

# **COMMISSION OF THE EUROPEAN COMMUNITIES**

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COMMISSION COMMUNICATION TO THE COUNCIL  
ON ECONOMIC POLICY TO BE FOLLOWED IN 1976 AND ON  
THE PREPARATION OF PUBLIC BUDGETS FOR 1977

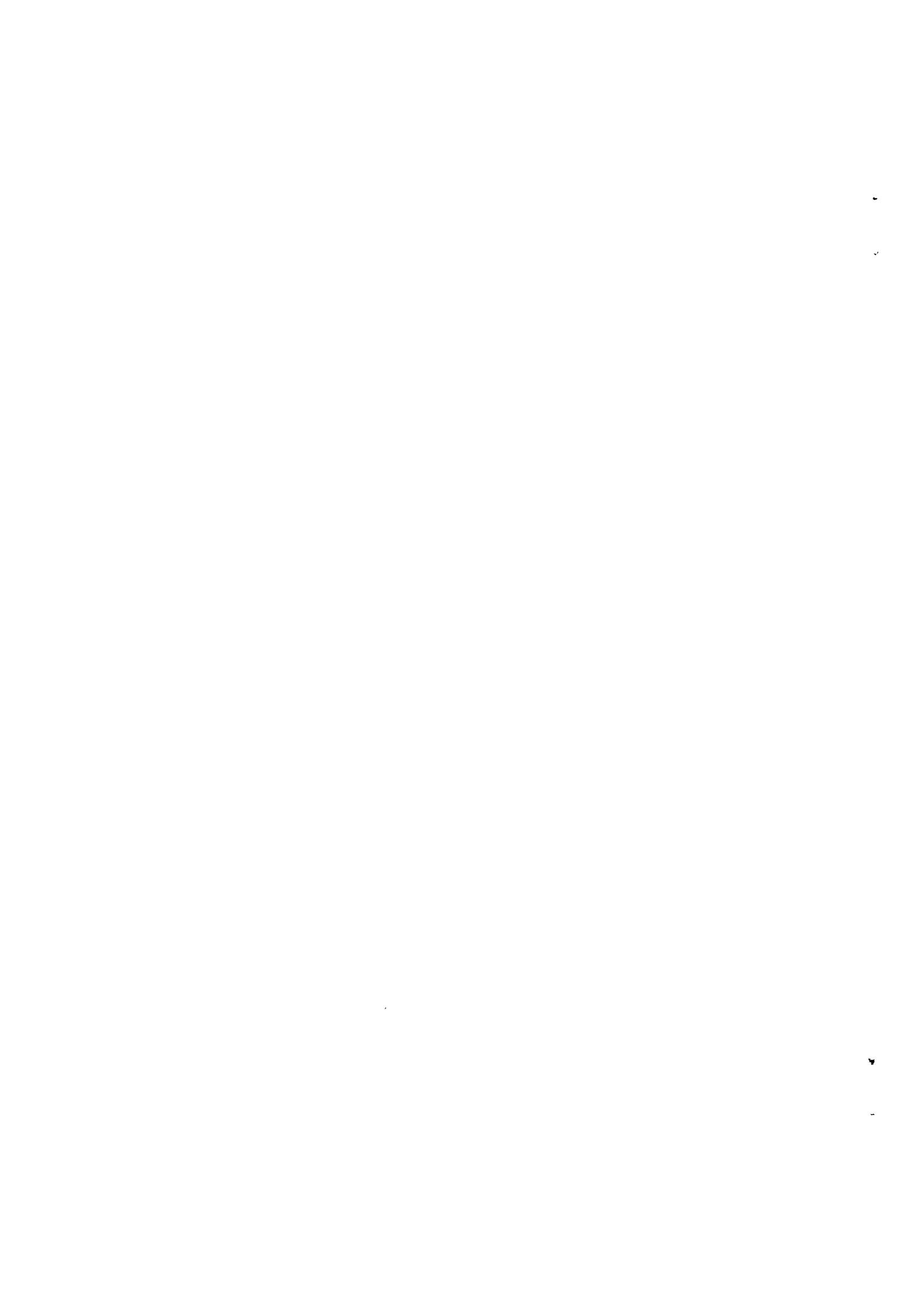
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## FOREWORD

Pursuant to Article 3 of the Council Decision of 18 February 1974 concerning the achievement of a high degree of convergence of the economic policies pursued by the Member States the Council, in its second annual examination of the economic situation, is to fix guidelines for the draft public budgets for the following year. To this end, and pursuant to Article 1 of the same Decision, the Commission hereby transmits this Communication to the Council.

At its first annual examination of the economic situation in March 1976, the Council had reaffirmed that consolidation of the economic recovery had priority. Progress in this respect has been considerable. Under the influence of expansionary measures introduced in most of the Member States in 1975, the recovery in the economic situation has become more pronounced, to the extent that in some cases the forecasts have been exceeded. The employment situation has improved only slowly, however. The upturn has, moreover, been accompanied by foreign exchange market disturbances and a revival of inflation in some Member States. Although these imbalances can be partly explained by non-economic factors or are purely accidental, they have nonetheless resulted in further disparities in prices and costs at Community level. It is of the greatest importance that this development be reversed and that, in the medium term, a moderation of inflation and an improvement in the employment situation should be gradually attained in a concerted way.

The Commission laid before the European Council of 1 and 2 April 1976 a series of concrete proposals aimed at reducing the substantial divergences in the overall economic performances of the Member States. These divergences stand in the way of progress towards economic and monetary union and indeed threaten the Community's cohesion.

In its annual report in September this year, the Commission proposes to set out economic policy guidelines for the Community aimed at achieving greater convergence in economic development in 1977. This Communication is basically confined to the budgetary policy guidelines for 1977, as provided for in the above mentioned Council Decision.



## I. THE ECONOMIC SITUATION

### A. The international environment

The revival of world economic activity is now well under way, to such an extent that in the main industrialized countries the strength of the spontaneous forces of expansion is in some cases putting pressure on producer prices, inducing greater caution in the monetary authorities and producing a renewed increase in interest rates, especially in the United States. In spite of efforts at international level, insufficient progress has as yet been made in solving the basic problems, which have assumed particularly serious proportions owing to the wave of inflation and the recession which has just ended: improving the employment situation, correcting the balance-of-payments disequilibria, organizing the relationships between developing and industrialized countries, and restoring orderly currency and exchange rate relationships.

