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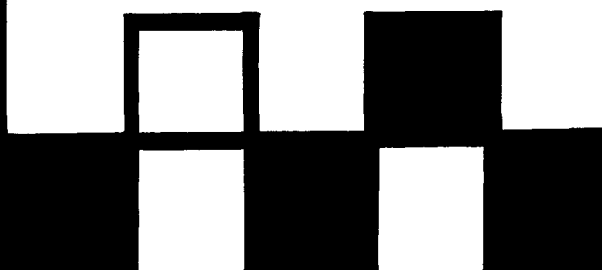
**Directorate-  
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**The economic situation  
in the Community**

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**1972**



Quarterly survey

**Commission of the European Communities  
Directorate-General for Economic and Financial Affairs  
Directorate for National Economies and Economic Trends  
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**EUROPEAN COMMUNITIES**

**COMMISSION**

**The Economic Situation  
in the Community**

**SEPTEMBER 1972**

*This issue contains the proposal of the Commission of the European Communities for the second 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. It also gives the related annex on recent economic trends and outlook for the near future. On the pattern of the quarterly surveys of the economic situation in the Community, the various chapters of the annex are supplemented by summaries of major economic policy measures and statistical tables.*

Brussels, 8 September 1972

# **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)*

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## FOREWORD

Within the programme of work towards the establishment by stages of an economic and monetary union and, more particularly, in accordance with Article 4 of its decision of 22 March 1971 on increased coordination of Member States' short-term economic policies, 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 determine guidelines of economic policy for each Member State 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 second annual report drawn up under this procedure. It proposes guidelines for short-term economic policy in the Community.

At the beginning of the first quarter of 1973, when the Council examines the report, as required by Article 2 of the decision of 22 March 1971, these guidelines may be adjusted to the exigencies of economic developments.





# I. CURRENT SITUATION AND OUTLOOK

## A. Current situation

Towards the end of the summer of 1972, the trend in most member countries reflected a strengthening in the expansion of economic activity and an improvement in the employment situation. The upward thrust of costs and prices, however, was still very vigorous, and capital transactions with abroad continued to be affected by disruptive influences.

### 1. International background

In the middle of 1971 already a number of conditions existed to arrest the slowdown in world trade. The recession in the United States was over. But protectionist measures and monetary troubles delayed the revival in world trade until early 1972. When it did set in, it was all the more appreciable as there was a drive to clear the backlog of orders and deliveries that had built up because of the monetary unrest. Towards the middle of 1972, the expansion of world trade had resumed a pace that was comparable to the one registered in earlier average periods.

#### (a) *International monetary situation*

The agreements of December 1971 on a new pattern of exchange rate relationships among the currencies of the principal industrialized countries paved the way for an attenuation of the disequilibria in overall balance of payments relationships. As a result of a certain reflux of capital, the deficit on the overall United States balance of payments has dropped considerably in recent months. On an official reserve transactions basis, the deficit in the second quarter of 1972 was \$ 800 million, compared with \$ 3 300 million in the first quarter of 1972 and \$ 5 900 million in the fourth quarter of 1971.

The agreements concluded in March between the Member States and the acceding countries, and introducing in mutual monetary and financial relations narrower margins of exchange rate fluctuation than those resulting from the Washington decisions of 18 December 1971, have contributed to greater security in trading relations, especially within the Community.

The speculation against sterling that started in mid-June brought new difficulties. On 23 June 1972 the outflow of capital from the United Kingdom reached such proportions that the British authorities, after increasing Bank rate, decided to abstain temporarily from intervening when sterling moved beyond the limits of 2.25 % on either side of parity, to cease participating for a time in the agreement on narrower margins of exchange rate fluctuation in the enlarged Community, and to introduce restrictions on capital movements. Ireland took similar measures.

At its meeting of 26 June 1972 the Council of the European Communities stressed its determination to comply with the obligations entered into on 18 December 1971 in Washington and to continue operating the system of narrower margins of fluctuation between Community currencies. However, in accordance with the Council resolution of 21 March 1972 (point III, 2, last indent) it agreed to authorize Italy to intervene on its foreign exchange market temporarily in dollars in order to maintain the intra-Community spread of 2.25 %.

