COMMISSION OF THE EUROPEAN COMMUNITIES

COM(76) 557 final.

Brussels, 20 October 1976.

ANNUAL REPORT ON THE ECONOMIC SITUATION IN THE COMMUNITY

(proposal by the Commission to the Council)

COM(76) 557 final.

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PROPOSAL FOR A DECISION

Adopting the annual report on the economic situation in the Community and laying down the economic policy guidelines for 1977

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the treaty establishing the European Economic Community,

Having regard to Council Decision 74/120/EEC of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community (1), amended by the Council Decision 75/787/EEC of 18 December 1975 (2), and in particular article 4,

Having regard to the proposal from the Commission,

Having regard to the Opinion of the European Parliament,

Having regard to the Opinion of the Economic and Social Committee,

Taking into consideration that, in adopting the Council Decision 76/646/EEC, on 26 July 1976 (3) the Council approved the analysis of the economic situation set out in the Communication of the Commission of 23 June 1976 concerning in particular the preparation of the public budgets for 1977; that according to this decision, the Member States pursue policies in conformity with the guidelines on the preparation of the public budgets for 1977 which are specified in the Annex of the said Decision,

Taking into consideration that the tripartite conference held in Luxembourg on 24 June 1976 carried out a thorough discussion of the problem of employment and stability in the Community, the conclusions of which were given in a joint statement (4) ,

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(1) OJ No L 63, 5.3.1974, p. 16

(2) OJ No L 330, 24.12.1975, p. 52

(3) OJ No L 229, 20.8.1976, p. 1.

(4) OJ No C 173, 28.7.1976, p. 1

HAS ADOPTED THIS DECISION

Article 1

The Council adopts the annual report on the economic situation in the Community shown annexed under I, II, III and lays down the guidelines to be followed by each Member State in its economic policy for 1977, as shown annexed under IV and V.

Article 2

This decision is addressed to the Member States.

FOREWORD

Under Article 4 of its Decision 74/120/EEC of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community, as amended by its Decision 75/787/EEC of 18 December 1975, the Council, acting on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, is required, during the fourth quarter, to adopt an annual report on the economic situation in the Community and to set the economic policy guidelines to be followed by each Member State in the following year. Once the report has been adopted by the Council, the governments must bring it to the attention of their national parliaments so that it may be taken into account in budget debates.

The guidelines contained in this report may have to be adjusted to take account of economic developments when the Council carries out its subsequent examinations of the economic situation.

I. THE SCALE OF THE RECOVERY IN 1976 AND THE CURRENT ECONOMIC SITUATION

Recovery under way, but imbalances continue

1.1. The most severe post-war recession reached its low point in the second half of 1975. The efforts made within the Community and in coordination with other industrialized countries to revive domestic demand have been supported by spontaneous expansionary factors, by increased confidence on the part of individuals and firms, and by a vigorous expansion in international world trade. The growth of trade has helped to consolidate the recovery, especially because the Community and the other industrialized countries, contrary to what many had feared, in general avoided protectionist measures or "beggar-my-neighbour" policies during the world recession.

The upturn in demand and output has not, however, allowed the divergences in price and cost trends in Member States to be reduced sufficiently, nor has it prevented the reappearance of balance of payments disequilibria in a number of countries. The recent signs of an almost general slackening in the upward movement of labour costs are, indeed, encouraging, but it is not certain that this improvement will continue. Besides, underlying inflation still remains too strong. As for the situation on the labour market, it is improving only slowly and in only a few of the Member States, while continuing to deteriorate in many countries compared with the situation last year.

Slowing in rate of expansion

1.2. The path of economic activity turned upwards towards the middle of 1975. Until the spring of 1976, industrial output rose very rapidly in almost all Member States. But since then, however, its rate of expansion has lost a good deal of momentum turning to stagnation in some cases. This pause can be partly explained by the loss of dynamism in certain sectors such as in stockchanges and demand in the motor vehicle industry, but is also due to the slow growth of private consumption and the continued weakness of fixed investment.

Divergent developments from one sector to another

The rate of recovery in industrial output has differed from one sector to another. Growth has been buoyant in the case of raw materials, intermediate goods, and consumer goods but has been weak for capital goods (1). Overall, industrial output in the Community in August 1976 was 10½% up on its lowest level recorded during the recession. However, it is still about 4% below the record level of 1974.

Growth rate of 5% in 1976

Compared with the preceding six months, and at an annual rate, the Community's real gross domestic product rose by approximately 2½% in the second half of 1975 and by 6½% in the first half of 1976; it will probably show an increase in the region of 4% in the second half of the year. For 1976 as a whole, the growth rate is expected to be some 5% compared with a contraction of 2½% in 1975.

The improvement in the economic situation in the Community has varied in timing and strength from country to country. The annual rate of expansion in real gross domestic product between 1975 and 1976 ranges between about 3% (Luxembourg and United Kingdom) and some 6% (Federal Republic of Germany (2). At the regional level these developments have resulted in increased divergences between the most prosperous and the poorest regions in the Community.

1.3. In **several** Member States, the economic recovery has brought to a halt the deterioration on the employment front. Almost everywhere, short-time working has been largely eliminated, while the number of hours actually worked have lengthened in some sectors. By contrast, the scope for productivity gains available in the wake of the recession, and the substantial expansion in the labour force in several countries has hindered any improvement as regards the number of wholly unemployed. The seasonally adjusted **number** of wholly unemployed, which stood at some 5 million at the end of last year, or 4.7% of the labour force, fell slightly in the first half of the year,

(1) See table 2.

(2) See table 3.

but it should be noted that this improvement is almost entirely attributable to developments in the Federal Republic of Germany and France. Since the spring the number of wholly unemployed has risen as a result of the arrival on the labour market of a large number of school-leavers, with the result that by August 4.9 million people were out of work, or 4.6% of the available labour force (seasonally adjusted figures) (1). The number of young people unemployed is at present (early autumn) put at more than two million, a figure much higher than that recorded a year earlier, notably due to the situations in the United Kingdom and Italy. In several Member States, the number of women out of work has also climbed sharply in 1976, because one result of the recovery has been that persons made redundant during the recession, who had left the labour market, are now seeking jobs once again. Generally unemployment rates have remained substantially greater in the economically weak regions of the Community than in the more prosperous regions, although in the latter there has been in some cases a relatively marked increase in unemployment.

