

# COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION BY THE COMMISSION TO THE COUNCIL ON ECONOMIC POLICY  
TO BE FOLLOWED IN 1975 AND ON THE PREPARATION OF PUBLIC BUDGETS FOR  
1976

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FOREWORD

Pursuant to Article 3 of the Council decision of 18 February 1974 concerning the achievement of a high degree of convergence of the economic policies pursued by the Member States the Council, in its second annual examination of the economic situation, is to fix guidelines for the draft public budgets for the following year.

To this end and pursuant to Article 1 of the same decision the Commission hereby transmits this Communication to the Council. It takes account of the conclusions reached by the Council at its meeting on 16 June last on the economic situation in the member countries.

The Commission again stresses the need for an overall view of national economic policies so that they may be judged in the light of their impact on the closely integrated economic unit which the Community represents. Thus the policy choices available for each country must be placed in the context of their contribution to the development of the Community, without which the difficulties experienced by individual Member States will be even more pronounced.

## I. THE ECONOMIC SITUATION

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### A. The international environment

1. During the last downswing in the world economy in 1970-71, the authorities in most of the industrialized countries applied measures to stimulate activity which were too strong. The recovery thus contained within itself the seeds of inflation and of recession the gravity of which was subsequently accentuated by the energy crisis.
  
2. Since 1974, the industrialized countries have been hit simultaneously by a recession of abnormal size, the ending of which remains uncertain. The first result of the recession has been a large fall in world trade, which in terms of both its size and duration, is the most important recorded since the war. It has led to the first interruption of any significance in the growth of Community exports since the Common Market was established. The total volume of imports of developed countries outside the Community has probably fallen by about 6% between the second half of last year and the first half of 1975. Imports by the non-oil-producing developing countries have no doubt also fallen further. This decline in demand has only been partly compensated for by the very dynamic growth in the purchases by the oil-producing countries and, to a lesser extent, by the continued expansion of imports by the state-trading countries.
  
3. The steepness of the decline in the volume of world production and trade during the early months of 1975 was much more extreme than had been foreseen, influenced notably by the reduction of stocks. The trade balance of the developed countries has improved strongly, especially since there has been a fall in the demand for oil due to the economic recession, the favourable weather conditions, and the reaction to the huge rise in the oil price. The developing countries have recorded a considerable increase in their trade deficit. Inflationary strains have tended to ease in several industrialized countries, mainly due to the fall in raw material prices and the weakness of domestic demand.

4. In the United States and Japan, some progress has been achieved in the fight against inflation and signs of an upturn in activity are now starting to become clearer. In the United States the tax cuts effective from May seem to be having some initial impact, and certain indicators, such as durable goods' orders, provide evidence of a strengthening in private consumption. The housing sector, which has been very depressed indeed, also appears to be picking up. In Japan, where in June the authorities introduced some further measures to encourage activity, industrial production has started to increase again since March and there has already been some improvement in the labour market situation.

5. Although the expectation of an upswing makes prospects for the industrialized countries a little brighter, the situation faced by the non-oil-producing developing countries remains very bleak. In 1973 and early 1974 many of them had benefitted from the commodity price boom; since then, however, they have all been hit by the increased cost of oil, a drop in the demand from the industrialized countries and a deterioration in their terms of trade. Their current account deficit has widened alarmingly and in spite of the aid which has been extended to them, they have had to cut back their purchases from the industrialized countries. According to provisional estimates, the deficit of the non-oil-producing developing countries as a group could increase to about \$ 32,000 million in 1975.

#### B. The economic situation in the Community

6. Member States are threatened on one side by demand deflation and the persistence of unemployment and on the other by price inflation. In addition a certain number of disparities exist in their relative position which prevent the achievement of significant progress through economic and monetary union.

7. The recession which began around mid-1974 has everywhere been more marked and has lasted longer than generally expected. For the Community indu-

ustrial production in the first quarter of 1975 has been 6% below the level reached a year earlier. The decline in real gross domestic product is likely to be of the order of 3% from a year earlier; the fall could be of the order of 3-4% in Germany and Italy. The weakness of demand and of production seem, however, to have a tendency to moderate progressively although it is not certain that the lowest point of the recession has yet been reached.

8. The degree of utilisation of labour and capacity is at the lowest level experienced. The number of unemployed in the Community at the end of May reached 4.4 million (1) and the unemployment rate expressed as a proportion of the active population has thus passed the worrying level of 4% (1). The unemployment rates in Member States, which admittedly are not completely comparable, vary between 9% for Ireland and 3% for the United Kingdom. Furthermore those figures give only an incomplete picture of the deterioration of the employment situation given the growth of short-time working. In addition unemployment is particularly affecting younger workers as well as those in certain sectors and regions.

