Commission of
European
Communities

Directorate-
General
for Economic
and Financial
Affairs

3

1973

The economic situation in the Community

Quarterly survey

Commission of the European Communities
Directorate-General for Economic and Fiancial Affairs
Directorate for National Economies and Economic Trends
Rue de la Loi 200, 1040 Brussels

EUROPEAN COMMUNITIES

COMMISSION

The Economic Situation in the Community

SEPTEMBER 1973

This issue contains the proposal of the Commission of the European Communities for the third annual report on the economic situation in the Community which the Council of the European Communities is to adopt in the autumn, in accordance with Article 4 of its decision of 22 March 1971 on increased coordination of the Member States' short-term economic policies.

Brussels, 18 September 1973

Annual report on the economic situation in the Community

(drawn up in accordance with Article 4 of the decision of 22 March 1971 of the Council of the European Communities on increased coordination of the Member States' short-term economic policies).

(Commission's proposal to the Council)

Contents

FOREWORD

Within the programme of work towards the establishment by stages of economic and monetary union and, more particularly, pursuant to Article 4 of its Decision of 22 March 1971 on the strengthening of coordination of short-term economic policies of the Member States, the Council of the European Communities, acting on a proposal from the Commission and after consulting the European Parliament, must each autumn adopt an annual report on the economic situation in the Community. This report must make it possible to set guidelines to be followed by each Member State in its economic policy for the following year. Once the report has been adopted by the Council, the governments bring it to the attention of their national Parliaments so that it may be taken into account in budget debates.

The present document is the third annual report drawn up under this procedure. It is the first one to cover the enlarged Community. Quantitative budget guidelines could be laid down, however, only for the six member countries of the Community as originally constituted. Because the financial year in the new Member States does not correspond with that of the others and because of problems of comparing their public finance data with those of the other Member States, in this report only qualitative guidelines could be given for the three new member countries. Maximum efforts must now be made so that these difficulties are overcome as far as possible when it comes to drawing up the next annual report.

At the beginning of the first quarter of 1974, when the Council examines the economic situation, as required by Article 2 of the Decision of 22 March 1971, these guidelines may be adjusted to the exigencies of economic development.

I. CURRENT SITUATION AND OUTLOOK

A. Current situation

In the previous annual report[1] the Community made the dampening of inflationary trends the prime objective for economic policy. Despite the efforts made at the Comumnity and at the national level, the upward movement in prices has gathered further momentum in the last twelve months; at present prices are rising at an annual rate of between 6 and 11 % depending on the country, as against 5.5 to 8 % a year ago. This alarming development is due to both external and internal factors.

1. International background

For the first time in many years, all the industrialized countries in the world are going through a strong economic boom at the same time. The United States, Canada, Japan and the European countries are giving a powerful impetus to the world economy, the result being a sharp acceleration in trade in goods and services. This general economic expansion has set off chain reactions which have meant not only that even the most optimistic growth forecasts have frequently been exceeded, but also that inflationary trends have been accentuated. In addition, the unstable monetary situation, the appearance of certain shortages, in particular of agricultural products, and speculation in raw materials have helped to push prices up even faster.

In recent years international liquidity has increased considerably. The International Monetary Fund has calculated that gross monetary reserves of the central banks have risen from 77,800 million S.D.R. at the beginning of 1970 to some 150,000 million in mid-1973. This has helped bring about a sharp increase in the money supply in most industrialized countries. Moreover the large quantities of international liquidity held by banks and multinational companies constitute a severe threat to monetary stability.

[1] OJ No C 133, 23 December 1972, p. 1.

The repeated crises on the exchange markets at the beginning of the year prompted the Council of the European Communities to launch the currencies of six Community countries on a joint float against the dollar on 19 March, while Ireland, the United Kingdom and Italy continued to let their currencies float independently (see graph and table annexed).

Since the beginning of 1973, world trade has expanded at a particularly rapid pace. For the year as a whole, world imports should increase by some 13 % in volume terms.

World trade

(% change on the previous year)

	Value	Volume
1968	11.5	12.5
1969	13.5	10.5
1970	14.5	9
1971	9	6
1972	11.5	8.5
1973[1]	18.5	13

[1] Estimates by the Commission's departments.

After falling from 1963 to 1967, raw material prices then began to rise, stabilized in 1971, but picked up again at a faster pace in 1972. By mid-1973 the year-to-year increase was 43 % on the Moody index, 61 % on the HWA index and 89 % on the Reuter index. Many factors have contributed to this rise : the expansion of world demand and restocking which has frequently been of a speculative nature, the formation of groups of producers and exporters, conscious and concerted reductions in production to maintain price levels, supply difficulties or even shortages, in particular of certain livestock products and recently of cereals, and finally the depreciation of the dollar and sterling.

With the generalized inflation, export prices of manufactured products increased appreciably in industrialized countries. This was especially true in the countries whose currencies had depreciated.

2. The economic situation in the Community

In the first half of 1973, economic activity grew very rapidly throughout the Community, and this meant a very high degree of utilization of plant capacity and frequently long delays in delivery.

Gross National Product

(% annual rate of growth in real terms)

Country	1965 - 1970	1971	1972	1973[1]
Denmark	4.5	3.7	4.7	5.5
Germany	4.7	2.8	2.9	6.2
France	5.8	5.0	5.4	6.2
Ireland	4.5	3.1	3.0	5.5
Italy	5.9	1.6	3.2	5.2
Netherlands	5.6	4.3	4.2	4.8
Belgium	4.8	3.7	4.9	5.8
Luxembourg	3.6	0.7	3.5	6.8
United Kingdom	2.4	1.6	2.5	6.8
Enlarged Community	4.7	3.0	3.6	6.0

[1] Estimates by the Commission's departments.

There was a rapid acceleration in the growth of Community exports to non-member countries. Sales to the United States have certainly tended to level off, but this has been more than offset by the faster expansion of sales to European and developing countries. Furthermore, intra-Community trade, which was given a fillip by the 20 % reduction in customs duties between the six original Community countries and the three new member countries on 1 April 1973, continues to provide a very strong impetus to economic activity.