2. Overall, the economic upswing is stronger than expected. In the United States, industrial production is almost back to its pre-crisis level and growth in real GNP in 1976 will come close to 7 %, a rate well above the long-term average. In Canada, expansion will be broadly in line with the long-term tendency. In Japan, the growth of real GNP in 1976 will roughly match the long-term objective set by the authorities. In many small industrialized countries, by contrast, the improvement in economic activity is lagging behind that in the large countries; in most of them there is now evidence of an upturn, but growth in 1976 will be only some 2 1/2 %, not much more than half the long-term average rate. The gross national product of the developed countries outside the Community is expected to grow in total by more than 5 1/2 % in 1976, and somewhat less rapidly in 1977.

3. The expansion of world trade followed that in demand and production and has also tended to become more generalized. Trade between industrialized countries is at present the main force behind this expansion; demand from the developing countries, by contrast, is picking up only slowly, and the rise in demand from the OPEC countries has slackened distinctly. The pattern of world trade/<sup>volumes</sup> now seems to be fairly

similar to what it was before the crisis. Furthermore, the flow of international direct investment is tending to change, more such investment going to the United States and less to Europe. The volume of world imports (excluding Community imports) is expected to be over 8 % higher in 1976 than in 1975.

4. With economic activity picking up, labour market trends have improved in several industrialized countries. Except in the United States, however, the total number of unemployed has so far shown little if any fall. Excessive unemployment therefore remains a key problem, notably in the least developed countries of Europe, where it has moreover been aggravated by a reversal of net migration.

5. In the large majority of countries, the upswing started from levels of inflation which were appreciably higher than in the past. World commodity prices are already close to the peak recorded during the last period of overheating: at the beginning of June the Economist's dollar index stood only 6 % below the record level reached in May 1974. Despite the large reserves of unused plant capacity and the high level of stocks of certain raw materials, the leeway to be made up by investment in many sectors may well mean that the upturn will soon come up against bottlenecks.

6. The deterioration in the balances of payments on current account of the industrialized countries which were the first to experience the upturn, and particularly in that of the United States, is of significant help in priming the economies of the other countries. It contrasts with an improvement in the external balance of Japan and especially of the OPEC countries and the non-oil-producing developing countries. So far the deficits of the latter countries have proved easier to finance than envisaged. In spite of the temporary import restrictions which some of them have had to introduce, imports have not shown the sharp fall that had been expected. However, even though these deficits are likely to narrow in the months ahead as the volume

of exports rises and the prices for commodity exports move up, the non-oil-producing developing countries will continue to be faced with serious financing difficulties. In the exchange rate field, the currency upheavals which affected several Community countries also hit various non-member countries. The currencies of Spain, Turkey and Portugal have depreciated since the beginning of the year while the Swiss franc and, to a lesser extent, the Japanese yen have appreciated. These movements have had little influence on the effective exchange rate of the dollar.

B. The economic situation in the Community

7. In the Community the economic recovery also gathered momentum. It was faster than forecast, especially in the Federal Republic of Germany, France, Denmark and Luxembourg. But renewed growth has not eliminated the danger that Member States' economies may stray off course nor has it removed the divergence of trends which jeopardizes the cohesion of the Community.

8. Until now, expansion has continued to be sustained by the factors which started the recovery, namely the end to destocking or the tendency to replenish stocks, strong private demand for consumer durables, especially motor cars, and the growth of exports. In spite of the application of appreciable budgetary stimuli and the easy monetary policy pursued until the spring, firms have remained cautious about fixed investment, except in the Federal Republic of Germany and, to a lesser extent, in Denmark.

9. Even though in the first half of 1976 economic growth in the Community as a whole reached an annual rate of some 6 %, compared with 2 1/2 % in the second half of 1975, the number of wholly unemployed has fallen only a little so far: in April, it still stood at 4.6 million, equivalent to an unemployment rate of 4.3 % (number of unemployed as a proportion of the labour force; seasonally adjusted figures). Until the spring at least, the increased output in most industries was in practice achieved mainly through drawing on productivity reserves and returning to a normal number of working hours. Short-time working was reduced to a very considerable extent by these factors.

10. Restraint on the wages and salaries front and, in some cases, large productivity gains should have produced an easing in inflationary pressures in the Community. However, since the beginning of the year several governments have adjusted taxation or public service charges, which has led to an acceleration in the upward movement of consumer prices. In addition, the increase in the cost of imported raw materials and in the prices of agricultural products and, in some countries, a significant fall in the exchange rate, are having their impact on producer prices, the more so as firms are trying to maintain, if not improve, their profit margins. Consumer prices in the Community as a whole increased at an annual rate of 13 % in the first four months of the year, compared with almost 9 % in the second half of 1975. What is more, there was a fresh and alarming widening in the disparity between inflation rates in the individual member countries. The extreme positions are to be seen, on the one hand, in the Federal Republic of Germany, where since the beginning of the year inflation has been running at an annual rate of less than 6 %, and, on the other hand, in Italy and Ireland where the annual rate of increase in prices has exceeded 20 %, partly under the influence of the special factors mentioned above.

11. In the field of public finance, 1976 will show almost everywhere a slowing down in the growth of expenditure compared with last year, which will in some cases be appreciable. On the other hand, the recovery in activity accompanied by continuing inflation will ensure a faster rate of increase in receipts. These trends, as a whole more favourable, should not however be sufficient to improve appreciably the balance in public finances, which was seriously upset last year. In some Member States - the Federal Republic of Germany, France and Italy - the general government deficit should be of the same order as in 1975, which would involve some progress in relative terms. Everywhere else the deficit should rise further, at least in absolute figures, even though an end to this deterioration can be seen from now on.

12. The Community's external balance deteriorated appreciably owing to the upturn in the volume of imports and the worsening in the terms of trade caused by the rise in world prices. The adverse movement was particularly marked in Italy and Denmark, but it slowed down in the spring, helped by the more buoyant trend in exports in several Member States.

13. The monetary upheavals experienced since the beginning of the year have, in recent weeks, given way to a period of greater calm. Even so they produced an appreciable fall in the lira and sterling, the effective depreciation in the period from December to May being 25 % and 11 % respectively, while the fall in the French franc, which left the Community exchange rate system on 15 March, was kept to some 4 1/2 %. In addition to the heavy drain on the foreign currency reserves of the countries concerned, these strains led, in Italy, to the introduction of a temporary deposit on foreign currency purchases for a three-month period starting on 6 May.

C. The economic outlook for 1976 and 1977

14. Between now and the end of 1976, economic growth in the Community will probably continue to be rapid. Taking the year as a whole, the Community's gross domestic product in real terms could expand by about 4 1/2 %. A similar figure will be recorded in 1977. Italy and the United Kingdom and also, to a lesser extent, Ireland and the Belgo-Luxembourg Economic Union could experience more rapid growth than had been expected, provided the tendencies towards stabilization at home and abroad become firmer. On the other hand, the rate of growth in the Member States in which the recovery first materialized and which are expected to make the largest gains in 1976 will probably come down closer towards the Community average. This will be the case in the Federal Republic of Germany and France in particular.