Slowing in private consumption

1.4. After making a substantial contribution at an initial stage to the reversal in the cyclical trends within the Community, private consumption has been expanding at a more moderate rate since the beginning of the year. It is still being pushed up by a fall in the savings ratio, which has returned to its long-term trend level in several countries. By contrast, the slower growth in real disposable income has, in most Member States, had a dampening effect on personal spending. The slackening in the rate of increase in wages has, in almost all countries, not been entirely offset by the rise in the total number of hours worked. In addition, there has been a less rapid expansion in transfer incomes. For 1976 as a whole, France will probably show the greatest improvement in real gross income per person in paid employment; in Ireland, the Netherlands, Luxembourg and United Kingdom no increase or even a slight fall is expected.

Although personal spending has still been boosted by replacement needs built up during the recession, particularly of motor cars, their impact is bound to have lessened during the year.

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(1) See table 3.

Following the high level reached at the beginning of the year, private consumption in the Community is expected to expand in real terms during 1976 by more than 3%, as against just over 1½% in 1975.

Investment climate still lukewarm

1.5. In spite of the incentives introduced and the quite general tendency for wages, expressed as a proportion of gross domestic product, to fall, the propensity to invest has remained weak in most Member States. In fact, the improvement in profits has mostly been only gradual and has mainly been used to reduce the short-term indebtedness of businesses. Moreover, in most industries production capacity is still not being used fully, and there is uncertainty as to the general business outlook. For the year as a whole, real gross fixed capital formation is expected to rise only in Denmark, the Federal Republic of Germany and France, that is to say generally in those countries where investment in building and construction has picked up. In most other Member States, the volume of fixed investment is expected to remain below last year's level, so that the Community as a whole will record a modest growth in this demand component of 1½% in 1976, following a decline of 5½% in 1975.

Recent slackening in the rate of inflation

1.6. The factors, first apparent in 1975, making for a slowdown in inflation and a greater convergence of developments within the Community were abruptly checked last winter. The increase in the prices of imported agricultural goods and raw materials, to which currency depreciation has in some cases contributed, was a key factor in the upsurge in both producer and consumer prices in several Member States. Since April, however, the combined impact of more fundamental factors - primarily the slowdown, significant in some countries, in the rate of increase in labour costs and favourable seasonal factors - has helped, a great deal in some cases, to reduce the rate of increase of consumer prices.

In the Community as a whole it slackened to about 8% at an annual rate from April to August 1976, compared with a rise of about 14% from December 1975 to April 1976. It must, however, be assumed that this improvement will not continue during the final months of the year, given the rise in wholesale prices. For the full year, the increase in consumer prices in the Community can be put at over 10%, as against 12.2% in 1975. The anticipated rise of 5% in the Federal Republic of Germany compares with a 16% increase in the United Kingdom and from about 17 to 18% in Ireland and Italy, with increases of between 9% and 10% being recorded in the other Member States (1).

Sharp recovery in the world economy

1.7. In the early months of 1976, the United States' economy continued to expand briskly and the economic upturn in Japan became more firmly established. In most of the non-member countries in Europe the recovery lagged several months behind that in the larger economies; it was boosted by the expansion in sales by these countries to the Community. During the spring and summer months, output continued to rise almost everywhere; however, the rate of this expansion proved to be less sustained than at the beginning of the year, particularly in the United States and Japan. Since, in 1976, the rate of growth in real gross product will exceed 6½% in the United States (2), it is expected to reach about 5½% for the developed countries as a whole.

... and in international trade...

1.8. As output recovered, the volume of the industrialized countries' imports rose strongly from the middle of 1975. Stock rebuilding in these countries has triggered a greater demand for raw materials. Purchases of oil, particularly by the United States, have begun to increase once again; this has further boosted the current account surpluses of the OPEC countries, whose own imports have

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(1) See table 4.
(2) See table 7.

risen much more slowly since mid-1975. The non-oil-producing developing countries are themselves reaping the benefits of a recovery in export demand and the rise in commodity prices. Nevertheless, in spite of this improvement, they are still running substantial current account deficits which restrict their scope for stepping up imports. Lastly, the purchases of state-stading countries would seem to be marking time. Overall, the volume of world imports - excluding the Community's imports - will probably grow by around 9% in 1976 (-2% in 1975).

...triggering a recovery in exports

1.9. Export demand has played an important role in the short-term development of the economies of the Community during both the recession and the recovery. According to estimates made by the Commission's services on the net impact of exports to the growth of gross domestic product, which take into account the effects of both domestic and international trade multipliers, almost half of the fall in the Community's real gross domestic product in 1975 can be attributed to the simultaneous contraction in trade among the industrialized countries while almost a third of the foreseeable expansion in 1976 is expected to be accounted for by the growth in exports. For each Member State intra-Community trade has a slightly greater impact than demand from the other OECD countries.

Deterioration in the payments balances of all the deficit countries

1.10. The Community's trade deficit continued to increase during the first half of 1976 (1). However, the deficit is now increasing more slowly with the weakening of the initial surge of imports, and the reduction in the rate of deterioration of the terms of trade. The Community's current account deficit has been seriously influenced in 1976 by the drought, and it is expected to rise to about $ 7 000 million compared with a surplus of $ 600 million in 1975 (2).

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(1) See table 5.
(2) See table 1.

This overall development marks considerable divergencies as between one country and another. For most of the deficit countries differences in the development of prices and costs have been reflected, since the beginning of the year, in a deterioration in exchange rates, the short-term perverse effects of which have again aggravated the difficulties, in some cases, on the external front. In fact, the expected deterioration in the Community's current account balance between 1975 and 1976 will be mainly attributable to the deficit countries, whose combined deficit is likely to have roughly doubled.

II. THE ECONOMIC POLICIES IMPLEMENTED IN 1976

Adjustments to short-term economic policy...

2.1. The problem of the direction and intensity of conjunctural policy has become more difficult in 1976. The recovery has concealed only temporarily the serious underlying questions still to be solved. Since the beginning of the year the differences persisting between countries in price, cost and balance of payments trends have constantly led to further strain on the foreign exchange market which, despite the insufficient reduction in unemployment, obliged several Member States to make their short-term economic policy stance restrictive.

... to contain the widening of public deficits

2.2. In August and September 1975, important measures for supporting economic activity were introduced by five Member States. Early in 1976, similar limited measures in the budgetary field were again taken in the Community. Since March the emphasis has, however, been on decisions aimed at containing public deficits. Ireland and Italy in particular have been led to limit their budget deficits as part of the action to promote financial solidarity introduced by the Community. Measures aimed to restrain expenditure have also been taken in the United Kingdom. The economic upswing helped to slow down the growth of public expenditure fairly generally, and in some cases on an appreciable scale, and to increase revenue more rapidly than in 1975. As a proportion of national income, budget deficits in all the countries, except the Netherlands, will be lower than in the previous year. France and the Federal Republic of Germany are, however, the only countries where the deficits will be really substantially reduced(1).

