

**Commission of  
European  
Communities**

**Directorate-  
General  
for Economic  
and Financial  
Affairs**



**1  
1976**

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

Quarterly survey

*This publication appears quarterly. Numbers 2 (June) and 4 (December) are surveys by the Commission of the European Communities of recent developments in and the outlook for the economic situation in the Community as a whole and in each of the Member States. They do not contain economic policy recommendations or guidelines, but are limited in this area to a statement of the conjunctural policy problems arising at Community level and in the various Member States. Number 3 (October) reproduces the Commission proposal for the annual report on the economic situation in the Community. This report, which the Council adopts in the autumn of each year in accordance with its decision of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States, establishes the economic policy guidelines to be followed by the Member States in the year that follows. Number 1 (March) reproduces the text of a communication by the Commission to the Council concerning the adjustment of these guidelines for the current year. It contains in addition a summary account of the economic policies pursued in the previous year, and a report on the application of the Council decision on the attainment of a high degree of convergence of the economic policies of the Member States and on the conformity of the policies pursued with the objectives set.*

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

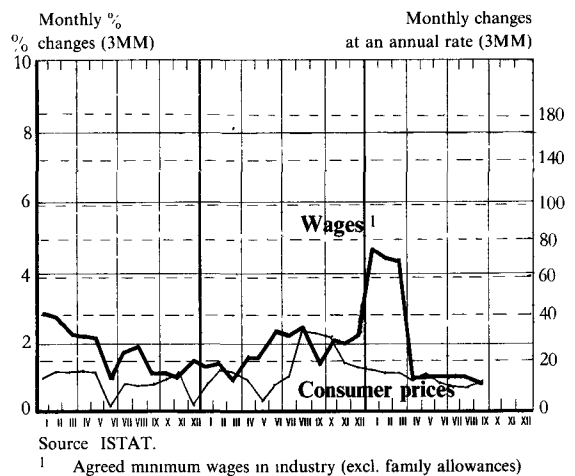
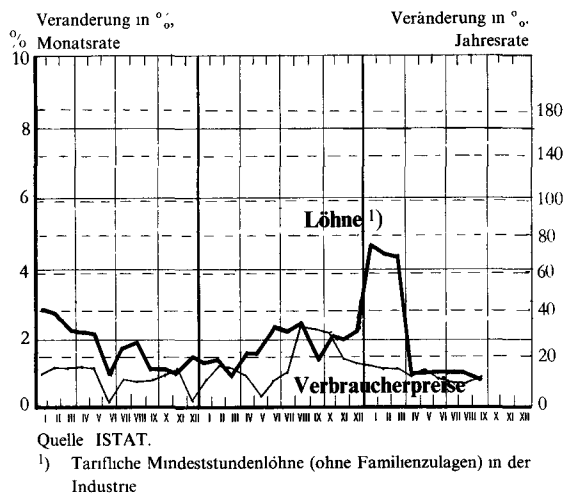
Rue de la Loi 200, 1049 Brussels

**BERICHTIGUNG**

**CORRIGENDUM**

Die Grafik über die Entwicklung der Verbraucherpreise und der Löhne in Italien auf Seite 53 des oben genannten Berichtes gibt nicht den wahren Verlauf der Entwicklung der Löhne wider. Sie ist durch die nachfolgende Grafik zu ersetzen.

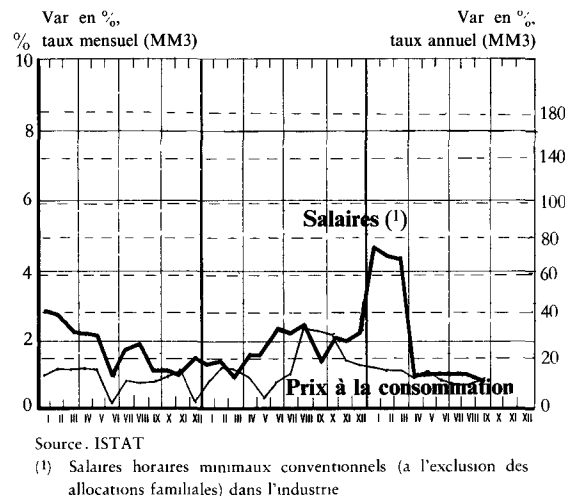
The graph on page 53 of the above publication, showing the development of consumer prices and wages in Italy, does not give the correct movement of wages. It should be replaced by the graph which follows.



**Rapport n° 4/1975 sur «La situation économique de la Communauté»**

**CORRIGENDUM**

Le graphique relatif à l'évolution des prix à la consommation et des salaires en Italie, et qui figure à la page 53 du document susmentionné, ne retrace pas correctement l'évolution des salaires. Il est à remplacer par le graphique ci-dessous





**COMMISSION OF THE  
EUROPEAN COMMUNITIES**

**The Economic Situation in the Community**

MARCH 1976

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## **I — Communication of the Commission to the Council concerning the adjustment of the economic policy guidelines for 1976**

### **FOREWORD**

1. Pursuant to Article 2 of the Council Decision of 18 February 1974 concerning the achievement of a high degree of convergence of the economic policies pursued by the Member States, the Council has undertaken to adapt, as early as possible in the first quarter, the economic policy guidelines for the current year to the new requirements of the economic situation. To this end, and pursuant to Article 1 of the same Decision, the Commission hereby transmits this Communication to the Council.

2. The Commission is also sending to the Council, in accordance with Articles 2 and 12 of the said Decision, a document containing a summary of the economic policies followed in 1975 and also a report on the implementation of the Decision and the degree to which those policies conformed with the objectives established.

3. The five year forecasts of the main macro-economic aggregates, which are referred to in the third paragraph of Article 2, Will be included in the fourth medium-term economic policy programme which the Commission will present to the Council before the summer, on the basis of the draft version being prepared within the Economic Policy Committee.

### **A. THE ECONOMIC SITUATION AND OUTLOOK**

#### **(a) Recent developments**

*Recovery of  
economic activity*

1.1. The marked deterioration in the economic situation in the Community, which began in the spring of 1974, has come to an end. During the second half of 1975 there were increasingly distinct signs in almost all the Member States of an upturn in the economy and an improvement in the business climate. Over the last few months, production and overall demand have been tending to pick up more strongly in most of the member countries (see Table 1 annexed).

*The causes*

1.2. The start of economic recovery had already been foreshadowed in the last 'Annual Report on the Economic Situation in the Community'.<sup>1</sup> The improved economic trend may be attributed to the combined effects of spontaneous expansionary factors and of reflationary measures, including:

- (a) a halt to destocking or a resumption of restocking;
- (b) the recovery of consumer spending, with savings and consumer behaviour beginning to return to normal as price rises eased;
- (c) the effects of the switch to an expansionary economic policy, and more especially budgetary policy, in most of the Member States;
- (d) the gradual improvement in export demand.

However, business investment has remained weak almost everywhere.

<sup>1</sup> OJ C 297 of 29.12.1975.

*Persistence of unemployment*

1.3. Since the beginning of the autumn, the rise in unemployment has slowed down a little in some Member States; a drop has actually been recorded in some cases, notably in the Federal Republic of Germany and the Netherlands. Nevertheless in January 1976 the seasonally adjusted number of wholly unemployed in the Community still amounted to roughly 4.7 million, equivalent to an unemployment rate of about 4.4 % (see Table 2 annexed). Compared with the lowest level of unemployment reached in 1973 during the last boom the number of wholly unemployed increased by approximately 2.5 million, and the number of people on short time by some 2 million.

*... and inflation*

1.4. Inflationary pressures are much weaker now than at the end of 1973. The slowing-down has been particularly marked in the second half of 1975 in Denmark, the Federal Republic of Germany, Ireland and the United Kingdom. Even so it was not possible to reduce the average monthly increase in consumer prices in the Community, expressed at an annual rate, to much below 10 %. Member countries' inflation rates still differ widely, and at the beginning of 1976 the year-to-year increases ranged from about 5 % in Denmark and the Federal Republic of Germany to more than 23 % in the United Kingdom (see Table 3 annexed).

*No further improvement in the current account*

1.5. The notable improvement in the Community's current account from mid-1974 onwards came to a halt as from the middle of 1975, with imports picking up more vigorously than exports as the economy began to recover. Also, after the sharp contraction apparent since the spring of 1974, the volume of world trade no doubt began to grow again, though only very moderately, towards the end of 1975, helped by the economic upturn in the United States. However, for the year as a whole, the volume of world trade, for the first time since the war, will have recorded a fall of more than 5 %.

#### **(b) The outlook**

*Uncertainties about the recovery*

2.1. The recovery now under way is not yet certain. The vigorous rates of growth of production now being recorded are for the most part a reflection of technical adjustments to stocks and the very low starting level. The impact of the deep recession of 1974/75, the lack of stability in world political and monetary relations, the persistence of inflationary dangers and high unemployment, the sharp differences of position between regions and industries, and the very slow recovery of confidence in the economic future by consumers, investors and the two sides of industry are hardly factors justifying an over-optimistic view as to the durability and strength of the economic upswing.

*Prospect of a slow recovery in world economic activity*

2.2. World trade will probably continue to revive between now and the end of 1976, mainly as a result of the renewed buoyancy displayed by the economies of the industrialized countries, especially the United States. It remains to be seen whether the recovery apparent in these countries will be vigorous enough to spread, as was the case in the past, to the other industrialized countries outside the Community and to the non-oil-producing developing countries. This is a particularly crucial point, since the growth in purchases by the OPEC countries and the state-trading countries is likely to slow down.

*Foreseeable worsening in the current account*

2.3. Even if the improvement in the world economy follows the pattern observed in the past, it can only be moderate. Thus, in 1976 the volume of Community exports is hardly likely to expand by more than 5 %. This compares with a medium-term growth rate of some 8 % in the past, a rate which, moreover, was considerably exceeded in previous booms. The faster increase in imports, combined with an adverse swing in the terms of trade, could cause the Community's current account balance to worsen in 1976 but by no more than 3 to 5 thousand million dollars. In these circumstances, a faster than expected economic recovery could, in certain cases, create problems for those Member States with balance of payments deficits.



There will probably be little basic change in the positions of the surplus Member States in 1976 as compared with 1975 (combined surplus of over \$ 5 000 million).

*Danger of straying off course*

2.4. Import prices and especially raw material prices will tend to move upwards in the recovery phase of the cycle. On the other hand, wage costs per unit of output should rise at a rate much lower than previously in all the Member States, particularly the Federal Republic of Germany, the Netherlands and Denmark. Inflationary pressures and wage cost pressures will, however, persist, particularly in cases where there are further disputes over shares in national income and where insufficient output and productivity gains could lead firms to raise profit margins. Without further vigorous efforts to contain inflation, there can be little hope of any appreciable slowdown in the upward movement of consumer prices between now and the end of the year. In some member countries, inflationary pressures could even get stronger again, thus enlarging the disparities which exist between the countries. Such a development would not be acceptable: it would result in a rise in consumer prices in the Community as a whole of about 10 % in 1976 on the previous year, compared with 12.5 % in 1975.

*Role of business investment in consolidating the recovery*

2.5. In order to achieve continuing and consolidated growth in 1976 despite these difficult conditions, it will be necessary, given the present lack of buoyancy in exports, for other components of demand to supplement the expansionary impetus now coming from the movement of stocks and the propensity to consume. This role will essentially fall to fixed investment. Although there is little doubt that the low degree of capacity utilization will continue to weigh on business investment decisions, it is also true that the recession, while accelerating the process of obsolescence of part of the productive apparatus, has also slowed down the implementation of investment programmes and has increased the need for investment in rationalization and modernization schemes. Consequently, the progressive improvement in the economic outlook, combined with the impact of the support measures taken by the public authorities, should bring about a revival in the propensity to invest in several Member States. However, a recovery in investment activity implies a substantial improvement in the profitability of enterprises. At this stage, it will be important to avoid, through collaboration with both sides of industry, the traditional sequence of a profit explosion followed by a wage explosion, and the harmful effects of too rapid a switch from 'stop' to 'go'.