15. As a result, the number of wholly unemployed should decline in all Member States. The improvement, which will be quite substantial in the Federal Republic of Germany and Belgium, will doubtless be less marked in France, Italy, Ireland and Denmark. The expected growth rate in the United Kingdom and the Netherlands will probably give rise to only a limited increase in employment in the first half of 1977, but a more pronounced improvement could occur during the second half of the year.

16. Intra-Community trade will contribute more than previously to market unification; in 1977, as in 1976, it will grow significantly, outpacing the expansion in exports to non-member countries. In addition, sales to non-member countries will probably continue to expand steadily. The propensity to invest could also pick up in most Member States, albeit at a later date in the United Kingdom and Italy. Real consumption will rise at roughly the same rate as in 1976 since the foreseeable halt in the fall in the propensity to save should be matched by a slightly sharper increase in real disposable incomes.

17. Closer alignment of the divergent price trends is a necessary and possible development between now and the end of next year. At Community level, it could make for some slackening in the rise in the implicit price index of private consumption, which can be estimated, excluding seasonal variation, to rise by some 12 % in the second half of 1976 .

In the United Kingdom, the private consumption deflator could rise next year at a rate approaching the Community average, thanks to the vigorous incomes policy being pursued and provided that any further pressure on sterling can be avoided. The present rapid pace increase in prices in Italy will probably slacken only gradually. The other member countries are expected to make variable progress towards restoring stability at home.

18. As regards the Community's external balance, the rapid growth in exports to non-member countries together with a slightly slower increase in the volume of imports will probably make for a gradual but continued improvement in the Community's balance on current account. This overall improvement does not, however, mean that trends in Member States will not develop differently. Thus in 1977 the current account deficit could increase in France and could remain relatively high in Denmark. By contrast, some improvement is expected in Italy and the United Kingdom, while the surplus of the Federal Republic of Germany and of the Netherlands should rise.

## II. ECONOMIC POLICY GUIDELINES

### A. General guidelines

19. The Member States and the Community are faced with major economic policy problems:

- the persistence of the recovery is not yet assured;
- employment prospects are only improving slowly;
- the rate of inflation is still too high;
- the excessive divergences from one country to another are in danger of persisting.

Classical economic management instruments are not in themselves sufficient to resolve these problems and to improve the cohesion of the Community. For that also necessitates:

- the adjustment of income claims to the macro-economic and structural constraints;
- a reorientation of medium-term policy to goals fixed jointly;
- the strict coordination of conjunctural policies in the Community in terms of these objectives;
- the implementation of appropriate structural and regional reforms.

20. With a view to safeguarding the current rate of economic growth within the Community and thereby improving the chances of full employment being restored in 1980, the Commission has proposed (1) the implementation of a strategy incorporating specific targets: an average real growth rate for the Community of between 4 1/2 % and 5 % in gross domestic product between now and 1980 and a reduction in the rate of increase in consumer prices to not more than 4-5 % on average by 1980. Targets for within this period and for each country could help to smooth out economic fluctuations and adapt the behaviour of consumers and firms.

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(1) Cf. Doc. SEC(76) 2003 final, prepared for the Tripartite Conference on 24 June 1976.

21. From the second half of 1976 onwards, the weakening of the effects of the temporary measures to stimulate demand and the operation of the built-in stabilizers will probably provide the needed moderating effect on the growth in the economy. In addition, the monetary policy measures taken in a number of countries to counteract upheavals abroad will doubtlessly work in the same direction, notably by making it easier for the disparities in the rates of growth of prices to be narrowed.

22. Beyond 1976, the attainment of the priority objective of a gradual return to an adequate rate of growth combined with economic stability calls for generally cautious economic policies making simultaneous use of the widest possible range of instruments available. A key factor here will be a suitable incomes policy that will need to be geared to the specific situation in each Member State. Monetary and budgetary policy instruments too will have to create the general conditions conducive to an easing of price and cost pressures. Ceilings should also be imposed on the growth in liquidity to complete the guidelines adopted each year for the trend in net budgetary positions. Economic policies will have to be chosen so as to obtain a rapid reduction in unemployment and the necessary switch in the structure in domestic demand towards fixed investment and, in some countries, to exports.

23. New proposals have been put forward by the Commission to restore full employment and stability in the Community (1). None the less, the Commission reiterates here that, as regards incomes policy and policy on savings and wealth:

- the State and the other authorities should show restraint with regard to the level of their current expenditure, should apply a fair fiscal policy and should enforce the rules on competition notably as regards business mergers;
- workers should take part in the joint effort to reduce production costs, in particular by being more flexible as regards the growth in their money wages, such as to take more into account the potential of the economy;
- non-wage income recipients should show a corresponding moderation;
- firms should impose upon themselves a strict discipline as regards price increases;
- the governments and both sides of industry should adopt appropriate measures to promote asset-ownership by employees as well as their participation in entrepreneurial decision-making.

24. As regards budgetary policy, the Commission sets out below (2), in accordance with Article 3 of Council Decision No. 74/120/EEC, guidelines for the public budgets in 1977. It also stresses that monetary policy will have to contribute to the effort to reduce the rate of increase of prices through ensuring non-inflationary financing of the economic upswing. To achieve this the expansion of liquidity, which has been too rapid up to the present in several countries, will have to be moderated, especially in those where an improvement in the balance of payments is required. This action must be undertaken within a Community framework. Savings both home and from abroad will have to be channelled more effectively towards investment financing.

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(1) Cf. Doc. SEC(76) 2003 final, prepared for the Tripartite Conference of 24 June.

(2) Cf. Chapter II B.

25. The exchange markets will become more stable as the erosion of domestic purchasing power in several Member States is checked and as the deficit countries' balances of payments improve. But an orderly situation in the exchange markets requires a greater convergence of monetary policy. For this interest rates will have to be kept at a relatively high level in those countries where the disequilibria are most serious.

B. Budgetary policy guidelines

26. The economic outlook for the second half of 1976 and for 1977 calls for prudent budgetary management.

For 1976, the governments have taken appropriate steps to soften gradually the stimulus given to the economy by the public budgets, by seeking to reduce or at least to stabilize the scale of the net borrowing requirement in proportion to GDP. This line must be firmly maintained in the second half of the year, particularly in Member States with balance of payments difficulties.

This policy of gradually reducing public deficits will have to be pursued in 1977, to re-establish equilibrium in the medium term, even if it means coordinated simultaneous action with regard to incomes. Given the requirements posed by such an objective, the relative reduction of deficits should be based not only on higher growth in tax revenue, already achieved in 1976, but in particular on appropriate curbs on public expenditure. If this strategy were unsuccessful, moderation of the growth of taxes and parafiscal charges, generally considered necessary over the years ahead, would almost certainly remain an illusory goal. The risk would also be reduced of excessive public deficits having to be financed through the creation of too much liquidity, which, together with the growth of credit necessary for the recovery of investment, would pose dangers for the monetary equilibrium of the economy.