Internal demand continued to grow stronger. Private consumption was stimulated by a sharp increase in disposable incomes and, in some countries, by a weakening of the propensity to save. The results of the last two Community surveys show that heads of industrial enterprises are tending to adjust their investment programmes upwards. They are also endeavouring to replenish their stocks of raw materials as quickly as possible, before there are further rises in world prices. So far, residential construction has hardly been affected by the rise in interest rates and credit restrictions.

While the growth of public investment in some countries, in particular Denmark, Germany and BLEU, was curbed by the restrictive measures taken by the authorities, public current expenditure went on rising rapidly, mainly as a result of higher salaries.

Employment rose in all the Community countries. The shortage of labour especially of skilled workers became more serious in most member countries. It is significant, however, that the level of unemployment in most of the countries has remained above the lowest levels in earlier periods of boom. This shows that the manpower supply is not adapted to demand, on a geographical basis or as regards vocational skills. At the same time employers are hesitant about taking on more workers who might be difficult to dismiss should the economic trend be reversed. The unemployment rate remains highest in Italy and above all Ireland. In these two countries, employment problems are essentially structural.

In the first half of 1973, most of the member countries saw the acceleration in price increases that had been common to all in the second half of 1972 gather even more momentum. The rates of increase were worrying throughout the Community, especially as the relative stability in agricultural prices customary in the summer was only partially reflected in retail prices and the rise in unit costs shows no signs of slowing down. Furthermore, the increase in producer prices and wholesale prices of industrial products is, in most countries, even more rapid than the rise in consumer prices.

Consumer prices

(% increase)

Country	Dec. 70 to June 71	June 71 to Dec. 71	Dec. 71 to June 72	June 72 to Dec. 72	Dec. 72 to June 73	July 71 to July 72	July 72 to July 73
Denmark	3.0	2.6	3.7	3.3	5.3	6.5	8.8[2]
Germany	3.6	2.1	3.3	3.1	4.6	5.6	7.2
France	3.1	2.8	2.8	4.1	3.2	6.0	7.4
Ireland[1]	4.4	4.0	3.8	4.3	7.1	8.0	10.0[2]
Italy	2.1	2.4	2.9	4.4	6.9	5.5	11.2
Netherlands	5.0	3.2	4.4	3.3	4.8	7.3	8.4
Belgium	2.7	2.8	2.7	3.7	3.2	5.6	6.6
Luxembourg	3.3	2.1	2.7	3.1	3.5	5.7	5.7
United Kingdom	6.4	2.5	3.5	4.0	5.1	5.8	9.4

[1] On the basis of quarterly indices.
[2] June.

With imports being stimulated by the vigour of internal demand and exports frequently held down by insufficient elasticity of supply, the Community's trade balance tended to deteriorate in the first half of the year. Only in the Netherlands and even more so in Germany was there an improvement.

B. Implementation of the council resolutions on the measures to combat inflation

The anti-inflationary measures to be taken at Community level and in the Member States were laid down in the Council Resolutions of 5 December 1972[1] and 28 June 1973. Even though the results hoped for have not always been achieved, considerable progress has been made recently in applying the various instruments of short-term economic policy.

In the monetary field, the growth of the money supply, which had already been very rapid at the end of 1972, gathered additional momentum at the beginning of 1973, mainly under the impact of considerable inflows of foreign capital and despite the restrictive measures taken by the authorities to neutralize their effects on domestic liquidity. Towards the middle of the year, however, the growth of liquidity slowed down, thanks to the restrictions on bank lending and, in some countries, also because of the deceleration brought about through the cash transactions of the public authorities.

[1] OJ No C 133, 23 December 1972, p. 12.

The restrictive measures led to a distinct increase in the cost of credit, especially short-term credit. In all countries the central banks raised their discount rates sharply, especially after the Council meeting of 28 June 1973.

Interest rates on savings accounts were increased. In order to make saving more attractive, several countries also took fiscal measures or are considering such measures at the moment.

The considerable inflow of short-term capital from abroad has been checked in recent months. The measures to regulate international financial flows and the Council decision authorizing the central banks to stop supporting the dollar have been important factors here.

As regards public finance, the trends in central government expenditure in the countries fully concerned in the resolution of 5 December 1972 suggest that its rate of growth in 1973 will be markedly higher than the limit set as a guide in Section V of the resolution.

% Increase in Expenditure and Revenue of Central Government Budgets

(January-June)

	Expenditure		Revenue	
	1972/1971	1973/1972	1972/1971	1973/1972
Denmark[1]	.	17	.	22
Germany[2]	11.5	9	11	14
France[3]	9.9	13.5	14.1	12.1
Ireland[1]	.	16.6	.	14.4
Italy	14.3	25.0	15.8	3.4
Netherlands[4]	16.0	15.1	19.3	13.3
Belgium[5]	21.1	14.5	7.4	14.0
Luxembourg[6]	16.7	14.1	12.0	20.0
United Kingdom	14.9	16.3	10.4	8.4

[1] No figures available for 1971.
[2] Estimates of the consolidated results for the Federal Government and the Lander.
[3] Budget transactions. Cash position.
[4] Cash transactions, irrespective of financial year. Excluding State road fund.
[5] Budget transactions. Ordinary and extraordinary budgets.
[6] Cash transactions, irrespective of financial year. Ordinary and extraordinary budgets.