*3-3.5 % growth of GDP*

2.6. After the sharp and general decline in production last year, all the Member States should experience positive rates of growth in 1976, with, however, appreciable differences from one country to another. The average annual growth rates will probably be highest in the Federal Republic of Germany, France, the Netherlands and Denmark, and could exceed 4 % in some of them. The rate of growth will be much lower in Ireland, Italy and the United Kingdom, where balance of payments and budgetary constraints and structural problems are more acute. As forecast in the last 'Annual Report on the Economic Situation in the Community', the Community's real gross domestic product is likely to grow by some 3 to 3.5 % in 1976, after falling by about 2.5 % in 1975.

*Slow decline in unemployment*

2.7. Given the appreciable productivity reserves at the disposal of firms, the first phase of the economic recovery will probably bring only a gradual reduction in short-time working and a slight fall in the number of wholly unemployed during the year. The average number of unemployed in 1976 could even be somewhat higher than in the previous year in those Member States in which the economic upswing lags behind that in the other member countries and in which the labour force is expanding sharply. The increasing proportion of young people in the total number of unemployed, which has been evident during the last few years (see Table 5 annexed), might indicate the existence of structural unemployment which, even on the assumption of a more rapid expansion in production, could not, in the absence of specific measures, be reduced to its pre-crisis level.

## B. GUIDELINES FOR ECONOMIC POLICY

### (a) General guidelines

*Need to consolidate the recovery*

3.1. The trends observed in recent months and the latest business surveys substantially confirm the outlook for 1976 set out in the 'Annual Report on the Economic Situation in the Community'.<sup>1</sup> Consequently, the general pattern of the economic policy guidelines contained in that Report is still valid. The main task is to underpin the upturn by:

- ensuring strict and prompt implementation of the measures already decided upon to stimulate economic activity and, where necessary, prolonging the application of certain measures so as to avoid interruptions to the economic recovery;
- making further progress in combating inflation and curbing the rise in wage costs, an essential move particularly in those Member States with little room for manoeuvre in the field of balance of payments and budgetary policy i.e. Ireland, Italy and the United Kingdom.

*... but without generating new pressures*

3.2. In spite of the good prospects for a gradual economic upturn in the Community, uncertainty and concern about economic policies will continue in all Member States in 1976. The most important task will be to set the stage for as rapid an improvement as possible in the employment situation and for sustained economic growth without generating renewed bouts of inflation.

*Budgetary policy to sustain economic activity*

3.3. Given the continuing uncertainty as to the strength of the economic upturn, budgetary policy should go on sustaining economic activity, by ensuring that the budget deficits should not be reduced at an unduly rapid rate and the expansion in public sector investment should continue. For the reduction in deficits which is required in the long term, current expenditure should be create more room for capital outlays. In some member countries, stepping up social infrastructure investment is not only the necessary corollary of reaching moderation through incomes policy, it is also a condition for the essential process of adjustment in the medium term.

*Expansionary but cautious monetary policy*

3.4. Monetary policy should also encourage sustained economic recovery. However, given that there is so far no reason to question the forecasts of continuing inflation, the expansion of liquidity in the Member States should be kept within narrowly defined limits. To achieve this, monetary financing of central governments' budget deficits must be strictly limited, and targets must be set for the expansion in the money supply which are compatible with the macro-economic objectives.

*Improvement in firms' profitability essential*

3.5. If there is to be steady economic growth and a high level of employment, job-creating investment must be stepped up considerably. In this connection, it is essential that firms' profitability improve. Rather than through price increases, this should be achieved by productivity gains resulting from economic growth and from a more moderate rate of growth of costs of production.

*Need for further progress in the fight against inflation*

3.6. The upward movement in consumer prices must be slowed down further to prevent the moderation in the rise in money wages from exerting a contractionary effect on consumer demand in real terms. This implies that the upward tendency of administered prices must be strictly controlled. The planned increase in indirect taxes in a number of Member States should, where possible, be disregarded in any wage settlements, so as to prevent chain reactions. A narrowing of the difference in price trends between member countries would prevent disturbances between the

<sup>1</sup> OJ C 297 of 29.12.1975.

*and for a narrowing of the difference in price trends*

'snake' currencies and would facilitate the coordination of monetary policies. If the external values of the Community currencies were kept as strong as possible, this would make an effective contribution to preventing rising import prices and world commodity prices from jeopardizing the progress made with difficulty on the price stabilization front.

*Complementary role of social and employment policy*

3.7. Overall management of the economy must be supplanted by measures under employment and social policy. Selective measures in the fields of basic and further training should in particular help to reduce the high level of unemployment, particularly among young people, which is giving cause for concern; for this purpose, increased use should also be made of the Community resources available under regional, social and structural policy.

*Joint effort from the various socio-economic groups*

3.8. In the current economic situation and also in the medium-term view, it would seem essential to achieve greater consensus between managements and unions on income targets and the economic policy conditions for achieving these targets so as to overcome as quickly as possible the effects of the deep recession which has just ended, to resolve the resulting adjustment problems and to put an end to the disputes concerning the distribution of income. It is only by joint efforts to promote confidence that the expansionary factors leading to the creation of new jobs can be strengthened and the upward movement in prices slowed down further.

The continuation of the dialogue between the two sides of industry, which was launched at the Tripartite Conference in 1975 between representatives of the employers' and workers' organizations, Member States' Ministers of Economic and Social Affairs and the Commission, could make an important contribution to strengthening the economic situation and restoring the confidence of firms and consumers in the Community's economic future.

#### **(b) Guidelines for the individual countries**

4.1. In *Denmark*, the economic recovery which began in the closing months of 1975, following the expansionary measures taken in September, is likely to become well established in 1976. The stimulatory effects which expansion in private consumption and residential construction is currently having on activity will no doubt be followed by an increase in investment in other areas and in exports. Unemployment could, therefore, be reduced somewhat during the year. Certain upward pressures could make progress, which has been observed up to the present, towards the improvement of prices and costs, more difficult. Consequently, the incomes policy, which was successfully applied in 1975, will have to be continued in order to ensure a balanced recovery.

4.2. In the budgetary field, the measures taken to ease direct and indirect taxation, which have already provided an appreciable stimulus, together with the increase in transfer payments, produced a sharp deterioration in the central government's net borrowing requirement in 1975. In 1976, budgetary policy will remain expansionary, but the expected increase in revenue resulting from the economic upswing and the planned cuts in certain categories of current expenditure should help to reduce this deficit at the end of the year. Given the current outlook for the economy, this would be a timely development and would constitute the first stage in the attainment of longer-term objectives.

4.3. In the monetary field, the expansion in domestic liquidity should be kept within limits which will make it possible to hold interest rates at a level compatible with the constraints stemming from the increased deficit on current account. To achieve this, the central government's borrowing requirement should be met by public loan issues.

4.4. In the *Federal Republic of Germany*, the combined effects of the reflationary measures already taken by the government and the federal bank and the marked

recovery in export demand produced a distinct change in the economic situation in the second half of last year. Judging from the information currently available, the recovery will gather momentum in the coming months, with the result that real gross national product can be expected to grow by an average of 4 to 4.5 % in 1976. In such circumstances, the authorities responsible for economic policy should be content to await the full effects of the measures already taken to stimulate economic activity.

4.5. As a result of the programmes already adopted, and taking into account that the deficit will be of the same order of magnitude as last year, budgetary policy in 1976 will again have a clearly expansionary effect which, in view of the slack in the economy would seem in line with short-term economic requirements. Any extra tax revenue which might arise from the gradual acceleration in the rate of growth should, however, be used to reduce the large borrowing requirement. This would also help to improve the chances of achieving the medium term aim of narrowing the budget deficit; the first steps in this direction were taken with the law relating to the structure of the budget which was adopted at the end of 1975.

4.6. In the field of monetary policy, the Bundesbank has adopted as its goal for 1976 an average growth in the central bank money stock of 8 %. As the velocity of circulation of money increases in a period of economic upswing this rate of growth should be sufficient to finance the foreseeable rise in production and employment whilst steadily lowering the level of liquidity in the economy, which at present is slightly too high, and continuing to reduce the scope for price increases.

4.7. In *France*, activity is steadily increasing in most sectors, mainly as a result of the end of destocking, the continuing growth of consumers' expenditure, and the public capital expenditure programmes contained in the 1975 plan to stimulate the economy. The pace of the recovery is not yet such that unemployment can be expected to fall significantly in the course of 1976. Moreover, there is reason to fear that progress in bringing down the rate of inflation will be seriously jeopardized in the second half of the year. The growth in imports, which will probably be more rapid than that of exports, will turn the small trade surplus recorded in 1975 into a deficit of the same order of magnitude.

4.8. Budgetary policy should continue to support the upswing in activity. In particular, in order to allow private sector fixed investment to recover, the authorities should aim to improve the liquidity position of firms. Fiscal reliefs, for example, by delaying tax payments, could again be used.

4.9. The personal sector has still not borne a sufficient share of the external burden, which was imposed two years ago by the deterioration in the terms of trade caused by the increase in oil prices. This disequilibrium can only be corrected by a deceleration in the rate of growth of disposable income.

4.10. Changes in the system for controlling prices will play a key role in bringing about a recovery in investment. The policy of easing controls on producer prices of manufactured products must be continued and should be accompanied by strict monitoring of traders' profit margins. The pressure of external competition and productivity gains which will accompany the recovery should limit, to a certain extent, the risks of accelerated inflation.

4.11. The actual stance of monetary policy seems well suited to the present recovery phase. Indeed, the rapid rate at which the money supply has been expanding in recent months will have to be gradually reduced.

4.12. In *Ireland*, the upturn in activity may take time to materialize. Exports could grow at a slightly slower rate than in 1975 as a result particularly of the drop in the volume of sales of agricultural produce. Private consumption is expected to rise only slowly. While investment should increase as a result of higher public capital

expenditure, the employment situation is unlikely to improve until the second half of the year. The rate of price increases should slacken but the extent of this slowdown will depend on the success of the incomes policy. The framing of economic policy should, therefore, reflect the priority that should be attached to this problem. In this respect, an incomes pause up to the end of 1976, as proposed, could well be the essential condition for a progressive return to a more balanced internal situation, which would stimulate the longer term prospects for growth and employment.

4.13. The budget presented on 28 January 1976 and which in general conforms with the guidelines fixed in the annual report on the economic situation in the Community should equally contribute to a large extent to the realization of these objectives. It is characterized by a marked curb on current expenditure, an appreciable strengthening of taxation and a strong increase in public sector capital expenditure, calculated to have a positive effect on employment. In total the borrowing requirements both of central and general government, although remaining high, have ceased to increase as a percentage of gross domestic product. This represents a break in the trend observed in the past few years.

4.14. As for monetary policy, the authorities should endeavour to finance as much as possible of the public sector's borrowing requirement by non-monetary means, such as long-term loans issued directly to the public.

4.15. In 1975, the economic situation in *Italy* was characterized by a marked deceleration in the rate of price inflation, a large reduction in the balance of payments deficit and a slowdown in economic activity which persisted into the summer months. The recovery, which first became apparent at the end of last year, should continue in 1976. However, it should be assumed that the recovery will develop only slowly, as several factors—especially the delays in the renewal of the collective wage agreements and, more importantly, the crisis involving the Government and the lira which occurred in January—might cause industrialists to adopt a 'wait-and-see' attitude.

4.16. The strong pressure on the lira in January forced the monetary authorities to suspend their intervention in the exchange markets. As a result, between 20 January and 2 March, the weighted depreciation of the lira increased by some 13 %. On the assumption that this development is maintained, the Italian balance of payments, which in any case would have worsened during the upswing, would have to bear the additional burden of a deterioration in the terms of trade. Such a possibility is all the more to be feared since in Italy, which is an important processor of raw materials, the price elasticity of imports is rather limited.