9. Some countries have already achieved progress in the fight against inflation. In general terms the rise in prices of industrial products has moderated substantially at the production stage; the slowdown has been a lot less marked at the consumer level, as a result of the increases in prices of services, the continued rise in agricultural prices and in some countries such as the United Kingdom by rises in indirect taxes. Compared with the same month of the preceding year the rise in consumer prices in May 1975 varies between 6% (Federal Republic of Germany) and 25% (Ireland and the United Kingdom). Some countries, especially Denmark and Italy, have in recent months been able to record a clear slowing down of the rate of price increase. In the United Kingdom and Ireland the rise accelerated further. The differences be-

tween the inflation rates observed in the various member countries have not been reduced (see Table 2).

10. The faltering of imports due to the weakness of economic activity and the destocking process as well as the improvement in the terms of trade has resulted in a large reduction of trade and current deficits in member countries and this has occurred in a surprisingly short time period in Denmark, Italy and France. Large differences nevertheless exist between Member States with regard to their external positions. On the one hand the surpluses registered by the Federal Republic of Germany and the BLEU are only falling slowly while that of the Netherlands could tend to increase. On the other hand the Irish and the United Kingdom deficits remain very high despite appreciable reductions. For the Community in total it cannot be excluded that the current balance of payments will move into equilibrium in 1975 as compared to a deficit of \$ 13,000 million in 1974 (see Table 1).

C. The economic outlook for 1975 and 1976

11. Economic forecasts are subject to more significant margins of error than ever because of the uncertainties which exist for economic developments at the world level, the repercussions of the weakness of the dollar as well as the uncertain trend in oil prices, the lags in the effects of conjunctural stimulation policies already adopted and the unforeseeable modifications of the behaviour of consumers and investors.

12. There exist however a certain number of positive elements favourable to a progressive recovery in economic activity in the Community during the autumn: the evident signs of a turn around in the conjuncture in the US and Japan which could be such as to improve the economic climate in other

countries, the probable end to destocking, the general easing of monetary policy and the fall in interest rates, and also the expansionary impact of high budget deficits, resulting in part from tax reductions in favour of households and businesses taken within the framework of conjunctural recovery programmes. The timing and magnitude of the recovery nevertheless remain difficult to state exactly, more especially because to the conjunctural uncertainties, both internal and external, are added lasting changes in the structure of demand.

13. Even if production recovers progressively in the autumn it must be expected, given the large fall in production registered during the first half of the year, that gross domestic product within the Community in real terms for the whole of 1975 will be slightly below the figure for last year. If the recovery really gets up momentum it should continue in 1976 at a sustained rate and result in an annual average increase of around 4 % in volume of gross domestic product of the Community. The growth rates will be above this level in the Federal Republic of Germany and France but less in the majority of other member countries where they will be between 2 and 3 1/2 %.

14. The situation on the labour market is unlikely to improve before the beginning of 1976 and could even get worse in some countries. Productive capacity is underutilised to a large degree and structural and frictional unemployment may tend to increase, the recovery in economic activity is only likely to moderate the position of employment with a long lag : it must be expected therefore that substantial unemployment will persist for some time.

15. The rise in prices should continue to moderate in the majority of member countries. In annual averages, however, the rise in Community costs and prices will hardly be less in 1975 than in 1974. Besides, the disparities between members will remain as long as those countries with high inflation rates do not attack resolutely the prevalent inflationary mentality. The productivity gains resulting from the conjunctural recovery will facilitate however the fight against inflation; they do introduce the risk that the gaps between coun-

tries could be enlarged even more, given that those countries which have made the greatest progress towards price stabilisation will profit most.

16. The forecasts concerning the development of the current balances of payments of Member States remain uncertain. For the majority of countries the terms of trade should continue to improve, but at a more moderate rate, while the world conjunctural recovery should bring about a growth in exports. The improvement, very marked up to the present, of the current account positions of member countries could, nevertheless, stop before very long if imports of raw materials and partly-manufactured goods begin to increase again and if the trend of prices on the commodity markets changes.