(1) See table 6.

More cautious monetary policy

2.3. In the autumn of 1975, when the tentative signs of economic recovery had been confirmed, the deliberately expansionary character of monetary policy was changed to a cautious stance. Since last spring monetary policy has followed a more restrictive course in most of the Member States.

Still rapid growth of liquidity

At the beginning of the recovery, the money supply had increased at a rapid rate under the influence of heavy budget deficits. Despite the introduction of a more cautious monetary policy and the reduction in the public sectors' financial requirements, the expansion has only slowed in a small number of cases. Until now demand for personal credit has shown an appreciable recovery mainly in the Federal Republic of Germany and, more recently, in the United Kingdom.

Recovery of interest rates

Short-term interest rates had been falling in the Community in 1975, but this development generally ended in the closing months of the year. The monetary unrest then contributed to reversing the path of interest rates. In Denmark, Italy and the United Kingdom short-term interest rates reached record levels at the beginning of the autumn. As for long-term interest rates, they have slightly increased since last spring.

Strains on the foreign exchange markets

2.4. The relative stability of exchange rates recorded during the recession came to an abrupt end early in 1976. Despite subsequent adjustments to short-term economic policy in the Member States whose currencies were tending to depreciate, the situation remained difficult thoughout the summer. Only the lira, following the deposit requirement imposed on purchases of foreign currency and other measures which brought a rise in interest rates, became firmer temporarily, but it was then subjected to a further downward movement. The significance of exchange rate strains is all the greater in that they occurred despite large-scale central bank support measures. During the first half of 1976 exchange rates between the dollar and the currencies within the Community exchange rate system displayed relative stability. Since then the latter have shown a tendency to appreciate.

Search for a social consensus to overcome inflation

2.5. The efforts made by the governments to moderate the rise in incomes and prices benefited in some Member States from the support and cooperation of the two sides of industry; in others, however, more or less mandatory measures proved unavoidable. After several years in which wages had moved up sharply, there has been a distinct slowdown in the trend in 1976, except in France and Italy.

Active policy on the labour market

2.6. Most Member States have resorted to a very wide range of employment policy instruments so as to make up for the lag before the recovery in the economic situation affects the labour market. In general terms, policy has continued to favour the protection of incomes of those unemployed, the prevention of large scale redundancies and the selective granting of employment subsidies, rather than the improvement of professional training and of labour mobility.

III. THE ECONOMIC OUTLOOK FOR 1977 AND ECONOMIC POLICY PROBLEMS

3.1. The very rapid expansion which characterised the initial phase of the recovery in the Community has been succeeded during the last few months by more moderate economic activity, owing to the disappearance of certain stimuli.

This moderation suggests that the risks of a boom in the domestic as well as in the primary-products markets have been avoided, creating an improved basis for stable growth. On the other hand, there are uncertainties about future developments which are at present very difficult to assess.

3.2. A number of factors suggest that the economic upswing will continue:

- the most recent EEC surveys have confirmed that consumer confidence has strengthened;
- social conflicts have become substantially less acute, while the cooperation of the social partners is beginning to bear fruit;
- the rise in prices and in labour costs has become less rapid, except in certain special cases;
- the productivity and profits of firms have improved in a number of industrial sectors; as a result of this, the likelihood of a recovery in demand originating in industry has improved;
- the improvement in world trade is continuing. Most Member States are at present benefitting from the strong expansion of world imports.

3.3. The slowdown seen in recent months could thus be only temporary; however, a more confident assessment of the prospects for a continuation of the growth phase into 1977 must depend on the trends which emerge during the autumn. In any case it is accepted unanimously within the Community that greater stability of prices, a reduction in balance of payments deficits and a halt to the deterioration in exchange rates are key conditions for the achievement of durable growth.

Several Member States have recently introduced - in part to contend with widening balance of payments deficits - programmes to fight inflation and rising costs, and also restrictive measures in the monetary field. These decisions carry with them the risk of braking the expansion of domestic demand and, so, of economic activity. It is not yet possible to evaluate the impact of these stabilization programmes, or of actions of this kind which might yet be introduced, on short-term economic developments in the countries involved and in the other Member States. The fragility of the expansion has its source essentially in the hesitant development of investment demand. Fears of new monetary disturbances and of a further rise in raw materials prices produce uncertainty which could undermine the confidence of businessmen and the growth of international trade.

3.4. In present circumstances it seems probable that the growth rate of real gross domestic product on average in the Community could attain 4% in 1977, providing the favourable influences continue at work. The volume of private consumption should continue to grow, given that the increase in incomes and the slowing of price increases reinforce consumer confidence. In most Member States, investment in equipment could begin to rise gradually and to an extent which will vary from country to country and from one industry to another. Construction, both of industrial and commercial buildings and of dwellings, will also continue to expand. Stock formation will, in general, no longer continue to stimulate output. In the majority of the Community countries, external trade is expected to impart the greatest stimulus to activity. Exports to non-member countries could increase in volume at the same rate as intra-Community trade, that is by about 10%.

3.5. In the developed countries outside the Community, the rate of growth of production in 1977 should be slightly above the longer-term average. In the United States, economic expansion is likely to continue next year but at a slower rate ($5\frac{1}{2}\%$). A recovery of activity is expected in Japan as well as in most of the smaller economies, in which the beginning of the recovery was hesitant. A rate of growth of 5 to $5\frac{1}{2}\%$ of real gross domestic product for the developed countries outside the Community can be foreseen for 1977, as against $5\frac{1}{2}\%$ in 1976. Most of the developed countries, with the exception of the United States, can be excepted to experience a more rapid growth in the volume of their imports next year. The progressive improvement in the export revenues of the non-oil-producing developing countries should permit a recovery in their imports. In total, the volume of world imports (excluding EEC imports but including those of the Eastern countries) should increase by about 8-9% in 1977 (1). Moreover, one should expect further price increases for industrial raw materials in 1977, as a result of the continued upswing in world economic activity. In most regions in the world, with the exception of those European countries hit by the drought, the harvests of the principal crops appear to be relatively good. The size of food price increases within the Community will thus largely depend on the decisions taken under the agricultural policy.

3.6. Given the reserves of capacity which still exist in most Member States, together with further additions to capacity, the growth of total output in the Community, estimated at about 4%, seems likely to lead to only a slight increase in employment in 1977. The unemployment rate in the Community could fall to a little below 4% of the labour force which, for most of the Member States, would not represent an adequate improvement. The number of wholly unemployed in the Community would still be at least as high as in 1975.