4.17. A further depreciation of the lira and its harmful repercussions on the wage-price spiral can only be avoided, as is desirable, by an economic policy aimed at absorbing the State budget deficit and stemming the rise in unit wage costs. To restore balance to the economy both internally and externally the Italian authorities must apply an economic policy even more stringent than that in the Council Directive of 18 December 1975 on the granting of medium-term financial assistance to Italy<sup>1</sup>. A restrictive policy should be followed in relation to government expenditure, the Treasury deficit and credit expansion. This implies a comparatively high level of interest rates, together with appropriate fiscal policy measures. In any case, an important contribution from the two sides of industry to achieving a more moderate increase in nominal incomes is essential.

In following such a policy, with the aim of fighting inflation and reestablishing a balance of payments equilibrium by a suitable development of exports, the Italian authorities would also be serving the interests of the Community as a whole. To this

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<sup>1</sup> Council Directive of 18 December 1975 (OJ L 330 of 24.12.1975, p. 48).

end, the Community should provide assistance, especially in the form of the Community loan, on condition that the authorities do not take any measures, either direct or indirect, which could impede or disturb trade between Member States.

4.18. In the *Netherlands*, the recovery, which began in the middle of last year and which brought with it an improvement in the employment situation, should continue during the first half of 1976. However, as the level of new orders remained low until the end of last year, it will be a few months before a firm base for balanced growth becomes established and spontaneous recovery factors take over from economic policy measures.

4.19. Budgetary policy must therefore continue to support economic activity. For the time being, the central government budget for 1976 must remain in line with the original guidelines, which urged that the reflationary programmes adopted in 1975 be maintained. On a cash basis, the net borrowing requirement will grow appreciably on last year's figure.

4.20. As the outflow of capital will probably be insufficient to offset the surplus on current account, the overall balance of payments will be in surplus. As a result, conditions on the money market will most probably be reasonably easy.

4.21. To reduce the risks of a resurgence of inflation at a later stage of the recovery, it would be advisable to finance the Treasury deficits as far as possible by long-term borrowing, without, however, putting a further brake on the outflow of capital.

4.22. The rise in wage costs will have to slacken if investor confidence and the employment situation are to improve. Steps in this direction have been taken recently and these should lead in the course of the year to a slowdown in the rate of increase of consumer prices. It would seem essential to obtain the collaboration of both sides of industry if such a policy is to be successful.

### **Belgo-Luxembourg Economic Union**

4.23. In *Belgium*, where activity picked up fairly rapidly in the fourth quarter, mainly as a result of an upturn in domestic demand and in exports, demand should continue to expand during the first half of 1976. This will be largely the result of restocking, increased public investment, and progress in residential construction, whereas the growth in private consumption may only be slight.

4.24. For most of the year, the rate of expansion will depend partly on the boost provided by public investment. There is therefore no need to change the general guidelines for budgetary policy set out in the 'Annual Report on the Economic Situation in the Community', and which are implied in the central government budget for 1976. The authorities could, in addition, encourage business investment by effectively removing the burden of value added tax from such investment and ensure that the subsidized housing programme is strictly implemented.

4.25. With business investment still sluggish it should be fairly easy for the Government to finance the budget deficit from private sector savings. Despite the difficulties arising from the close interdependence of the internal and external markets, the authorities should seek to avoid a fresh rise in interest rates, or at least to limit the extent of any upward movement. In this context, some recourse to short-term borrowing could be acceptable.

4.26. The continued rise in prices is a source of concern. Some moderation in prices and costs would seem to be a prerequisite for any lasting improvement in the economic situation and particularly in the labour market. The measures envisaged as part of the recovery programme are, moreover, a move in this direction, but will only be fully effective if applied without delay. The same is true for the new

procedure for the prior notification of price increases and for the strict control of profit margins.

4.27. In *Luxembourg*, where activity seems to be picking up again in a number of newly-established export-based industries but where the revival in new orders received by the iron and steel industry is still modest, it will probably be several months before the economy shows signs of a significant recovery.

4.28. While the putting into operation of the new law creating an unemployment fund is awaited, the maintenance on a temporary basis of selective measures aimed in particular at avoiding short-time working still appears desirable. There is no need to change the budgetary policy guidelines laid down in the Annual Report. The central government budget for 1976 will no doubt provide for a large net borrowing requirement. However, although the budgetary reserves built up previously have already been drawn upon substantially for, among others, expenditure arising from the implementation of works of public interest to occupy the unemployed, there should not be much problem in financing this deficit in the near future.

4.29. Despite the considerable progress that has been made recently in the *United Kingdom*, towards reducing the rate of inflation and the deficit on the current balance of payments, the annual rate of price inflation remains a source of concern. Given the unforeseen depth of the recession and a higher rate of inflation than expected originally, public expenditure rose to a higher level than planned, leading to a larger public sector borrowing requirement. The financing of this deficit did not, however, prevent a slowing down in the growth of the main monetary aggregates in 1975, although it has created a potential for a more rapid expansion of the money supply in 1976.

4.30. Prospects for 1976 point to a small but gradually strengthening recovery in output, mainly on account of a sharp reduction in the rate of destocking, a recovery of consumers' expenditure in the second half of the year and a marked shift of real resources into the balance of payments, partly because of the contribution from North Sea oil. The rising trend in unemployment is not expected to come to an end before the second half of the year. As a result of the policy of income restraint, combined with continued controls on prices, there are good prospects that the rate of inflation will decline further in the months ahead. To ensure the continued success of the counterinflation policy, new arrangements will be needed to replace the present pay limit from the end of July 1976. These arrangements should be compatible with the over-riding objective of bringing the rate of wage inflation closer to that obtaining in the United Kingdom's principal competitors, which is an essential precondition for a return to higher levels of employment in the foreseeable future.

4.31. Despite the very high, and still rising, level of unemployment, three important constraints—the balance of payments deficit, inflation, and the size of the public sector borrowing requirement—make it necessary for the authorities to continue to resist the growing pressure to significantly reflate the economy. Assuming that the recovery in economic activity gathers momentum during the course of the year, it would be both necessary and feasible to start reducing the borrowing requirement. To this end, the announced policies of introducing more extensively the use of cash limits, and of allowing no further increase in the volume of public expenditure between 1976/77 and the following three financial years should be strictly implemented.

4.32. The stance of monetary policy should be such as to ensure that, when private sector demand for credit starts to expand more vigorously, the rate of growth of the money supply broadly defined (M3) remains sufficiently restrained to help achieve the Government's target for inflation. Such a policy would contribute to

maintaining interest rates at a level appropriate to the need to finance the continuing external deficit.

### **C. CONCLUSIONS**

The economic outlook has improved somewhat in most Member States since the « Annual Report on the Economic Situation in the Community » was presented in October last year. The economic policy guidelines for 1976, adopted by the Council in November 1975, are in broad terms still valid.

In 1976, the member countries of the Community can count on a moderate economic recovery, which will set in only after a lag in those countries facing severe structural difficulties, i.e. Ireland, Italy and the United Kingdom.

The risks inherent in the current upturn are still, however, present. They range from uncertainty about export demand, fears of a renewed upsurge in inflation, the still inadequate level of consumer confidence at a time of persistent high unemployment, to the doubts concerning the strength of firms' propensity to invest in the months ahead.

The efforts to consolidate the short-term economic trend must be geared to curbing further the rise in costs and prices and to narrowing the differences in price movements between Member States, on the one hand, and to improving the conditions in the medium term necessary to bring down unemployment, on the other. Specific measures of employment and training policy are called for in all member countries. Incomes policy in the broadest sense will, however, have to play a key role in the current situation. It must prevent the emergence of fresh upward pressure on prices and also make possible the necessary adjustments to the income and behaviour patterns of the various groups in the economy and, consequently, a rapid reduction in unemployment.

The Commission requests the Council to adopt the above guidelines and to invite Member States to draw up their economic policies accordingly.



TABLE 1  
Industrial production <sup>1</sup>  
(% change on preceding period)

Country	1974		1975							Dec. 1975 Dec. 1974
	III	IV	I	II	III	IV <sup>2</sup>	Oct. <sup>2</sup>	Nov. <sup>2</sup>	Dec. <sup>2</sup>	
F.R. of Germany	- 2.7	- 3.2	- 2.3	- 3.6	+ 1.8	+ 2.8	+ 0.3	+ 5.3	- 3.0	+ 0.9
France	- 1.9	- 3.7	- 4.2	- 2.6	- 0.5	+ 3.8	+ 1.4	+ 0.3	+ 4.9	+ 2.2
Ireland	- 2.4	- 2.0	- 2.3	- 0.4	:	:	:	:	:	:
Italy	- 1.8	- 9.1	0.0	- 3.7	+ 2.3	+ 0.3	- 0.1	+ 1.9	- 3.9	+ 0.6
Netherlands	0.0	- 1.3	- 2.7	- 3.5	- 0.4	+ 4.4	+ 0.3	+ 6.5	- 2.4	+ 0.6
Belgium	- 1.7	- 3.7	- 3.3	- 2.9	- 5.0	+ 4.3	+ 2.8	+ 5.3	- 7.4	- 6.5
Luxembourg	- 2.5	- 5.3	- 8.8	- 10.2	- 10.1	+ 13.9	- 8.0	+ 11.1	- 0.8	- 8.5
United Kingdom	- 0.9	- 1.2	+ 0.2	- 5.6	- 1.6	+ 2.8	+ 2.5	+ 0.3	+ 0.5	- 2.7
Community	- 1.9	- 3.6	- 2.0	- 3.5	- 0.2	+ 3.1	+ 1.2	+ 3.0	- 1.0	+ 0.3

<sup>1</sup> Excluding construction. France: excluding construction, food, beverages and tobacco. For Denmark, no comparative data available, calculated on the basis of seasonally adjusted indices of the Statistical Office of the European Communities.

<sup>2</sup> Provisional.

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TABLE 2  
Unemployment <sup>1</sup>

(thousands)

Country	1974		1975						1976	Rate of unem- ployment
	III	IV	I	II	III	IV	Nov.	Dec.	Jan.	Jan
Denmark	61.6	76.4	99.8	100.3	110.1	112.3	108.1	112.3	111.9	4.5
F.R. of Germany	695.1	854.1	1 026.9	1 125.7	1 155.9	1 126.9	1 154.3	1 126.9	1 059.3	4.0
France	547.1	662.9	732.2	870.9	958.5	913.8	922.5	913.8	886.9	4.0
Ireland	75.0	87.6	97.3	105.9	108.1	113.0	109.2	113.0	109.8	9.7
Italy <sup>2</sup>	594	551	632	671	692	:	:	:	:	:
<sup>3</sup>	1 016.3	1 013.8	1 053.1	1 117.3	1 163.2	1 151.7	1 160.1	1 151.7	:	:
Netherlands	154.1	169.0	188.9	206.0	223.4	220.4	222.3	220.4	215.1	4.5
Belgium	126.4	142.9	168.0	195.7	218.5	235.0	235.0	235.0	234.0	5.9
Luxembourg	0.1	0.1	0.1	0.2	0.2	0.6	0.6	0.6	0.5	0.3
United Kingdom	-682.8	701.8	780.2	996.2	1 248.2	1 243.5	1 204.8	1 243.5	1 340.4	5.3
Community <sup>4</sup>										
Change ('000) on preceding period.	+364	+310	+480	+546	+444	- 39	- 34	+ 19	+ 8	:
Rate of unemployment <sup>5</sup>	2.8	3.1	3.5	4.0	4.4	4.4	4.4	4.4	4.4	4.4

<sup>1</sup> Figures at end of period, seasonally adjusted.

<sup>2</sup> Italy: ISTAT.

<sup>3</sup> Italy: Ministry of Labour.

<sup>4</sup> Estimates by services of Commission, include Italy: ISTAT.

<sup>5</sup> Number of unemployed as % of civilian labour force: include Italy ISTAT.

