

COMMISSION OF THE EUROPEAN COMMUNITIES

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PROPOSAL FOR A

COUNCIL DECISION

on the adjustment to the guidelines for economic policy
for 1974.

(submitted to the Council by the Commission)

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THE COUNCIL OF THE EUROPEAN COMMUNITIES

Having regard to the Treaty establishing the European Economic Community, and in particular Article 103 thereof,

Having regard to the Council Decision 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, and particularly Articles 1 and 2 thereof,

Having regard to the proposal by the Commission

TAKING INTO CONSIDERATION that the Council agrees with the analysis of the economic situation set out in the Communication from the Commission of the concerning the adjustment of the economic policy guidelines for 1974,

HAS ADOPTED THIS DECISION

Article 1

The Member States pursue their economic policies in conformity with the guidelines which are specified in the Annex to this Decision.

Article 2

This Decision is addressed to all Member States.

Done at Brussels,

1974

For the Council
The President

GUIDELINES FOR ECONOMIC POLICY

a) General guidelines

The current situation requires that Member States' short-term economic policies aim at the following objectives:

- restructuring their economies to adapt them to the changes in the external situation;
- stepping up the fight against inflation in order to preserve purchasing power;
- in the case of those countries whose external situation had deteriorated appreciably even before the crisis, achieving a reduction which must be substantial in the balance of payments deficit.

The fulfilment of these requirements may in certain cases endanger full employment. Although this is also a priority objective it is necessary to stress that in the current situation it cannot be achieved by a general stimulation of nominal internal demand, but rather by means of specific actions.

In order to realize all these objectives, some means of regulation of overall demand is indispensable, but it must, necessarily and especially in present circumstances, be incorporated into a longer-term view. The changes to be brought about are of such size that they imply action in depth which needs to be undertaken forthwith in order to achieve results in a reasonable period of time. The sacrifices they will require will be the more acceptable the better they are distributed over time and between the different socio-economic groups.

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The essential problem posed for the coming year is the maintenance of a substantially lower rhythm of growth of private expenditure than that of gross national product. Only in this way will it be possible to free the necessary resources to enable the additional investment and export effort to be made. To this end the expansion of all money incomes must be slowed down, in order to avoid adding to inflation and the disequilibrium of the balance of payments. This objective can only be attained where the social partners indulge in a constructive dialogue.

A possible way of reaching agreement between them might be if income restraint was accompanied by social measures. Various steps can be envisaged, according to the specific situation of each member country. A special effort should be made in certain countries to bring all the various forms of wealth, in particular housing, within reach of all sections of the population. Such a move could well strengthen the propensity to save of households.

The number of workers in danger of having to change their jobs will be noticeably higher than in the past. The aim should be to safeguard employment by improving the flexibility of the labour market, rather than preserving jobs which are no longer productive. To this end, the infrastructure can be considerably strengthened where the situation arises, as well as expenditure on retraining of

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labour. It is above all during the period of readaptation that the worker should be guaranteed a level of income not too far below that which he previously enjoyed.

This highlights the importance of schemes for maintaining a substantial portion of incomes during retraining. At a time, like this when the level of training and retraining required is expected to increase, Member States should be prepared to increase the effectiveness of the Social Fund.

In the member countries, where unemployment benefits only represent a small fraction of money incomes, the amount available for this purpose will have to be improved. In any case, community solidarity must help to prevent a flow of labour back to Italy and Ireland, where the employment problem is already at its most acute.

A movement towards the necessary restructuring of production will come about spontaneously, and it should moreover be encouraged and not resisted. All the actions to be taken should thus be designed to encourage investment in the energy sector and the other priority areas.

Special efforts are necessary, as regards research and investment, with a view to achieving a more rational use of energy and developing sources of energy capable of guaranteeing the Community a certain degree of autonomy in the longer term, at a reasonable cost. It would thus be possible to soften the impact of the higher price of oil on the balances of payments and real incomes. In order to speed up the process of substitution and to save energy, the rise in the price of oil will have to be reflected in the structure of domestic prices of oil products.

The far-reaching transformations which must be made in the Community's energy patterns require considerable investments which, in some cases, are far from certain to prove a success. On a Community scale, more possibilities exist for research into new schemes and at the same time the burden would be less. The Community owes it to itself to exploit fully the advantage offered by its size, by putting into operation a common energy policy.