Recent trends in primary liquidity (M1) and the money supply (M2)

(% increase on a year earlier)

	Belgium		Denmark		Germany		France		Ireland		Italy		Netherlands		United Kingdom	
	M1	M2	M1	M2	M1	M2	M1	M2	M1	M2	M1	M2	M1	M2	M1	M2
1972																
March	12.2	14.5	14.2	12.0	14.9	13.3	12.1	18.0	.	.	19.0	18.9	18.1	9.4	.	12.3
June	13.5	16.0	16.1	13.2	14.3	13.9	13.1	19.2	12.2	14.7	17.7	18.5	17.8	11.6	.	21.1
September	11.5	15.5	13.4	12.8	14.0	15.6	15.2	20.2	16.7[1]	17.2	16.7	17.8	20.8	12.1	.	24.1
December	14.0	17.6	17.1	15.1	14.4	16.9	14.9	18.6	16.0	18.2	17.3	18.2	17.6	11.9	13.7	25.3
1973																
January	12.8	16.6	15.8	14.2	12.2	16.7	13.0	17.1	17.9	21.0	18.4	18.8	17.6	14.8	13.5	25.5
February	15.2	17.6	14.1	14.4	12.1	18.2	12.4	15.9	14.9	21.4	18.0	18.5	17.8	15.7	13.5	29.8
March	15.1	18.4	11.6	12.9	13.6	20.3	10.5	14.7	14.1	23.6	17.8	18.5	16.1	16.3	11.4	28.1
April	14.7	17.9	12.0	13.1	11.6	20.2	13.2	16.7	12.1	23.0	18.2	18.5	15.3	16.9	12.1	25.7
May	14.7	17.2	13.3	14.2	8.4	21.0	13.2	16.3	12.4	22.1	20.1	19.4	12.7	16.8	10.8	24.3
June	12.6	16.0	14.2	14.7	5.7	18.0	10.8	13.8	12.6	21.7	21.7	20.3	9.3	15.1	9.6	22.7
July	.	.	13.7	14.1	3.1	16.4	.	.	12.2	21.3	.	.	.	.	11.9	24.8

[1] Adjusted for the effects of the bank strikes.

However, except in Italy and Belgium, the net borrowing requirement will be distinctly lower than was initially forecast; this is also true of France, if the effects of the reduction in value added tax are disregarded. The sharp increase in tax revenue, stemming largely from inflation, will be the decisive factor here.

It proved possible to avoid monetary financing of the deficit in those countries where this had been recommended.

The price supervision arrangements were tightened considerably, especially in countries such as the United Kingdom, Ireland and Italy, where the measures to dampen the expansion of overall demand remained limited.

In accordance with the Council resolutions, the common agricultural policy contributed to the fight against inflation; until mid-September 1973, the customs duties applicable to beef and veal were cut by 50 % and those on imports of calves for fattening suspended; in addition, the restrictions on imports of potatoes were lifted from 4 December to 15 February 1973; butter stocks were cleared at reduced prices, and since 1 May the price of butter has been reduced in a number of member countries.

In the field of competition, too, the national and Community authorities took a large number of measures, but their effect on prices will only be felt in the longer term. Basing itself on Articles 85 and 86 of the Treaty of Rome, the Commission took action in several fields, including cement, sugar and potassic fertilizers.

At the moment a number of Commission proposals are before the Council, especially concerning pre-merger control and arrangements to facilitate intra-Community trade in certain products.

In the field of public works, an Advisory Committee for Public Works Contracts has been set up. Finally, the Commission transmitted to the Council a proposal for coordinating procedures for the award of public supply contracts.

C. Outlook for 1974

The outlook for 1974 suggests no basic change in the level of world economic activity. Economic growth in real terms will probably slow down somewhat in most industralized countries but this will be largely the expected reaction to a phase of vigorous expansion that brought a sharp reduction in the margin of unused capacity. The problem of inflation will remain just as serious.

1. Outlook for the world economy

There is every likelihood that the growth of world trade will slacken gradually owing to less buoyant economic growth in the United States, Canada and most European countries. The expansion of import demand in the industralized countries may therefore slow down from the end of 1973 onwards. In the developing countries, on the other hand, imports are likely to remain at a high level, especially since these countries have registered a further rise in their foreign exchange reserves. It must be borne in mind, however, that these countries have to spend a greater part of their purchasing power on the purchase of foodstuffs, whose prices have gone up sharply. In addition, prices of manufactured products will probably continue to increase in 1974, although the rise in world market prices may decelerate distinctly and prices may even be adjusted downwards. Moreover, the expansion of world trade may be closely linked to developments in exchange rates between industralized countries and to progress in the trade talks started this autumn. Serious imbalances in international monetary relations and the adoption, in a number of countries, of unilateral measures designed to combat shortages and adding further to the difficulties for the markets of their trading partners would be bound to strengthen tendencies towards protectionism and affect international trading relations.

2. Outlook for economic trend in the Community

Following a year of unusually rapid growth, economic expansion will remain lively in 1974.

The trend of world trade and the relative appreciation of the currencies of most Community countries suggest a certain slackening in the expansion of exports to non-member countries. The growth of intra-Community trade, on the other hand, is hardly likely to slow down. It will be stimulated by the further 20 % cut, from 1 January 1974, in customs duties on industrial products in trade between the six original Community countries and the new members. As international competition stiffens the changes in exchange rates will influence market shares to the benefit of the countries whose currencies have depreciated.

The expansion of internal demand may settle down to a somewhat calmer pace in 1974. The key factors here will be changes in stocks and, provided the governments pursue a strict budgetary policy, public expenditure. On the other hand, private consumer spending, which is being stimulated by the continued growth of disposable incomes, and corporate spending on investment will lose little of their buoyancy.

In the Community as a whole, growth in internal supply will depend largely on capacity expansion and productivity gains. Real gross Community product is likely to grow by some 4 ½ %, compared with 6 % in 1973. In Italy, economic activity is expected to accelerate, and in France and Ireland growth rates are likely to stabilize at a high level. In the other Community countries, by contrast, especially Germany and the United Kingdom, the rate of expansion will probably slacken. Employment will expand further and average unemployment rates will decline. Internal supply will not be sufficient to bring any real easing of inflationary pressures.

While the outlook for production and employment is thus quite satisfactory, the rise in costs and prices continues to be a source of great concern.

3. Main problems of short-term economic policy

In the previous annual report on the economic situation in the Community, fears had been expressed about the risk of the inflationary tendencies strengthening as the expansion of demand gathered additional momentum; these fears have proved to be fully justified.