Source: S.O.E.C.

TABLE 3  
Consumer prices

Country	1974		1975 <sup>1</sup>						1976	12 month rate of change
	III	IV	I	II	III	IV	Nov. <sup>2</sup>	Dec. <sup>2</sup>	Jan. <sup>2</sup>	
Denmark	+ 3.5	+ 3.3	+ 1.1	+ 2.3	+ 1.7	- 0.9	+ 1.6	+ 0.1	+ 0.6	+ 4.7
F.R. of Germany	+ 0.7	+ 1.6	+ 1.9	+ 2.1	+ 0.4	+ 0.9	+ 0.3	+ 0.3	- 0.8	+ 5.3
France	+ 3.2	+ 3.0	+ 2.7	+ 2.4	+ 2.2	+ 2.0	+ 0.6	+ 0.6	+ 1.1	+ 9.6
Ireland	+ 3.9	+ 4.6	+ 8.0	- 6.1	- 0.8	- 2.8	:	:	:	+ 16.8
Italy	+ 7.2	+ 4.7	+ 2.9	+ 2.9	+ 1.9	+ 3.0	+ 1.1	+ 0.8	+ 1.3	+ 11.3
Netherlands	+ 2.5	+ 2.6	+ 2.3	+ 2.2	+ 2.7	- 1.4	+ 0.4	+ 0.2	+ +.5	+ 8.8
Belgium	+ 4.1	+ 2.6	+ 2.9	+ 2.3	+ 2.6	+ 2.8	+ 1.1	+ 0.5	- 0.9	+ 10.9
Luxembourg	+ 1.9	+ 2.9	+ 2.9	+ 2.6	+ 2.1	- 3.0	+ 0.8	+ 0.6	+ 1.5	+ 11.8
United Kingdom	+ 2.1	+ 5.3	+ 6.3	+ 10.4	+ 2.5	- 3.9	+ 1.2	- 1.2	+ 1.3	+ 23.4
Community	+ 3.0	+ 3.3	+ 3.2	+ 4.0	- 1.7	+ 2.2	+ 0.8	0.7	+ 1.0	+ 11.4

<sup>1</sup> Quarterly percentage variation (end of quarter data).

<sup>2</sup> Monthly percentage variation.

: Data not available.

Source: national statistics.

TABLE 4  
Trade balance<sup>1</sup>

(Mto Eur)

Country	1974		1975						1976
	III	IV	I	II	III	IV	Nov.	Dec.	Jan.
Denmark	- 94	- 111	- 86	- 61	- 103	- 180	- 208	- 239	:
F.R. of Germany	+ 1 316	+ 1 323	+ 1 207	+ 1 045	+ 768	+ 896	+ 1 006	+ 903	+ 807
France	- 518	- 341	- 111	+ 53	- 97	- 386	- 239	- 415	- 376
Ireland	- 99	- 47	- 54	- 39	- 31	- 32	- 43	- 71	- 71
Italy	- 778	- 558	- 122	- 132	- 207	- 457	- 253	- 745	:
Netherlands	- 123	- 157	- 82	+ 3	- 69	+ 68	+ 3	+ 9	:
B.L.E.U.	- 18	+ 17	+ 60	- 65	- 111	:	- 22	:	:
United Kingdom	- 1 041	- 961	- 587	- 425	- 625	- 635	- 706	- 494	- 567
Community <sup>2</sup>	- 1 272	- 865	- 77	- 80	- 209	:	(- 774)	:	:

<sup>1</sup> Seasonally adjusted figures. Quarterly figures = monthly averages.

<sup>2</sup> Extra-Community trade only.

: Data not available.

Source: S.O.E.C.

TABLE 5  
Structural variations of unemployment by age and sex

Country	Middle of 1974 <sup>1</sup>			End of 1974 <sup>2</sup>			Middle of 1975 <sup>1</sup>			End of 1975 <sup>2</sup>		
	Unem- plov. of youth as % of total <sup>4</sup>	Unemployment Rate <sup>3</sup>		Unem- plov. of youth as % of total <sup>4</sup>	Unemployment Rate <sup>3</sup>		Unem- plov. of youth as % of total <sup>4</sup>	Unemployment Rate <sup>3</sup>		Unem- plov. of youth as % of total <sup>4</sup>	Unemployment Rate <sup>3</sup>	
		Total	Masc.		Fem.	Total		Masc.	Fem.		Total	Masc.
Denmark <sup>5</sup>	25.2	1.2	1.0	0.2	:	:	3.0	2.2	0.8	:	:	:
F.R. of Germany	23.1	2.0	1.1	0.9	28.4	1.4	4.5	2.6	1.7	28.6	4.9	2.6
France	32.6	2.1	0.9	1.1	45.8	1.5	3.8	1.9	1.9	45.8	4.2	:
Ireland <sup>5</sup>	:	5.9	4.7	1.1	:	6.2	9.0	7.1	1.8	:	10.3	8.3
Italy <sup>6</sup>	58.2	5.1	3.2	1.8	56.6	1.9	5.8	3.7	2.1	:	5.9	:
Netherlands	28.7	2.8	2.2	0.6	36.7	0.7	4.2	3.4	0.8	39.2	4.6	3.5
Belgium	18.1	2.9	1.4	1.5	30.1	1.8	5.1	2.5	2.5	35.4	5.9	:
United Kingdom <sup>5</sup>	28.9	2.4	2.0	0.4	:	:	4.3	3.3	1.0	:	4.8	3.7

1 F.R. of Germany and Netherlands: May; Belgium, France and Italy: June; Denmark, Ireland and United Kingdom: July.

2 F.R. of Germany: September; Netherlands: November; Belgium, France, Ireland, Italy and United Kingdom: December.

3 Seasonally adjusted number of unemployed as a percentage of the active population.

4 Unemployed aged less than 25 years; Italy: less than 21 years.

5 Rates calculated on the basis of unadjusted figures.

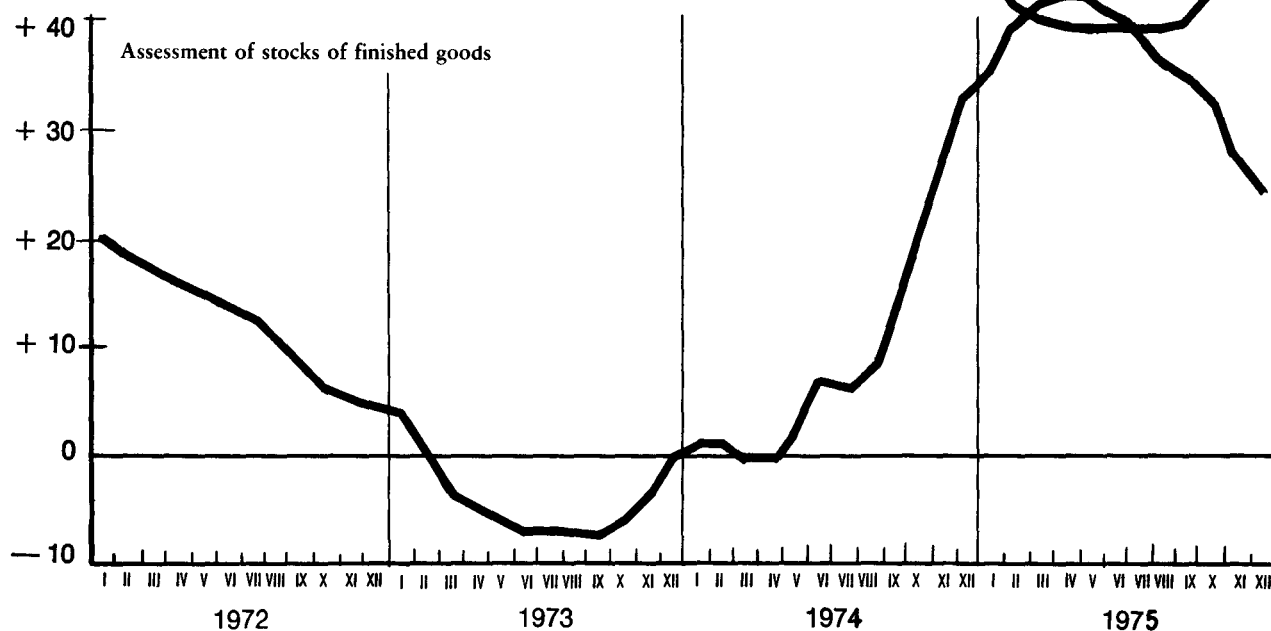
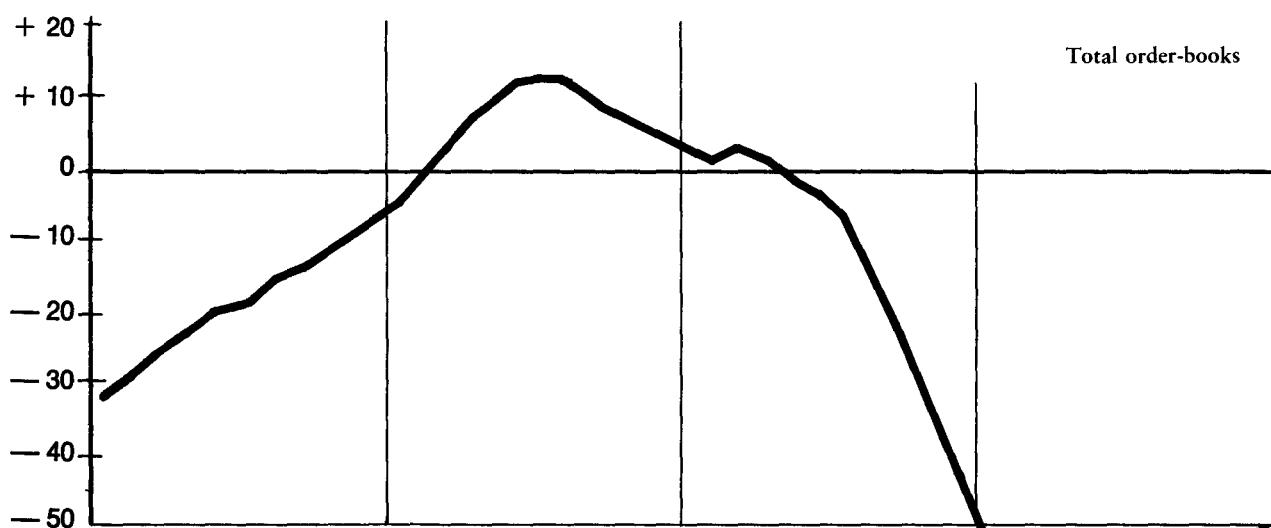
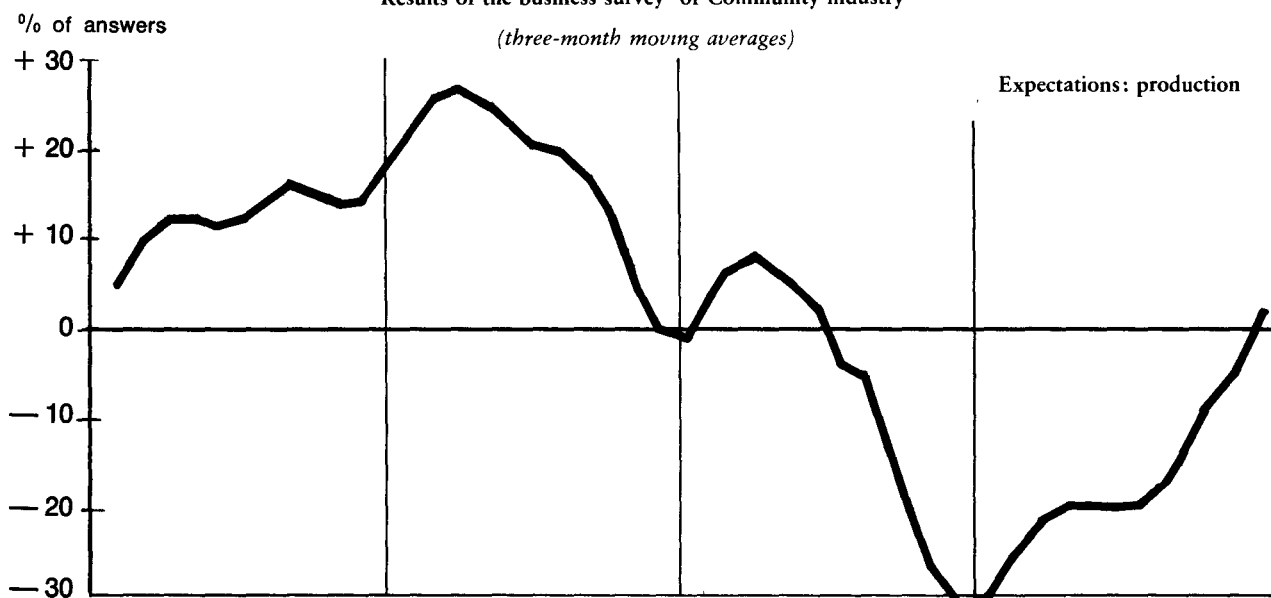
6 Statistics of the Ministry of Labour.