The measures proposed here will contribute towards the absorption within a reasonable period of disequilibria in the balance of payments position. However, this can only be done by a gradual process of adjustment, more especially as the reestablishment of a general balance to be achieved at the world economy level. In the meantime, the solidarity of the member countries must enable those with the largest deficits to obtain, by means of Community machinery already existing or to be created, at least part of the means of financing necessary.

A differentiation of actions is certainly necessary, as regards conjunctural policy. Against a background of close coordination this must take account of the initial situation and the outlook in each member country. Inside the Community one can, indeed, distinguish two groups of countries according to their external payments situation

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and their inflationary tendencies. The first group comprises Germany and the Benelux countries, whose current accounts in 1974 will be in surplus or close to equilibrium, despite a sharp deterioration. The second group comprises the other countries (Italy, the United Kingdom, Denmark and, to a lesser degree, France and Ireland), which will have to cope with heavy deficits on their external balances and very rapid price increases.

In the countries included in the first group, especially Germany, the authorities responsible for economic policy must make sure that the recovery expected between now and the end of 1974 culminates, towards the end of the year, in a trend which, while not exceeding the growth of productive capacity, can nevertheless be regarded as distinctly upward. It is desirable for the growth in real gross national product in these countries to reach a trend rate of 3 to 4 % by the end of 1974. The resulting deterioration in the balance of payments on current account would have to be accepted. It would help to reduce the inflationary tendencies in these countries while assisting the countries with large deficits in their efforts to improve their balance of payments situation.

Economic policy in the first group of countries will have to be, if necessary, so contrived as to act on the growth of demand principally by applying budgetary measures. Should the expected budgetary stimulus not be sufficient to sustain growth, an easing of the burden of direct taxation or additional expenditure should be considered, especially with a view to providing extra incentives for investment in the energy sector. A relaxation of the monetary restrictions would, however, not seem advisable at present having regard to the exchange rate relationships within the Community and at the international level.

In the second group of countries the constraints imposed by the balance of payments situation and by the vigorous upsurge in costs and prices call for policies to restructure demand aimed at improving the external balance. To stimulate exports, the economic policy of these countries will have to aim at reducing by the end of 1974, the growth of domestic demand to a rate distinctly below the expansion of productive capacity.

In the countries which before the oil crisis had already noted a sharp deterioration in their balances of payments on current account an important part will have to be played by monetary policy in order to help make the necessary adjustments. The restrictive line of monetary policy must therefore be maintained or even tightened. The reduction in domestic liquidity as a result of the deficits on current account will help in this respect. Interest rates should be maintained at high levels, as much to ensure an adequate level of real rates as to maintain a sufficient margin over the rates obtaining in the main foreign markets. This expected deterioration in the budgetary positions will have to be curbed either by cutting back the growth of expenditure or by increasing taxes. In this connection the stepping up of exports and investment in the energy sector are to be considered as priority aims at the expense of consumption expenditure by the public authorities and households. With regard to the fight against the rises in costs and prices a stabilisation of exchange rates would appear desirable.

The economic policy described above will have both more rapid and more effective results if the main trading partners in the Community act in parallel. As for the Community, it should work in this direction within the framework of international cooperation.

b) Guidelines for the individual countries

In Denmark the main features of the economic situation in the period up to the end of 1974 could be a slowdown in economic activity, an increase in inflationary tendencies and a deterioration in the balance of payments on current account which already showed a heavy deficit in 1973.

Economic policy should aim more at restoring equilibrium in the balance of payments and curbing rising prices and costs. If this objective is to be achieved, private consumers' demand must be reduced and the increase in government spending checked. The resources freed in this way should then be directed towards exports. The measures adopted recently by the Government, which include in particular a reduction in public spending and the introduction of compulsory private saving, are a first step in this direction. However, if these should prove inadequate to bring about the desired reduction in the growth of domestic demand in money terms it would be necessary to supplement them by further cuts in public spending, or new taxes in order to maintain the budget surplus at a level near to the guidelines for the 1974-75 financial year in the third annual report on the economic situation in the Community.

In the monetary field a distinct slowdown in the expansion of domestic liquidity has been observed since last autumn. Care should be taken to see that this tendency is maintained. The authorities should continue to concentrate particularly on curbing consumer credit as part of a policy for restricting bank lending.