The economic, social and political dangers inherent in this development, especially in the longer term, are extremely serious. The erosion of purchasing power due to inflation impairs the working of economic and monetary mechanisms and consequently entails misallocation of resources and structural distortions as between regions, industries and occupational groups. Inflation hinders the satisfaction of important public needs (for instance in the fields of public health, education, transport and protection of the environment) which in general are severely affected by sharp price increases. It considerably limits the scope of those responsible for economic policy for safeguarding full employment and economic growth. Inflation also distorts the distribution of incomes and capital to the disadvantage of the weakest social and economic groups, which are least able to protect themselves from price increases and whose standard of living suffers particularly from the reduction of purchasing power. It adds to the tensions between the various groups of society which, in their efforts to secure an increase in their incomes to offset supposed or real losses of purchasing power, outbid each other in their claims for higher incomes and prices and often push through their demands to the detriment of the least protected sections of society.

If inflation were to continue, it could also result in new differences between member countries in cost and price trends and bring about divergent policy reactions which are likely to jeopardize the progress so far made on the road to integration. It consequently constitutes a serious obstacle to the attainment of the objectives and the construction of economic and monetary union, in which growth, full employment and stability are aims to be achieved simultaneously and with equal emphasis.

Some of the factors behind this inflation have their origin outside the Community, but factors within the member countries have also become important. In particular, inflationary behaviour has become still more engrained, disturbing the customary economic relationships of cause and effect, at least in the short-term. Price increases thus no longer necessarily entail a slowdown in demand but often provide an additional boost because purchasers anticipate further price increases and make new demands for higher incomes, which help to keep the price spiral in motion. On the other hand, with people having become accustomed to a rapid increase in money incomes, it is difficult to secure a moderation in the demands for higher incomes when the upward movement of prices slackens.

II. GUIDELINES FOR ECONOMIC POLICY

A. General guidelines

Inflation has taken on such proportions that the return to a more balanced rate can only be gradual : firstly through stabilizing the rate of increase, then reducing it and restoring an acceptable trend in prices. This means that reducing the inflationary pressures will more than ever have to remain the main objective of the Community's economic policy in 1974. All economic policy measures must therefore be geared to this objective, in line with the resolutions adopted by the Council in October 1972 and June 1973.

The current inflationary tendencies can be controlled only through the continued efforts and serious participation of all economic groups. Given the close interdependence of Member States' economies, the fight against inflation can bring lasting success only if all member states work towards this goal at the same time and with the necessary energy. This requires, within the Community, both effectively integrated measures and common objectives, so that the difficulties entailed for each country can be reduced to a minimum. Complex problems arise in this context, because in applying the various economic policy instruments account must be taken of the special situation of each individual country, particularly as regards the economic, social and regional structure.

In using the various instruments, especially those of monetary and credit policy and budgetary policy, the authorities must strike a careful balance, taking account particularly of the international repercussions. Measures to curb overall demand must be combined with selective intervention in the fields which are particularly important sources of inflation. Medium- and short-term priorities must be aligned and carefully balanced; here, it is not necessary to make a choice between growth and stability; the task is rather, by progressively reducing price increases to an acceptable pace, to secure the basis for lasting economic growth, a satisfactory rise in real incomes and an appropriate increase in the standard of living of all sections of the population. The fight against inflation is also necessary to restore stable exchange rate relationships between all member countries and secure the full participation of Ireland, Italy and the United Kingdom in the Community's monetary mechanisms.

The drive to curb inflation will be all the more successful if it becomes the common cause of all sections of the population, of all regions and of all partner countries. Efforts must therefore be made to distribute equitably the burden entailed by the stabilization policy, at least in the short term, protecting as much as possible the lowest income groups. As part of a coordinated policy, each member country should take account of the problems facing the partner countries and help to solve them. Special importance attaches in this respect to improving the allocation of investment in the Community. In particular, it is necessary, especially in the current period of boom, that part of the investment by enterprises be made in regions where there are manpower reserves, rather than in highly industrialized regions experiencing an acute labour shortage. This approach could offer a number of advantages. It would make it possible to reduce unemployment, which in certain regions is an obstacle to the pursuit of an energetic stabilization policy. In addition, it would help to combat the growing difficulties, both psychological and material, created by the large-scale migration of workers. It would also help to establish better regional equilibrium in the distribution of productive investment. Lastly, by encouraging investments, which because of the strains in the business situation could not otherwise be implemented or would have to be postponed, it would help to increase supply on the market. For the latter reason it is desirable, especially in the countries where the investment ratio is comparatively low, that the measures to curb demand bear mainly on consumer spending.

Economic policy should therefore be based on the following guidelines :

1. In 1974 all member countries should continue to pursue an economic policy aimed at curbing the rise in prices. To this end they should continue and, if need be, extend the measures which they have taken to contain growth in overall demand and money incomes within the limits set by the increase in productive capacity, while ensuring that the impact of these measures does not aggravate the situation of the economically weakest sections of the population, which have already been seriously affected by inflation.

In all countries the fight against inflation requires simultaneous application of all economic policy instruments. The policy mix must, however, be carefully balanced. Thus, the need to tighten the restrictions introduced under monetary policy since the summer could be obviated only if overall demand was curbed much more sharply by budgetary policy.

In those countries where the unemployment rate is still relatively high, namely Ireland and Italy, no curbs should be placed on investment which could improve the economic structure. To give this policy the necessary selective bias those countries should make use of fiscal incentives and budgetary measures in general rather than monetary measures.

2. As for budgetary policy, the budgets of all Member States for the coming budgetary year must, in accordance with Section 4 of the Council Resolution of 28 June 1973, provide for a reduction in the growth rate of expenditure.