· Data not available.

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

Results of the business survey<sup>1</sup> of Community industry<sup>2</sup>

(three-month moving averages)



<sup>1</sup> Excluding construction, food, beverages and tobacco.

<sup>2</sup> Original Community.

## **II — Summary account and degree of convergence of the economic policies pursued in the Member States in 1975**

*(submitted to the Council by the Commission in accordance with articles 2 and 12 of the Council decision of 18 February 1974).*

### **FOREWORD**

Together with its Communication of the adjustment of the economic policy guidelines for 1976, the Commission herewith submits to the Council a report on the economic policies pursued in the Member States last year. In so doing, the Commission is acting in accordance with Article 2 of the Council Decision of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community.

At the same time the report describes, in accordance with Article 12 of the abovementioned Decision, the application of this Decision during 1975 and assesses the conformity of the policies pursued with the objectives set.

The report will also be transmitted to the European Parliament.

### **A — THE ECONOMIC POLICIES OF THE MEMBER STATES IN 1975**

#### **I — The economic context**

1.1. The Member States were confronted by an unusually serious challenge at the beginning of 1975; they had at the same time to combat both unemployment and inflation and also, in certain cases, to reduce large-scale balance of payments deficits. The effects of stagflation had reached proportions which were without precedent in the post-war years. Divergences in economic development in the member countries had never been greater since the establishment of the European Community and even threatened its cohesion.

1.2. By the end of 1974, the rise in consumer prices for the Community as a whole had accelerated to reach an annual rate of 14 %. The spread in the annual growth rates between the member countries was from 6 to 26 %. The balance of payments disequilibria of the Member States had also reached unusual proportions. The current account surplus of the surplus countries in the Community (Federal Republic of Germany, the Netherlands, Belgium and Luxembourg) amounted to \$ 12 000 million in 1974, while the current account deficit of the deficit countries totalled \$ 25 000 million.

1.3. Domestic and foreign demand had declined more and more sharply during 1974 and in the second half of the year had resulted in a worldwide recession which affected all the Community countries, although to varying degrees. The slump in industrial output very quickly led to a deterioration in the labour market situation. At the beginning of 1975, the seasonally adjusted number of unemployed in the Community totalled approximately 3.7 million, or some 3 % of the working population. In most of the member countries, the unemployment rate was close to this average figure, the only significant exceptions being Ireland (9 %) and Luxembourg (0.1 %).

1.4. The problems and difficulties involved in combatting unemployment and inflation were common to all the member countries, but there were extremely wide differences in the initial situation between the member countries. The reasons for this include: differences in the timing and intensity of the counter-inflation and restrictive policies introduced in previous years, differences in the extent of the conflict

between the two sides of industry on the distribution of income, differences in the degree of dependence on energy and raw material imports and in the trend of exchange rates, and differences in the financial positions of firms and the public sector. The considerable divergences which became apparent between the Member States at the beginning of 1975, particularly the rate of inflation and the balance of payments situation, limited in varying degrees the scope for manoeuvre in economic policy in the different Member States.

1.5. The economic policy guidelines for 1975 were based on the principle that the short-term economic policy of the deficit and surplus countries of the Community should complement one another, so as to be able to meet the challenges on a basis of joint solidarity.<sup>1</sup> The surplus countries were to intensify as far as possible their reflationary measures, so as to stimulate, through increased imports, economic activity in the other member countries. The deficit countries, on the other hand, were to maintain their restrictive policies, to increase their efforts to contain cost and price inflation, and as for maintaining economic activity to restrict themselves to specific measures.

1.6. Contrary to expectations, the economic downswing did not gradually bottom out at the beginning of 1975, but worsened even further in the first half of the year. There were several factors behind this: the rapid slump in world trade, intensive stock reduction, restraint on the part of consumers and the over-cautious expansionary policy of the surplus countries. Under the pressure of the ever deteriorating economic and employment situation and on the recommendation of the Commission, most of the member countries later introduced further reflationary measures. Only in the autumn of 1975 did economic recovery in the Community begin to make itself felt.

It is against the background of these economic developments that the economic policy measures which have been taken in the various member countries must be assessed.

## **II — Budgetary Policy**

2.1. In all the Member States, public budgets exerted a powerful counter-cyclical influence in 1975. This resulted in part from the operation of the built in regulators: short falls in tax revenue and social security contributions, on the one hand, and increased transfer expenditure on unemployment benefits or on subsidies in the public sector, on the other. In addition, there was the effect of discretionary measures taken in most of the countries to sustain or revive the economy, with the timing chosen, in accordance with the guidelines laid down at Community level, to take account of the special features of the cycle in each of the Member States. Thus, the budgetary policy pursued in 1975 was, in most of the Member States, quite different in character from that pursued in 1974, when the line was predominantly cautious, if not restrictive. The only exceptions were Ireland and the United Kingdom, where the previous, expansionary, stance became still more expansionary. All in all, public budgets in 1975 will, therefore, have made a major contribution to limiting the extent of the economic downturn in the Community and to speeding up its reversal.

2.2. The changeover to a stimulatory budgetary policy began first in Germany and the Netherlands. In Germany, this was mainly reflected in the entry into force, on 1 January 1975, of a tax reform easing considerably the burden of personal income tax, and in a series of short-term economic policy programmes launched between September 1974 and August 1975 and mainly designed to raise the level of investment. In the Netherlands too, as from autumn 1974, the authorities adopted a series of budgetary measures aimed at reviving economic activity, combining tax reliefs and supplementary expenditure intended to generate or encourage an upturn in investment and employment. In Belgium, a budgetary stimulus was provided at an early stage too, but it was more limited in its objectives since it only involved an appreciable increase in the public investment programmes provided for in the 1975 budget. In Luxembourg, a programme of special works in the public interest was adopted in July 1975.

In Denmark, budgetary policy began to switch to a reflationary line in spring 1975, in the initial budget for 1975/76, and the new stance was strengthened by additional provisions adopted in June and particularly in September 1975. In France, initial budgetary measures to support economic activity, involving in particular tax aids to productive investment, were passed in April 1975, but the main part of the reflationary plan was introduced in September; this took the form of an amending budget involving supplementary aids to

<sup>1</sup> See Annual Report on the Economic Situation in the Community for 1975, OJ C 149 of 28.11.1974, and Communication on the adjustment of economic policy guidelines for 1975, OJ L 162 of 25.6.1975, p. 13.

TABLE 1  
Development of central government budgets (1973-1975)<sup>1</sup>

Country	Receipts			Expenditure				Net balance			
	1973	1974	1975	1973	1974	1975	Rate of change		1973	1974	1975
							1974 1973	1975 1974			
Denmark (Mrd Dkr)	54.6	60.0	59.7	49.1	60.4	72.5	+ 23	+ 20	+ 5.5	- 0.4	- 12.8
F.R. of Germany (Mrd DM)	219.8	234.7	236.0	222.0	251.5	291.5	+ 6.8	+ 16	- 2.2	- 16.8	- 55.5
France (Mrd FF)	220.5	264.8	261.0	214.5 <sup>(2)</sup>	246.4 <sup>(2)</sup>	301.0 <sup>(2)</sup>	+ 20.0	+ 22.2	+ 4.8	+ 5.7	- 38.0
Ireland (Mio £)	759.0	899.0	1 098.0	968.0	1 234.7	1 679.0	+ 18.5	+ 36.0	- 209.0	- 335.7	- 581.0
Italy (Mrd Lit.)	14 858	18 934	23 790	22 589	25 846	32 422	+ 27.5	+ 25.6	- 7 731	- 6 912	- 8 632
Netherlands (Mrd Fl.)	43.7	49.3	56.2	44.8	52.0	64.9	+ 12.8	+ 14.0	- 1.1	- 2.7	- 8.7
Belgium (Mrd Bfrs)	441.2	531.2	635.0	523.0	604.2	744.0	+ 20.4	+ 23.1	- 81.8	- 73.0	- 109.0
Luxembourg (Mrd Lfrs)	19.5	24.1	27.0	17.1	21.1	27.0	+ 23.6	+ 28.0	+ 2.4	+ 3.0	0
United Kingdom (Mio £)	24 298	30 140	38 165	26 520	35 264	46 736	+ 24.0	+ 26.7	- 2 222	- 5 124	- 8 571

<sup>1</sup> Denmark and United Kingdom: Fiscal years 1973/74, 1974/75, 1975/76.

<sup>2</sup> Excluding the balance of 'Special Accounts' with the exception of Advances.  
Source: Services of the Commission.

families and the aged, the extension of tax payment dates and a special programme for public and industrial investment.

2.3. In Italy, an initial programme of supplementary expenditure was adopted in May 1975. Then in August a major package to support the economy was brought in, aiming in particular, by means of budgetary transfers, at promoting exports, boosting activity in the building and construction industry and the public works sector, and stimulating investment in a number of other sectors. In Ireland, budgetary policy for 1975 was initially aimed at supporting the economy, principally by means of a sharp increase in current Government expenditure. This policy was strengthened in June 1975, with the introduction, under supplementary budget, of consumer subsidies and additional capital expenditure. In the United Kingdom the 1975/76 budget also provided for a marked increase in expenditure, particularly current expenditure, producing an expansionary effect which was only slightly reduced by increases in indirect taxation.

2.4. Although the reflationary budgetary measures introduced in 1975 had only a partial effect on budget management during the year itself, particularly as regards expenditure, they nevertheless contributed appreciably to the tendency towards deficits in public finance management, a tendency which was very strong in all the Member States. The figures given in the table 1 illustrate this phenomenon, although they do not reflect it fully, since they relate only to central governments and since, at least, as far as the six Member States of the original Community are concerned, the consolidation of their accounts with those of the regional and local authorities and social security funds would show an even sharper deterioration.

2.5. In all the Member States, expenditure rose at an extremely rapid pace, not only because of the additional burdens connected with the recession and the measures taken to combat it, but also as a result of the still considerable increase, in terms of annual expenditure, in the cost of public services. In all the countries, with the exception of Denmark, the rates of growth of expenditure thus exceeded, in some of them to a considerable extent, the already very high rates of growth in 1974. Revenue, by contrast, often rose more slowly than in 1974, and in a number of Member States there was actually no increase at central government level. Consequently, very considerable net borrowing requirements developed in countries such as Denmark, Germany and the Netherlands, where budget management in 1974 had produced only small deficits, or again in France, where there had been a surplus. In Ireland and in the United Kingdom, where the initial situation was already one of marked disequilibrium, budget management in 1975 only strengthened the previous tendency towards a growing deficit. In Italy, the worsening of the deficit in budget management proper compared with the already very high level of previous years was relatively limited, but there was a much more serious deterioration at the more significant level of the Treasury borrowing requirement. In Belgium, where the deficit is traditionally fairly high, the deterioration of the situation as compared with the previous year was less than in the other member countries.

