lira, set by the Council last March for the net public borrowing requirement, to be strictly respected. Anything above this limit could well result in further untimely growth in the money supply. For 1977 the net public borrowing requirement should remain within this limit and consequently its ratio to gross national product would be further reduced by a substantial amount. To this end it will not be sufficient to increase the revenue from the fiscal system by allowing less time for credit repayment and intensifying the campaign against tax evasion. Selective increases in taxes and the cost of public services are also necessary to increase State revenue and reduce its expenditure on subsidies and, consequently, put a brake on consumption. A better quantitative movement in public expenditure should be sought both at central and local level. Savings should be looked for on the current expenditure side, to compensate partially for supplementary charges, related notably to the industrial reorganization plan and the increased assistance which will have to be given to local authorities as far as possible in return for improvements in administration. It will be essential in any case to aim at bringing the rate of increase of budgetary expenditure markedly below the 25 % expected for 1976. It will also be necessary to reduce substantially the contribution of the Central Bank in financing the deficit.

In addition, in anticipation of the usually difficult period at the end of the year, the monetary authorities should ensure that the trend towards rapid expansion in liquidity is kept in check sufficiently to avoid serious difficulties on the foreign exchange market. Account should also be taken, by appropriate means, of the effect on liquidity of the gradual reduction, recently authorized by the Commission, of the compulsory deposits lodged with the Bank of Italy for purchases of foreign currency.

To this end, even the broad version of the money supply (M_2) from 1976 to 1977 should be closely monitored, as the intermediate objective is always overall credit. In addition, it seems necessary, in view of the difficult position of the balance of payments, to keep interest rates well above the rates abroad.

The measures recently adopted and announced by the Italian authorities show that they see fully the necessity of directing economic policy on the lines traced above. These measures mainly involve an increase in taxes and the cost of public service of some 5 000 000 million lira, most of which would be used to reduce the budget deficit. It is indeed essential to achieve such a reduction in the budget deficit and necessary to improve the structure of budgetary expenditure, by reserving as much as possible for investment purposes. These measures should result in a marked reduction in the relative share of the money supply in financing the budget deficit.

Under these conditions, the growth of gross domestic product in volume between 1976 and 1977 will be necessarily a lot less rapid than between 1975 and 1976. At the same time the rise in consumer prices should be limited to not more than in 1976; this implies a slowdown in the inflationary trend if account is taken of the effect on prices of increases in the cost of public services.

In the *Netherlands*, where economic activity levelled off in the first half of 1976 and where unemployment continued to rise until the autumn, the medium-term employment outlook is unlikely to improve unless the rates of increase in labour costs slows down and productive investment becomes more profitable. Consequently, the main economic policy objective must be to establish the conditions for reversing these trends. In 1977 a growth in gross domestic product of about 4.5 %, an increase in consumer prices not higher than 7 % and a rise of 8 % to 8.5 % in wage earnings per head would simultaneously improve the medium-term outlook and help to reduce the differences in the Community economies.

Since the current level of unemployment is largely attributable to structural factors and cannot be reduced by overall measures to stimulate demand, budgetary policy should aim at stimulating investment and consequently employment. This would necessitate a gradual return to a tighter budgetary policy. This implies, for 1977, a stabilization of the net borrowing requirement at about 12 000 million guilders, which is a considerable reduction in proportion to gross domestic product. Since further increases in the tax burden are to be limited, this objective will have to be attained mainly

by cutting back the rise in current expenditure and, in particular, social transfer payments.

A return to stricter budgetary policy would have two advantages: firstly, it would make it easier to finance investment by undertakings outside the energy sector, whose own resources are still well short of actual needs, and secondly, it would enable the authorities to implement a monetary policy designed to encourage capital movements compatible with the surplus on current account. This policy should permit the monetary authorities to limit the increase of domestic liquidity for 1977.

In *Belgium*, where economic activity seems to have marked time since last spring and where recent rises in the prices of raw materials and certain agricultural products, together with probable future increases in wages and salaries, point to the danger of a new inflationary surge in consumer prices, economic policy should aim at a growth in gross domestic product of about 4 % and at keeping the increase in consumer prices below 8 % to 9 %.

Such a development alone would make it possible, in fact, to remove the threat that still exists to employment and to the equilibrium in the foreign exchange markets. Since this objective cannot be attained by means of budgetary policy, at least in the current situation, efforts should continue — especially when the effects of the economic recovery programme come to an end — to align income formation procedures with the essential requirements of an open economy operating under the constraints set by close monetary cooperation with other Member States. It is important that the sacrifices imposed be shared fairly between the various socio-economic groups.

Budgetary and taxation policy must gradually be adapted to medium-term objectives. As sources of finance are already limited, this approach would imply, for 1977, a definite slackening in the rise in expenditure and a reduction in relative terms in the net borrowing requirement. Within this framework, the net central Government borrowing requirement should not in the end exceed Bfrs 145 000 million.