These general guidelines do not preclude, and may indeed necessitate, specific and limited measures providing tax relief, to the extent that such measures would help restrain cost and price rises and promote the recovery of private investment in countries where such a recovery is slow to develop.

Denmark

27. The economic upswing should continue during the second half of 1976 thanks to a strengthening of investment demand together with a growth in exports and despite a reduced level of private consumption compared with the early months of this year. The outlook for 1977 appears to show some slackening of growth mainly due to weak home demand, while between now and the end of 1977 unemployment should continue to decline gradually and price and cost increases should slow down. On the other hand the external deficit will probably greatly exceed that for 1975 both in 1976 and 1977, and will give cause for concern, although it should decline from the second half of 1976 onwards.

From now until the end of 1977 economic policy should have the objective of improving the current balance of payments and the employment situation and assisting the slowing down in the rate of price increases. To achieve these aims action should be taken to restrain income growth and to cast budget policy in as strict a mould as economic circumstances permit. This means that rather than seeking a significant increase in the total tax burdent, the policy should be strictly to limit the growth of expenditure. In such circumstances the net borrowing requirement of central government which will increase in 1976/1977 and reach between 5 and 5 1/2 % of GDP could be stabilized in 1977/78 at nearly the same absolute level and show a relative improvement. A further objective in the two fiscal years should be to increase the non-monetary means of financing the deficit as far as possible.

Germany

28. The recovery has continued to gather momentum over the last few months, and although some degree of slowing down is expected during the second half of 1976 as the direct impact of the recovery programmes begins to wear off, economic activity should still expand strongly. Growth should continue in 1977 with a progressive reduction of the number of unemployed throughout the year.

The main aims of economic policy should be to achieve the desired growth, to reduce unemployment and in particular to limit the rate of growth of prices and costs and obtain a sufficient level of investment. This implies, besides a reasonable pricing policy on the part of firms and an appropriate growth in incomes, a monetary policy which sets limits to nominal increases and a public finance policy which must endeavour to achieve a gradual reduction in the net borrowing requirement by restricting the growth of expenditure. Indeed, the second half of 1976 should see the introduction of a more restrictive line in expenditure policy by the Federal, Land and local authorities, particularly at Federal level where the budget was still providing stimulus to the economy at the beginning of the year. Despite a more substantial increase in tax revenue, however, there should be hardly any reduction in the deficit of the Federal, Land and local authorities in 1976. The central government deficit should be a little under the DM 55 000 million recorded in 1975, that is about 4.5 % of GDP. Maintaining the restrictive line planned with regard to expenditure should make it possible by 1977 to reduce this figure as a result of increased revenue mainly due to growth and without taking account of the proposed increases in value added tax. With regard to social security, on the other hand, the deficit is if anything, likely to increase, so that efforts to economize in this sector should be pursued.

France

29. During the second half of 1976 and in 1977, economic activity will continue to receive considerable stimulus from domestic demand (particularly private consumer demand) and from exports. Unemployment, however, is likely to fall only slowly. The tendency for prices to rise is likely to remain strong, while the balance of payments on current account will probably continue to deteriorate.

Following the massive recovery programme carried out in 1975, budgetary policy in 1976 reverted to the strict management principles previously applied. Although the central government budget was balanced when it was tabled and passed, the outturn will probably show a still sizeable deficit of 15.000 to 20.000 million FF., as a result of the carry-over into 1976 of a number of measures introduced in September 1975 to support the economy, particularly the tax assistance on investment and the special capital expenditure committed in 1975.

For 1977, the main aim of economic policy should be to reduce significantly the rise in costs and prices, using both direct means in terms of action on incomes and indirect means in terms of monetary policy and strict budget policy. In this latter area, the growth of central government expenditure should be reduced to a level close to the growth rate of GDP, so as to avoid providing too strong a stimulus to domestic demand, which is already sufficiently dynamic. In view of the underlying trend of revenue, this is the only possible means of achieving a return to government finance equilibrium without recourse to major tax increases in 1977, which could well lead to increased cost and price pressure. Under these conditions the budget outturn could be close to one of balance. As for the financial position as regards social security, it could worsen and call for action to keep it in balance.

Ireland

30. The upturn in economic activity in the second half of 1976 should grow progressively stronger in 1977 whereas the rise in prices will not slow down until the second half of the year. Unemployment will remain at a high level for 1977 as a whole, despite an increase in exports, the current balance of payments will probably only show a slight improvement over 1976.

The 1976 budget outturn of central government should show a net borrowing requirement a little less than the figure of £ 679 Mio originally forecast, this slight improvement being due to an increase in revenue exceeding the expected additional expenditure.

In 1977 budget policy should aim at a further reduction in the central government net borrowing requirement as a share of GNP, in conformity with Council decision of the 15th March 1976 fixing the conditions of economic policy to be observed by Ireland. This can be achieved, in conjunction with an appropriate incomes and prices policy, by a strict limitation on salaries and social transfer payments, by stabilising the amount of subsidies and the volume of capital expenditure, together with a modest increase in due tax burden. Furthermore, the proportion of monetary financing of the borrowing requirement should be reduced.

Italy

31. The weakening of economic activity which seems probable in the second half of 1976 should be followed in 1977 by a new upswing, whereas the increase in prices and the evolution of the balance of payments will be a cause of concern.

Budget policy for 1976 has, in view of the developments on the balance of payments account, taken on a more vigorous tone. Due to an especially strong growth in revenue the net budget deficit should reach only 9.600 Mrd Lire and the adjusted Treasury borrowing requirement only 13.800 Mrds Lire, i.e. 10 % of gross domestic product as against 12 % in 1975. This will be in conformity with Council's decision of 15th March fixing the conditions of economic policy to be observed by Italy. These steps towards a more balanced management of public finance are, however, dependent not only on maintenance of the rate of public expenditure within forecast limits, but also on an absence of delay in the receipt of expected tax revenue; it will not be possible unless the government uses all means necessary to achieve these two objectives. Particular care must be taken to see that the Treasury borrowing ceiling is not exceeded since there is a risk that this could only be covered by simply increasing the money supply.

Determined action appears vital in 1977 to reduce the rate of cost and price increases and to avoid a new deterioration in the balance of payments. These objectives will not be achieved unless incomes rise much less rapidly than can be forecast as yet, and/budget policy seeks to moderate home demand so as to further reduce the Treasury net financing requirement as a share of GDP. This means that the inevitable slow down in the growth of tax revenue must be offset as far as possible by the institution of effective measures to reduce tax evasion, and also that public expenditure must grow at a rate substantially less than GDP in value terms. The latter can be achieved by the thorough reconsideration of certain expenditure items. These measures must be paralleled by an attempt to reduce further that part of the Treasury net financing requirement which is met by increasing the money base.