(1) See table 7.

The outlook for the rate of inflation depends essentially on the success of economic policy and the attitude of the social partners. In the absence of determined action by the Member States, already taken in certain cases, it is to be feared that in 1977 the rise in consumer prices for the Community as a whole would be scarcely less than the rate recorded for this year. The repercussions of the drought on agriculture and any further currency depreciations and import price increases could accentuate this problem.

Continued inflation of this magnitude would be unacceptable. Not only would it undermine the economic recovery, but it would threaten the cohesion of the Community and would give a durable character to the differences in the development of prices and costs within the Community.

3.7. The continuation of the economic recovery, the worsening of the terms of trade and the delayed effects of the 1976 drought will be reflected again in 1977 by a deficit in the balance of payments on current account of the Community. This deficit will only be smaller than in the previous year if import demand in the deficit countries tends to slow and if world demand mains buoyant. The current account surplus of the OPEC countries may grow larger in 1977, while the deficits of the non-oil-producing developing countries and the state-trading countries will tend to decline. In these circumstances the developed countries of the Western world must accept for 1977 as a whole a current account deficit greater than in 1976, if stagnation of world trade, which would particularly effect the Community, is to be avoided. The efforts made by most Member States to reduce their balance of payments deficits could thus meet with success only if the other Community countries reduce their surpluses, and if developed countries outside the Community, more particularly the United States and Japan, accept corresponding deficits. Community solidarity requires henceforth that the process of adjustment within the Community should be helped by :

- the coordination of aggregate demand management, with a view to restraining the growth of consumption in the deficit countries and strongly increasing import demand in the surplus countries;
- the provision of funds for financing, if the adjustment process within the Community were to appear too slow, of if the other developed countries were not prepared to accept large deficits.

IV THE GUIDELINES FOR ECONOMIC POLICY

A. General guidelines

4.1. The governments, the representatives of unions and employers' organizations in the member countries, together with the Commission, resolved, at the end of June 1976, to implement a common strategy with the aim of reaching the following medium-term targets (1):

- the simultaneous restoration of full employment and stability as a matter of priority;
- the annual rate of real growth of the domestic product of the Community should average around 5% in the period from 1976 to 1980;
- full employment should be reached by 1980;
- in all Member States the annual rate of inflation should be reduced gradually to between 4 and 5% by not later than 1980.

4.2. The guidelines for the medium-term which correspond with these targets were the subject of the fourth medium-term economic policy programme, recently submitted to the Council. The Community must establish, for 1977, an economic policy which is compatible with these medium-term targets and attempt to reduce the wide disparities in the rate of increase of costs and prices between member countries.

4.3. In 1976, member countries were able to register some initial success in their struggle against the world-wide recession. It is, however, to be deplored that the position in the labour market has improved only very slowly, that the rate of inflation has scarcely fallen, and that the divergences in price and cost trends in the Community have hardly lessened.

As things stand at present, the economic outlook for 1977 suggests that the rate of growth, in real terms, of gross domestic product of the Community will be somewhat below the medium-term growth target.

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(1) Joint declaration adopted at the conclusion of the Tripartite Conference on employment and stability in the Community, held on the 24th June 1976 (O.J. of the European Communities, No L 229, p. 1, of 20.8.1976).

The experience of the initial stage of the recovery has served to highlight, in several member countries, the persistent nature of inflationary expectations, of the growth of costs and of the external disequilibria, and the handicaps which these factors impose on the growth of total demand. It is possible to imagine that, in certain member countries, a conflict will arise, in 1977, between, on the one hand, the need to reduce the rate of inflation and the balance of payments deficit, and, on the other hand, the need to strengthen the economic recovery and to improve the employment situation. If the present weakness in economic growth happened to co- incide with the effects of stabilisation programmes introduced in member countries, the result could be a cumulative c ontraction of external demand. It would, however, be just as mistaken, in present circumstances, to expect that some stimulus to demand and production would produce quick results in the battle against unemployment. It is highly unlikely that the risks inherent in a policy of economic "stop-go" and in a worsening of the overall economic equilibrium would be adequately rewarded by the short-term advantages of a forced expansion of demand. Eventually, every member state could be affected by spreading stagflation, as the example of the world recession of 1974-1975 has shown.

If, in the present situation, it becomes impossible to avoid the threatening conflict between objectives, the difficulties may nevertheless be lessened:

- by overall coordinated intervention both on a Community and world-wide scale;
- by a better appreciation, by the social partners, of the macro-economic possibilities;
- by an active employment policy combined with measures which encourage structural change.

4.4 The overall approach to the Community economy in 1977 must be such as to ensure that the expansion in domestic demand, in those member countries where there are no payments constraints and where a further slowdown in price increases is likely, is not hampered. This could necessitate a rather cautious reduction in budget deficits of the countries concerned and also the use of specific measures for job creation and the provision of training places especially if, contrary to expectations, investment demand fails to pick up reasonably vigorously in the months ahead (1).

In those member countries faced with high underlying rates of inflation, sizable payments deficits, and the threat of a vicious circle of monetary depreciation and rising prices, economic policy must be used to impose some constraints on consumer demand and to make the most of the stimuli provided by export demand. The stance of domestic economic policy can be less restrictive to the extent that export demand proves to be stronger, and that the reduction in the rate of price and cost inflation is achieved more quickly. Nonetheless, it would be dangerous for all the Member States to consider the expansion of their exports as the principal factors supporting economic activity in 1977.

4.5. In almost all member countries, the return to price stability should have high priority. As far as the United Kingdom is concerned, it is envisaged that the present phase of incomes policy will continue to slow down the rise in prices, in so far as this policy is not thwarted by new exogenous disturbances. In France, the implementation of the stabilisation programme decided last September should lead to a significant reduction in the rate of inflation. If member countries made the necessary effort, the annual rate of increase in consumer prices, on average for the Community as a whole, could be reduced to a rate of 7 to 8% in 1977 and the divergence between rates of inflation in individual member countries could be significantly reduced. In fact, however, the deceleration of price inflation is likely to be less sharp than this, as indirect taxes and charges for public services are to be raised in certain Member States.