By making it possible to relax the restrictive monetary measures adopted in 1976, this relative decline in the borrowing requirement would be likely to ease the financing of private investment. Thus stricter budgetary control might well contribute to balance on the exchanges and reduce the differences in rates of inflation for countries within the 'snake'. A watch must be kept on the rate of increase in lending to households and undertakings in

1977 to ensure that it does not encourage demand by inflation or excessive foreign commercial debts.

In *Luxembourg*, the expansion also seems to have lost a little momentum in recent months. Owing to the prospect of a relatively good level of corporate investment and private consumption, the volume increase in national expenditure should be higher next year. Exports should also continue to expand appreciably, but the steel industry will not benefit very much, as its sales are likely to remain relatively low.

Within the framework of a convergent economic policy for the Community as a whole, Luxembourg could expect a growth rate in gross domestic product of about 4.5 % in 1977 and should aim at limiting the rate of increase of consumer prices 8 % to 8.5 %.

The aim of budgetary policy should therefore be the gradual, medium-term consolidation of the public finance situation, once the revenue depreciation and increased expenditure due to adverse short-term conditions have been absorbed.

Economic activity in the *United Kingdom* continued to recover in 1976, led by strong growth in exports and a turnaround in stock building. The rate of inflation was considerably lower than in 1975, but the underlying rate remained virtually unchanged during the year, largely as a result of increases in commodity prices and the sharp fall in the sterling exchange rate. Partly because of the up-turn in economic activity, the current account of the balance of payments remained in substantial deficit. Unemployment, however, continued to increase.

The Government refrained from general reflationary measures which might have weakened the balance of payments and aggravated inflationary pressures, and, notwithstanding the large public sector borrowing requirement (PSBR), budgetary policy could be regarded as being slightly restrictive. Indeed, the net tax cuts, announced in April for the fiscal year 1976/77, did not reduce the overall tax burden and, in addition, the direct tax element of the package was largely made conditional upon an agreement with the trade unions (reached in June) on achieving sufficient restraint in wage and salary increases in the 12 months to July 1977.

Despite the Government's relatively cautious economic policy and the encouraging trends in the first few months of the year both for inflation and the balance of payments, sterling weakened considerably

during the period March to early June. In response to this crisis, the Government announced on 7 June a short-term credit stand-by of \$ 5.3 billion⁽¹⁾, followed by a programme of public expenditure cuts and increases in social security contributions announced on 22 July. These moves were designed to restore confidence and to underline the Government's determination to control the level of public expenditure.

Renewed pressure on sterling in September led the Chancellor of the Exchequer to announce on 29 September the UK Governments' intention to apply to the International Monetary Fund for its remaining credit tranches with the fund to be made available.

At the same time the Bank of England has twice raised its minimum lending rate (MLR) and called for special deposits from the commercial banks. The effect of these measures will be to reduce surplus liquidities and ensure monetary discipline.

Notwithstanding the weakness of the sterling exchange rate, the Government's overall economic strategy, by helping to reduce inflationary expectations, has considerably improved the prospects for a period of sustained economic growth. Between 1976 and 1977, real gross domestic product should grow by about 3 %. As this rate of growth is not expected to exceed, by more than a small margin, the trend rate of increase in productive potential and as the supply of labour could well continue to expand in the short-term, the outlook for unemployment in the next 12 months is particularly uncertain; however, a substantial fall in the level is unlikely to occur. The Government's industrial strategy should go some way towards easing the unemployment situation and raising the level of industrial investment.

The Government should give priority to achieving a further reduction in the rate of inflation and should, in particular, aim for a resumption, as soon as possible, of a significant deceleration as the year progresses. Such an objective, combined with the need to improve the balance of payments, means there will be no scope, in the near future, for any move to a reflationary stance of budgetary and monetary policies. Indeed, given the size of the public sector deficit, now foreseen for 1977/78, even the level of demand forecast for 1977 could lead to problems of financing and resource allocation, with the danger of renewed inflationary pressures, as the recovery proceeds.

⁽¹⁾ Arranged with the Central Banks of the Group of Ten (except Italy), Switzerland and the Bank of International Settlements.

An important element of the Government's strategy for reducing the rate of inflation must be the continued reduction of the PSBR. Therefore, the Government's July measures aiming at a PSBR of £ 9 billion for the fiscal year 1977/78, are to be welcomed as a contribution to that end and should be a permanent element of Government policy for the coming year.

During the past year, the Government's policy on incomes has played an important role in bringing down the rate of inflation. If further progress is to be made — itself a prerequisite for an improvement in employment prospects in the longer term — some form of incomes restraint will continue to be necessary after July 1977. This could take the form of an incomes policy that includes some limited

provisions designed to alleviate the anomalies in the structure of relative wages that have occurred over the past two years. Decisions on the broad principles of such a policy should be determined in close cooperation with both sides of industry and be adopted early in 1977, long before the present 4.5 % pay policy expires. This would not only permit some degree of synchronization of budgetary and incomes policies, but would also avoid a period of uncertainty with its possible adverse effects on confidence both at home and abroad.