Denmark too decided to suspend implementation of the agreement on narrower margins. After a short period of fairly sharp fluctuation, however, the exchange rate of the Danish crown stayed within the Community margin. Norway continued to apply the Community system of narrower margins.

When after the Council meeting of 26 June the foreign exchange markets reopened the dollar rate was tending distinctly downwards, forcing several central banks to buy the U.S. currency. Combined with operations to support sterling, these purchases caused member countries' official gross monetary reserves to rise by a total of 6 800 million units of account between the end of May and the end of July 1972. The country registering the heaviest inflow was Germany, where reserves went up by no less than 4 600 million units of account. In order to stem capital inflows as much as possible, the member countries, Switzerland and Japan took measures to regulate capital transactions with abroad or tightened the arrangements already in existence.

These developments have confirmed that an efficient reform of the international monetary system is essential to lasting stability in monetary relations. The representatives of the countries of the enlarged Community, meeting in London, on 17 and 18 July, began to work out a common attitude on this subject and reached agreement on the objectives to be pursued.

After having ceased, since 15 August 1971, to use convertible currency to support the dollar on foreign exchange markets, the U.S. authorities for their part have since 19 July occasionally intervened again on these to help defend the Washington agreement.

Although the large-scale movements of foreign exchange prove that the international monetary system is still very unstable, the solidarity of the Community countries and the cooperation between their central banks give grounds for greater confidence that the problems still in abeyance will be solved gradually.

#### (b) *World trade*

Since the beginning of 1972 world trade has been expanding at a satisfactory pace. While in the second quarter growth was probably less lively than in the early months of the year, when it had been strongly influenced by the revival of confidence after the conclusion of the Washington agreements, world trade has been stimulated by the acceleration of economic expansion in the large majority of industrialized countries.

Growth in North America has maintained its rapid pace, and there has been a revival of economic activity in the acceding countries, Japan, and most industrialized countries of continental Europe. With raw material imports by industrialized countries going up more rapidly and world market prices rising, the foreign exchange position of the developing countries has also improved.

## **2. The economic situation in the Community**

Economic activity in the Community expanded quite appreciably in the second quarter although the advance was not as strong as in the first, when very good weather and other fortuitous factors had enabled production to rise sharply.

Moving in line with the trend of world trade, the Community's exports to non-member countries slowed down a little in the spring. The expansion of domestic demand, on the other hand, gathered momentum, if anything, with the strongest stimuli still coming from expenditure on consumption by households, which benefited from the continued sharp rise in disposable incomes. The growth of building investment continued, helped by the more favourable trend of housing demand and the execution of a large number of public works projects. The replenishment of stocks of raw materials and semi-manufactures probably also made a major contribution to growth. At the same time there were signs of fixed investment by enterprises showing a less sluggish trend than at the end of 1971.

The increase in production enabled employment to expand; at the same time the rise in unemployment slackened considerably in the countries where it had been sharpest until recently.

The economic trend in Italy differs from this general pattern to the extent that the expansionary forces were weaker and took longer to work through.

The rise in consumer prices continued to be very lively throughout the Community. The

### Industrial production

(Seasonally adjusted % change) <sup>1</sup>

	1971				1972		Between II/71 and II/72
	I	II	III	IV	I	II	
	During the quarter						
Community	+ 2.6	- 1.5	+ 1.5	- 0.2	+ 3.4	+ 1 <sup>2</sup>	+ 4 <sup>2</sup>
Germany	+ 3.8	- 1.2	- 1.3	- 1.3	+ 5.1	- 0.6	+ 2
France	+ 2.5	0	+ 4.2	+ 1.2	+ 2.3	+ 0.6	+ 7.9
Italy	- 1.4	+ 2.9	- 2.0	+ 5.6	0	- 0.9 <sup>2</sup>	+ 2.7 <sup>2</sup>
Netherlands	+ 2.6	+ 1.1	+ 0.9	+ 1.1	+ 4.2	+ 2.2	+ 8.6
Belgium	+ 3.1	- 4.1	+ 1.8	+ 1.9	+ 4.7	+ 3 <sup>2</sup>	+ 12 <sup>2</sup>
Luxembourg	+ 1.5	+ 5.3	- 0.1	- 2.7	- 0.5	+ 7 <sup>2</sup>	+ 2 <sup>2</sup>

<sup>1</sup> Seasonally adjusted national indices for Germany, France, Italy and the Netherlands; the remaining indices are those of the Statistical Office of the European Communities.