## II. ECONOMIC POLICY GUIDELINES

### A. Conjunctural policy measures put into effect

17. The member countries of the Community declared themselves ready in 1974, and again in March 1975 when the guidelines on economic policy were adapted, to harmonise their policies and national conjunctural programmes. The objective set was to shape the different measures, expansionary or restrictive, which were to be introduced in the monetary or budgetary fields, in such a way as to complement each other. Although only the initial results have been observed, given the success expected from this harmonisation - a conjunctural boost in surplus countries and a return to internal and external equilibrium in the deficit countries - progress has been disappointing. The recovery has not yet come while the movement of costs and prices has accelerated in certain deficit countries. As for the improvement in the balance of payments of most countries, it can be explained mainly by the slowdown in economic activity and destocking.

Because the development of internal and external demand was overestimated, the institution of restrictive measures to combat inflation and of stimulatory programmes in surplus countries has been too slow and hesitant. The majority of member countries have underestimated the cumulative effects of the recession in partner countries and have overestimated their capacity to control inflation from external or internal sources.

18. It would however be premature to expect substantial effects straight away from the measures taken:

- The relaxation of monetary policy and the budgetary stimuli only start to act with a quite long lag; moreover, because of structural changes some important sectors (vehicles, construction) cannot have a leading influence on activity.
- The recessionary tendencies have been intensified by the development of precautionary saving by households through fears of falling incomes.
- Because of the uncertain international environment, the greater hesitancy on the part of consumers and the very high level of underutilization of capacity, firms are reluctant to add to their productive capacity.
- The different investment incentive measures taken in the budgetary and monetary areas are only playing a marginal role in the behaviour of private business. The profit outlook remains the decisive element in this respect. After the strong squeezing of profits seen in recent years, which has led to a deterioration in the financial position of businesses, the situation in this field is likely to improve only gradually.

#### B. General guidelines

19. Given the difficulty of forecasting the development of the economic situation and taking account of the stimulatory action applied, there is no reason at present for any fundamental change in the existing economic policy guidelines, which differentiate between countries but have a common theme, adopted by the Council in March 1975. This remains the case, even though, as appears likely, the economic upturn may be delayed and though, as a result, the leading role to be played by the countries in surplus may be late in emerging. Indeed, too hasty an adoption of new global stimulatory measures would threaten to unleash a wild bout of inflation and to reach, as in 1973, a situation which would require restrictive action of an even more severe nature and would lead to an

employment crisis much more severe than at present. The difficulty in slowing down any further the rise in consumer prices indicates how precarious are the initial successes scored in the fight against inflation and how hard it is to change inflationary behaviour which has taken root over the years. On the other side, however, one cannot disregard the risks which could arise in relation to employment, production and the social situation, if the recovery in the economic situation, at world level and in the Community, did not materialize until into 1976 or remained very limited in scale. In such a case, further stimuli could be made use of by the Member States where general conditions would permit such action to be put into effect.

20. In implementing the conjunctural policy which, during the coming months, must steer between the dangers of inflation and recession, the measures taken by the public authorities, the behaviour of the social partners and the interaction between them should be kept under constant scrutiny.

Of course, the scope for acting on this policy is limited at present in almost all the member countries, but can be extended by effective concerted action on economic policies at Community level to make easier, if necessary, a quick revision of the economic policy guidelines.

21. The member countries of which the balance of payments is strongly in deficit should base their economic policy on the exploitation of their export potential. Any excessive domestic demand pressure would endanger the re-establishment of balance of payments equilibrium and also their opportunities for borrowing abroad, and would be bound to increase even more their inflation rate. For the countries in deficit which have made more progress towards re-establishing basic equilibrium the scope for increasing encouragement of activity relies closely on any further success which can be gained on the way to stabilization.

22. In the surplus countries, the expansionary stance of monetary and budgetary policy has created the basis for a conjunctural recovery which should increase the share of output destined to the domestic market and reduce the large external surpluses. Although the cautious behaviour of consumers and investors has not yet changed so far, the situation could turn around at short notice. Nevertheless, should recovery not be under way by the autumn of this year, additional stimulatory measures, for example, through public orders and encouragement of social housing construction, could offer a supplementary impulse to domestic demand.

23. In any case, there is no reason to expect a speedy reversal of trends in the labour market. Moreover, any impression that the employment problem can be resolved in the short term by swelling nominal demand and by unloosing the inflationary spiral once more must be guarded against. The Commission has recently stressed the need to attack the problem of unemployment, especially unemployment among young people. The efforts to be made in this area should make further use of the mechanisms already set up on a Community basis (regional fund, European social fund, ECSC means, EAGGF, etc.).

24. An essential condition for economic recovery and a reduction in unemployment is the rapid re-establishment of confidence, in particular through the return to a more stable economic and monetary order, at international level as well as in the Community.