The stance of monetary policy should be distinctly restrictive with attention being focused, in particular, on controlling the expansion of domestic credit whilst ensuring an adequate supply of funds to priority borrowers.

V. CONCLUSIONS

Since mid-1975, the Member States of the Community have achieved some initial success in overcoming the worst recession in the post-war period. Since the summer of 1976, with the decline of earlier expansionist forces, the powerful upward tendency has given way to a steadier economic trend. This has reduced the danger of too strong a boom, but at the same time many Member States have been the re-emergence of earlier imbalances.

The labour market situation has improved only slowly. Balance of payments deficits have increased, inflation rates are high and the wide differences in price and cost trends between the Member States

have remained almost unchanged. Exchange rate relationships continue to be unstable.

In some Member States, drastic programmes have been introduced or are being drawn up to overcome domestic and external trade and payments imbalances. The success of these programmes will determine the progress achieved in consolidating the economic upswing and in developing greater convergence in economic trends within the Community. To postpone the necessary adjustments any further would be to make the return to full employment and stability all the more difficult and painful.

APPENDIX

TABLE 1

MAIN MACRO-ECONOMIC AGGREGATES (a)

	Gross domestic product (volume)					Consumer prices (b)				
	% changes on preceding year									
	Average 1968- 1972 (c)	1973	1974	1975	1976	Average 1968- 1972 (c)	1973	1974	1975	1976
Denmark	4.8	3.0	1.6	- 1.0	5.0	5.6	8.5	15.0	8.8	9.0
Germany	5.5	5.1	0.7	- 3.3	5.7	3.8	7.0	7.3	6.1	4.5
France	6.0	5.2	2.9	- 1.3	5.0	5.3	7.1	13.9	11.5	9.5
Ireland	5.0	5.6	0.8	- 0.5	3.5	7.5	11.8	15.7	21.3	18.0
Italy	3.9	6.8	3.4	- 3.7	4.5	5.1	12.1	20.2	17.4	17.0
Netherlands	5.7	4.1	2.9	- 0.9	3.7	6.0	8.8	10.0	10.5	9.5
Belgium	5.4	6.3	4.2	- 1.8	3.7	3.5	6.0	13.0	12.1	9.0
Luxembourg	4.3	7.1	3.4	- 7.7	3.1	3.9	6.1	9.5	10.7	9.0
United Kingdom	2.2	5.3	0.2	- 1.6	3.0	5.6	8.7	15.4	22.0	16.0
Community	4.7	5.2	1.8	- 2.4	4.8	5.2	8.3	12.6	12.2	10.3
	Number of unemployed as a % of the total labour force (d)					Balance on current account (⁰ 000 million \$) (e)				
	Average 1968- 1972 (c)	1973	1974	1975	1976	Average 1968- 1972 (c)	1973	1974	1975	1976
Denmark	1.3	0.9	2.4	5.2	4.9	- 0.3	- 0.5	- 1.0	- 0.5	- 1.7
Germany	0.8	1.0	2.2	4.1	4.0	1.1	4.3	9.2	3.1	2.0
France	2.0	2.1	2.3	3.8	4.3	- 0.4	- 0.7	- 7.0	- 0.2	- 3.6
Ireland	5.6	6.0	6.4	9.2	10.0	- 0.1	- 0.2	- 0.7	0	- 0.3
Italy	3.4	3.5	2.9	3.3	3.5	1.8	- 2.5	- 8.0	- 0.5	- 2.8
Netherlands	1.6	2.4	3.0	4.3	4.7	0.1	2.3	2.0	1.6	2.2
Belgium	2.3	2.4	2.6	4.5	6.0	0.6	1.1	1.0	1.0	0.8
Luxembourg	—	—	—	0.2	0.4	0.6	1.1	1.0	1.0	0.8
United Kingdom	2.9	2.6	2.6	4.0	5.5	0.9	- 2.0	- 8.4	- 3.8	- 3.2
Community	2.1	2.1	2.5	3.9	4.5	3.7	1.8	- 12.8	0.6	- 6.7

(a) 1968-1975: actuals; 1976: estimates.

(b) On a national accounts basis.

(c) Geometric mean of annual changes between 1967 and 1972; unemployment and current balance of payments: arithmetic mean over five years.

(d) As a result of disparities in definition, unemployment statistics cannot be compared between countries but only reflect development within each country.

(e) Sum of components may not exactly equal total because of rounding differences.

Source: SOEC and Commission departments.