### **III — Monetary Policy**

3.1. At the end of 1974 monetary policy had begun to be relaxed in some Member States and throughout 1975 this tendency became more general and gradually more marked. However, the degree of the relaxation and its pattern during the year varied between countries. The Member States which, because of their balance of payments situation and inflation rates, had most scope for manoeuvre were the first to determine on measures of this kind. This is especially the case for the Federal Republic of Germany and the Netherlands.

3.2. The tighter monetary policy pursued in the Member States in the period 1973/74 began to bite only after more or less long time lags; similarly, the increasingly marked relaxation of monetary policy was unable to prevent the gradual worsening of the economic situation in 1975. It would appear, therefore, that the time it takes for the economy to respond to changes in the direction of monetary policy is now longer than in the past. This makes the readjustment process more difficult and monetary control less precise.

3.3. However, the easing of monetary policy improved the conditions for economic recovery. The central banks in the Community increased the monetary base, sporadically to begin with in the autumn of 1974, and then on a larger scale during 1975. This was associated with a big rise in bank liquidity and a fall in interest rates. Later in the year, conditions for a recovery in private investment improved.

3.4. The Bundesbank announced in advance the growth rate in the monetary base aimed at for 1975, while in Italy the growth of bank lending has been subject to defined limits for the same year. In other Member States the central banks have fixed similar targets for monetary growth, but rather less precisely defined.



3.5. The discount rate was the policy instrument used most frequently for expansion. In most Member States the rate was subjected to successive but minor reductions. In the United Kingdom, however, the Bank of England's minimum lending rate was raised several times between May and October. In France, the Federal Republic of Germany and Belgium considerable amounts of bank liquidity were released by cuts in the compulsory reserve ratios. The requirement that banks should hold a proportion of their deposits in bonds was dropped in Belgium, and eased in Italy. The quantitative limits on the growth of bank lending were also lifted in these two countries. In the United Kingdom the requirement placed on banks in December 1973 to make supplementary deposits with the Bank of England, when the increase in their interest-bearing deposits exceeded a certain rate, was discontinued in March 1975. On the other hand, the Danish National Bank in the final months of 1975 absorbed some of the liquidity resulting from the large deficit of the public authorities.

3.6. The tendency for liquidity to grow more rapidly which was apparent in some Member States from the beginning of 1975 spread from the summer onwards to the whole Community and has in general continued since then. In the Federal Republic of Germany, the Netherlands and the United Kingdom it is only imperfectly seen in the growth of money and near-money ( $M_2$  or  $M_3$ ) since in these countries there were major changes in the relative importance of near-money and other financial assets. In certain countries the money supply in the broad sense ( $M_2$  or  $M_3$ ) grew noticeably more slowly than the money supply in the narrow sense ( $M_1$ ). On average in the Community the annual growth rate of the latter was of the order of 10 % during the first half-year, rising to about 17 % in the autumn. In most Member States money creation in 1975 was largely determined by the demand for credit of the public authorities. The degree of liquidity in the Member States at the end of 1975 may be regarded as relatively high.

3.7. The expansionary monetary policy was mainly reflected in a sharp fall in short-term interest rates, which were a good deal lower at the end of 1975 than at the same time a year earlier. However, the Member States with balance of payments deficits moved towards this reduction much more cautiously than those not subject to serious external constraints. The falls in interest rates were concentrated in the first half of the year; subsequently rates became virtually steady.

3.8. Long-term interest rates fell much less than short-term rates, and there emerged a clear margin between them. This revived the capital markets which were swift to take up new share and bond issues.

#### **IV — Exchange rate policy**

4.1. Despite a striking improvement in the current account of the Community as a whole (from a deficit of \$ 13 billion in 1974 to a position of approximate balance in 1975), and of most individual member countries too, the underlying tendency during the year was for Community currencies to weaken against the US dollar. This trend can be explained largely by the return on the dollar becoming relatively more favourable as the year progressed, since the monetary policy of the Member States was still aiming at a reduction in interest rates, while they began to rise in the United States. At the same time the turn-around in the US balance of payments has been equally if not even more spectacular than that of the Community.

The four currencies which participated in the Community exchange rate system throughout the year depreciated against the dollar by between 7 and 8.5 % during 1975, but these figures do not reflect the very substantial fall in these currencies since the spring. After first rising against the dollar by about 4 to 6 % in January and February, the snake currencies then fell steeply by 12 to 14 % during the remaining ten months of the year. Between January and December 1975 sterling depreciated by about 14 % against the dollar, and the lira by about 5 %. Only the French franc just about maintained its value over the year as a whole (-1 %).

4.2. Since early in the year Community central banks have been intervening more actively with a view to smoothing out day to day movements against the dollar. Subsequently, at their meeting on 17 December at Rambouillet, the heads of governments of France, the Federal Republic of Germany, Italy, the United Kingdom, Japan and the United States agreed to move further in this direction and to instruct their central banks to intervene in the markets with a view to controlling erratic exchange rate movements over a somewhat longer time-span. A Community position on, in particular, the revision of the quotas of Member States in the International Monetary Fund and the problem of gold was reached for the meeting which the Interim Committee of the IMF was to hold in Jamaica at the beginning of 1976.

TABLE 2  
Developments in the monetary situation  
(as at end of December, unless otherwise indicated)

Country	Money supply <sup>1</sup> Annual growth rates, %						Short-term bank credit (Annual growth rates, %)			Interest rates					
	1973		1974		1975 <sup>3</sup>		1973	1974	1975 <sup>4</sup>	Short-term <sup>2</sup>		1973	1974	1975 <sup>5</sup>	1976
	M <sub>1</sub>	M <sub>2</sub>	M <sub>1</sub>	M <sub>2</sub>	M <sub>1</sub>	M <sub>2</sub>				1973	1974				
Denmark	+ 10.0	+ 12.7	+ 5.9	+ 8.9	+ 26.1	+ 25.1	+ 15.4	+ 7.1	- 2.4	12.7	4.5	12.2	15.2	13.2	
F.R. of Germany	+ 1.8	+ 13.8	+ 10.9	+ 5.2	+ 13.5	- 0.1	+ 5.4	+ 8.5	- 3.9	8.4	3.9	9.7	9.9	8.6	
France	+ 9.7	+ 14.3	+ 15.2	+ 16.8	+ 15.0	+ 18.1	- 0.8	+ 18.4	+ 11.4	11.2	6.5	9.8	10.9	9.9	
Ireland	+ 7.1	+ 25.7	+ 5.3	+ 20.2	+ 19.5	+ 21.8	+ 22.9	+ 15.5	+ 13.3	13.5	10.9	13.5	16.9	14.6	
Italy	+ 24.5	+ 23.3	+ 10.7	+ 15.4	+ 7.4	+ 20.3	+ 19.2	+ 20.1	+ 11.5	8.2	8.6	7.4	11.4	10.5	
Netherlands	- 0.2	+ 22.0	+ 12.2	+ 20.0	+ 21.9	+ 6.4	+ 34.5	+ 25.4	+ 7.3	8.8	4.4	7.9	7.6	7.7	
Belgo-Luxembourg Economic Union	+ 8.4	+ 14.8	+ 8.7	+ 11.3	+ 14.3	+ 14.8	+ 19.5	+ 10.0	+ 11.8	7.2	3.9	7.8	9.0	8.5	
United Kingdom	+ 4.5	+ 28.5	+ 8.3	+ 11.9	+ 20.1	+ 8.0	+ 53.6	+ 27.1	+ 17.9	12.8	10.2	12.5	17.2	14.8	

- 1 M: Notes and coins in circulation plus demand deposits. M<sub>2</sub>: (M<sub>3</sub> for Ireland and the United Kingdom); M<sub>1</sub> plus near money.  
2 Interest rate on overnight loans; United Kingdom: Treasury Bills yield.  
3 Italy: September; France: October; Ireland and Netherlands: November.  
4 Denmark, Netherlands and F.R. of Germany: November; France and Italy: October; Ireland and B.L.E.U.: September; United Kingdom: March.  
5 December except France and United Kingdom (November), Ireland and Italy (October).  
6 December except Italy (November).  
Source: Services of the Commission.

4.3. The changes in exchange rates of Community currencies on a trade-weighted basis were substantially smaller than the changes in nominal rates against the dollar, although for most countries they moved in the same direction as nominal rates (see graph). The two exceptions to this general rule were the French franc and the lira. The former registered an effective appreciation between the beginning and the end of the year of 3.5 %. The latter showed virtually no change at all over the year, as a result of selective intervention by the Banca d'Italia.

4.4. The major feature of the trends in Community currencies was the rapid recovery of the French franc, which climbed back by about 7 % between January and June against the currencies in the Community exchange rate system which it rejoined on 10 July 1975 after an absence of about one and a half years. The position of the lira against the Community currencies scarcely changed in 1975, but, by contrast, sterling fell a further 8 % against the average of the other Community currencies.

4.5. The Community exchange rate system was not subject to pressure during 1975. Intervention in Community currencies to maintain them within the 2.25 % margin was much less extensive than in previous years, and indeed during the last five months of 1975 there was no intervention. The improved cohesion of the snake currencies came from a closer convergence of economic policies between the member countries together with a policy of more active intervention in dollars.

Besides the enlargement of the Community exchange rate system, changes were introduced relating in particular to the automatic renewal of debts and the methods of settlement. In addition, after the Council authorized the rules for the placing of Community loans to finance the balance of payments deficits of Member States, the Commission started negotiations for the issue of an initial loan.

4.6. There was very little change in the Community's total official foreign exchange reserves during the year although there were significant shifts in reserves between member countries. The United Kingdom, Italy and the Federal Republic of Germany were obliged to draw on their reserves to support their currencies, while the French authorities added substantially to their holdings of foreign currency by buying dollars in the foreign exchange market.

## **V — Prices and incomes policy**

5.1. The generally expansionary guidelines for demand management policy have given a greater role in 1975 to incomes policy in the controlling of cost push inflation. As the close link between inflation and unemployment became more clearly recognized, interventions in the incomes policy area and cooperation between the two sides of industry improved.

5.2. The measures introduced to restrain the rise in personal incomes came up against many difficulties. The dividend controls imposed in the United Kingdom and the changes in direct taxation introduced in the Federal Republic of Germany, Denmark and Ireland did, however, create more favourable conditions for a slowing-down in wages. In general, it was evidently not possible, either in the private sector or the public sector, to achieve a sufficient slowing-down in the increase in nominal pay; in addition, in view of the fall in production, the pressure of wage costs was necessarily stronger in 1975 (see Tables 3 and 4). In the Federal Republic of Germany the consensus achieved between the social partners resulted in a more moderate development in salaries and prices without direct intervention by the authorities. In the other Member States, the results of the measures adopted in 1975 to limit the rise in salaries were not immediate or similar. In the United Kingdom as in Denmark where the indexation system was modified in a restrictive direction, the measures had a marked effect on inflation. In Italy and Luxembourg, on the other hand, the indexation system was widened in 1975.

5.3. Further measures were taken to assist the lowest paid. Social security benefits were increased in most of the countries; old age pensions, inter alia, were raised in the Netherlands, the Federal Republic of Germany and France, and were indexed in Italy. Similarly, minimum wages were increased and unemployment benefits readjusted, in particular by extending the range of those eligible, by lengthening the compensation periods and by raising the amounts paid. Lastly measures were taken to protect small savers by indexation, in particular in the United Kingdom and Ireland.