Because of the many ties which join the Community with the rest of the world and the increased synchronisation of conjunctural cycles, the balanced development of the economy of the Community depends on a steady expansion of world trade and on orderly monetary and financial relations. The Community can make an effective contribution to these, notably within the framework of GATT so as to reduce the barriers to the expansion of trade and at the level of the IMF to advance the work towards greater stability of the international monetary system. Progress in this area relies on concerted action by the Community with its major partners. Cooperation between the industrialized countries and the raw-material-producing countries as a group would also go in the same direction. Lastly, the Community should make its contribution to the problem of financing the massive deficits of the developing countries most seriously affected by the oil crisis and world recession.

25. Another element of a kind to contribute to the re-establishment of confidence is greater stability in exchange rates within the Community. The return of the French franc into the Community exchange rate system is a positive feature. The enlargement of this area of European monetary stability, which should be encouraged, implies a much closer coordination than before of economic and monetary policies: this is especially so for interest rate and exchange rate policies, which should be the subject of concerted action such that the differences in rates in operation in the member countries contribute to the appropriate guidance of capital movements. There is also a place for the rapid development of the role of the European unit of account.

26. A decisive factor in re-establishing the confidence of investors and consumers is the cooperation of the social partners. Exaggerated nominal wage claims stir up inflation, reduce business incomes and the propensity to invest and thus put at risk, in the present transitional phase, the recovery in activity and employment without adding to the workers' real purchasing power. It is certain that moderation in wage claims can be expected that much more if workers and unions are convinced that they are not the only ones who must carry the burden of the economic difficulties. With such a reserved attitude in relation to wages there should be a corresponding moderate price policy on the part of businesses. Closer participation of workers in the formulation of economic policy and wider information on the economic realities are indispensable for arriving at more trustful collaboration, so necessary from now on. The slowing down in the expansion of workers' incomes during this difficult conjunctural phase could be compensated for by a greater satisfaction of their collective wants. The need for an effective incomes policy is above all valid in the member countries in which the inflation rate is still rising and in those where the initial success in re-establishing domestic and external equilibrium remains fragile.

C. BUDGETARY POLICY GUIDELINES

1. Evolution of Public Budgets in 1975

27. The evolution of public budgets in 1975 is characterized in most of the Community countries by a serious deterioration in the borrowing requirement, an accelerated growth in the volume of public expenditure and mediocre developments in tax receipts, phenomena closely related to the economic recession which started in 1974.

The aim of the budgetary policy of the Member States, within the limits imposed by the persistence of a heavy price increase and in some cases by balance of payments problems has been to halt the lowering of production and employment by measures on both the expenditure and the tax receipts side. Such a policy was applied relatively early and affected the main budget aggregates in Germany and the Netherlands where developments in prices and the balance of payments made it relatively easy to apply; more recently Belgium, France and even Italy have also taken budgetary support measures but in a more modest and selective way than in the above-mentioned countries.

Besides the discretionary support measures, the public budgets have exercised an important automatic stabilisation function. The financing of the accrued deficits has not resulted in major deficits on the financial markets; credit demand from the private sector of the economy has in effect considerably weakened and has resulted in a lowering of both short and long-term rates of interest despite the accrued recourse of the public sector to the capital markets.

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2. Budgetary guidelines for 1976

a) General observations

28. For the purposes of establishing the budgetary guidelines for 1976 in accordance with the general hypotheses described in Chapter I, it has been assumed that, from the second half of 1975, economic activity will show an upturn, of varying degrees, in most member States. A continuation of this upturn in 1976 should scarcely change, during the larger part of that year, the budgetary tendencies described below, when one takes account of the fairly long time period which is needed for the budgetary aggregates to react to changes in economic variables. In particular, the net borrowing requirement will continue to deteriorate, especially when one considers the year as a whole.

Having regard to the precarious prices and incomes situation, and in some cases also the balance of payments situation, it would seem propitious, in most member States, not to attempt to accentuate too much the improvement in economic activity by using strong budgetary stimulants.

However, certain policies would seem to be opportune such as the partial or total adaptation for inflation of income taxation levels and budget financing of extensions in the limit of unemployment benefits, these policies being aimed at maintaining the level of household incomes and at compensating for inequalities created by the recession.

If, as is assumed, the upturn in the level of activity proved to be significant, a gradual reduction of the net borrowing requirement during the year would be desirable, because a continuation of deficits considerably larger than the medium term tendencies would not fail to involve, as soon as investments start to increase, a narrowing of capital markets or to cause a monetary policy dilemma - faced with the choice of potentially inflationary monetary policy or a steep increase in interest rates which would in turn be prejudicial to the maintenance of economic expansion.