TABLE 2
CHANGES IN INDUSTRIAL PRODUCTION ⁽¹⁾
(as % of seasonally adjusted data)

	% change on preceding year					% change on pre- ceding half-year		% change on preceding months							
	1973	1974	1975	January to August 1975	August 1975	August 1976	First half 1975	Second half 1975	Second half 1976	March	April	May	June	July	August
Annual average															
Denmark	3.2	:	:	:	:	:	:	:	:	:	:	:	:	:	:
Germany	7.2	-1.5	-6.2	7.7	7.9	7.9	0.6	6.3	6.3	-3.3	4.5	-0.3	0.8	-1.0	1.1
France	7.8	2.4	-8.8	7.8	9.3	9.3	-1.1	8.2	8.2	1.7	1.2	-1.1	0.8	-0.7	-2.7
Ireland	9.9	2.9	-6.1	8.2 ⁽⁴⁾	9.0 ⁽⁵⁾	9.0 ⁽⁵⁾	1.1	6.9	6.9	5.2 ⁽⁶⁾	:	:	1.2 ⁽⁶⁾	:	:
Italy	9.7	3.9	-8.8	9.4	14.7	14.7	-1.1	9.0	9.0	1.5	-0.6	5.4	-2.2	0.5	-3.8
Netherlands	6.0	3.3	-5.1	5.4	7.7	7.7	-1.2	6.1	6.1	0.3	-0.1	-0.2	0.2	-0.9	-0.2
Belgium	6.2	4.0	-10.0	5.4 ⁽²⁾	6.5 ⁽³⁾	6.5 ⁽³⁾	-3.9	9.2	9.2	-0.5	6.0	-2.5	2.7	-5.4	:
Luxembourg	12.0	3.5	-21.9	4.7	39.7	39.7	-11.6	13.8	13.8	1.1	2.8	8.7	-3.3	-8.0	-0.4
United Kingdom	8.2	-2.6	-5.0	0.0	3.8	3.8	-3.7	2.7	2.7	-1.7	1.0	1.5	-3.7	2.1	-0.7
Community	7.5	0.5	-6.9	6.1	8.5	8.5	-1.0	6.3	6.3	-1.1	1.8	0.7	-0.2	-0.4	:
Investment goods	6.5	2.7	-2.8	-1.0 ⁽²⁾	-1.8 ⁽³⁾	-1.8 ⁽³⁾	-1.7	1.5	1.5	-2.3	2.8	0.9	-1.3	(-2)	:
Consumer goods	6.8	-1.2	-3.9	6.3 ⁽²⁾	4.1 ⁽³⁾	4.1 ⁽³⁾	1.0	5.5	5.5	-1.6	4.0	0.1	0.5	(-2)	:
Raw materials and producer goods	8.6	0.3	-10.2	8.0 ⁽²⁾	12.6 ⁽³⁾	12.6 ⁽³⁾	-1.9	8.8	8.8	0.3	1.3	1.6	-0.1	(0)	:

⁽¹⁾ Excluding building and construction, and for France the food, drink and tobacco industry.

⁽²⁾ January to July.

⁽³⁾ July 1976 over July 1975.

⁽⁴⁾ January to June 1975 over January to June 1976.

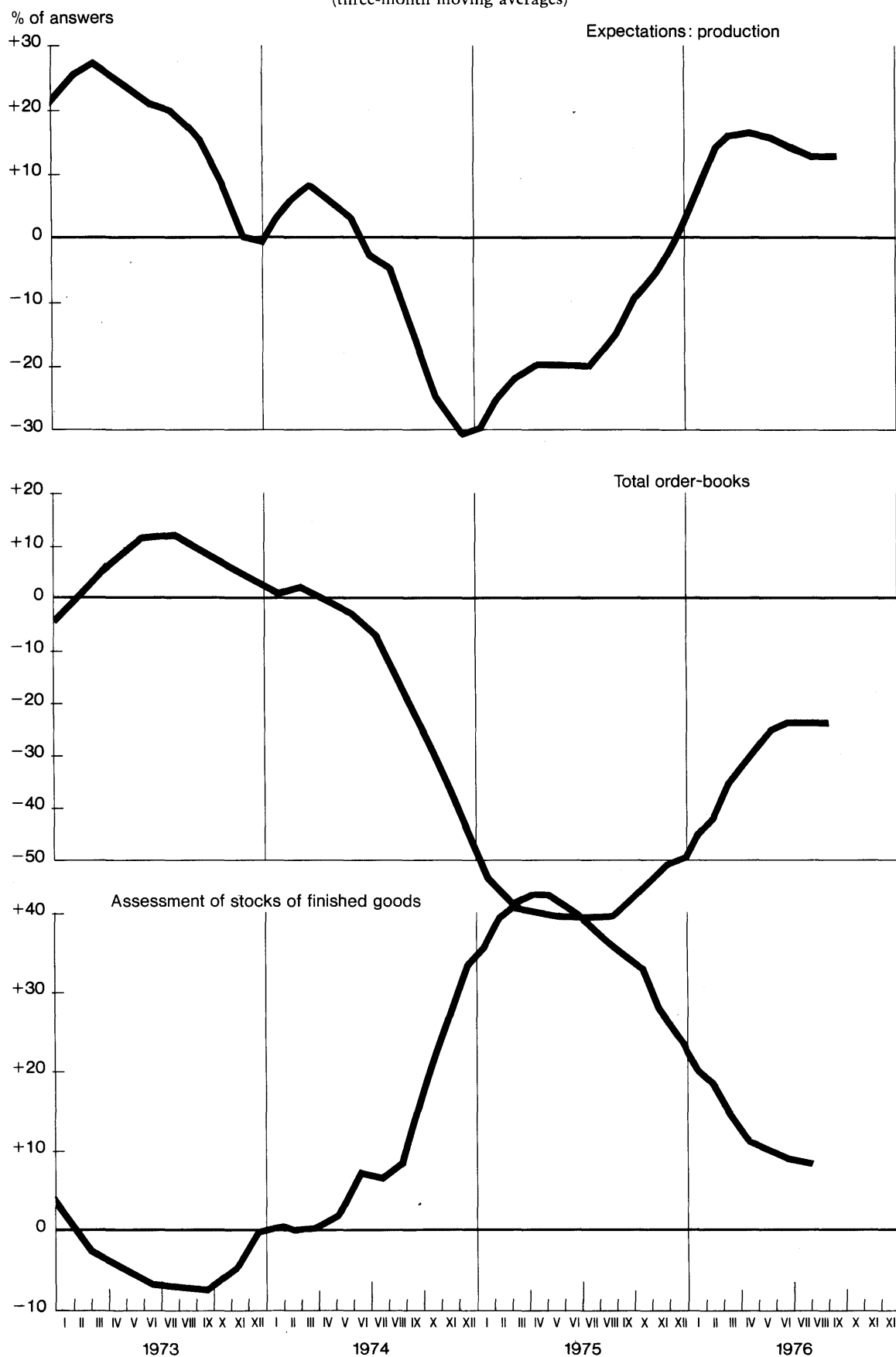
⁽⁵⁾ Second quarter of 1976 over second quarter of 1975.