5.4. In addition to efforts carried out in the incomes policy field, the authorities were led to act directly on the level of prices in the majority of Member States. A range of measures was involved, from the control of prices of a limited number of goods and services (Italy and Luxembourg), to a general price freeze, such as

Weighted appreciation or depreciation  
of the currencies of member states in

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

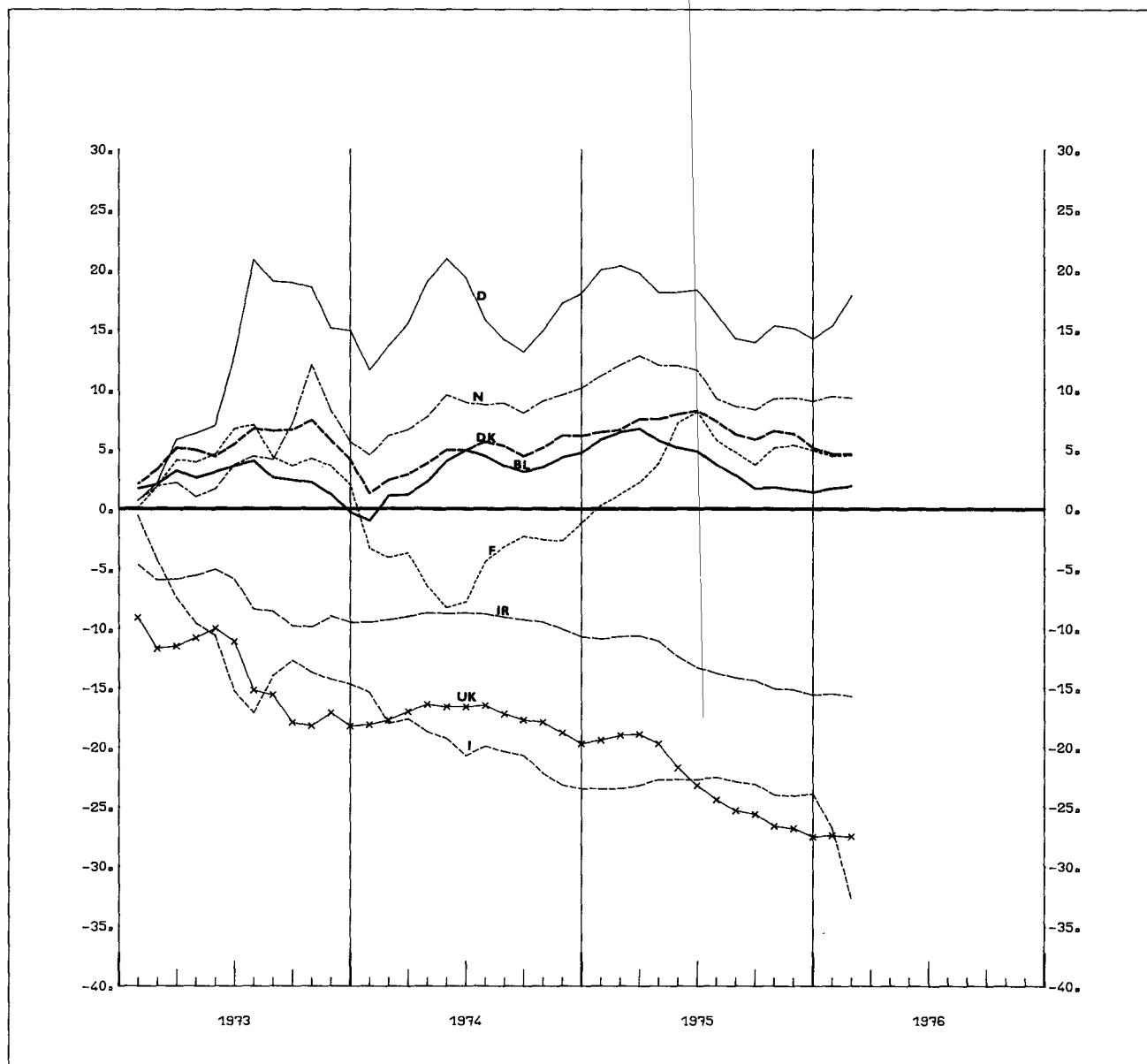
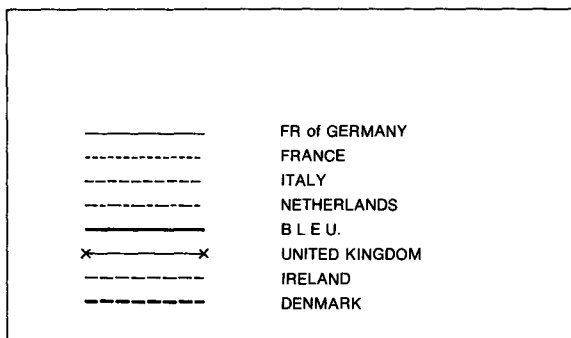


TABLE 3  
Some indicators of the growth of incomes, prices and costs  
(% change on preceding year)

Country	G.D.P. in value		Price of G.D.P.		Price of National Expenditure		Price of Private Consumption		Wage and Salary Bill		Wage and Salary Bill per head		Wage and Salary Bill as of % G.D.P.		Wage and Salary Bill per unit of output	
	1974	1975	1974	1975	1974	1975	1974	1975	1974	1975	1974	1975	1974	1975	1974	1975
Denmark	+ 11.9	+ 10.5	+ 10.2	+ 11.5	+ 14.4	+ 10.5	+ 15.0	+ 9.5	+ 18.5	+ 11.5	+ 19.0	+ 14.0	56.3	56.9	+ 16.6	+ 12.9
F.R. of Germany	+ 7.4	+ 4.4	+ 6.8	+ 8.3	+ 8.6	+ 6.2	+ 7.3	+ 6.1	+ 9.6	+ 4.1	+ 11.6	+ 7.8	54.8	54.7	+ 8.9	+ 8.0
France	+ 15.4	+ 10.2	+ 11.4	+ 12.5	+ 14.5	+ 12.0	+ 13.7	+ 11.8	+ 19.8	+ 14.3	+ 17.6	+ 15.2	51.0	52.9	+ 15.4	+ 16.8
Ireland	+ 8.5	+ 20.8	+ 8.1	+ 25.3	+ 19.2	+ 24.3	+ 17.3	+ 20.9	+ 17.2	+ 22.0	+ 15.3	+ 24.6	54.2	54.8	+ 16.7	+ 26.6
Italy	+ 20.6	+ 16.0	+ 16.6	+ 19.9	+ 21.6	+ 18.1	+ 19.6	+ 17.0	+ 24.1	+ 20.5	+ 20.6	+ 19.0	54.9	57.0	+ 20.0	+ 24.6
Netherlands	+ 12.5	+ 9.4	+ 9.4	+ 11.3	+ 11.8	+ 11.4	+ 10.0	+ 10.8	+ 15.0	+ 12.5	+ 15.5	+ 13.5	60.0	61.7	+ 12.8	+ 14.4
Belgium	+ 17.0	+ 10.5	+ 12.7	+ 13.1	+ 13.9	+ 13.1	+ 12.3	+ 12.4	+ 19.8	+ 15.8	+ 17.5	+ 17.3	55.2	57.8	+ 15.3	+ 18.8
Luxembourg	+ 16.5	+ 4.8	+ 12.5	+ 3.1	+ 11.7	+ 12.0	+ 9.5	+ 10.5	+ 24.8	+ 13.4	+ 20.6	+ 15.1	56.3	67.0	+ 20.6	+ 22.9
United Kingdom	+ 13.4	+ 24.4	+ 12.6	+ 26.3	+ 17.9	+ 24.0	+ 15.2	+ 21.5	+ 20.6	+ 28.7	+ 19.8	+ 31.7	64.2	66.4	+ 19.8	+ 30.5
Community	+ 12.7	+ 11.3	+ 10.5	+ 14.3	+ 13.8	+ 13.0	+ 12.6	+ 12.5	+ 16.9	+ 14.4	+ 16.3	+ 16.4	56.0	57.5	+ 14.6	+ 17.5

Source: Services of the Commission.

TABLE 4  
Wage costs in industry per unit of gross value added at constant prices  
(including construction)

Country	% increase on preceding year						1970-1975 % increases in Eur <sup>1</sup>	1970-1975 % increases in national currency
	In national currency			In Eur <sup>1</sup>				
	1973	1974	1975	1973	1974	1975		
Denmark	+ 12.2	+ 18.9	+ 19.0	+ 12.1	+ 18.9	+ 19.0	+ 80	+ 78
F.R. of Germany	+ 7.3	+ 9.0	+ 6.5	+ 12.9	+ 12.6	+ 6.5	+ 41	+ 60½
France	+ 9.5	+ 16.1	+ 21.5	+ 9.5	+ 7.3	+ 28.7	+ 74	+ 70
Ireland	+ 6.1	+ 14.0	+ 29.0	- 9.3	+ 9.2	+ 15.7	+ 87	+ 30½
Italy	+ 12.8	+ 21.0	+ 34.0	- 2.3	+ 8.5	+ 26.2	+ 115½	+ 56
Netherlands	+ 9.0	+ 12.3	+ 15.0	+ 10.6	+ 16.3	+ 15.0	+ 56	+ 68½
Belgium	+ 6.5	+ 14.9	+ 21.5	+ 6.5	+ 14.9	+ 21.5	+ 61	+ 65½
United Kingdom	+ 8.5	+ 20.9	+ 33.0	- 7.2	+ 15.6	+ 19.1	+ 102	+ 41
United States	+ 3.1	+ 7.9	+ 8.8	- 10.4	+ 7.9	+ 3.0	+ 24	- 6

<sup>1</sup> Calculated on the basis of figures in national currencies, adjusted for exchange rate variations in relation to the Eur.  
Source: Estimates by Commission's departments.

was introduced in Belgium in May 1975 and gradually eased thereafter. A freeze on profit margins was introduced in France and Denmark, and in this latter country, and also in Ireland, the granting of subsidies and temporary reductions in value added tax were also used as part of prices policy. In the United Kingdom and the Netherlands, where the monitoring of prices had remained very strict, some relaxation of controls was introduced during the year, especially so as to safeguard private investment. A limited number of countries, and in particular the Federal Republic of Germany, refrained from all direct intervention in price formation.

## **B — CONVERGENCE OF ECONOMIC POLICIES IN THE COMMUNITY**

### **VI — Application of the Council Decision of 18 February 1974**

6.1. The Council Decision of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the Community provides for a number of fixed periods and consultation and examination procedures whose observation is assessed in the following.

6.2. In application of Article 1, the Council regularly examined the economic situation and adopted guidelines on economic policy in the Community at a total of eight meetings<sup>1</sup> in 1975. The economic and social situation in the Community was discussed at each of the three meetings of the European Council<sup>2</sup>. Finally, at two meetings held in the autumn, the Ministers for Finance of the Member States drew up a common position in preparation for the international monetary conferences. The Member States belonging to the 'snake' met on a number of occasions for consultation, at which the other Community countries were not present.

In November, the Ministers for Economic Affairs and for Employment, the Commission and representatives of the two sides of industry met for the first time and had full and frank discussions on the economic and social situation in the Community and on the future outlook.

6.3. The examination provided for in Article 2 took place during the first quarter at the Council meeting held on 18 March. The decision on the adjustment of the economic policy guidelines was not finally adopted until 16 June.

The second examination, provided for in Article 3, took place at the Council meeting held on 10 July on the basis of a communication from the Commission on the economic policy to be pursued in 1975 and on the drawing up of the public budgets for 1976. It proved difficult to fix quantitative guidelines for the draft public budgets, because of the uncertain economic outlook in the spring of 1975.

Because of the lack of adequate information on economic trends up to the summer, it was not until the middle of October that the Commission presented the annual report on the economic situation in the Community fixing the guidelines to be followed by each Member State in its economic policy for the following year, though these were scheduled for the end of the third quarter under Article 4. The annual report and the guidelines were adopted by the Council in November<sup>3</sup>.

The Commission intends to present the draft of the annual report for 1976 in September this year once again, so that it can be taken into account in the budgetary debates in the national parliaments.

6.4. The draft of the fourth medium-term economic policy programme for the Community is at present being prepared, and it will be presented to the Council before the summer.