The application of a policy of deliberate stimulation of internal demand would be difficult in those countries (mainly the United Kingdom and Ireland) where internal and external equilibrium are less assured; a restrictive budgetary management will be necessary throughout 1976; it should result in a substantial reduction in the net borrowing requirement.

All the same, the possibility cannot be excluded that there will not be an upturn in economic activity during the autumn of 1975. In this case, the economic outlook for 1976 would be considerably modified; it would then be necessary to review or change fundamentally the guidelines set down here.

The Commission would then make the necessary proposals within the framework of the annual report on the economic situation in the Community in 1976, which will be submitted to the Council in the autumn.

b) Guidelines country by country

29. In Denmark, the combined effects of the tax reform and the economic developments of 1975 have resulted at the same time in tax-revenue shortfalls and supplementary transfer expenditures arising mainly from the employment situation. As a result, the budget which had been in surplus during many years will show, during 1975-1976, an appreciable deficit, of approximately 4 % of G.D.P., whereas in 1974-1975 it was only 0.3 %.

The economic perspectives for 1975 give hope of an upturn in activity by way of an increase in external demand and an improvement in internal demand in real terms. At the same time, the situation on the employment market would improve notably. As a consequence, budgetary receipts would increase substantially again in 1976-1977, whereas the rate of increase of expenditure would be appreciably reduced leading to a progressive decrease in the net borrowing requirement, desirable for both structural and conjunctural reasons.

30. In Germany, public budgets and especially those of central government will be characterized, in 1975, even disregarding discretionary measures, by the particularly strong stimulus which they will have given both to consumption and investment. For the central government alone, the net borrowing requirement will show, compared to 1974, an increase equivalent to more than 3.5 % of G.D.P. of which 1.5 % is due to the effects of the tax reform. The remainder is chiefly attributable to the measures to encourage investment taken within the framework of the anticyclical programmes as well as to tax revenue shortfalls and additional unemployment benefits resulting from the unfavourable economic developments. Since the major part of conjunctural reserves has been used for the implementation of these programmes, the net borrowing requirement which should reach 5 % of G.D.P. will be met principally by recourse to the capital market.

Even if no account is taken of the limits set down in the Constitution on the Federal government's indebtedness, present economic prospects for 1976 do not appear to make further growth in the net borrowing requirement possible or even desirable. If one assumes that, in fact, an upturn in exports, an increase in private consumption and a marked recovery in corporate investment could take place and that the financing need of the general government continues to grow, the reduction in the rate of household savings and the increase in the financing needs of companies would risk,

given the orientation of the monetary policy of the Bundesbank in favour of stable market conditions, to produce a rise in interest rates and consequently costs, which could have a negative effect on exports, investment and prices. It would seem appropriate as the recovery gradually develops to attempt to reduce the deficit, although when one considers the take-off point a sudden and sharp reduction seems neither possible nor desirable. This implies, by comparison with the previous years, a considerably less dynamic budgetary policy which mainly will depart gradually from past rates of expenditure growth. In the interest of recovery in employment in the Federal Republic of Germany and of conjunctural support in the Community as a whole, such an orientation is dependent on the evidence of a net recovery of internal demand in the autumn of 1975. In any case, adequate attention should be paid to investment within the framework of overall expenditure.

31. In France, the 1975 budget, which it was expected at the beginning of the year would result in a considerable surplus, will probably show a slight deficit not only as a result of the support measures adopted in April to halt the increase in unemployment and whose budgetary cost will amount to about 7 billion francs (0.5 % of GDP), but also because of tax-revenue shortfalls which are arising from the marked weakness in economic activity.

Even if economic activity picks up during the second half of 1975, the budget outturn will probably show a deficit in 1976, because of the repercussions which are likely on state advances to local authorities from the replacement of licences by professional tax and from the effect of investment expenditure undertaken in 1975. Under the prevailing economic conditions, it would not be appropriate to try to eliminate the deficit by a significant strengthening of overall fiscal pressure, the more so because financing by non-monetary methods of a moderate deficit should not raise significant difficulties.

32. In Ireland, the objective of the initial budget for 1975 was to stimulate economic activity. This however, continued to decline whilst the rise in prices accelerated. An additional budget was therefore introduced at the end of June aimed at increasing employment by stimulating investment and reducing inflation through lowering both indirect taxes and certain public charges while giving subsidies to consumers. In spite of increases in direct taxation which were also introduced, the net borrowing requirement should increase sharply to reach a level of 16 % of G.D.P.