4.6. Monetary policy must play a central role in the steps to be taken to reduce inflationary expectations and to moderate cost and price increases. In almost all member countries, the growth of the money supply remains much

(1) It is appropriate to recall, in this context, the obligations of Member States to set five year public investment programmes (cf. the Council directive of 18.2.74 concerning stability, growth and full employment in the Community, article 6).

too fast to be consistent with the target of reducing the annual rate of price increase to between 4 and 5 per cent by 1980 at the latest. The prior notification by the Member States of targets for the growth of the money supply should exert a stabilizing influence on companies and households in particular with regard to their production, investment and savings decisions and on the behaviour of the social partners. For each Member State, the following common criteria for the expansion of the money supply in 1977 should be adopted, taking into account any expected changes in the velocity of circulation:

- a real rate of growth, consistent with medium term targets, that would allow an appreciable increase in the utilisation of capacity;
- a rate of price increase that would allow the rate of inflation to be progressively reduced to an annual rate of change of between 4 to 5% by 1980 at the latest.

As the initial situation in each country is different, these quantitative guidelines will necessarily also differ and should be defined in relation to the various instruments of monetary policy that are available in the various Member States (central bank money, M_2 or M_3, or total credit). If need be, they should be the subject of an adjustment on the occasion of the first examination of the economic situation next March. The governments and central banks must work closely together to assure as close a correspondence as possible between the orientation of their budgetary and monetary policy and the targets for the growth of the money supply. The continuous and progressive alignment of the money supply growth targets for the various member states could contribute significantly towards stabilising both present and anticipated exchange rate movements.

4.7. The policy on competition is a necessary instrument in the fight against inflation. The proposal from the Commission concerned with ensuring at the Community level more systematic control of major mergers (1), should be discussed and implemented as soon as possible. It is also a suitable time to intensify efforts to improve the transparency of the market and the process of price determination particularly through consumer information.

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(1) Proposal for a regulation (EEC) to the Council on the control of mergers. Doc COM (73) 1210 final of 18 July 1973.

4.8. In order to be able to reduce the large budget deficits in some Member States, it is necessary to increase indirect taxation, as is already foreseen in some Member States, and, in certain cases, to allow an adjustment of public sector charges to reflect the increases in costs already sustained. The effect of these measures on prices - at least those which represent higher indirect fiscal charges - should not be compensated for in wage and salary increases. This implies changes in the indexation provisions for wages and other incomes in certain countries.

4.9. The recovery of investment constitutes, for all the Member States, the essential problem as far as the strengthening of domestic demand, in 1977, and the creation of employment opportunities, are concerned. Government measures in this area can only have a limited scope and effect. An adequate improvement in the profitability of enterprises and in sales, both immediately and over coming years, can alone ensure a continued expansion of fixed investment. The investment climate will be determined by the attitudes of the social partners in the course of the forthcoming renewal of collective agreements. The room for manoeuvre for macro-economic policy will be the greater to the extent that the social partners have taken account of macro-economic imperatives. Wage and salary agreements should be reached taking into account, not past rates, but rather the target rates of inflation. In circumstances in which actual inflation exceeds the target, additional compensation should be added to the agreed settlement. Incomes policies should include elements of a policy on the distribution of wealth.

4.10. The employment situation should improve as a result of increased capacity utilisation. However, at a later stage in economic development, this improvement will be hindered by the effect of certain factors. In all Member States, the working population will grow at a faster rate than previously due to demographic changes. On the other hand, in the present phase of the recovery, the hiring of workers is adversely affected by the uncertainties which surround the economic outlook and by the unfavourable effects of measures designed to make the shedding of labour more difficult. As the use of general budgetary measures to stimulate the economy carries too great a risk of inflation, the improvement in the employment situation must be sought essentially by a restructuring of government expenditure in favour of outlays which permit some direct or indirect stimulation, as selective as possible, of job-creating investment. The creation of new jobs and of training places could be temporarily encouraged by employment premiums adjusted to take account of the regional situation. But it would be mistaken to seek to counter the needed adjustments by means of subsidies or protectionist measures. All Member States should develop employment policy (retraining assistance, professional training, labour mobility, etc.) in order to gradually reduce structural unemployment and to facilitate the adjustment of workers in certain professions and in certain age groups to the changes that have occurred.

4.11. Global regulatory instruments are no longer sufficient, by themselves to conduct simultaneously the fight against inflation and unemployment, whilst bringing about the numerous structural changes which are required. These changes have become more and more necessary in the last few years. In countries with deficits, the redistribution of resources in favour of exports must be continued. In virtually all the countries of the Community, the long-term trend towards a weakening of investment by private firms should be reversed at the expense of consumer expenditure and it will be necessary to reduce the relative importance of public expenditure and wage costs which have shown excessive growth. The structural changes will be needed within the Community, in the relationships with countries which supply raw materials and with the less-developed countries. The solution to the problems of energy and of the environment, the fundamental changes in the relationship of prices and exchange rates, as well as the basic conditions of the world economy will mean intensive recourse to regional and sectoral factor mobility. Structural policy will have the task of stimulating transfers from structurally weak to strong sectors, while the onus on the Community institutions will be to facilitate these transfers at a Community level and to ensure that they are coordinated. The fourth programme of medium term economic policy of the Community should constitute the frame of reference for the realisation of the structural and social reforms in Member States.

4.12. Given that the recovery is still fragile and the need to reduce budget deficits, it is of the utmost importance that expenditure on regional development, as much at the national as at the Community level, geographic viewpoint is most likely to resolve the problems of structural unemployment. So as to preserve the cohesion of the Community and to move on towards further integration in a situation of weak investment, Community regional policy should be strengthened both as regards its financial means and as regards its regulatory instruments. The public expenditure policies of the Member States should be determined with more account taken of their likely impacts on regional development and in such a way as to increase their effectiveness at the Community level.

B. The guidelines for Member States

In Denmark, the deterioration in the current balance of payments, with the deficit reaching 6,000 million kroner in the first half of the year, and the prospect of the renewal of wage and salary agreements have led the authorities to reinforce the already restrictive stance of economic policy and, in particular, continue to maintain a strict incomes policy. The measures taken in August aim basically to limit the growth in nominal incomes and costs for the two coming years and restrain strictly the expansion in consumer demand. Although a slowdown in imports and a growth in exports can be expected, the latter, which depends on the buoyancy of world trade, may not be sufficient to give an additional impetus to private investment. Thus growth may be held back, reaching at most 3% for 1977 as a whole. For this reason the employment situation could tend to worsen.

Given that the increases in salaries and other incomes should not exceed 6% for each of the next two years, such a framework will have additional moderating effects on consumer price increases, which for 1977 as a whole should be below 8% (including changes in indirect taxation).