⁽⁶⁾ Change on preceding quarter.

Source: SOEC

: = Data not available.

CHART A
RESULTS OF THE BUSINESS SURVEY ⁽¹⁾ OF COMMUNITY INDUSTRY ⁽²⁾
(three-month moving averages)



⁽¹⁾ Excluding construction food, beverages and tobacco.

⁽²⁾ Original Community.

TABLE 3

UNEMPLOYMENT

(a) Number of unemployed persons (as % of the civilian labour force) ⁽¹⁾

	Annual average			1975				1976				
	1973	1974	1975	March	June	Sep- tember	De- cember	March	June	July	August	Sep- tember
Denmark	1.0	2.1	5.2	5.2	5.6	5.5	5.7	4.6	4.9	5.0	4.8	:
Germany	1.0	2.2	4.2	3.9	4.3	4.5	4.5	4.4	3.9	4.0	4.0	3.9
France	1.2	2.2	3.8	3.4	3.7	4.2	4.4	4.3	4.1	4.1	4.1	4.1
Ireland	6.0	6.4	9.2	8.6	9.3	9.5	9.7	9.7	9.9	10.2	10.2	10.1
Italy	3.4	2.8	3.4	3.2	3.5	3.6	3.8	:	:	4.0	:	:
Netherlands	2.4	2.7	4.1	3.7	4.1	4.4	4.4	4.3	4.4	4.5	4.7	4.6
Belgium	2.8	3.0	4.9	4.2	4.8	5.4	6.1	6.4	6.7	6.9	7.0	6.9
Luxembourg	—	—	0.2	0.1	0.1	0.2	0.3	0.3	0.3	0.3	0.3	:
United Kingdom	2.5	2.3	3.8	2.9	3.5	4.3	5.5	5.0	5.4	5.7	5.7	5.2
Community	2.1	2.5	4.0	3.5	3.9	4.3	4.7	4.5	4.5	4.6	4.6	:

⁽¹⁾ Seasonally adjusted series except for Italy: ISTAT figures; as a result of disparities of definition, data cannot be compared between countries. For Ireland, percentage of the total labour force.

(b) Vacancies (as % of the number of unemployed persons) ⁽¹⁾

	1975				1976				
	March	June	September	December	March	June	July	August	September
Denmark	0.7	0.6	0.6	0.9	2.0	1.8	1.7	1.7	:
Germany	24.4	19.0	17.8	18.7	20.7	23.6	23.3	22.5	21.5
France	14.7	10.3	9.8	10.9	12.3	13.7	14.1	14.3	:
Netherlands	29.6	20.8	18.6	19.2	20.6	20.1	19.0	18.3	:
Belgium	2.7	1.0	1.0	1.4	1.5	1.4	1.4	1.4	:
United Kingdom	25.6	14.7	10.3	8.1	8.8	7.6	7.3	7.8	7.5

⁽¹⁾ Seasonally adjusted series. Statistics not available for Ireland and negligible for Italy and Luxembourg.

: = Data not available.

Source: SOEC and Commission departments.