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After the slowdown recorded in the second half of 1973, economic activity in Germany remained at a relatively high level at the beginning of 1974. Despite the oil crisis a certain recovery in expansion seems probable in the coming months. The rise in prices is likely to remain rapid.

The authorities meanwhile, find themselves with the particularly delicate task of supporting the tendency towards an improvement in the level of economic activity and at the same time reducing inflationary pressures. In this respect the development of the balance of payments does not impose any appreciable constraints; on the contrary, a rise in imports could contribute to an improvement in internal equilibrium. The effects of the lifting of the tax restrictions introduced in May 1973 combined with the expansionary pressures resulting from the deficits in the Federal and Länder budgets should be sufficient to bring about a 3 to 4 % growth rate in the economy towards the end of the year. If, however, it should appear that this objective will not be obtained, the Government should cautiously go about stimulating the economy further, essentially to encourage investment.

The acceleration in budgetary expenditure compared to the initial forecasts, chiefly as a result of the steeper rises in wages and prices, the selective measures in favour of specific industries and certain regions, and the lifting of the tax restrictions, will mean that in 1974, the Federal Government and the Länder together will have a net borrowing requirement of DM 11.000 to 13.000 million, instead of the slight surplus forecast in the third annual report. The deficit in the Federal Government and Länder budgets should be financed primarily through the capital market and only to a lesser degree by drawing on the "counter-cyclical reserves" at present frozen with the Bundesbank.

The policy on liquidity should continue along the present lines.

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In France, economic expansion will probably remain appreciable although somewhat slower compared to last year. The strains which affected production capacities in 1973 will probably slacken. The situation on the labour market should gradually become easier during the year. The increase in the prices of imported basic products and in particular of energy products will probably give rise to a large external deficit. Furthermore, domestic prices are likely to continue to rise at an increasing rate.

The economic policy to be implemented in 1974 must aim primarily - as part of a medium-term strategy - at gradually absorbing the external deficit. It would be advisable, above all, to facilitate and encourage the re-adjustment of productive capacity in order to achieve a distinct improvement in the position on external account in 1975. At the same time, the increase in domestic costs should be curbed in order to safeguard the country's competitive position and to ensure the stabilization of the exchange rate.

In the field of public finance, recent tendencies indicate that there will be a budget surplus in 1974 which will exceed the level of 2.000 million francs fixed in the guidelines laid down in the third annual report. Budgetary management in the course of the first half of 1974 will have a distinctly restrictive character. If the trend towards a slowdown in growth should become too pronounced the introduction of fiscal measures to encourage investment in priority sectors should be considered.

It would be advisable to maintain the restrictive bias which has progressively been given to credit policy; nevertheless, without prejudicing those measures necessary to promote capital expenditure on adjustments made necessary by the energy crisis. Consumer credit and credit granted for investment in non-priority sectors should continue to be kept strictly curbed.

In Ireland, before the presentation of the budget, the general outlook for the Irish economy was for a modest resumption of growth following the slow down experienced in the second half of 1973. No great improvement in the labour market seemed likely.

The recent National Pay Agreement would lead to a large increase in salaries. Prices would continue to rise briskly and the current balance of payments would show an appreciable deterioration. A continuation of net capital inflows was expected.

To ensure that the economy would operate in 1974 at a level close to the full utilisation of capacity the Government decided to provide a stimulus in the budget presented in the beginning of April. Despite a reform of the income tax structure and a considerable advance towards securing greater equity in the distribution of the tax burden, principally by extending the tax base and the introduction of a capital gains tax, the budget deficit forecast is substantial. Due to the delicate balance needed to achieve external and internal equilibrium it is necessary to adopt a flexible economic policy. If the capacity of the economy proves to be insufficient to absorb the additional stimulus of the budget on internal demand and inflationary pressures become stronger than foreseen it will be necessary to revise economic priorities particularly in the context of the execution of the budget.

During the second half of 1973 the growth of domestic liquidity accelerated. The present restrictive stance of monetary policy should be continued with regard to the money supply and should be accompanied also in the future by selective measures in favour of the most productive investments. The task of the monetary authorities would be made easier by less reliance on monetary means for the financing of the budget deficit.