Netherlands

32. As a result in particular of the rapid upswing in external demand, production should increase during the second half of 1976 and in 1977 at a rate approaching the underlying growth of productive capacity, without however bringing about any appreciable fall in unemployment. There should be a substantial increase in the current balance of payments surplus. The rise in prices could well remain high and the propensity to invest inadequate unless there is a marked slowing down in the rise of costs.

Central government budgetary policy for 1976 has been marked by the deferred effect of many important measures to support the economy and combat structural unemployment introduced earlier and by the growth of large-scale current transfer expenditure. Since the growth of revenue, both fiscal and non-fiscal, has proved lower than forecast, the net borrowing requirement will be in the region of F1 15 000 million, that is nearly 6.5 % of GDP, as compared with 3.8 % in 1975. This figure presupposes that the excess expenditure already carried out can, as forecast, be entirely offset by similar reductions. Strict management at central government level is all the more necessary as the deterioration of local authority and social security finances is tending to increase and as the financing of the public deficit as a whole will necessitate considerable recourse to monetary means.

For 1977, it is necessary to reduce the central government net borrowing requirement so as to move towards the medium-term objective envisaged. This policy implies effective implementation of the provisions planned by the government and presented to Parliament in June 1976 to modify the medium-term trend of expenditure. This is all the more true because the measures to stimulate investment, proposed at the same time, have a significant budgetary cost. In view of the deficit of the other government sub-sectors, whose underlying deterioration can be slowed down only by reviewing a number of priorities, the public deficit as a whole will still require monetary financing, whose scale should be limited as far as is possible.

Belgium

33. In the second half of 1976, the strengthening of domestic and external demand should ensure the rapid expansion of production which should continue at a slightly slower rate in 1977. Unemployment should fall only slowly. The slowdown in cost and price-increase<sup>5</sup> could be jeopardized in 1977 if the restraint measures at present in force are not renewed. The balance of payments surplus on current account could none the less remain substantial.

In view of the slowdown in revenue growth resulting from the measures to accelerate tax collection carried out in 1975, budgetary policy in 1976 has endeavoured to bring about an appreciable reduction in the growth of expenditure, despite a further increase in unemployment expenditure and the carry-over into 1976 of investment expenditure decided on previously. Provided expenditure under the supplementary budget is contained within very strict limits, the central government net borrowing requirement could be kept down to Bfrs 140 000 million, higher in absolute terms than the 1975 figure, but equivalent in percentage terms to GDP. A further deterioration in the finances of the social security and local authority sectors seems inevitable, so that the financing of the public deficit taken as a whole could well give rise to an increase in the monetary base.

For 1977, it is essential that determined action be continued to reduce the rate of cost and price increases. Furthermore, in the budgetary field, so as to offset as far as possible the probable worsening of social security and local authority deficits and to avoid excessive tensions on the financial markets, efforts should be made to achieve a relative reduction in the central government net borrowing requirement through strict limitation of the real growth of current expenditure and transfer payments. Similarly, energetic action should be undertaken to control the trend of social security benefits and the freedom of action of the local authorities so as to avoid any lasting damage to the financial structures of these sub-sectors and to the medium-term objectives sought for general government as a whole.

Luxembourg

34. The recovery in external demand should provide the main support for economic activity throughout the present year, though a temporary slowdown seems probable in the second half of the year and during part of 1977. The rise in prices, while remaining worrying, should continue to moderate slowly.

Despite the appreciable deceleration in the growth of expenditure, the budget outturn in 1976 will probably show a deficit of the order of 0.6 % of GDP : as economic activity gradually returns to normal, revenue will for the most part not revert to such a high growth rate as in the past and the yield from corporation tax will reflect the losses suffered by the iron and steel industry in 1975. Provided there is prudent management of operating expenditure and transfers of income, the budget outturn in 1977 should come close to achieving equilibrium, in accordance with the desirable medium-term trend. A slight deficit could however persist as a result of the carry-over of losses which will continue to affect the yield of corporation tax. As in 1976, the long-term financing of this deficit seems assured by institutional investors.

United Kingdom

35. During the second half of 1975 the chief source of growth in demand will continue to be exports whilst, apart from stocks, domestic demand will remain relatively weak. In addition the recent decline of the exchange rate will not only have an unfavourable effect on prices, which can no longer be expected to decelerate substantially, but also on the deficit on the current balance of payments which might well increase in the short term. The contrary might be expected in 1977 when appreciable progress could be made in these fields provided that the exchange rate is stabilised, that incomes restraint is continued, and that the money supply is suitably controlled. The rapid growth of exports combined with a modest increase in internal demand is likely to ensure a steady rate of growth.

Budgetary policy for 1976-77 has been fashioned in such a way as to exercise moderation on internal demand and inflation. Provided that the ceilings imposed on a large part of expenditure during 1976-77 are respected, the borrowing requirement of the central government and the public sector will be appreciably below the initial (official) forecast (10,400 million and 12,000 million £ respectively).

The elasticity of personal income tax might remain high and company taxes might reverse their recent decline. Even if the public deficit is reduced in relative terms it still appears to be high given the requirement of a strict monetary policy.

The budgetary policy for 1977-78 should aim at a substantial reduction in the public deficit and a further moderation of income growth. The maintenance of strict ceilings on expenditure will be all the more necessary as the contribution to receipts of personal income tax will be less buoyant and the yield of corporation tax is subject to considerable uncertainty.

The reduction in the public deficit will diminish the risk of excess liquidity jeopardizing the achievement of greater price stability and external equilibrium.

**III. CONCLUSIONS**

The Commission requests the Council to adopt the guidelines set out above and to invite the Member States to conform with them in applying their economic policies.

PROPOSAL FOR A COUNCIL DECISION

on the preparation of public budgets for 1977

THE COUNCIL OF THE EUROPEAN COMMUNITIES

Having regard to the Treaty establishing the European Economic Community,

Having regard to the 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), and particularly Articles 1 and 3 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 23 June 1976 concerning in particular the preparation of the public budgets for 1977

HAS ADOPTED THIS DECISION :

Article 1

The Member States pursue their economic policies in conformity with the guidelines on the preparation of the public budgets for 1977 which are specified in the Annex (2).

Article 2

This decision is addressed to all Member States.