TABLE 4
CHANGES IN CONSUMER PRICES ⁽¹⁾

(% changes)

	% change on preceding year				% change on preceding half-year		% change on preceding month					
	1973	1974	1975	August 1975 August 1976 (³)	First half 1975 Second half 1975	Second half 1975 First half 1976	April	May	June	July	August	September
Denmark	12.6	15.5	4.3	7.7	0.9	6.9	0.3	1.0	— 0.2	0.1	0.7	:
Germany	7.9	5.8	5.4	4.0	1.3	3.2	0.6	0.4	0.3	— 0.4	0.4	0.0
France	8.5	15.2	9.6	9.5	4.3	4.7	0.9	0.7	0.4	1.0	0.7	:
Ireland (²)	11.4	17.0	20.9	18.9	1.9	14.0	:	6.2	:	:	1.5	:
Italy	12.5	24.5	11.2	17.0	5.0	10.8	2.6	2.0	0.5	0.5	1.1	:
Netherlands	8.2	10.9	9.1	8.3	4.1	5.0	2.1	0.4	0.0	— 0.5	1.0	1.1
Belgium	7.3	15.7	11.0	9.3	5.4	3.7	0.9	0.7	0.2	0.8	0.4	1.3
Luxembourg	6.1	11.2	10.9	9.4	5.1	4.5	1.4	0.6	0.1	0.8	0.8	0.1
United Kingdom	10.6	19.1	24.9	14.3	6.5	6.8	1.9	1.1	0.5	0.2	1.4	1.3
Community	9.5	14.8	11.8	10.2	4.0	5.8	1.3	0.9	0.4	0.3	0.8	:

(¹) Data relate to the last month of each period.

(²) Ireland, quarterly data.

(³) Germany, Netherlands, Belgium and Luxembourg: September 1976 over September 1975.

: = Data not available.

Source: SOEC and Commission departments.

TABLE 5
DEVELOPMENT OF BALANCES OF TRADE
(in million \$ US, seasonally adjusted)

	1973	1974	1975	1974				1975				1976	
				I	II	III	IV	I	II	III	IV	I	II
Denmark	- 1 720	- 2 313	- 1 770	- 688	- 722	- 492	- 411	- 308	- 393	- 418	- 651	- 732	- 660
Germany	+ 12 366	+ 19 645	+ 13 990	+ 5 112	+ 5 131	+ 4 532	+ 4 870	+ 4 838	+ 2 975	+ 3 181	+ 2 996	+ 3 516	+ 3 397
France	+ 1 435	- 3 373	+ 1 607	+ 623	- 1 071	- 1 097	- 582	+ 584	+ 1 120	+ 495	- 592	- 446	- 254
Ireland	- 657	- 1 151	- 573	- 245	- 361	- 340	- 205	- 190	- 127	- 110	- 146	- 308	- 150
Italy	- 5 587	- 10 664	- 3 548	- 2 977	- 3 101	- 2 628	- 1 968	- 897	- 722	- 501	- 1 428	- 1 739	- 1 937
Netherlands	+ 127	- 195	- 43	- 21	+ 13	- 193	+ 6	- 188	+ 261	- 211	+ 95	+ 252	- 259
BLEU	+ 359	- 1 549	- 1 910	- 501	- 446	- 487	- 115	- 89	- 587	- 779	- 432	- 675	- 746
United Kingdom	- 5 616	- 12 276	- 7 109	- 2 916	- 3 275	- 2 945	- 3 140	- 2 033	- 1 583	- 2 098	- 1 395	- 940	- 1 764
Community	+ 739	- 11 844	+ 503	- 2 862	- 3 850	- 3 672	- 1 500	+ 1 680	+ 887	- 505	- 1 536	- 1 070	- 2 397

Sources: National statistics and SOEC.

TABLE 6

EXPENDITURE, RECEIPTS AND NET BORROWING REQUIREMENT OF CENTRAL GOVERNMENT

	Expenditure		Receipts		Borrowing requirement			
	% change				Value ⁽¹⁾		% of GDP	
	1975	1976	1975	1976	1975	1976	1975	1976
Denmark ⁽²⁾	+ 20.1	+ 10	+ 3.0	+ 14.5	— 10.7	— 9	— 5.2	— 3.8
Germany	+ 15.6	+ 6	+ 1.6	+ 8.5	— 54.7	— 52	— 5.2	— 4.5
France	+ 26.7	+ 8	+ 3.4	+ 17	— 37.7	— 17.5	— 2.7	— 1.1
Ireland	+ 35.5	+ 17.8	+ 21.9	+ 33	— 601	— 540	— 16.9	— 12.3
Italy	+ 25.5	+ 24.5	+ 25.6	+ 29.5	— 8 632	— 9 600	— 7.7	— 7.0
Netherlands	+ 24.2	+ 18.2	+ 15.4	+ 11.8	— 7.2	— 12.1	— 3.5	— 5.2
Belgium	+ 24.1	+ 16.7	+ 19.0	+ 16.1	— 116.6	— 140.0	— 5.0	— 5.3
Luxembourg	+ 21.8	+ 14.5	+ 10.4	+ 8	+ 0.9	— 0.4	+ 1.1	— 0.5
United Kingdom ⁽²⁾	+ 30.0	+ 16.5	+ 22.9	+ 20.5	— 8 800	— 8 900	— 8.1	— 7.4

⁽¹⁾ In thousand million Dkr, DM, FF, Lit, Fl, Bfrs and Lfrs and million £.