Budgetary policy, used as a supplementary instrument to incomes policy, relies principally on severe increases in indirect taxation as well as cutbacks in current and capital expenditure. However, conjunctural developments could lead to a lack of buoyancy in receipts as well as to supplementary expenditure. Thus, in order that the deficit for the 1977/78 financial year does not exceed the norm of 11,500 million kroner fixed last June it will be necessary to ensure that expenditure which is not automatically linked to conjunctural developments is maintained within the appropriate limits.

Having regard to this objective, monetary policy should endeavour to limit the expansion of domestic liquidity (M2) to a rate of growth slightly lower than that expected for gross domestic product in value (11 to 12% in 1977). In this respect it should endeavour to limit the monetary creation of the government and maintain the ceiling on bank lending within tight limits in such a way as to encourage firms to borrow externally. In addition, credit policy should be flexible and selective, by giving priority to export sectors.

In the Federal Republic of Germany the economic revival, which had developed considerable momentum in the initial phase, has continued at a calmer pace in the past few months. After slowing down a little in the summer, investment demand has picked up again recently, and export demand has continued to provide a very vigorous stimulus. Growth in private consumption, on the other hand, is still sluggish. Stockbuilding too, has been less buoyant.

With expenditure on consumption likely to rise and export demand buoyant, expansionary forces will probably strengthen again in the near future. However if steady economic growth is to be maintained, it is essential that the distinct improvement in company profits be safeguarded, and, sustained by favourable sales prospects, to be reflected in a lasting increase in investment activity. In the circumstances it should be possible for real GNP to grow by an average of at least 5% in 1977. Even under relatively favourable conditions for growth, the structural problems on the labour market will ease only gradually, so that selective measures are still necessary to reduce disequilibria in certain sections of the labour market. Despite a further rise in demand all groups involved in business activity should continue their efforts to curb the upward movement of prices. An attempt should be made, on the basis of the stabilization achieved so far, to restrict the average increase in consumer prices in 1977 to 4½% at the most.

The appropriate target for the expansion of central bank money should be below the rate of growth in value of gross domestic product (9-10%), because of the increase in the velocity of circulation, and should take into account the level of liquidity in the economy at the end of 1975.

With the economy moving further ahead, the policy of reducing the heavy structural deficits of the public authorities, particularly the Federal Government and the Länder, introduced in 1975, should be continued cautiously, thus gradually creating more room for the expected increase in the private sector's financing requirements. In trying to improve the budget structure, care should also be taken to see that public investment in real terms does not go on falling. The planned spending policy and the increase in revenue, mainly due to the economic upswing, should bring the combined Federal Government and Länder deficit - not including the planned increase in value-added tax - to well below the amount, some DM 50 000 million, expected for 1976.

In France, the major disequilibria which appeared in the course of the past recession have not yet been eliminated. The continued search for higher real disposable income both by salary and non-salary earners, while the national product is growing less rapidly is still generating rapid increases in costs. The rate of price rises no longer seems to be falling below its present, unacepptable, level. On external markets, the resulting deterioration in competitivity, on top of certain exogenous factors, is aggravating the trade deficit and so putting pressure on the franc, thus reinforcing domestic inflationary pressures.

The recovery in growth has not brought with it a solution to these problems. A cautious stance has been generally adopted : reserve with regard to consumption and a rapid increase in liquid saving, and sluggishness in investment being the most noticeable examples. Thus, a return to balanced and durable growth, particularly in areas of costs and employment, will necessitate a reorientation of economic and social policy designed to encourage confidence, by cutting back price rises and restoring external equilibrium, and satisfying aspirations for a more just distribution of income.

The series of measures adopted recently can point the French economy towards a marked slowdown in inflation and a re-establishment of external equilibrium. Indeed, they should permit:

- a quite rapid limitation in cost increases, currently the principal source of inflation, by limiting the overall growth in incomes;
- a recovery in investment;
- a progressive return to Government budget equilibrium and at the same time a redirection of public expenditure and a transformation of the tax system aimed at supporting economic activity;
- the improvement of the financial position of the social security system;
- a regulation of the rate of money creation in such a way as to avoid any restrictive effect;
- a limitation in imports by cutting back on oil purchases;
- a start in the restructuring of the tax system in order to bear more heavily on higher incomes and begin (by a reduction) to bring the rate of value added tax into line with the average applied in the Community as a whole.

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Overall, these measures are likely to result in a less rapid development in final internal demand : in this event the rate of increase in gross domestic product in real terms of 4½% in 1977 sought by the French Government will be more difficult to reach. The opportunities for a considerable reduction in the rate of increase of prices exist; the increase should not exceed 7 to 8% on an annual average basis, which is consistent with a 6½% increase in the course of the year. Finally, the improvement should be equally marked in so far as the balance of payments on current account is concerned.

It is important that this plan be put into operation with determination and continuity. The effective increase in central government expenditure should not exceed 13% and if necessary the appropriate measures should be implemented in order to prevent this norm being exceeded by the local authorities. The guidelines set for monetary creation in 1977 (M2 : +12.5%) should be respected. Finally, action aimed at adjusting the tax structure towards greater equity is indispensable.

In Ireland, growth should continue in the coming months, because of a relatively sustained progression of private consumption and exports and despite a persistent weakness of private investment. For 1977 as a whole the real growth rate of gross domestic product could be around 3%. Therefore, the employment situation should only improve slowly and the unemployment rate could remain high. Although weakening somewhat from the middle of the year the factors behind the rise in prices will remain undoubtedly relatively important, the delayed effect of the depreciation of the pound coming on top of the growth in internal costs. Despite a slower progression in the volume of imports, the current balance of payments deficit is unlikely to fall.

Under these conditions and with the aim of improving employment in the longer term, economic policy will have to be directed primarily at the fundamental problem of cost increases. To this end a strict incomes policy should be implemented with, as its objective, a substantial moderation of the rise in wages, salaries and other incomes in the course of the year. This would imply a year-to-year rise, which, including the carryover effect of increases granted in 1976, should not exceed 10%. Such a development would permit a reduction in the inflation rate for the year as a whole to around 13% and to 10% for the final quarter of the year. It will also be essential to set out now the lines of a more restrictive income agreement for 1978.

Budgetary policy will have to maintain, in this context, the restrictive orientation given to it in 1976 and ensure notably that the net borrowing requirement does not exceed about £700 million in 1977, thus registering a further relative decline. This guideline implies a strict limitation in the rate of growth of expenditure, which should be substantially below that of gross domestic product in value, or, should the occasion arise, by further fiscal measures.