In case the expected upswing of internal demand occurs in the second half of 1975 and if external demand recovers in 1976, budgetary policy should reinforce the anti-inflationary action pursued by the authorities through an appropriate limitation of public and private consumption. Such a policy should, in 1976, make a start at reducing substantially the net borrowing requirement (expressed as a percentage of G.D.P.), in particular in order to diminish borrowing abroad.

33. In Italy, the outturn of the 1975 budget should show a considerable worsening compared with 1975. Expenditure is expected - on a comparable basis - to increase by about 17 % and receipts by about 11 %, the latter mainly because of the impact of the unfavourable development of the economy on the yield of indirect taxation and the possible delay in collecting certain indirect taxes. The result will be a net borrowing requirement considerably higher than that of the previous year and representing about 6.2 % of G.D.P. instead of 5.3 %. The rate of increase of expenditure would thus slightly exceed the limit fixed at the time of the provision of medium-term financial support to Italy.

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However, this excess of expenditure can be justified by the weakening of the economic situation which was worse than expected.

On the other hand, in the recovery phase in 1976 efforts should be made to reduce considerably the size of the net borrowing requirement (compared with gross domestic product) so as to limit at the same time the expansionary role associated with money creation as a result of Treasury transactions. In spite of the constraints affecting expenditure, it seems that thanks to the slow down of the rise in prices, its rate of growth could be reduced compared with 1975. This moderation would not be sufficient however to achieve the objective required and it should be accompanied by an appropriate taxation increase, because there is a danger that receipts will increase spontaneously at a lower rate.

34. In the Netherlands, the budget will clearly have a stronger expansionary effect in 1975 than was originally planned. In their efforts to fight the increase in unemployment - with the balance of payments strong and the evolution of prices relatively satisfactory - the authorities have on several occasions (November 1974, February and April 1975) increased public investment and transfer expenditure, while revising in a downward direction estimates of receipts. Thus, the net borrowing requirement will probably be about 5 billion florins greater (almost 3 % of G.D.P.) than the initial estimates. Only a part of this deficit will be financed by recourse to the capital markets.

In spite of the expected recovery in economic activity, the employment situation will still be unsatisfactory in 1976. In these circumstances a deficit which is considerably higher than the norm observed by the Netherlands in a medium term perspective seems acceptable. Gradually as the recovery continues, it will however be necessary to come closer to this norm. Taking account of the already heavy pressure of tax charges and social security contributions, it is implied that new expenditure which would significantly affect future exercises should be avoided in the 1976 budget or that such expenditure should be offset within the framework of the existing pluriannual programmes.

35. In Belgium, the 1975 budget was restrictive, involving mainly heavier taxation, having regard to the tensions present in the economy in the autumn of 1974. Its execution is being adapted to the new problems raised by the sudden decrease in employment possibilities, as much automatically in the form of net expenditure increases arising from unemployment as deliberately by economic support measures taken in the spring and aimed at stimulating investment. The net borrowing requirement will thus exceed the level initially estimated.

Because of the considerable slowing down in the growth of tax receipts expected for 1976 in spite of the hoped for recovery in economic activity, the net borrowing requirement will increase. Even though such a development is acceptable in the economic context forecast for this year, it will be necessary to restrict, as far as possible, public consumption and transfer payments. Furthermore, there should be a readiness to curb public works programmes and other stimuli in the event of an upturn in private investment involving greater recourse to the capital market. In this perspective and taking account of the growing impact on 1976 expenditure of the public works programmes adopted in 1975, fairly strict limits should be imposed on consumption and transfer expenditure.

36. The recession and, in particular, the serious fall in steel production will have had profound effects on the Luxemburg budget in 1975. In latter years this always showed a substantial surplus but now there will be a significant deficit resulting from a shortfall on the tax on corporations and the measures which have had - or will <sup>have</sup> - to be taken particularly to combat employment problems. Even in the absence of any measures to aid recovery, the budget will still be in net deficit in 1976. Taking account of the employment problems which could be caused by a continued weakness in activity, such a budgetary situation would seem acceptable especially since the reserves which the authorities have at their immediate disposal will assure its financing without great difficulty.

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37. In the United-Kingdom, the 1975-1976 budget should have an overall support effect on economic activity tending to limit the extent of the decline in activity expected up to the end of 1975. The restrictive effects of the tax increases on personal income and consumption should be more than compensated for by the impetus generated from the strong increase in public consumption and transfer expenditure and by the relief in company taxation. Overall, the budget will show a considerably larger borrowing requirement than the preceding year amounting to more than 7.5 % of G.D.P. It is plainly important that the financing of the larger deficit should not lead to an accelerated growth in the money supply and so avoid any danger of reinforcing the expansionary impact of the budget.