As a general rule, in 1974, central government expenditure should increase at a slower rate than that foreseeable for 1973. In those countries where, during the last two years, this increase has been lower than the rate of growth of gross national product in money terms, it is essential that it be in any case, lower than the rate forecast for 1974. Should it prove impossible to cut back the increase in expenditure sufficiently, a rise in taxation would have to be considered. This would, in the first place, have to involve direct taxation; in certain Member States this could be achieved *inter alia* by not easing the progressivity of income tax. However, the budgetary authorities' stabilization efforts should be concerned with expenditure rather than revenue, especially in the countries where the tax burden is heaviest. Tax increases in these countries might result in a fresh wave of demands for higher incomes and thus have a direct or indirect effect on the level of prices. Application of a strict budgetary policy should generally result in an appreciable improvement in budget positions, either by reducing deficits or generating surpluses. In Ireland and Italy the stimuli which budgetary policy provided to economic activity in 1973 should be progressively reduced in order to avoid a further deterioration in the budgetary deficit in 1974.

Budget deficits should be financed by long-term borrowing. In Ireland and Italy, where monetary financing of the deficit was particularly large in 1973, an appreciable reduction in such financing would seem essential. The policy of freezing liquidity through the treasury should be continued in Member States where it is applied and, if possible, practised by other Member States.

It is also essential that local and other public authorities should adapt their financial management to the requirements of the fight against inflation. Where necessary, the central government should use the means at its disposal to induce these authorities to cooperate.

3. In the monetary field the measures taken pursuant to the resolutions which the Council adopted on 5 December 1972 and 28 June 1973 should be continued; they should be strengthened in those member countries where the money supply is still expanding too rapidly. In particular, the excessive expansion of bank lending should be curbed. To this end consumer credit and credit for construction purposes and for real estate transactions should be closely supervised.

It is necessary to keep interest rates at a high level while ensuring that the policy in this field is closely coordinated at Community level and, as far as possible, with the main industrialized countries outside the Community, in order to avoid fresh imbalances on foreign exchange markets.

To make saving sufficiently attractive, the deposit interest rates paid by financial institutions should take greater account of the erosion of purchasing power. Consideration should also be given to the use of other incentives to save, particularly in the field of taxation.

For a strict monetary policy to be effective Member States must continue in concert the measures they have taken to stem the undesirable inflow of liquidity from abroad. It might even become necessary to strengthen the arrangements introduced to regulate international financial flows and to neutralize their effects on internal liquidity. Progressive harmonization of the controls at present applied by Member States in respect of non-member countries is desirable. This would help further progress towards liberalizing capital movements within the Community.

4. Short-term economic policy measures should be conceived and carried out in such a way as to correct in the longer term the misallocation of resources due in large part to the gravity and duration of the inflationary process.

The appearance of serious labour shortages in the Community's most developed regions should lead to the adoption of concrete measures to assist the least developed areas, where unemployment persists, and, in particular, to efforts to channel a part of new investment into areas of underemployment. This implies not only the dismantling of obstacles to capital movements but also the provision of suitable infrastructure facilities, particularly in the administrative, financial and transport fields.

The difficulties which have recently appeared as regards the supply of raw materials, energy products and agricultural products are a clear indication of the need not only for a comprehensive survey of the situation and of medium-term developments on the various markets but also for the preparation, at Community level, of joint measures which could be rapidly implemented in the event of further shortages.

The weakening of competition, which is a feature of an inflationary situation partly stemming from demand factors, should allow for sectors which until now have been protected by the diversity of national regulations to be incorporated into the system of intra-Community trade. To stimulate competition it should also be made easier for consumers to obtain supplies in other member countries. Furthermore, the efforts to rationalize the distribution system should be continued.

5. In 1972 and 1973 several Member States strengthened the machinery of prices policy. Although such a policy cannot eliminate the fundamental causes of inflation, direct action on price formation may prove useful in the present circumstances. Close attention should, therefore, be paid to the results of the policies pursued at present. Besides it would be valuable if prices for the main consumer goods were publicized as widely as possible.

6. As the fight against inflation can meet with success only if all transactors—the state, the other public authorities, workers, entrepreneurs and other social groups—contribute, it is important that at all levels an information campaign be launched concerning the harmful economic and social effects of a persistent, excessive rise in prices.

B. Guidelines for the individual Countries

In Denmark economic trends in the next few months will probably still be marked by a rapid growth in incomes and in domestic demand, by the persistence of inflationary pressures and by a heavy deficit in the balance of payments on current account.

In the circumstances, a return to equilibrium should be the primary objective of economic policy. To this end, the restrictive line adopted by the authorities should be maintained, if not strengthened.

In the budgetary field, the central government's surplus during the 1974-75 financial year should be maintained at approximately the same level as the previous year. Since the tax burden is already heavy, the efforts required should mainly take the form of a curb on expenditure. This means that there should be only a slight increase in the volume of central government spending. The local authorities, whose expenditure during the last few years has risen even more rapidly than that of the government, should contribute to the fight against inflation by strict budget management.

Monetary policy should continue to keep the expansion in domestic liquidity under strict control. To this end, it is essential that the energetic efforts to limit bank liquidity be pursued and that credit ceilings be retained while a certain selective approach is adopted in favour of corporate investment.

Furthermore, for price trends to become more satisfactory, all economic and social groups must cooperate actively and should be fully aware of the economic and social consequences of their demands.

In Germany the main problem will be to moderate the economic upswing, which at the moment is very rapid and is accompanied by strong inflationary pressures. It would be necessary to ensure that the reduction in excess demand, initiated by the measures taken during the first half of 1973, be completed next year.

The stabilization efforts made, especially in the form of tax measures affecting high incomes, corporate investment and residential construction, and in the form of monetary restrictions and revaluations of the German mark, should be supplemented by strict limitation of budgetary expenditure in 1974. It is essential that the Federal Government and the Lander together achieve a net financial surplus of at least DM 2,000 million as against a deficit of DM 2,000 million in 1973. With revenue likely to go up appreciably, this objective could be attained without a further increase in tax rates. The growth of expenditure by the Federal Government and the Lander together should not, however, exceed 10.5 % under any circumstances. This means that the Lander will have to curb appreciably their expenditure compared with 1973. Here care will have to be taken to ensure that any change in revenue-sharing arrangements in favour of the Lander does not cause the latter to increase expenditure during 1974.