<sup>2</sup> Estimates.

prices of agricultural products climbed considerably, and in most member countries public utility charges were put up. It is only in finished industrial products that the price increase appears to have slackened in some countries.

Costs per unit of output likewise continued to go up appreciably, despite greater productivity gains.

A worrying feature of recent economic developments is that the expansion in the money

### Consumer prices

(% increase)

	1971				1972		Between II/71 and II/72
	I	II	III	IV	I	II	
	During the quarter						
Germany	+ 2.5	+ 1.1	+ 0.8	+ 1.3	+ 2.1	+ 1.1	+ 5.2
France	+ 1.3	+ 2.6	+ 1.3	+ 1.4	+ 1.3	+ 1.5	+ 5.5
Italy	+ 1.1	+ 1.0	+ 1.2	+ 1.3	+ 1.2	+ 1.7	+ 5.1
Netherlands	+ 3.0	+ 1.9	+ 1.7	+ 1.5	+ 2.5	+ 1.9	+ 7.8
Belgium	+ 1.8	+ 1.0	+ 1.7	+ 1.0	+ 1.1	+ 1.5	+ 5.0
Luxembourg	+ 2.2	+ 1.1	+ 0.6	+ 1.5	+ 1.0	+ 1.7	+ 4.4

Source : Statistical Office of the European Communities (SOEC).

supply has gathered speed. Although in the past few months the inflow of capital from abroad has been a major contributing factor in almost all member countries, the sharp

expansion of bank lending and in some countries the financing of government expenditure by monetary means have also been playing an important role.

### *Money supply*

(% change between June 1971 and June 1972)

	Money supply (M <sub>1</sub> )	Holdings of near-money (M <sub>2</sub> )	M <sub>1</sub> + M <sub>2</sub>
Germany	+ 14.4	+ 13.6	+ 14.1
France	+ 12.9	+ 30.4	+ 18.9
Italy	+ 17.8	+ 19.4	+ 18.5
Netherlands	+ 18.5	- 7.7	+ 10.9
Belgo-Luxembourg Economic Union	+ 13.2	+ 18.4	+ 14.8

The Community's trade surpluses went up appreciably in the first half of the year,

especially as a result of an improvement in the terms of trade.

## **B. Outlook for 1973**

### **1. Outlook for the world economy**

The expansionary factors currently apparent in world trade will probably remain strong, if not gather additional momentum, in the months ahead. In North America general economic activity is likely to remain very buoyant; in the acceding countries, most other industrialized countries of Europe and in Japan, the business upswing should gain in vigour while import demand from the developing countries may become firmer. There is a risk, however, that the expansion of world trade may be accompanied by further, very considerable increases in prices for agricultural products, raw materials and industrial products.

Steady and buoyant development of world trade hinges on the maintenance of stable relationships between realistic rates of exchange. In this

respect, the determination of the major world trading countries to hold to the exchange rate pattern agreed upon in Washington, and the work already started and initial negotiations held on the reform of the international monetary system are helping to improve the atmosphere in international economic and monetary relations. However, as the return to a more balanced situation must take place under difficult conditions, the Member States of the Community may well be forced to take new measures of a common accord, in order to defend their rates of exchange.

### **2. Outlook for the economic trend in the Community**

1973 holds out the prospect of being a year of vigorous economic growth in the Community.

Given the foreseeable expansionary trend of the world economy, the Community's exports can be expected to rise considerably in the next few months, despite the impact of the appreciation of Member States' currencies.

This tendency could be reinforced by the 20 % cut, from 1 April 1973, in customs duties on industrial products within the enlarged Community and in relations with the EFTA countries that do not join the Community.