Done at Brussels,

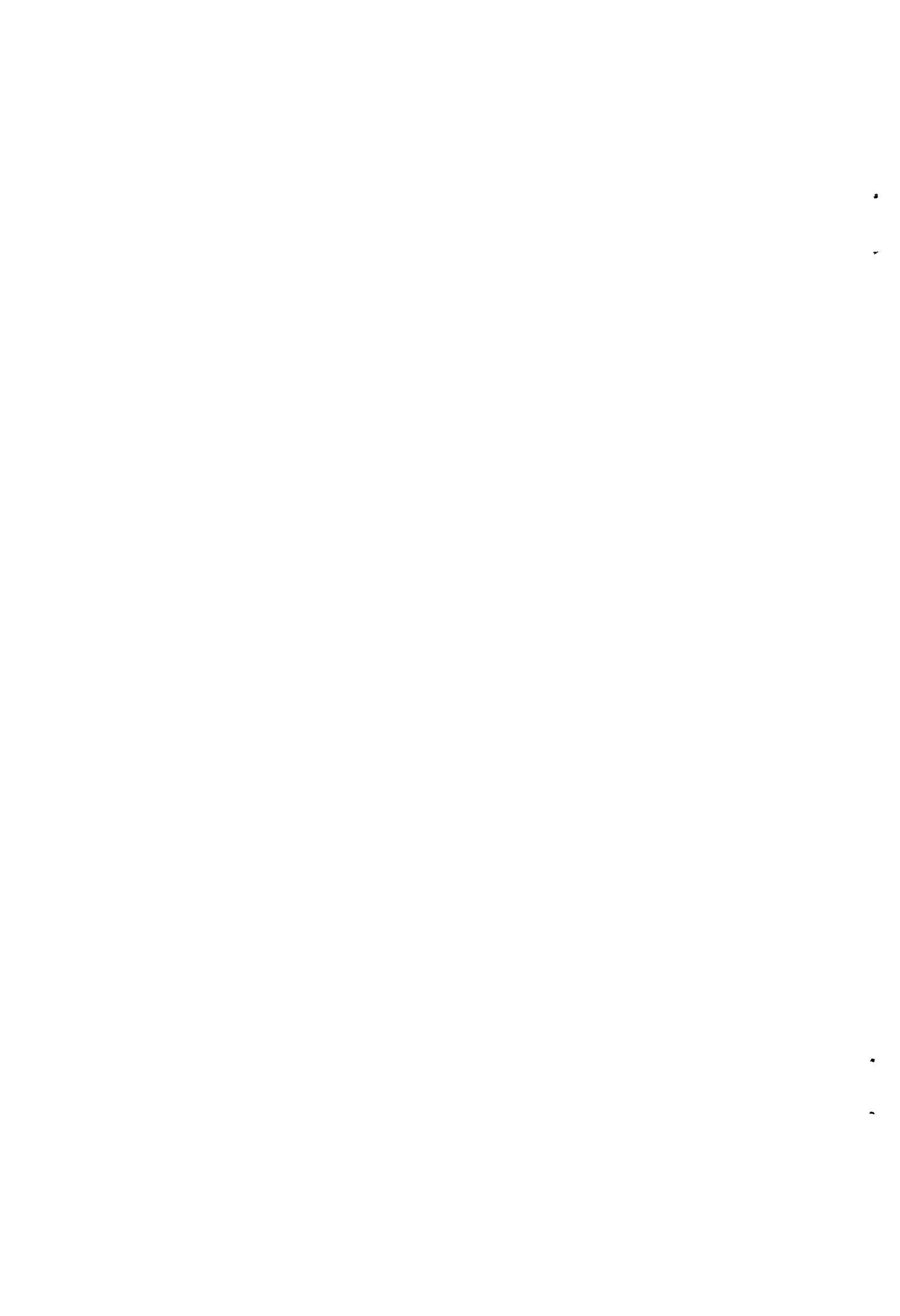
For the Council

The President

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(1) OJ No L63, 5 March 1974, p. 16.

(2) Chapters II/A and II/B of the Communication from the Commission to the Council.



A N N E X

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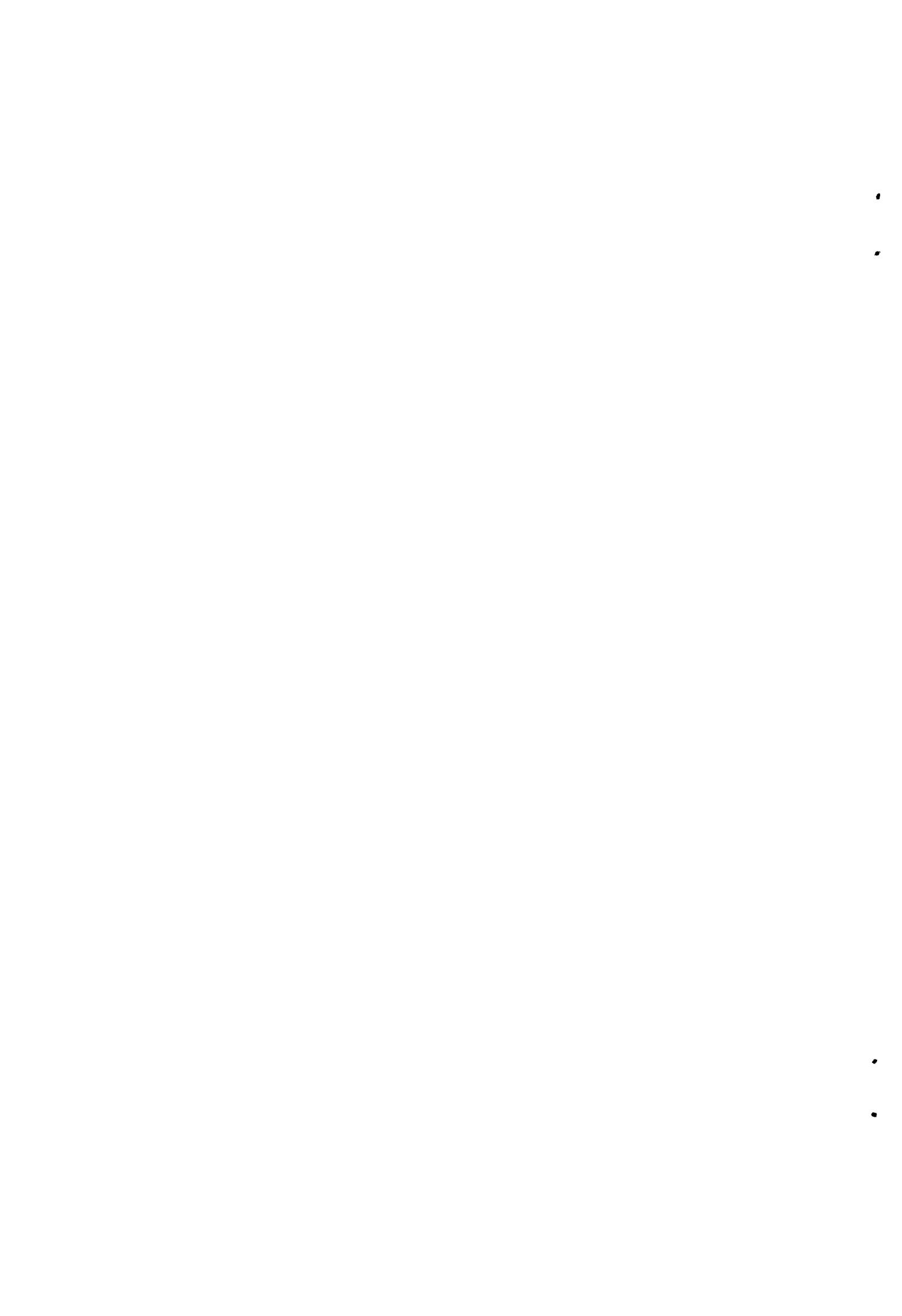