While taking account of the requirements essential to the smooth functioning of the Community's exchange rate system, the Bundesbank should, in the coming months, continue to apply its distinctly restrictive monetary policy in order to dampen the persistent growth in demand in money terms by further reducing the expansion of primary and secondary liquidity.

If need be, the liquidity squeeze should be backed up by the issue of new public loans which go beyond the public authorities' financial requirements and the proceeds from which would be frozen with the Bundesbank.

The stabilization measures must produce results rapidly if a strengthening of inflationary expectations and a deterioration in industrial relations are to be avoided.

In France the inflationary pressures brought about by the very rapid increase in overall demand are likely to persist in 1974. These pressure will continue to make themselves felt in the main supply-demand relationships in the economy generally and the labour market in particular. Wages and salaries and, consequently, costs will continue to forge ahead.

Public authorities should continue and indeed step up their efforts to control inflation. The emphasis should still be on budgetary and monetary policies. The increase in budgetary expenditure by the central government should, as in previous years, be lower than the growth of gross national product in money terms and should not exceed 12.5 % in terms of estimates in the Finance Law or 10.5 % in terms of actual expenditure. This curb should be brought to bear, in particular, on the increase in current expenditure. The 1974 budget should be implemented in such a way that, in cash terms, a surplus of FF 2,000 million is achieved, with this surplus to be frozen with the Banque de France.

If the inflationary pressures do not ease sufficiently, a further increase in revenue would have to be sought via direct taxation.

In the monetary field the efforts to slow down the rise in domestic liquidity should be continued. Within the context of a policy of restricting bank lending, particular emphasis should be placed on curbing consumer credit and mortgage loans. Furthermore, with a view to protecting savings against currency erosion, a further increase in the interest paid on savings deposits would be advisable.

The return to a more balanced economic trend will be greatly facilitated if both sides of industry become aware of the dangers inherent in the present trends in costs and prices, and cooperate actively with the public authorities to ensure the success of the stabilization policy.

In Ireland expansion is likely to continue at a rapid pace during the next few months owing to the strong rise in domestic and export demand; this should be reflected in a further increase in the degree of capacity utilization. At the same time costs and prices will probably climb rapidly.

In the circumstances, the main task facing the Irish authorities will be to dampen the growth in demand and reduce inflationary pressures. The curbing of price increases will certainly be facilitated by price supervision measures and by tax exemption for foodstuffs. This is also assuming, however, that a less expansionary policy will be followed in the budgetary and monetary fields and that both sides of industry moderate their demands.

In particular, the net borrowing requirement for the 1974/75 financial year should be held at the level of that expected for the current financial year. For this to be achieved it would be necessary to curb the rise in public expenditure and to consider an increase in taxation, especially by taxing certain types of income which at the moment are exempt from tax. The very large proportion of the budgetary deficit which is financed by monetary means should be reduced.

In the field of monetary policy it might be necessary to curb the still very buoyant growth in domestic liquidity. Lending should be made stricter and more selective, in particular by reducing the growth in personal loans and in credit of a speculative nature and by promoting the financing of investment aimed at improving the structure of the economy.

In Italy the economic upturn has strengthened distinctly since the spring and the employment situation has improved. The upward movement of prices, which was already rapid, gathered additional speed during the first half of the year. Under these circumstances, economic policy should be aimed less at underpinning the economic upswing than at combating inflation, all the more so since, in certain sectors, capacity limits have already been reached. Care must be taken, however, to see that the desirable growth in investment in infrastructure and industry is not hampered.

This being so, the main emphasis should be on budgetary policy. The central government's net borrowing requirement, including the deficit incurred by the autonomous public corporations (aziende autonome), which was forced up sharply especially by the reform of indirect taxation and which in 1973 will probably be approximately Lit. 6,000,000 million on a cash basis, should not increase further in 1974. To attain this objective it would be necessary to restrict the increase in central government expenditure to less than 14 % compared with a foreseeable increase of almost 24 % in 1973. As far as possible, expenditure on consumption should be the first item to be subjected to the squeeze. Furthermore, a certain increase in taxation may prove necessary. In any case, care should be taken to see that the reform of direct taxation does not cause the growth in revenue to slow down in 1974. The borrowing requirement should more and more be met by the use of non-monetary means.

Monetary policy should aim at gradually reducing the excess liquidity held by private individuals which is an important potential source of inflation. The resulting increase in interest rates would probably help to stabilize the exchange rate for the lira and thereby to slow down the increase in the cost of imports. As the demand for long-term finance must be expected to rise rapidly not only in the public but also in the company sector, measures should be taken to encourage long-term investment and to increase the supply of risk capital. The idea of authorizing Italian investment funds under consideration for quite some time, could be a suitable means of achieving this.

The stabilization measures should be backed up by an active prices policy and by energetic action to rationalize the distribution sector.

In the Netherlands, producers will continue to be subject to fairly heavy pressure in 1974, especially as the world economic situation will have further disruptive effects on equilibrium, even in spite of the 5 % revaluation of the guilder which took place on September 17, 1973. The authorities' efforts to halt the inflationary spiral by means of a more effective incomes policy must therefore be continued; they might also help in reducing structural unemployment, which is partly linked to the persistence of strong inflationary trends in recent years. These efforts could be facilitated by restricting the increase in taxes and charges equivalent to taxes, which recently have contributed appreciably to the price upsurge.

It is also necessary to limit the borrowing requirement (on a cash basis) in 1974 to Fl 1,500 million. To achieve this target, the increase in central government spending in 1974 must not be allowed to exceed 10 %, by fixing a strict scale of priorities for transfer payments to private households and to enterprises and by limiting any increase in the number of public officials.

The rate of increase of domestic liquidity was too rapid in the first half of the year and should be moderated. To this end, the measures announced by the authorities in the summer aimed mainly at freezing an increasingly large part of bank resources will have to be strictly applied. The efforts to curb the increase in the money supply could be backed up by suitable management of the public debt.