In addition, the conditions appear to be met for an appreciable revival in the expansion of domestic demand. The flow of new orders for capital goods and the results of the business surveys suggest that corporate investment will slacken less sharply in the countries where it has been relatively weak so far and expand at a faster rate in the others. An improved sales outlook, rising capacity utilization and, in some countries, wider profit margins, are favourable factors that should make for an appreciable pick-up, in 1973, in corporate spending on building and on plant and machinery. In residential construction and investment by the public authorities, the substantial inflow of new orders and the high number of building starts point to a faster rate of growth. Activity in some industries, particularly the first stage of metal processing, will benefit from the sustained drive to replenish stocks. Private consumers' expenditure, too, is likely to tend upwards, not only on account of the increase in numbers employed but even more because there will still be substantial wage awards.

The growth rate of real gross national product in Germany and the Benelux countries should therefore be distinctly higher in 1973 than the one expected for 1972. In France, the rise is likely to remain substantial, with the rate tending to be even higher than in 1972. In Italy, growth will probably distinctly exceed the fairly modest result expected for 1972. All in all, the real gross Community product may grow by some 5 % in 1973, compared with a rate of some 3.5 % in each of the two preceding years. This would bring economic growth in the Community back to the trend charted for the medium term.

The outlook for the trend of costs and prices, by contrast, remains disquieting. There is a

risk of consumer prices in all Community countries continuing to rise too rapidly towards the end of 1972 and in 1973.

### **3. Main problems of short-term economic policy**

Curbing the inflationary tendencies therefore appears to be the overriding aim for short-term economic policy in the Community, unless there is a willingness to consider price increases of an order of 5 to 6 % a "normal" feature of the business situation and to accept their harmful effects on the general economy and the social climate.

In 1973, employment problems will have to be tackled from the angle of structural policy, if anything. This is because in almost all member countries the progress of economic activity appears to be sufficiently rapid to permit an appreciable increase in the level of employment and a reduction in cyclical unemployment. None the less there will still be a need to try and establish better equilibrium on the labour market by means of structural measures.

At present the upward movement of prices is being reinforced by the fact that inflationary behaviour is becoming ingrained as a result of the duration and strength of the inflationary process. Should economic expansion continue to accelerate at the present rate, it would become increasingly difficult to meet rising demand out of available plant capacity; the emergence of strains on the labour market would also be inevitable. This could be the pattern in a large number of sectors, so that precautions must be taken at this stage already to see that bottlenecks do not reappear soon and a new process of demand-pull inflation is touched off. Given the increasing interpenetration of Member States' economies, such a process would rapidly spread in the Community and also extend — perhaps sooner than might be supposed — to the member countries with less high rates of utilization of production capacity.

Efforts must therefore be made in the Community countries to widen the physical scope for expansion and keep the rise in overall demand

to a rate that is compatible with the requirements of balanced medium-term growth.

The expansion of production capacity hinges mainly on a change in structures. With investment activity likely to pick up in 1973, it does not appear to be expedient to take general measures to promote corporate investment; the need is rather for increased efforts to eliminate regional imbalances in the distribution of manpower reserves and plant capacity. It would indeed be desirable for the less developed regions to benefit to a greater extent from the acceleration in economic growth than they did during the upswing of earlier business cycles. The creation of new jobs in the sectors that

will benefit most from the expansion in demand would also be greatly assisted by stepping up vocational training and retraining efforts.

Success in controlling the inflationary tendencies also depends on changes in the pattern of the public finances. In the past few years there have been certain tendencies in this field which, should they persist, would likewise keep the inflationary process going without enabling budgetary policy to achieve the aims fixed as first priorities in the satisfaction of public needs. In the past few years the share of total public expenditure in gross national product, at current prices, has risen in all Community countries except France.

*% share of total public expenditure  
in gross national product at market prices*

	1966	1967	1968	1969	1970	1971	1972
Germany	37.2	38.9	38.1	37.9	37.8	38.8	39.7
France	37.5	33.6	39.0	37.7	37.1	37.4	37.6
Italy	34.8	34.6	36.1	35.7	35.9	38.0	39.8
Netherlands	40.3	42.1	42.8	43.7	45.5	46.7	47.4
Belgium	33.1	34.1	36.2	36.1	36.6	38.3	41.3

1966-70 : SOEC.