In order to contribute to the reestablishment of equilibrium, monetary policy should aim in 1977 at keeping the increase in the money supply, (M3), below that expected for gross domestic product in value (±16%). Such a development would be facilitated by the less rapid growth in the financing requirement of the public sector, given that a sufficient proportion of these needs can be financed by non-monetary means.

In Italy, the conjunctural recovery progressed markedly in the first half of the year and during the summer of 1976. Employment increased and capacity utilisation has been much higher. At the same time, however, price rises have continued at a too rapid rate and in the first half of the year the balance of payments suffered a very substantial deterioration. Although the balance of payments was again in surplus in July-August, principally due to seasonal factors, and the price momentum slowed down in the middle of the year, external and internal equilibrium, as reflected in the new lira crisis at end September/beginning October, remained extremely fragile, while unemployment only fell slowly.

There is no doubt, if free rein were left to the spontaneous growth of internal demand, that there would be a risk of the reappearance of very strong strains on the balance of payments. Under these conditions and when account is taken of the low level of official foreign exchange reserves, the balance of payments constitutes a dominant constraint for economic policy. Accordingly policy should be extremely prudent and aimed, by an appropriate dosage of conjunctural and structural measures, at keeping within narrow limits the growth of internal demand while at the same time encouraging those investments which reinforce Italian international competitivity and reduce dependence on imports. This would have at the same time beneficial effects on the development of employment. In addition, housing investment, which is labour intensive and requires relatively little imports, should be supported.

In order to lay the foundation of a durable and balanced growth of production and employment, it is also essential to moderate the growth of unit production costs. In this context it is necessary to put into motion an incomes policy aimed at stability which would also have as a task the adaptation of the present system of wage indexation.

In the area of public finance, the conjunctural necessities as well as more long term considerations, set a particularly rigourous framework for budget management. It will be necessary firstly that the ceiling of 13,800,000 million lira, set by the Council last March for the net borrowing requirement of the Treasury, be strictly respected. Anything above this limit would create the risk of bringing with it a supplementary and totally ill-timed growth of the money supply. For 1977 the net borrowing requirement of the Treasury should remain within this limit in absolute figures and in so doing reduce further and substantially its magnitude in relation to gross domestic product. To this end it will not be enough to improve the efficiency of the fiscal system by acceleration the collection of arrears and intensifying the campaign against tax evasion. Selective increases in taxes and prices of public services are also necessary to increase State receipts or reduce expenditure on subsidies and, at the same time, put a brake on certaion consumption. Other savings should be looked for on the current expenditure side, to compensate partially for supplementary charges, related notably to the industrial adaptation plan and the increased assistance which will have to be given to local authorities and which, as far as possible, should correspond to improvements in administration. It will be essential in any case to aim to bring the rate of increase of budgetary expenditure markedly below the 25% expected for 1976. It will also be necessary to reduce substantially the proportion of Central Bank financing in the deficit.

In addition, in anticipation of the usually difficult period at the end of the year, the monetary authorities should ensure that the trend towards a particularly rapid expansion in liquidity is thwarted sufficiently in order to avoid serious difficulties on the foreign exchange market. It is also necessary to take account, by appropriate means, of the effect on liquidity of the progressive reduction, recently authorised by the Commission, of the obligatory deposits amassed with the Banca d'Italia for purchases of foreign currency.

The broad version of the money supply (M_2) should not be allowed to grow by more than 18 to 19% between 1976 and 1977. In addition, it seems necessary, having regard notably to the difficult situation of the balance of payments, to keep interest rates well above the rates ruling abroad.

The measures recently adopted and announced by the Italian authorities show that they see fully the necessity of directing economic policy on the lines traced above. These measures imply, principally, an increase in taxes and public service prices of some 4,000,000 million lira, half of which would be deployed in reducing the budget deficit and the remainder in increasing investment and employment. It is indeed essential to achieve such a reduction in the budget deficit and necessary to improve the structure of budgetary expenditure, by reserving as much as possible for investment purposes. It is also advisable, that these measures are reflected in a marked reduction in the relative share of monetary financing in the budget deficit.

Under these conditions, the growth of gross domestic product in volume between 1976 and 1977 will be necessarily a lot less rapid than that between 1975 and 1976. At the same time the rise in consumer prices should be limited to a rate equal or less than that of 1976, which, when account is taken of the effect on prices of increases in the prices of public services, implies a slowdown in the underlying inflation.

In the Netherlands, where economic activity levelled off in the first half of 1976 and where unemployment continued to rise until the autumn, the medium term employment outlook is unlikely to improve unless the rate of increase in labour costs slows down and productive investment becomes more profitable. Consequently, the main economic policy goal must be the establishment of the conditions for a significant turnaround of the recent trends in these areas. In 1977 a growth in gross domestic product of about 4½ per cent, an increase in consumer prices not higher than 7 per cent and a rise of 8 to 8.5 per cent in wage earnings per head - goals consistent with those of the national authorities - would simultaneously improve the medium term outlook and reduce divergences within the Community.

Since the current level of unemployment is largely attributable to structural factors and cannot be reduced by overall measures to stimulate demand, budgetary policy should aim at stimulating investment and consequently employment. This would necessitate a gradual return to a tighter budgetary policy. This implies, for 1977, a stabilisation of the net borrowing requirement at about 12 thousand million guilders, representing an appreciable reduction in proportion to gross domestic product. Since further increases in the tax burden are to be limited, this objective will need to be attained mainly by cutting back the rise in current expenditure and, in particular, social transfer payments.

Resumption of stricter budgetary policy would have two advantages : firstly, it would facilitate the financing of firms, whose own ressources (except in the energy sector) are still well short of actual needs, and secondly, it would enable the authorities to implement a monetary policy designed to encourage capital movements as a counterpart to a substantial current account surplus. This policy should permit the monetary authorities to limit the increase of domestic liquidity to no more than 11 per cent in 1977 on an average annual basis.

In Belgium, where economic activity seems to have marked time since last spring and where recent rises in the prices of raw materials and certain agricultural products, together with probable future increases in wage costs, point to the danger of a new inflationary surge in consumer prices, economic policy should aim at a growth in gross domestic product of about 4½ per cent and at keeping the increase in consumer prices below 8 to 9 per cent.

Such a development alone, would make it possible, in fact, to remove the threat that still exists to employment and to the equilibrium in the foreign exchange markets.
Since this objective cannot be attained by means of budgetary policy, at least in the current situation, efforts should be pursued -especially when the effects of the economic recovery programme come to an end - to adapt income formation mechanisms to the essential requirements of an open economy operating under the constraints set by close monetary cooperation with other Member-states. It is of importance that the sacrifices imposed be shared fairly between the various socio-economic groups.