⁽²⁾ 1975/76, 1976/77.

Source: Commission departments.

TABLE 7
OUTPUT AND TRADE IN THE WORLD ECONOMY

(% change on preceding year)

	Real GDP ⁽¹⁾				Volume of imports (goods)			
	1969 to 1973 average ⁽²⁾	1974	1975	1976	1969 to 1973 average ⁽²⁾	1974	1975	1976
USA	3.3	— 1.7	— 1.8	6.5	6.9	— 3.4	— 11.3	20
Canada	5.3	2.8	0.6	5	10.0	10.0	— 5.2	10
Japan	9.6	— 1.2	2.1	6	14.9	— 0.7	— 13.9	8
Other developed countries (excluding EEC)	6.0	3.7	0.1	2.5	8.9	11	— 7	4
Total developed countries (excluding EEC)	4.6	— 0.4	— 0.6	5.5	9.2	3.5	— 9.5	11
EEC	4.7	2.0	— 2.5	4.8	10.3	— 1.5	— 5	12
Total developed countries (including EEC)	4.6	0.4	— 1.2	5.5	9.8	1	— 7.5	11.5
OPEC countries					7.4	38	45	20
Other developing countries						13	— 2	2
Centrally-planned economies					8.4	10	6	4
World (excluding EEC)					8.6	9	— 2	8.5
World (including EEC)					9.2	5.5	— 3	10

⁽¹⁾ Real GNP for USA, Canada and Japan.

⁽²⁾ Compound growth between 1968 and 1973.

Sources: National statistics and Commission departments.

CHART B

WEIGHTED APPRECIATION OR DEPRECIATION OF THE CURRENCIES OF MEMBER STATES IN %

(Reference period: 'Smithsonian Agreement', December 1971; weighting according to the structure of foreign trade)