1971-72 : Estimates.

More detailed examination shows, however, that this has been due mainly to a relative increase in current transfers (especially social security transfers). In real terms, the share of government consumption and investment by the public authorities has contracted increasingly, except in Belgium. This is all the more disquieting as satisfaction of the "traditional" public needs (education, health, town and country planning, transport), together with "new" needs (protection of natural resources, pollution control) means that increasing demands must be made on real resources.

The rise in the share of government expenditure necessarily poses difficult problems of choice : the public authorities must decide whether to opt for a higher tax burden, a larger net borrowing requirement, the passing on of the costs of certain public services directly to the beneficiary, or a cut in certain types of expenditure. The first three solutions may help to accelerate the already rapid upward movement of costs and prices, while the last sometimes leads to delays in the satisfaction of public needs ranking high on the list of priorities.

## II. GUIDELINES FOR ECONOMIC POLICY

### A. General guidelines

Continuation of the fight against inflationary tendencies remains the overriding aim of economic policy in the Community.

This implies that member countries will have to put an immediate end to the spontaneous tendencies towards an acceleration in the upward movement of prices such as is apparent at the moment.

In addition, Member States must seek, in accordance with their discussions at the Council meeting of 26 June 1972, to reduce the rise in consumer prices — which currently can be estimated to run at 5 to 6 % during 1972 in all member countries — to 3.5 % between December 1972 and the end of 1973. This aim may appear to be more difficult to achieve today than in June. But even if it is achieved, the rise in consumer prices on 1972 will still be 4 to 5 %, taking the average for the whole year and disregarding the possible effects of any changes in indirect taxation. This would none the less mean a break in the upward movement of prices, a break which it has as yet been impossible to obtain in the Community and which would produce a change in the inflationary expectations of those active in economic life.

To achieve this result, the public authorities and the large economic and social groups must make a serious collective effort to exercise moderation. What is needed is both a monetary and budgetary policy capable of creating the basic conditions for a more balanced development of member countries' economies, and a contribution from the various economic and social groups with regard to the trend of incomes.

1. With this end in view, policy in the public finance field must comply with the following guidelines :

(a) Strict implementation of the current 1972 budget. This is all the more necessary as the rise in cash spending over the corresponding period of the previous year has so far been considerable in most member countries : in the first seven months 18.3 % in Italy, 9.8 % in Germany (Federal Government) and 6.6 % in France and, in the first six months, 20.5 % in Belgium, 16.4 % in Luxembourg and 15.7 % in the Netherlands.

(b) As regards the 1973 budgets, the rise in expenditure over actual outlays in 1972 should be kept within strict limits. To achieve the price target indicated above, it would be desirable for the increase in expenditure not to exceed the expected real growth in gross national product, after making allowance for the average price increase resulting from a rise of 3.5 % between December 1972 and the end of 1973. Should such an effort in the public finance field prove impossible, particularly for reasons of structural policy, the rise in expenditure must in any case not exceed the expected growth of gross national product in terms of money. This would require correspondingly stricter use of the other instruments of economic policy.

In any event there is a need to reduce the net borrowing requirement, particularly in those countries where it has gone up considerably in the past few years, and to finance the shortfall out of savings.

In Italy the switch to such a policy should not be made until general economic activity in 1973 picks up sufficiently to warrant a gradual reduction in the stimuli provided by the public sector.

2. Monetary policy, too, should exercise a moderating influence on the expansion of overall demand; it should aim at restricting the

excessive growth in the money supply registered at the moment. Any liquidity resulting from capital inflows from abroad, particularly short-term inflows, should be frozen. The creation of liquidity from internal sources should be cut down, mainly by curbing lending to the private sector and refraining from financing the public deficits by monetary means.

In Italy, the share of medium- and long-term financing by the authorities could be stepped up as economic growth accelerates.