6.5. As provided for in Article 7, the prior consultation on exchange rate alterations was observed when the French franc returned to the Community exchange rate system. The consultations on the strengthening of cooperation between the central banks of the Member States, with the aim of promoting the continual coordination of their monetary policies, especially as regards the development of the money supply and bank liquidity, the conditions for granting credit and the level of interest rates, take place regularly within the framework of the Committee of the Governors of the Central Banks and the Monetary Committee.

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<sup>1</sup> Dates of meetings: 17 February, 18 March, 21 April, 20 May, 16 June, 10 July, 22 September and 17 November.

<sup>2</sup> European Council: 11 and 12 March, 16 and 17 July, 1 and 2 December.

<sup>3</sup> See OJ C 297 of 29.12.1975.

6.6. In the standing consultations on the general economic policy measures envisaged by the Member States and on their conformity with the economic policy guidelines, the Coordinating Committee on Short-Term Economic and Financial Policies largely confined itself to an exchange of information on economic developments in the member countries. Prior consultations have only taken place in a limited number of cases.

## **VII — Conformity of the policies pursued with the objectives set, and success of the efforts at coordination undertaken within the Community**

7.1. In the first Report on the Application of the Council Decision of 18 February 1974, the Commission stressed that the coordination of economic policies in 1974 had been insufficient and regretted the fact that in the surplus and deficit countries the necessary measures had been undertaken with a lack of wholeheartedness and had achieved only limited effectiveness.<sup>1</sup> In view of the major disequilibria existing within the Community and the uncertain outlook for world trade, there was 'no reason to expect that production will start rising again in the Community countries before the autumn (1975)'.<sup>2</sup> However, the decline in economic growth proved sharper in the first half of the year than expected, since export demand in all the member countries fell drastically. In the Recommendation of 23 July 1975 concerning the measures to combat the recession, the Commission asked the Federal Republic of Germany, the Benelux countries, France and, to a lesser extent, Denmark and Italy to take additional measures to stimulate the economy and reduce unemployment. In August and September 1975, five Member States, particularly France and the Federal Republic of Germany, decided to adopt extensive short-term economic policy programmes, which were closely coordinated as to content and timing and which were also announced at about the same period.

7.2. Monetary and credit policy in 1975 was almost generally along expansionary lines. The effects became apparent only in the subsequent trend of economic activity and reinforced the impetus of the built-in growth of budget deficits and public budget programmes. The greater convergence of monetary and budgetary efforts in the Community strengthened monetary cohesion. With the exception of the pound sterling and the Italian lira, the exchange rates of the Member States drew closer together up to the end of the year. With the return of the French franc into the Community exchange rate system, the area of monetary policy stability in the Community was enlarged once again.

7.3. In March 1975, as a result of the rapid success achieved in reducing its balance of payments deficit, Italy was able to lift the cash deposit requirements for imports which had been introduced the previous year. The monetary and budgetary policy ceilings, which were imposed on Italy in connection with the granting of medium-term assistance for 1975,<sup>3</sup> were exceeded considerably particularly towards the end of the year, mainly because the economic down-swing proved much sharper than expected and necessitated stimulatory measures. However, the possibility cannot be ruled out that, amongst other factors, the exceeding of these ceiling contributed to the fall in the value of the lira in January 1976.

7.4. The United Kingdom and Ireland were at first hesitant in following the restrictive economic policies provided for in the Community guidelines, as is shown in the rapid rise per capita in wages and unit labour costs (Table 3 and 4). It was not until later in the recession that energetic incomes policy measures were taken to reduce price and cost pressure, so as to counteract the rapid worsening of the balance of payments and inflation.

The improvement in the economic situation seems to have been clearest in those countries which responded most rapidly and most vigorously to the numerous calls for voluntary cooperation between the two sides of industry.

The Tripartite Conference held in November 1975, at which the Ministers for Economic and Social Affairs and, the Commission and the two sides of industry met, was an important basis for developing the exchange of ideas on the short and medium-term problems facing all the Community countries, which can only be solved on a Community basis and through cooperation.

<sup>1</sup> Report on the Application of the Council Decision of 18.2.1974, Paragraph 2.1. (doc. COM (75) 93 final, p. 2).

<sup>2</sup> Commission Communication to the Council concerning the adjustment of the economic policy guidelines for 1975, OJ L 162 of 25.6.1975, Paragraph 1.5., p. 13.

<sup>3</sup> Council Directive of 17.12.1974 on the granting of medium-term financial assistance to Italy. OJ L 341 of 20.12.1974, p. 51.



7.5. The success of the efforts at coordination undertaken within the Community cannot be measured simply by the number of Council, committee or working party meetings, nor simply by the result of the overall economic trend in the form of comparisons of annual average figures. 1975 was not only a year of marked unfavourable tendencies. The improvement in the external trade disequilibria within the Community and—in the second half of the year—also in the internal economic situation was noteworthy and can without doubt be attributed to the more vigorous short-term economic policy efforts undertaken by the member countries at Community and international level.

7.6. All the deficit countries, particularly Italy and France, were able to reduce their current account deficits as a result of a sharp decline in imports. The total deficit of these countries was \$ 5000 million at the end of the year. On the other hand, the Federal Republic of Germany maintained a high level of imports despite a decline in economic activity and was able to reduce its current account surplus by two-thirds to almost \$ 3000 million as compared with the previous year.

7.7. The reduction in inflation rates during the year became particularly distinct during the second half of the year in all the member countries except for Belgium, Luxembourg and the Netherlands. Unit labour costs, which have gone on rising and have accelerated in almost all the Member States except Denmark and the Federal Republic of Germany, are a cause for concern (see Table 3). These tendencies have been reversed only in the last few months in the United Kingdom and Ireland as a result of the prices and incomes policies introduced.

7.8. The downward trend in industrial production bottomed out after the summer and production has since then begun to recover in most of the member countries. At the end of 1975, all the Community countries except Luxembourg, Belgium and the United Kingdom, had either regained or indeed exceeded the level of the previous year. The labour market situation, which usually reacts to the recovery of economic activity with a time lag is already improving in some countries, if seasonal influences are disregarded. The climate of confidence among consumers and firms is improving steadily. The chances of a general recovery in economic activity and of sustained growth are becoming more favourable.

## **CONCLUSIONS**

Although the coordination of economic policies between Member States still leaves a lot to be desired, some progress has been realized in this respect as compared with the previous year. Inflationary trends eased, disequilibrium in the balance of payments was reduced surprisingly rapidly, and, finally, the likelihood and indeed the basis for a new upswing in the economic situation have improved considerably. Cooperation between Member States at European and international level has without doubt helped to check the recession quickly and to set off a recovery in demand and production. However, it has not been possible to hold back the worrying increase in unemployment. Besides, although the divergencies in the development of inflation rates and balances of payments have lessened in the Community, differences still persist.

The main problems for 1976 will be to secure steady growth without giving a further push to inflation, and to reduce the high level of unemployment. It will be possible to see from the approach adopted to these problems to what extent the great willingness to cooperate which has been shown by governments and the two sides of industry is due to a lasting recognition of their mutual interdependence rather than to the pressures from the most serious recession since the war.

Brussels, 29 February 1976.

## Opinion to the Council and the Commission

1. The Economic Policy Committee examined a draft report to Council concerning 'The adjustments of the economic policy guidelines for 1976 and proposal for a Council decision' which had been submitted to it by members nominated by the Commission.
2. The Committee is broadly in agreement with the analysis of the situation as presented by the Commission. It also accepts the Commission's proposal that no basic changes should be made for the time being to the guidelines for economic policy as presented in the Annual Report on the Economic Situation of the Community approved by Council in December 1975.
3. Current projections for most member countries show an improvement in the prospects for the growth of aggregate demand, both domestic and external, in the last few months. However, there is uncertainty as to the extent and duration of the upturn. The improvement in the short-term economic outlook in the industrialized countries outside the Community does not, as yet, appear to be firmly established. This, in turn, affects prospects for the growth of international trade and the likely outcome for the balance of payments in the individual member countries of the community. The Commission assures that international trade (excluding intra-Community trade) will expand by at least 5 % between 1975 and 1976. The further development of the domestic element in demand depends on the extent to which confidence of business and consumers in the Community can be restored, and this in turn to a great extent on success in dampening cost and price increases. Households are still saving a large, although decreasing, portion of their disposable income, while the business sector is lagging behind in investment, as profit levels both actual and prospective remain somewhat subdued.
4. Taking into account the recent indications of a slightly higher rate of expansion, the Commission foresees a growth of total output of 3 to 3.5 % between 1975 and 1976 in the Community as a whole—though with considerable variation from country to country. This is still below the estimated rate of growth of productive potential. The Commission forecasts that the level of unemployment over the area as a whole will still be high in twelve months time, though it will in all likelihood be somewhat lower than at present. It is probable that the level of unemployment will decrease in some countries and increase in others. The prospect is one which gives cause for concern.
5. During the year an appreciable deceleration in the rate of price inflation is to be expected but its level will still remain unsatisfactory at the end of the year. The Commission estimates that it may come down for the Community on average to a little below 10 % a year. In the light of the present prospects in various countries for the growth of productivity and for increases in money earned incomes, there would seem to be opportunities for securing a deceleration of the rate of inflation, and it is important that policy should be designed to make the best of these opportunities.
6. Although, therefore, there are good reasons to believe that a turnaround in the production cycle was reached in autumn 1975, and to have confident expectations of a recovery in the Community in 1976, the picture still presents some unsatisfactory aspects which are in part of a structural nature. The core of the problem lies in the fact that the member countries of the Community emerging from a protracted and serious recession, are confronted with persistent unsatisfactory levels of unemployment and inflation. Moreover, the large differences between the countries in both rates of growth and inflationary tendencies expected for 1976 are very disturbing for the overall outlook for the Community. At the same time, considerable balance of payments disequilibria still exist. If a remedy to this is not found, tensions are bound to arise within the Community.
7. Substantial expansionary measures taken by the different countries in 1975 have not yet fully worked through into demand. These measures, which have already been decided, must be carried out without

delay. Furthermore, priority should be given to efforts likely to strengthen the confidence of consumers and producers, to stimulate investment, and dampen inflationary expectations. The Committee believe that the unemployment problem cannot be solved in the short-term through strong additional expansionary measures which can only give rise to new inflationary pressures and thus create additional risks for medium-term employment and balance of payments prospects. Some members, however, believe that moderate further expansionary measures could be undertaken without undue risks.

8. A particularly important responsibility falls upon both employers and unions in all countries. Wage settlements must take into account the necessity of avoiding cost increases, so as to encourage investment and promote the reduction of unemployment. At the same time, a foundation should be laid for a reduction of the public deficits in the medium-term in all countries in order that resources should be available in the economy for the expansion of investment and room should be left in the capital market for its finance.

9. With regard to the high level of unemployment which raises very serious problems particularly for the younger and older sections of the work force, the Committee believe it would be desirable to take specific employment policy measures. In this context, greater consideration should also be given to improved vocational training of young people.

10. Monetary policy should be orientated towards financing growth in a manner in accordance with stability by maintaining the growth of money supply within limits compatible with the macro-economic objectives. Because of this, monetary policy in the countries with particularly high inflation rates and large deficits on their current balances should be relatively less expansionary than in the other countries.

11. The Committee emphasized that it is very important to avoid any measures restricting international trade.

12. The Committee is aware that a combination of the traditional macro-economic instruments of policy may not provide an entirely satisfactory answer to present problems which are in part of a structural nature. The essential policy objectives of stability and full employment can be fully achieved only in the framework of a medium-term policy. In this framework, priority should be given to efforts to increase factor mobility and to the abolition of structural, social and regional disequilibria. Efforts should also be made to modify attitudes and institutions so as to reduce the strength of the link between high pressure of demand and the rate of price inflation and to moderate the struggle between different sections of society for a larger share of the total national income. The Economic Policy Committee has undertaken an overall study of medium-term prospects and the problems relating to them which it will submit to the Council and the Commission during the year.