The expected improvement in the economic outlook for 1976 depends on the one hand on the timing and extent of the recovery of world demand and on the other, on the success of the incomes and prices policy to reduce inflation to the extent and within the time limits envisaged. Budgetary policy for 1976-1977 should therefore be aimed at supporting action to moderate the rise in prices and at encouraging the transfer of resources towards exports. To this end, it should attempt to reduce strongly the expansionary forces arising from public consumption, prevent any marked rise in private consumption and be strictly selective in its investment expenditure. This orientation means a very weak development in global expenditure in real terms and implies a reduction in certain expenditures, especially subsidies. A new adaptation of public charges to the rise in costs will be necessary to achieve this latter objective. If the effort to contain expenditure is satisfactory, the net borrowing requirement could be significantly lower in absolute terms without any overall increase in the tax burden.

ANNEX

Table I : CHANGES IN THE PRINCIPAL MACRO-ECONOMIC AGGREGATES IN THE COMMUNITY,  
THE USA AND JAPAN

Table II : CHANGES IN CONSUMER PRICES IN THE COMMUNITY AND IN MAJOR NON-MEMBER  
COUNTRIES SINCE 1973

Table III: INDUSTRIAL PRODUCTION AND UNEMPLOYMENT RATES

Table I

## CHANGES IN THE PRINCIPAL MACRO-ECONOMIC AGGREGATES IN THE COMMUNITY, THE USA AND JAPAN

	GDP (volume) (b)			Consumer prices (c)					Number of unemployed (d)			Balance of payments on current account (\$ '000 million)			
	Percentage change on preceding year					1973			1974			1975			
	1973	1974	1975	1973	1974	1975	1973	1974	1975	1973	1974	1975	1973	1974	1975(e)
DENMARK	4.2	1.6	½	9.2	15.0	10 1/2	20	45	90	- 0.5	- 1.0	- 0.5	- 0.5	- 1.0	- 0.5
GERMANY (FR)	5.2	0.6	-1½	7.3	7.3	6	273	582	1060	4.5	8.8	8.0	4.5	8.8	8.0
FRANCE	5.8	3.8	0	7.1	12.8	11 1/2	450	501	850	- 0.7	- 6.0	- 0.5	- 0.7	- 6.0	- 0.5
IRELAND	6.8	0.4	0	11.7	17.3	25	66	65	95	- 0.2	- 0.7	- 0.5	- 0.2	- 0.7	- 0.5
ITALY	6.2	3.4	-1½	11.5	19.6	18	668	560	700	- 2.4	- 7.8	- 2.5	- 2.4	- 7.8	- 2.5
NETHERLANDS	4.2	1.8	-1	8.9	10.3	10 1/2	117	143	195	1.8	1.4	2.0	1.8	1.4	2.0
BELGIUM	5.4	4.0	0	7.0	12.5	12	96	102	170						
LUXEMBOURG	7.5	4.5	-3	6.1	9.5	10	-	-	-	1.2	0.8	0.5	1.2	0.8	0.5
UNITED KINGDOM	5.4	0	1	8.5	15.0	19 1/2	630	637	860	- 3.1	- 8.9	- 6	- 3.1	- 8.9	- 6
COMMUNITY	5.5	1.9	-½	8.2	12.3	12	(2320)	(2635)	(4020)	0.7	-13.4	0.5	0.7	-13.4	0.5
U S A	5.6	-2.1	-4	5.6	11.4	8	4304	5076	9000	0.5	- 4	- 4	0.5	- 4	- 4
JAPAN	10.5	-1.8	1	10.7	21.2	10	670	720	.	- 0.1	- 4.5	- 1	- 0.1	- 4.5	- 1

(a) 1973: actuals; 1974: actuals and estimates; 1975: forecasts by the services of the Commission.

(b) Gross domestic product; gross national product for USA and Japan.

(c) National accounts implicit price deflators for private consumer's expenditure.

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

(e) Conversion based on the \$ rate of exchange for the first 5 months of 1975.