Generally, the monetary authorities of the member countries should seek to bring the rate of increase of the money supply gradually down to the rate of growth of real gross national product augmented by a target figure for price increases fixed in the light of the objectives of short-term economic policy.

Pursuit of a cautious line of credit policy could lead to a certain increase in short-term interest rates in the member countries and thereby attract foreign capital. The tendency for interest rates to go up, already apparent in a number of important non-member countries, and appropriate use by Member States of the instruments to regulate capital transactions with abroad should, however, enable the size of such capital inflows to be kept within bounds. There would be a case for gradually harmonizing the relevant rules at Community level, with a view to opening the Community's capital market more widely to each other and getting inte-

gration of member countries' capital markets off to a new start.

3. To create appropriate conditions, on the supply side, for a break in the upsurge of the cost of living, the necessary measures should be taken in the field of competition, trade and agricultural policy. In the latter field, the moves made should relate mainly to items not produced in sufficient quantity in the Community.

4. In modern industrialized societies, the only key to achieving an ordered trend of prices and incomes — barring direct authoritarian controls — lies in concerted action by the various social groups, whose efforts must supplement and back-up each other. It is important in this context that, in fixing their prices, entrepreneurs should not be guided at all by inflationary expectations, that the trend of incomes should take account of the medium-term advance in general economic productivity, and that monetary and budgetary policy should contribute to the maintenance of the basic equilibrium of the economy. These are by no means unrealistic conditions in a society whose functioning is determined by informed and powerful private and public decision-making centres. Inflation is indeed largely the result of incompatible economic and social behaviour. Technical measures alone will not suffice to bring it under control; a joint effort for greater coherence in economic and social matters is also necessary.

## **B. Guidelines for the individual countries**

In Germany, the likely acceleration in economic activity will start from a level of capacity utilization that is distinctly higher than the one recorded in the final phase of slowdown of earlier business cycles. There is thus a particularly great danger that there will soon be bottlenecks in production, which would strengthen the upward tendency of costs and prices. This danger must be forestalled by appropriate management of demand.

To this end, monetary policy should be aimed at curbing the expansion of the money supply

and of lending to business. The various measures taken since the beginning of the year<sup>1</sup> could be used in an appropriate way to stem the inflows of capital from abroad and neutralize their effects on domestic liquidity.

<sup>1</sup> Acquisition of German fixed-interest securities by non-residents made subject to authorization; foreign borrowing made subject to the payment of a non-renumerated cash deposit with the Bundesbank; increase in minimum reserve ratios and reduction in rediscount quotas; gentlemen's agreement between the Bundesbank and the commercial banks, under which the latter cease to sell certain securities and claims to non-residents and to arrange foreign loans for residents.



The quest for greater stability also requires caution in the way the public authorities handle their finances. A more restrictive line must be adopted, in particular over administrative expenditure and subsidies. In the past few years the efforts at cutting budgetary expenditure have been mainly at the expense of public investment, creating a gap whose persistence could jeopardize the longer-term development of the economy. While making allowance for this fact, the rise in aggregate spending by the Federal Government and the Länder should be kept within the limits indicated at point II A 1 b of the general guidelines, that is between 9 and 10.5 %. The aggregate net borrowing requirement of the Federal Government and the Länder should in any event not exceed DM 9 000 million. This could call for an increase in taxation.

Determined use of the instruments of monetary and budgetary policy to improve general equilibrium is an essential condition for concerted action, undertaken together with the two sides of industry, to keep the rise in incomes at a rate compatible with an appreciable slowdown in the upward movement of prices.

In France the recovery of corporate investment and the expected rise in exports, especially to the other Community countries, will provide an additional boost to expansion, fairly rapid though it already is. In the circumstances there are serious reasons to fear that inflationary pressures will mount further and that the foreign trade and payments situation will deteriorate. The economic policy pursued in the closing months of 1972 and 1973 should therefore be particularly watchful.