In Belgium the likely buoyancy of demand in 1974 gives rise to fears that heavy inflationary strains will persist, in spite of the restrictive measures taken by the Government as part of a concerted plan of action with the two sides of industry. It is therefore important not only that the measures introduced in the summer be strictly implemented, but also that steps be taken to ensure that, if necessary, they can be reinforced rapidly.

To bring about a rapid slackening of the movement of prices and costs, the impetus coming from public finance should be distinctly moderated. To this end, the increase in government expenditure should be curbed by fixing strict priorities. In deciding on the measures to take, a coherent medium-term view should be taken of the problem : in particular, less urgent expenditure must be contained so as to be able to continue as far as possible the improvement of the infrastructure and the execution of projects which could lead to a gradual elimination of structural unemployment. Overall, the increase in central government spending[1] should be limited to 10 % in 1974 and the net borrowing requirement reduced to less than BF 83,000 million, compared to the likely figure of BF 9,500 million in 1973. Besides the automatic increase in revenue, it might prove necessary to raise the rates of certain direct taxes.

In the monetary field, the tightening of the provisions on the upper limits for rediscount and certification and on liquidity reserves should, provided the arrangements are flexibly adjusted to the requirements of the situation, help appreciably towards curbing the expansion of domestic liquidity. This move is likely to prove insufficient, however, unless at the same time the government deficit is financed with means which likewise put the brake on the increase in the money supply.

In Luxembourg the level of activity should remain high in 1974, even though demand for iron and steel products is likely to slacken. Strains will continue in building in particular. Prices could well go on rising at a rapid pace.

Caution should be the watchword in the field of public spending and it would seem advisable to adjust tax scales to the trend of prices. At all events, the increase in expenditure should not exceed 12.5 % and the budget should be balanced. In addition the restrictions imposed on consumer and building credit and also on prices should be maintained.

In the United Kingdom, economic activity and employment advanced considerably in the first half of 1973, but inflationary tendencies remained very strong.

The prime objective of economic policy should therefore be to attenuate the disequilibria that have appeared on most markets, and at the same time to see that a larger proportion of domestic resources are channelled into exports and industrial investment. As the degree of capacity utilization has increased sharply, it will be possible to attain this objective only if the growth of private consumption and government

[1] Including expenditure not included in the budget and expenditure from the special funds.

spending is limited. For this, an active prices and incomes policy will have to be pursued, with the public authorities and the various economic and social groups working in close collaboration.

Budgetary policy, which for the last two years has been resolutely expansionary, should now take a distinctly restrictive turn. The increase in total central government spending (excluding loans and advances) in the 1974/75 financial year should be appreciably less than the growth (10 to 11 %) of gross national product in money terms. Current expenditure should rise at a much slower rate while capital transfers to local authorities, public corporations and the private sector should be reduced. The local authorities should also adopt a policy to curb the increase in expenditure.

In 1974/75, there will be no repetition of the loss of some £ 700 million of tax receipts that occurred in the previous financial year as a result of the introduction of value added tax. In view of the faster growth in tax revenue, the deficit with which the budget is likely to close for the current financial year (excluding loans and advances) should be replaced by an appreciable surplus.

In spite of measures adopted by the authorities—the call for further special deposits from the banks and the substantial rise in the Bank of England's minimum lending rate—the money supply has continued to grow at a very rapid pace. The restrictive monetary policy should therefore be retained and interest rates kept at a relatively high level. This policy is also necessary to strengthen sterling on exchange markets.

CONCLUSIONS

In 1974 the level of economic activity will be high in the Community. There will be a further major improvement in living standards. Employment trends will continue to be satisfactory. However, 1974 will be the fifth year in succession to be marked by serious inflationary strains.

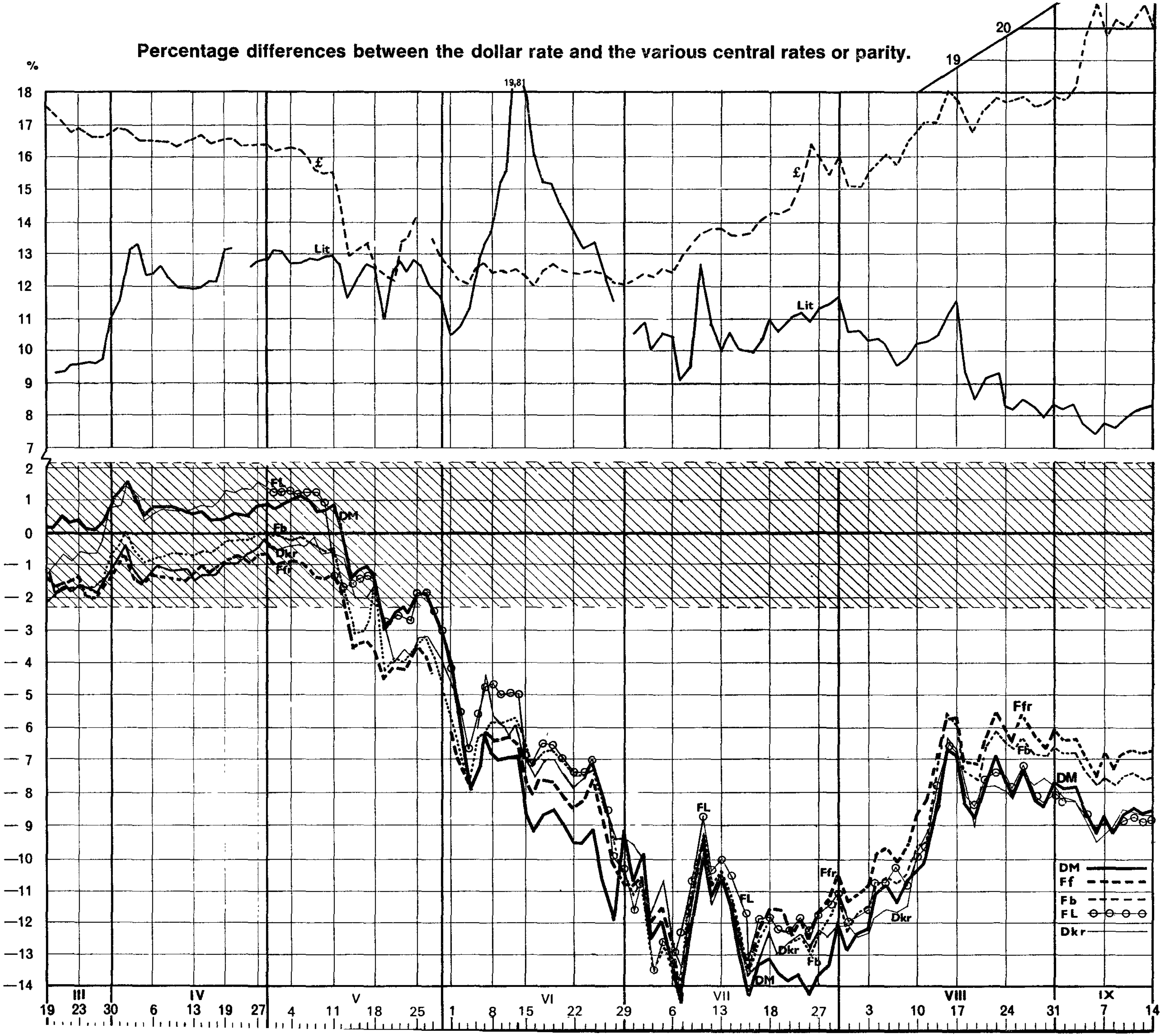
Many steps have been taken in the Community to combat inflation. They have not yet made it possible to get a grip on prices, which are still rising at an alarming pace.