Table II

CHANGES IN CONSUMER PRICES IN THE COMMUNITY AND IN MAJOR  
NON-MEMBER COUNTRIES SINCE 1973

	Dec. 1973 to June 1974		June 1974 to Dec. 1974		Nov. 1973 to May 1974		Nov. 1974 to May 1975		1975					May 1974 to May 1975				
	% increase over six months									% increase on preceding month							%	
										Jan.	Feb.	March	April	May				
DENMARK	7.9	7.0	7.8	3.7	0.1	0.3	0.8	0.3	0.3	0.3	0.8	0.3	1.3	1.3	11.8			
GERMANY (FR)	3.5	2.3	4.0	3.6	0.9	0.5	0.5	0.8	0.5	0.5	0.8	0.8	0.6	6.1	6.1			
FRANCE	8.4	6.2	7.9	5.2	1.1	0.8	0.8	0.9	0.8	0.8	0.8	0.9	0.7	12.1				
IRELAND	10.4(1)	8.7(2)	10.4	14.6	8.5(3)	8.5(3)	8.5(3)	8.5(3)	8.5(3)	8.5(3)	8.5(3)	8.5(3)	6.1(3)	24.5				
ITALY	10.9	12.3	10.9	6.0	1.2	1.5	0.1	1.3	1.3	1.3	0.1	1.3	0.8	19.7				
NETHERLANDS	5.5	5.0	5.6	4.8	0.6	0.3	1.5	1.2	1.2	1.2	1.5	1.2	0.6	10.1				
BELGIUM	8.3	6.8	8.1	5.6	1.1	1.1	0.7	1.1	1.1	1.1	0.7	1.1	0.8	13.7				
LUXEMBOURG	6.1	4.9	6.8	4.8	0.7	1.5	0.7	1.2	1.2	1.2	0.7	1.2	0.6	10.1				
UNITED KINGDOM	10.8	7.5	10.5	16.8	2.6	1.7	2.0	3.9	3.9	3.9	2.0	3.9	4.2	25.0				
COMMUNITY	7.6	6.4	7.8	7.3	1.3	0.7	0.9	1.6	1.6	1.6	0.9	1.6	1.4	14.3				
UNITED STATES	6.1	5.8	5.7	3.2	0.5	0.7	0.4	0.5	0.5	0.5	0.4	0.5	0.4	9.5				
CANADA	6.6	5.4	5.8	4.1	0.5	0.8	0.5	0.5	0.5	0.5	0.5	0.5	0.8	10.1				
JAPAN	12.5	8.4	11.9	5.2	0.5	0.3	0.8	2.3	2.3	2.3	0.8	2.3	0.7	14.1				

(1) Nov. 1973 to May 1974.

(2) May 1974 to Nov. 1974.

(3) Ireland: quarterly rate; Nov.-Feb. and Feb.-May.

Source: National statistics.

Table III

## INDUSTRIAL PRODUCTION AND UNEMPLOYMENT RATES

	INDUSTRIAL PRODUCTION (1) (% change on preceding quarter) (2)				UNEMPLOYMENT RATE (4) (Number of unemployed as % of civilian labour force)					
	1974				1975					
	I	II	III	IV	I (3)	IV	III	II	I	
Denmark	-	-	-	-	-	-	2.6	1.7	2.8	4.0
Germany (FR)	- 0.6	+ 0.3	- 2.6	- 3.9	- 2.3	- 3.9	2.7	2.1	3.1	3.7
France	+ 2.0	+ 0.4	- 1.5	- 3.1	- 4.2	- 3.1	2.5	2.1	3.0	3.2
Ireland	+ 4.9	- 2.4	- 2.4	-	-	-	6.6	6.1	8.0	9.0
Italy	- 0.7	+ 0.4	+ 1.2	- 9.7	- 2.3	- 9.7	5.3(5)	5.1(5)	5.1(5)	5.4(5)
Netherlands	- 0.1	+ 0.2	+ 2.0	+ 0.5	- 5.0	+ 0.5	3.2	2.9	3.5	3.9
Belgium	+ 6.0	+ 1.5	- 2.6	- 2.8	- 4.5	- 2.8	3.2	2.9	3.6	4.3
Luxembourg	+ 3.5	- 2.8	- 0.8	- 5.1	- 10.2	- 5.1	0.0	0.0	0.1	0.1
United Kingdom	- 6.1	+ 4.8	+ 0.5	- 2.1	+ 0.9	- 2.1	2.7	2.3	2.8	3.0
Community	- 1.2	+ 1.4	- 1.1	- 3.7	- 2.3	- 3.7	3.2	2.8	3.4	3.8

(1) Excluding construction, food, beverages and tobacco, Ireland: mining and manufacturing industries. Denmark: no similar data available.

(2) Calculated on the basis of the seasonally adjusted indices of the SOEC. Ireland: OECD figures.

(3) Estimates.

(4) Figures for the final month of each quarter, seasonally adjusted by the SOEC.

(5) Ministry of Labour Statistics.