For one thing, the expansion of domestic liquidity, which has been very rapid in recent months, will have to be kept within much narrower limits by making full use of the possibilities available for raising minimum reserves on bank lending and borrowing and for tightening the rules governing the granting of consumer credit and personal loans. A certain increase in interest rates could be helpful if this does not result in unwanted inflows of capital from abroad. It could act as an encouragement to saving, which should be stepped up so as to help moderate the expansion of private consumer demand.

Secondly, the public authorities should not give any additional boost to the expansion of demand in 1973. With the financial situation of the local authorities, and especially of the social insurance system, tending to deteriorate — incidentally a development that should be countered through suitable measures — the 1973 central government budget should be drawn up and implemented in such a way as to achieve equilibrium.

To attain this objective, the expansion of public expenditure in 1973 should not exceed 10.5 % of the original estimates for 1972, or 8.5 % of the probable out turn for that year. The restraint will have to be mainly in current expenditure on goods and services, transfers to enterprises and loans advances, so as to permit a correspondingly larger rise in expenditure on public investment and in certain type of public consumer spending that must be given priority. For the tax yield to grow at the rate necessary to safeguard budgetary equilibrium, income tax concessions must not go further than laid down in the 1972 Finance Act.

It will be impossible to dampen the upward thrust of costs and prices if incomes continue to rise as rapidly as in the past few months. Success therefore depends largely on the behaviour of the two sides of industry.

Short-term economic policy must finally be backed up by a longer-term strategy aimed at securing a more rapid expansion of the supply potential and reducing the current imbalance in the regional distribution of productive resources. To this end, a systematic effort should be made to promote vocational training, step up residential construction and improve the financing mechanisms.

In Italy the revival of business activity which began in the autumn of 1971 has made very slow progress, so much so that there has even been a rise in unemployment. An appreciable increase in economic activity therefore continues to be the overriding aim. In implementing economic policy it must be borne in mind, however, that the current price trend, the unusually large number of collective agreements coming up for renewal in the autumn, and the introduction of value added tax on 1 January 1973, are elements of uncertainty that may impede the achievement of balanced growth.

The upswing is helped by the plentiful supply of domestic liquidity. It will be necessary, however, to modulate the easy money policy to changes in the situation. There appears to be a case for ensuring that the unusually sharp expansion of the money supply of the past few years does not produce inflationary effects once there is a distinct new rise in the rate of utilization of production capacity.

Budgetary policy too has an important regulatory function to perform. Transitional measures taken to prepare for the tax reform, and delays in the collection of indirect taxes after the introduction of value added tax, will inevitably lead to shortfalls in tax revenue in the 1973 budget year. In the circumstances the rise in cash spending by the Government should be kept to 10 % in 1973 so as to ensure that the net borrowing requirement, including the deficit of the autonomous public corporations (*Aziende autonome*), does not exceed Lit. 4 000 000 million. The stimulus thus provided by the public finances will help to speed up production and consolidate the level of employment; the need may arise, however, to vary it in line with the vigour of the business upswing. The deficit should increasingly be financed by non-monetary means.

Whether the Italian economy will be able to enjoy balanced development in 1973 and beyond also depends largely on the results of the next wage negotiations. Every effort should be made to see that they do not engender an abrupt and unduly sharp rise in production costs. An important point is that the wage increases should be appropriately staggered. To facilitate the conclusion of agreements that meet these particular criteria, the authorities would immediately have to take the necessary measures enabling the increase in consumer prices resulting from the introduction of value added tax to be kept as small as possible. To this end, care should in particular be taken to see that there are no unjustified price increases, and to provide enterprises and consumers with adequate information on the mechanics of the new tax. In addition, the inevitable impact of an increase in the taxation of essential consumer goods could in a first stage be mitigated by applying reduced rates.

The revival of the Italian economy must increasingly be investment-led. To safeguard

lasting expansion of the economy and of employment, it would above all be necessary to reduce the gap that has opened up in the past few years in the field of directly productive and social investment. Such a policy will, of course, have to take account of the special structural and regional organization of the Italian economy. It will be possible only if a larger part of savings is channelled into long-term investment. There appears to be a particular case here for facilitating the financing of private investment by promoting the supply of risk capital.