In Italy, last year's strong recovery in demand should make continued economic growth possible in 1974; however, in spite of a faster expansion of exports, its pace may slow down appreciably as a result of the oil crisis. Little change should occur in the labour market situation. The most pressing problems will concern the overall equilibrium of the economy; in this respect, it is to be feared that the increase in prices, already rapid in 1973, will accelerate further and that the deficit on current account of the balance of payments will increase considerably. The apparently excessive depreciation of the lira has increased the inflationary pressures without alleviating the difficult current account position.

In these circumstances, the emphasis of economic policy should be on eliminating the disequilibrating factors. The immediate problem facing the Italian authorities is that of rapidly achieving tangible results in the form of a distinct improvement in the external accounts which cannot be allowed to continue on their present trend. Given the high level of Italy's external indebtedness, a distinct improvement in the balance of payments current account will have to be achieved in the second half of the year and during 1975. As the depreciation of the lira since February 1973 will have its greatest effect on the volume of exports next year, economic policy must aim at reducing the total balance of payments current deficit in 1975 to not more than Lit. 2.000.000 millions. In this respect, it is appropriate to recall that, within the deficit of Lit. 4.100.000 millions forecast for 1974, approximately Lit. 2.800.000 millions are the result of the increase in oil prices. Given that the high current balance of payments deficit forecast for 1974 is not only the consequence of increases in the price of oil but equally to internal factors due to the increase in total demand and the rapid acceleration of the price spiral, strict control of the growth of domestic demand as well as some moderation of internally-originated cost pressures, are necessary from now on. In this connection, urgent action is required not only to stabilize the exchange rate of the lira, but also to use the instruments of demand management in such a way as to divert resources into productive investment and, above all, into exports.

With respect to budgetary policy all the possibilities still available should be used to reduce the budget deficit for the current year and measures should be introduced to bring about a gradual improvement in the public finances of national and local government and social insurance bodies. For the present exercise a strong effort should be made to restrict less urgent forms of expenditure, especially those directly linked to consumption. At the same time, it would be advisable to support, either directly or indirectly, priority investment expenditure, especially where linked to exporting activities and infrastructure improvements. Taking into account the supplementary expenditure decided upon since last autumn, the Government's net cash deficit will amount to Lit. 9.200.000 million in 1974. Such a figure is a ceiling which should not be broken under any circumstances. To achieve this result, an increase in the fiscal burden seems inevitable. Incidentally, the deficit should be financed to a large extent by non-monetary means.

As regards monetary policy, the balance of payments deficit should contribute to mopping up excess liquidity. On the other hand, the growth in lending must be limited in order to stay well below the ceiling of 22.400.000 million lira fixed in the letter of intent addressed to the IMF. It will be necessary, nevertheless, within this overall framework to give priority to investments in those sectors clearly orientated towards exports and energy. The rise in interest rates which will result from these restrictions should tend to improve the balance of payments on capital account, mitigate import price rises by supporting the exchange rate of the lira, and stimulate saving.

In the Netherlands, it is expected that the expansion of demand and production will be relatively moderate between now and the end of the year and the employment situation is liable to deteriorate. Prices will tend to rise more sharply. The external balance should deteriorate, whilst remaining in surplus.

The Government, anxious to maintain a satisfactory level of national expenditure, has already announced policy actions to support demand - especially in the budgetary field: (deferment of the introduction of the investment tax in the country's western region, acceleration of the second stage of the anti-unemployment programme adopted last September) and other measures were announced on the 19th March, 1974 (a reduction of income tax with effect from 1 July 1974, an increase in tax allowances for investment, supplementary expenditure). In the event of such measures being adopted, the net borrowing requirement may be expected to exceed by Fl. 700 millions the figure of Fl. 1.500 million laid down in the third annual report. Any eventual further budgetary measures - especially to increase investment - should involve as far as possible a restructuring of public expenditure without further increasing the deficit.

The principal feature of the monetary situation up to now has been a substantial increase in secondary liquidity. Special factors have contributed to this development. The general stance of monetary policy requires no modification for the present.

The special powers act of 10 January 1974, which will remain in force until the end of the year, gave the Dutch authorities very wide powers in the field of incomes policy. In this connection, the imposition of temporary controls on prices and all incomes, accompanied by a reduction in direct taxation on small incomes seems appropriate insofar as it may help to curb the rise in wage costs.