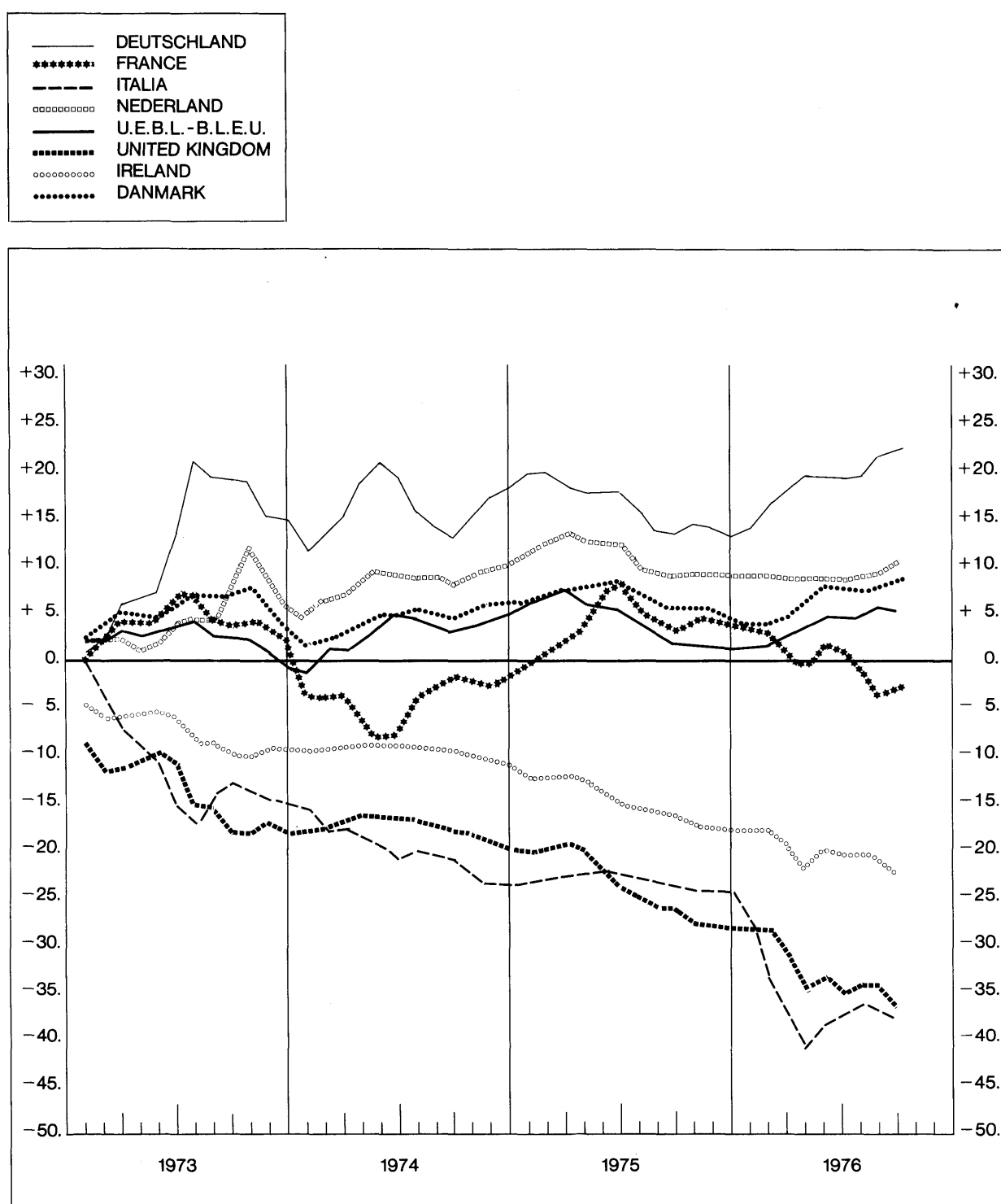


TABLE 8
MONETARY DEVELOPMENTS

	Denmark	Germany	France	Ireland	Italy	Belgium	Netherlands	United Kingdom
Money supply (M_1) ⁽¹⁾ % annual rate of increase ⁽²⁾								
Last 36 months	13.1	9.5	12.3	10.5	15.8	10.7	10.6	14.7
Last 12 months	23.5	13.9	15.8	19.0	13.3	13.3	20.4	19.2
Last 3 months	20.0	11.4	18.5	18.6	24.3	12.4	15.3	14.4
Month of observation	July	August	June	May	May	June	June	August
Money supply (M_2) or (M_3) ⁽³⁾ % annual rate of increase ⁽²⁾								
Last 36 months	15.6	5.4	16.4	21.3	20.6	13.3	15.8	15.3
Last 12 months	24.4	2.8	18.7	20.9	22.0	14.1	8.1	9.2
Last 3 months	22.9	7.9	20.6	20.9	25.5	15.0	10.7	10.3
Month of observation	July	August	June	May	May	June	June	August
Bank lending to private sector % annual rate of increase ⁽⁴⁾								
December 1973	15.4	9.6	18.2	22.9	27.7	15.1	22.6	38.4
December 1974	7.0	6.5	16.9	15.5	22.4	13.5	17.9	14.7
June 1975	8.8	4.1	14.5	8.6	15.6	11.2	15.8	10.7
December 1975	14.3	4.6	13.9	16.3	17.1	13.8	12.2	0.7
Latest month of 1976 available	16.5	8.8	13.6	16.4	21.7		13.3	5.3
Short-term interest rates ⁽⁵⁾								
1973 IV		11.3	11.2	14.3	7.9	7.1	8.2	9.6
1974 IV		8.3	12.5	12.2	17.4	9.2	7.1	7.8
1975 I		5.6	10.2	14.3	13.5	5.3	6.4	8.8
II		5.0	7.8	16.6	10.7	4.5	2.3	8.1
III		3.4	7.1	12.0	9.6	4.8	1.4	8.8
IV		3.5	6.6	12.2	8.5	4.1	4.4	10.5
1976 I		3.5	7.1	9.6	10.8	5.7	3.0	8.7
II		3.6	7.5	9.7		7.1	3.9	9.0
July		4.5	8.3			7.1	5.2	10.5
August		4.2				10.3	7.8	9.3
September							8.7	
Long-term interest rates ⁽⁶⁾								
1973 IV	11.4	9.7	9.7	13.1	7.4	7.7	8.4	11.9
1974 IV	14.9	10.5	11.5	16.2	11.2	9.0	9.5	16.6
1975 I	12.8	9.1	11.4	14.2	10.7	9.0	8.9	14.7
II	12.8	8.6	11.0	13.8	10.7	8.4	8.6	14.3
III	12.6	8.6	10.7	13.5	10.5	8.2	8.9	13.9
IV	13.2	8.7	10.9	14.5	10.5	8.5	8.8	14.8
1976 I	14.1	8.1	10.7	13.9	10.9	8.8	8.4	13.7
II	14.8	8.1	10.8	14.1	12.2	9.2	8.8	13.8
July	14.7	8.4	11.0		12.5	8.9	9.6	14.2
August	15.5	8.3				8.8		14.3
September		8.1				9.2		14.8

⁽¹⁾ Notes and coin in circulation and sight deposits.

⁽²⁾ Year-to-year change: average of monthly figures.

⁽³⁾ Money and near money.

⁽⁴⁾ Year-to-year change.

⁽⁵⁾ Day-to-day money rate, average of period.

⁽⁶⁾ Average of period.

Source: SOEC and national statistics.