In the Netherlands, the pick-up in expansion apparent since the beginning of 1972 will probably lead to a tendency for the cyclical employment situation to improve while impeding desirable progress towards a more balanced development of the economy.

To achieve an appreciable slackening in inflationary strains, which is indispensable if the competitiveness of enterprises is to be maintained and structural unemployment removed, energetic short-term economic policy measures will have to be enacted. These must rely on the use of all available instruments of budgetary and credit policy and on concerted action by the Government and the two sides of industry to secure a sufficient moderation in the rise of incomes.

Strict control must still be exercised over the liquidity available in the economy. This means in particular that the authorities must take the necessary measures to regulate capital transactions with abroad, and that moves are made to prevent any excessive expansion in lending to the corporate sector.

In the coming months and in 1973 the budget should be handled in such a way as to have a less expansionary effect than in the past few years. The growth of total spending by the central government in 1973 should stay within the limits indicated in the general guidelines (point II A 1 b), that is between 9.5 % and 11 %. The main cuts would have to be in administrative expenditure.

As an increase in the already very heavy burden of taxation would have negative effects on the upward movement of costs and prices, rapid as it already is, caution should be exercised when

putting up the rates of certain indirect taxes. In the circumstances, a net borrowing requirement could be envisaged for 1973 not in excess of Fl. 2 500 million and fully financed by non-monetary means.

In Belgium, the expansionary course of economic policy adopted in 1971 has contributed to a distinct acceleration in growth, which in the months ahead is likely to have a favourable effect on the employment situation. Given the disquieting trend of costs and prices, however, economic policy will now have to concentrate on dampening the inflationary strains.

Monetary policy should aim at curbing the expansion of domestic liquidity. Where necessary, the effects on liquidity of any inflows of speculative funds from abroad would have to be neutralized.

In the field of budgetary policy it is important to return as soon as possible to sufficiently large public saving, in accordance with the guidelines contained in the 1971-75 economic plan. This aim can be achieved only through strict limitation of the rise in current expenditure. If such restriction cannot be secured, it will be necessary to increase taxes and charges of a similar nature, particularly in the field of indirect taxation. In the absence of thorough-going measures to this effect, the

desired reduction in the Government's net borrowing requirement could only be made at the expense of public investment. The growth of Government spending in 1973 should stay within the limits indicated in the general guidelines (point II A 1 b), i.e. between 9 % and 10.5 %; the net borrowing requirement should be reduced appreciably (Bfrs. 92 000 million in 1972 to Bfrs. 82 000 million in 1973)<sup>1</sup> and should be financed entirely by non-monetary means.

In Luxembourg, the outlook for the trend of export demand in 1973 is favourable. In the circumstances, the Government should manage domestic demand cautiously so as to prevent a fresh upsurge in costs and prices.

To this end, the Government would have to handle investment projects selectively, especially since there is also a need to ensure balanced development in residential construction. With the tax yield going up considerably, it should be possible, by placing certain restrictions on the rise in public spending, to keep the 1973 net borrowing requirement to Lfrs. 1 700 million<sup>2</sup>.

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<sup>1</sup> Including the autonomous funds and institutions.

<sup>2</sup> Including the special funds.

## CONCLUSIONS

The outlook for the Community's economy during the coming months and 1973 suggests that economic activity will expand at a very satisfactory rate and that the standard of living will rise appreciably; this makes it reasonable to assume that the situation on the labour market will come very close to full employment.

But the outlook also gives reason to fear a continuation of the inflationary process which it has been impossible to bring under control for almost four years now.

The difficulty experienced in restoring greater stability stems from various sectors, internal and external, political and economic. The risk therefore is that the countries of the Community

will tend to live with inflation and get accustomed to a rate of increase in prices and incomes which, though perhaps convenient in the short term, is fraught with dangers in the longer run. Once the state of the economy has radically deteriorated as a result of inflation, the necessary rehabilitation can indeed only be achieved through great sacrifices in terms of growth and employment.

This is why the Community countries must continue, despite all difficulties, to try and combine sustained growth with stability. Over and above the considerations set out above, this is also an essential condition for the smooth working and the economic and social development of the Community.