If this objective is not to be abandoned and the harmful economic, social and political consequences of such an attitude accepted, the struggle against inflation will have to be stepped up.

To this end, the authorities of the member countries will have to deploy all the available instruments, taking care to see that all countries are following the same line and that Community ranks are not broken. The different social and economic groups must each play a role in the fight against inflation by moderating their income and price demands.

As the struggle against inflation grows longer and fiercer, more and more attention must be paid to seeing that the efforts and sacrifices required in the short term, which are necessary to ensure the future of the Community and the establishment of economic and monetary union, are distributed fairly.

Percentage differences between the dollar rate and the various central rates or parity.



Appreciation or depreciation (—) of the currencies of the main industrialized countries on 30 August 1973

(% changes from the parities fixed on 20 December 1971)

	In US $	Changes weighted according to geographical structure of exports (in foreign currency)		
		EEC	Outside EEC	Overall
Dkr	20.2	4.93	9.45	7.35
DM	31.9	15.74	18.35	17.15
FF	19.1	1.27	8.13	4.47
Lit	2.9	– 15.77	– 5.94	– 10.62
Fl	21.2	1.01	10.21	3.73
Bfrs/Lfrs	19.5	– 1.14	9.32	1.67
£	– 5.5	– 21.47	– 13.19	– 15.21
US $	—	– 11.74	– 7.25	– 8.41
Yen	16.1	2.49	9.73	9.03

TABLE 2

Exports

(% change from one year to another in terms of value and in national currencies)

		1971		1972		1973
		1st half	2nd half	1st half	2nd half	1st half
Denmark	World	9.1	7.7	15.2	10.3	14.5
	EEC	6.5	7.8	10.9	16.5	(32.9)
Germany	World	11.7	5.7	7.4	11.7	18.9
	EEC	12.5	6.1	8.3	12.6	19.2
France	World	15.6	18.9	18.7	15.0	(19.0)
	EEC	13.9	19.4	21.1	13.1	(16.6)
Ireland	World	22.6	21.7	13.3	30.5	36.7
	EEC	− 7.3	1.6	10.8	11.7	(18.9)
Italy	World	11.8	14.9	18.0	13.4	6.3
	EEC [1]	17.7	17.5	21.3	14.1	(2.0)[3]
Netherlands[2]	World	16.3	13.1	11.0	15.6	(17.9)
	EEC	17.1	16.9	13.5	10.2	(20.2)
BLEU	World	4.3	4.1	13.0	14.0	(20.4)
	EEC	1.4	6.9	15.5	14.2	(33.1)
United Kingdom	World	10.3	17.5	9.0	3.5	22.8
	EEC	10.2	15.2	10.9	10.2	30.5

[1] Excluding Ireland and Denmark.
[2] Excluding BLEU.
[3] January-May.
( ) Estimates.

TABLE 3

Fixed investment as % of GNP at market prices

Country	Private investment (excluding dwellings)			Dwellings			Investment by general government			Total fixed investment		
	1965-1970	1971	1972	1965-1970	1971	1972	1965-1970	1971	1972	1965-1970	1971	1972
Denmark	12.2	11.3	10.9	4.6	4.7	5.4	4.8 a	5.7 a	5.2 a	21.6	21.7	21.5
Germany	15.0	16.7	15.7	5.8	5.9	6.5	4.1	4.1	3.7	24.9	26.7	25.9
France	14.8	15.7	15.9	6.9	6.7	6.8	3.3	3.2	3.2	25.0	25.6	25.9
Ireland	12.1	13.5	13.2	3.8	4.5	3.8	4.2	4.4	4.7	20.1	22.4	21.7
Italy	10.8	11.7	12.2	6.5	5.9	5.6	2.4	2.3	1.5	19.7	19.9	19.3
Netherlands	15.0	14.5	12.8	5.3	5.7	6.2	4.8	4.8	4.2	25.1	25.0	23.2
Belgium	12.7	12.5	12.0	5.9	5.1	4.9	3.1	4.0	4.2	21.7	21.6	21.1
Luxembourg	13.0	—	15.4	8.9	—	9.8	4.1	—	5.6	26.0	—	30.8
United Kingdom	10.0	10.1	9.9	3.4	2.9	3.1	4.7	4.7	4.7	18.1	17.7	17.7

a Including public corporations.