In Belgium, the slackening of world demand and the rise in import prices resulting from the oil crisis will not fail to affect economic growth in 1974. Unemployment could well spread. The current account surplus of the balance of payments will be substantially reduced, though still in surplus. In these circumstances, it is important at present to maintain very selectively the current level of activity during the coming months whilst, given the persistent price and cost increases, taking care to maintain it below productive potential.

In the budgetary field, it seems that the reduction in the deficit recommended in the third annual report and provided for in the budget presented by the Belgian Government will be maintained as the increase in prices is likely to affect budgetary receipts as much as expenditures. This nevertheless implies restrictions on additional expenditures given the structural nature of the budgetary deficit. The need for new investment in the energy field should be covered essentially by restructuring expenditure.

A restrictive monetary policy should be preserved. International trends may, however, cause a rise in interest rates.

In order to prevent the higher cost of raw materials from leading to a persistent upward price-wage spiral, an active price policy should be maintained and the various social and occupational groups should be persuaded to moderate their claims for higher incomes. In this connection, increases in incomes in certain sectors must not be allowed to set the pace for other sectors.

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In Luxembourg, a high level of economic activity will probably be maintained during the coming months, especially in the iron and steel industry. The upward movement of consumer prices is likely to gather additional momentum during 1974. The external balance should continue to show a substantial surplus.

The outlook for the employment situation is favourable, so economic problems appear less acute than in some other countries of the Community. Because inflation essentially originates abroad, it can only be curbed very moderately by internal measures. It does not seem necessary, therefore, to make any appreciable changes to the general guidelines for budgetary policy recommended by the Council in the third annual report. Nevertheless, a degree of caution appears necessary in allocating budgetary resources for new measures in the implementation of the Government's social programme.

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In the United Kingdom, economic trends will be strongly affected throughout the rest of the year by the repercussions of the temporary limitation of the working week to three days and of the miners' strike. Even assuming that production losses during the first quarter are partly made good later in the year, the gross national product in real terms will certainly be considerably reduced for the year as a whole. The trend of rising prices could increase sharply during the coming months. Prospects for the balance of payments on current account, already in very large deficit in 1973, continue to give cause for concern.

Thus, the need to bring the external account back into a sound basis and to protect the foreign exchange reserves conflicts with the desire to avoid an excessively low level of economic activity and a deterioration in the employment situation. Thus, although the improvement of the position on current account is a priority objective, it should be placed within a strategy covering a period longer than the current year. In this respect, it is anticipated that the beneficial effects of the depreciation of the effective exchange rate of sterling, which has occurred since mid-1972, will become increasingly important. Judging from previous experience, the full effects on the current balance will be felt in 1975 and subsequent years. From now on, economic policy should have the objective of ensuring that the total current account deficit, in 1975, will be less than £ 2 milliards. This amount would correspond to that part of the deficit which, in 1974, is attributable to dearer oil. The achievement of such an objective requires an economic policy which will permit the release of the real resources necessary for a vigorous expansion of exports.

As for budgetary policy, measures to moderate domestic demand should be introduced following a return to normal economic activity. The budget for the fiscal year 1974/75 constitutes an important step in this direction. While providing for a reduction in the fiscal burden at the lowest income levels, where purchasing power has already been sharply eroded by inflation, and while introducing subsidies in order to contain the rise in food prices, the budget aims at restraining

domestic demand both by a limitation in the growth of expenditure and by an increase in taxation. If during the coming month it appears that domestic demand in nominal terms is rising at a rate inconsistent with the required improvement in the current account of the balance of payments, additional measures will be necessary in the budgetary field. These should aim at preserving productive investment as much as possible.

In view of the rapid and continued increase in the principal monetary aggregates, fresh efforts should be made to slow down the expansion of the money supply in 1974. However, within the overall framework of such action, there are grounds for applying any restrictions on bank lending selectively, especially in relation to those small and medium-sized business which have been most affected by events at the beginning of the year, and also where exports are concerned. Moreover, the balance of payments situation calls for short-term interest rates to be maintained at a level appreciably higher than those prevailing on international monetary markets. This policy should contribute to the desirable stabilisation of the external value of sterling and to containing inflationary pressures which, in the recent past, have arisen from the depreciation of the currency.