Table 1  
MAIN MACRO-ECONOMIC AGGREGATES  
(a)

	Gross domestic product (volume)					Consumer prices (b)				
	% changes on preceding year									
	Average 1968-72 (c)	1973	1974	1975	1976	Average 1968-72 (c)	1973	1974	1975	1976
Denmark	4,8	3,0	1,6	- 1,1	5,0	5,6	8,5	15,0	9,6	9
F.R. Germany	5,5	5,1	0,6	- 3,5	6,0	3,8	7,0	7,3	6,1	5
France	5,7	5,6	3,9	- 2,0	6,0	5,3	7,2	13,7	11,8	10 $\frac{1}{2}$
Ireland	5,2	5,4	0,4	- 1,5	3,0	7,5	11,0	17,3	21,0	17
Italy	3,9	6,8	3,4	- 3,7	1 $\frac{1}{2}$	5,1	12,1	19,6	17,4	20 $\frac{1}{2}$
Netherlands	5,7	4,1	2,9	- 0,7	4,0	6,0	8,8	10,0	10,4	9
Belgium	5,4	6,3	3,9	- 1,3	3 $\frac{1}{2}$	3,5	6,3	12,3	12,8	10 $\frac{1}{2}$
Luxembourg	4,3	7,5	4,4	- 7,7	4,0	3,9	6,1	9,5	10,7	9 $\frac{1}{2}$
United Kingdom	2,2	5,6	0,3	- 1,6	2 $\frac{1}{2}$	5,6	8,75	15,2	22,0	15 $\frac{1}{2}$
Community	4,7	5,3	1,0	- 2,5	4 $\frac{1}{2}$	5,2	8,3	12,6	12,4	11
	Number of unemployed as a % of the total labour force (b)					Balance on current account ('000 million \$)(e)(f)				
	Average 1968-72	1973	1974	1975	1976	Average 1968-72	1973	1974	1975	1976
Denmark	1,3	0,8	2,1	4,7	4,4	0,3	- 0,5	- 1,0	- 0,5	- 1,3
F.R. Germany	0,8	1,0	2,2	4,1	3,8	1,4	4,3	9,7	3,1	2,2
France	2,0	2,1	2,3	3,8	4,1	0,3	- 0,7	- 5,9	- 0,2	- 3,9
Ireland	5,7	5,9	5,7	8,0	10,0	0,2	- 0,2	- 0,7	- 0,1	- 0,6
Italy	3,4	3,5	2,9	3,3	3,8	2,0	- 2,5	- 7,8	- 0,5	- 0,8
Netherlands	1,6	2,4	3,0	4,3	4,7	0,1	1,8	1,6	1,6	2,2
Belgium	2,3	2,4	2,5	4,4	5,3	0,6	1,1	0,9	1,0	0,8
Luxembourg	0	-	-	0,8	0,6					
United Kingdom	2,9	2,5	2,4	3,8	5,0	0,9	- 2,0	- 8,6	- 3,8	- 3,3
Community	2,1	2,1	2,5	3,9	4,4	4,8	1,3	- 11,8	0,6	- 4,7

(a) 1968-1974: actuals; 1975: estimates; 1976: forecasts by the services of the Commission.

(b) On a national accounts basis.

(c) Geometric mean of annual changes between 1967 and 1972.

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

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

(f) Under the hypothesis that exchange rates will remain at their level in April 1976.

Source: Commission's Departments.

**Table 2**  
**INDUSTRIAL PRODUCTION**

	% change on average of preceding year				Min. 1975	April'76 Min. 75	% change (3)	% change on average of preceding quarter								April'75 April'76		
	1968- 1972 (2)	1973	1974	1975				1974	1975				1976	% change (3)				
				Month	Index 1970 = 100	I		II	III	IV								
F.R. Germany	6,9	7,3	-0,9	-6,2	April	99,8	10,8	-2,7	-3,2	-1,7	-3,6	1,6	3,4	2,3	10,8			
France	7,6	7,6	2,6	-8,8	May	107,5	14,2	-1,9	-3,7	-4,3	-2,6	0,1	3,8	4,9	8,3			
Ireland	6,3	10,3	2,8	:	Aug.	113,5	:	-2,4	-2,0	-2,3	-0,4	-1,6	:	:	:			
Italy	3,4	9,8	3,8	-8,8	May	101,6	13,6	-1,8	-9,1	0,0	-3,8	2,6	1,1	3,5	5,9			
Netherlands	9,9	6,1	3,2	-5,0	June	112,1	4,6	0,0	-1,3	-2,9	-3,5	0,1	5,2	2,2	3,4			
Belgium	5,7	6,1	4,6	-10,7	April	103,8	15,6	-1,7	-3,7	-4,4	-3,0	-3,8	2,9	7,7	15,6			
Luxembourg	3,5	11,8	3,9	-22,0	Aug.	60,6	98,6	-2,5	-5,3	-8,7	-9,0	-12,1	14,1	4,3	6,5			
United Kingdom	2,4	8,4	-2,5	-4,8	Sept.	99,4	4,6	-0,9	-1,2	-0,1	-5,5	0,6	0,7	1,5	2,0			
Community	5,8	7,5	0,6	-6,9	May	104,5	8,8	-1,6	-3,7	-1,6	-3,7	0,3	3,0	3,3	7,4			
U.S.A.	2,9	9,0	-0,6	-8,9	April	103,0	11,5	0	-3,3	-8,0	-1,2	3,5	2,9	2,2	11,5			
Japan	10,9	15,7	-3,1	-10,9	Feb..	104,4	16,8	-3,7	-6,0	-8,5	4,0	2,9	0,3	4,1	15,1			

(1) Excluding construction, and for France the food, drink and tobacco industry; seasonally adjusted.

(2) Geometric mean of the change between 1968 and 1972.

(3) Expressed at annual rates.

Source: SOEC; USA and Japan: national statistics.

: No data available.

Table 3

UNEMPLOYMENT RATES (SINCE 1973)

(seasonally adjusted data, in %)

	1973				1974				1975				1976	
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	May (3)
Denmark	1,0	0,4	0,4	1,6	0,7	1,6	2,5	2,8	4,0	4,1	4,5	4,6	4,1	4,0
F.R. Germany	1,1	0,8	0,8	1,8	1,8	2,1	2,6	3,1	3,9	4,2	4,3	4,3	4,3	4,0
France	1,8	1,6	2,0	2,2	1,9	2,1	2,5	3,1	3,3	3,8	4,3	4,1	4,1	4,2
Ireland	6,4	5,6	5,5	6,1	5,8	6,1	6,7	7,8	8,0	8,8	9,1	9,7	9,8	9,8
Italy (2)	3,8	3,6	3,1	2,9	2,6	2,9	3,1	2,9	3,2	3,5	3,6	3,9	(3,5)	(3,5)
Netherlands	2,4	2,3	2,4	2,4	2,6	2,8	3,0	3,5	3,7	4,0	4,4	4,4	4,3	4,2
Belgium	2,7	2,5	2,7	3,0	2,7	2,9	3,2	3,6	4,3	4,9	5,5	6,0	6,1	6,4
United Kingdom	2,9	2,3	2,3	2,0	2,3	2,6	2,7	2,8	3,1	3,7	4,5	4,8	5,0	5,2
Community	(2,3)	(2,0)	(2,0)	(2,2)	(2,2)	(2,4)	(2,8)	(3,0)	(3,5)	(3,9)	(4,3)	(4,4)	(4,4)	(4,3)

(1) Number of unemployed as % of civilian labour force. Figures for the first month of each quarter. As definitions are not standard, unemployment rates cannot be compared between countries.

(2) Italy: ISTAT data. 1976: estimates.

(3) Italy and Community: April

Source: SOEC.

Table 4

CONSUMER PRICES (SINCE 1973)

	Dec. 73	June 74	Dec. 74	June 75	Nov. 75	1975	1976					May 75	
	June 74	Dec. 74	June 75	Dec. 75	May 76	(3)	Dec.	January	February	March	April	May	May 76 (4)
	Half-yearly % increase						% increase on preceding month						% increase
Denmark	7,9	7,0	3,4	0,8	7,7	0,1	0,6	0,7	4,3	0,3			8,8
F.R. Germany	3,5	2,3	4,1	1,3	2,6	0,3	0,8	0,7	0,4	0,6			5,0
France	8,4	6,3	5,1	4,3	4,9	0,6	1,1	0,7	0,9	0,9			9,6
Ireland (1)	10,4	8,7	14,6	2,0	13,7			7,3(2)			6,0(2)		15,9
Italy	10,9	12,3	6,0	5,0	10,2	0,8	1,1	2,2	2,0	2,6			15,4
Netherlands	5,5	5,0	4,7	4,1	5,2	0,2	0,6	0,9	0,9	2,1			9,6
Belgium	8,3	6,8	5,3	5,5	4,1	0,5	0,9	0,3	0,6	0,9	0,7		9,6
Luxembourg	6,1	4,9	5,5	5,1	5,0	0,6	1,5	0,5	0,2	1,4	0,6		10,4
United Kingdom	10,8	7,5	17,3	6,4	7,6	1,2	1,3	1,3	0,5	1,9			15,4
Community	7,8	6,4	7,5	4,4	5,9	0,6	1,0	1,1	1,0	1,3			11,2

(1) Changes calculated from indices relating to the middle of each quarter.

(2) Quarterly variation.

(3) Denmark, France, Italy and Community: variation Oct. 1975 - April 1976

(4) Denmark, France, Italy and Community: April 1976 - April 1975

Source: Commission's Departments.

Table 5  
BALANCE OF TRADE (SINCE 1973)  
 (seasonally adjusted data, in national currencies)

COUNTRY	UNIT	1973				1974				1975				1976	
		I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II
Denmark	Dkr Mill.	- 1947	- 3142	- 2899	- 2411	- 4435	- 4309	- 2981	- 2424	- 1706	- 2150	- 2173	- 3141	- 4503	
F.R. of Germany	DM Mill.	+ 6190	+ 7690	+ 10240	+ 8930	+ 13880	+ 12840	+ 11830	+ 12280	+ 11300	+ 9980	+ 8120	+ 7780	+ 9050	
France	Ffr Mill.	+ 1734	+ 2190	+ 1587	+ 879	+ 3075	- 5187	- 5244	- 2703	+ 2499	+ 4590	+ 2157	- 261	- 2019	
Ireland	£ Mill.	- 66	- 62	- 73	- 55	- 109	- 158	- 154	- 73	- 95	- 79	- 82	- 63	- 158	
Italy	Lit '000 Mill.	- 624	- 880	- 775	- 976	- 1922	- 1980	- 1717	- 1300	- 572	- 454	- 333	- 971	- 137	
Netherlands	Fl Mill.	+ 477	+ 703	- 865	+ 66	- 60	+ 35	- 515	+ 15	- 453	+ 629	- 555	+ 254	+ 663	
Belgo-Luxembourg economic union	Fb Mill.	- 164	+ 3591	+ 3411	+ 7152	- 20681	- 17035	- 18825	- 4322	- 3116	- 20494	- 29664	- 16927	- 16048	
United Kingdom	£ Mill.	- 329	- 388	- 583	- 995	- 1297	- 1366	- 1253	- 1348	- 850	- 681	- 986	- 683	- 470	
Community	Eur Mill.	- 496	- 244	- 814	- 1438	- 4021	- 4947	- 2891	- 2684	- 5	+ 83	- 1157	- 2519	:	

Source: National statistics and S.O.E.C.

Table 6

VOLUME OF WORLD TRADE

	Shares in EEC exports; % (1975)	Volume of imports (goods) (% change on preceding year)				
		1968-72 average (1) (2)	1973 (2)	1974 (2)	1975 (3)	1976 (3)
Total developed countries (excluding EEC)	49.1	9.7	13	3 1/2	- 9 1/2	11
OPEC countries	15.3	7.0	11	38	45	20
Other developing countries	23.8			13	- 6	-
Centrally planned economies	11.8	7.6	12	10	6	4
World (excluding EEC)	100.0	8.6	12 1/2	9	- 3	8
Community		10.6	12	-1 1/2	- 5	9
World (including EEC)		9.3	12	5 1/2	- 4	8 1/2

(1) Geometric mean of the change from 1967 to 1972.

(2) Source: national statistics and UN.

(3) Estimates by Commission's Departments.