Budgetary and taxation policy must gradually be adapted towards medium-term objectives. As sources of finance are already limited, this approach would imply, for 1977, a définite slowdown in the rise in expenditure and a reduction in relative terms in the net borrowing requirement. Within this framework, the net realised borrowing requirement of central government should not exceed FB 145 thousand million.

By making it possible to relax the restricitive monetary measures adopted in 1976, this relative decline in the borrowing requirement would be likely to facilitate the financing of private investment. Thus stricter budgetary control might well contribute to equilibrium on the exchanges and reduce the differences in rates of inflation for countries within the "snake". Against this background, it would seem appropriate that the total rise in lending to households and enterprises in the course of 1977 be kept below 223 thousand million francs (representing an increase of some 15 per cent from end 1976 to end 1977).

In Luxembourg, the expansion also seems to have lost a little momentum in recent months. Owing to the prospect of a relatively good level of corporate investment and private consumption, the volume increase in national expenditure should be distinctly higher next year. Exports should also continue to expand appreciably, but the steel industry will not benefit very much, as its sales are likely to remain relatively weak.

Within the framework of a convergent economic policy for the Community as a whole, Luxembourg could expect a growth rate of gross domestic product of about 4½ per cent in 1977 and should aim a limiting the rate of increase of consumer prices to 8 per cent. In these circumstances, the selective measures taken in 1974 and 1975 to sustain activity and help employment could be gradually phased out, whilst budgetary policy should be adapted to medium-term objectives and to the availability of funds given the likely growth of government revenue.

Economic activity in the United Kingdom continued to recover in 1976, led by strong growth in exports and a turnround in stockbuilding. The rate of inflation was considerably lower than in 1975, but the underlying rate remained virtually unchanged during the year, largely as a result of increases in commodity prices and the sharp fall in the sterling exchange rate. Partly because of the up-turn in economic activity, the current account of the balance of payments remained in substantial deficit. Unemployment, however, continued to increase.

The Government refrained from general reflationary measures which might have weakened the balance of payments and aggravated inflationary pressures, and, notwithstanding the large public sector borrowing requirement (PSBR), budgetary policy could be regarded as being slightly restrictive. Indeed, the net tax cuts, announced in April for the fiscal year 1976/77, did not reduce the overall tax burden and, in addition, the direct tax element of the package was largely made conditional upon an agreement with the trade unions (reached in June) on achieving sufficient restraint in wage and salary increases in the twelve months to July 1977.

Despite the Government's relatively cautious economic policy and the encouraging trends in the first few months of the year, both for inflation and the balance of payments, sterling weakened considerably during the period March - early June. In response to this crisis, the Government announced on 7 June a short-term credit stand-by of $ 5.3 billion(1), followed by a programme of public expenditure cuts and increases in social security contributions announced on 22 July. These moves were designed to restore confidence and to underline the Government's determination to control the level of public expenditure.

Renewed pressure on sterling in September led the Chancellor of the Exchequer to announce on 29 September the UK Government's intention to apply to the International Monetary Fund for its remaining credit tranches with the fund to be made available.

Notwithstanding the weakness of the sterling exchange rate, the Government's overall economic strategy, by helping to reduce inflationary expectations, had considerably improved the prospects for a period of sustained economic growth. Between 1976 and 1977, real gross domestic product should grow by about 3%. As this rate of growth is not expected to exceed, by more than a small margin, the trend rate of increase in productive potential and as the supply of labour could well continue to expand in the short-term, the outlook for unemployment in the next twelve months is particularly uncertain; however, a substantial fall in the level is unlikely to occur. The Government's industrial strategy should go some way towards easing the unemployment situation and raising the level of industrial investment.

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(1) Arranged with the Central Banks of the Group of Ten (except Italy), Switzerland and the Bank of International Settlements.

The Government should give priority to achieving a further reduction in the rate of inflation and should, in particular, aim for a annual average rate of increase in prices in 1977 of no more than 11%, with a deceleration as the year progresses. Such an objective, combined with the need to improve the balance of payments, means there will be no scope, in the near future, for any move to a reflationary stance of budgetary and monetary policies. Indeed, given the size of the public sector deficit, now foreseen for 1977/78, even the level of demand forecast for 1977 could lead to problems of financing and resource allocation, with the danger of renewed inflationary pressures, as the recovery proceeds.

An important element of the Government's strategy for reducing the rate of inflation must be the continued reduction of the PSBR. Therefore, the Government's July measures are to be welcomed to the extent that they reduce the official forecast for the PSBR for the fiscal year 1977/78 to a maximum of £ 9 billion. However it should be possible to aim for a lower limit.

During the past year, the Government's policy on incomes has played an important role in bringing down the rate of inflation. If further progress is to be made - itself a prerequisite for an improvement in employment prospects in the longer term - some form of incomes restraint will continue to be necessary after July 1977. This could take the form of an incomes policy that includes some limited provisions designed to alleviate the anomalies in the structure of relative wages that have occurred over the past two years. Decisions on the broad principles of such a policy should be determined in close cooperation with both sides of industry and be adopted early in 1977, long before the present 4½% pay policy expires. This would not only permit some degree of synchronisation of budgetary and incomes policies, but would also avoid a period of uncertainty with its possible adverse effects on confidence both at home and abroad.

The stance of monetary policy should be distinctly restrictive with attention being focussed, in particular, on controlling the expansion of domestic credit whilst ensuring an adequate supply of funds to priority borrowers. The authorities should aim to ensure that the money supply, as broadly defined, grows no faster than 12% in 1977.

V. CONCLUSIONS

Since mid-1975, the Member States of the Community have achieved some initial success in overcoming the worst recession in the post-war period. Since the summer of 1976, with the decline of earlier expansive forces, the powerful upward tendency has given way to a steadier economic trend. This has reduced the danger of too strong a boom, but at the same time many member countries have seen the re-emergence of earlier disequilibria.

The labour market situation has improved only slowly. Balance of payments deficits have increased, inflation rates are high and the wide divergences in price and cost trends between the member countries have remained almost unchanged. Exchange rate relationships continue to be unstable.

In some Member States, courageous programmes have been introduced or are being drawn up to overcome domestic and external trade and payments disequilibria. The success of these programmes will determine the progress achieved in consolidation the economic upswing and in developing greater convergence in economic trends within the Community. To postpone the necessary adjustments any further would be to make the return to full employment and stability all the more difficult and painful.

A N N E X

TABLE 1

MAIN MACRO-ECONOMIC AGGREGATES

(a)

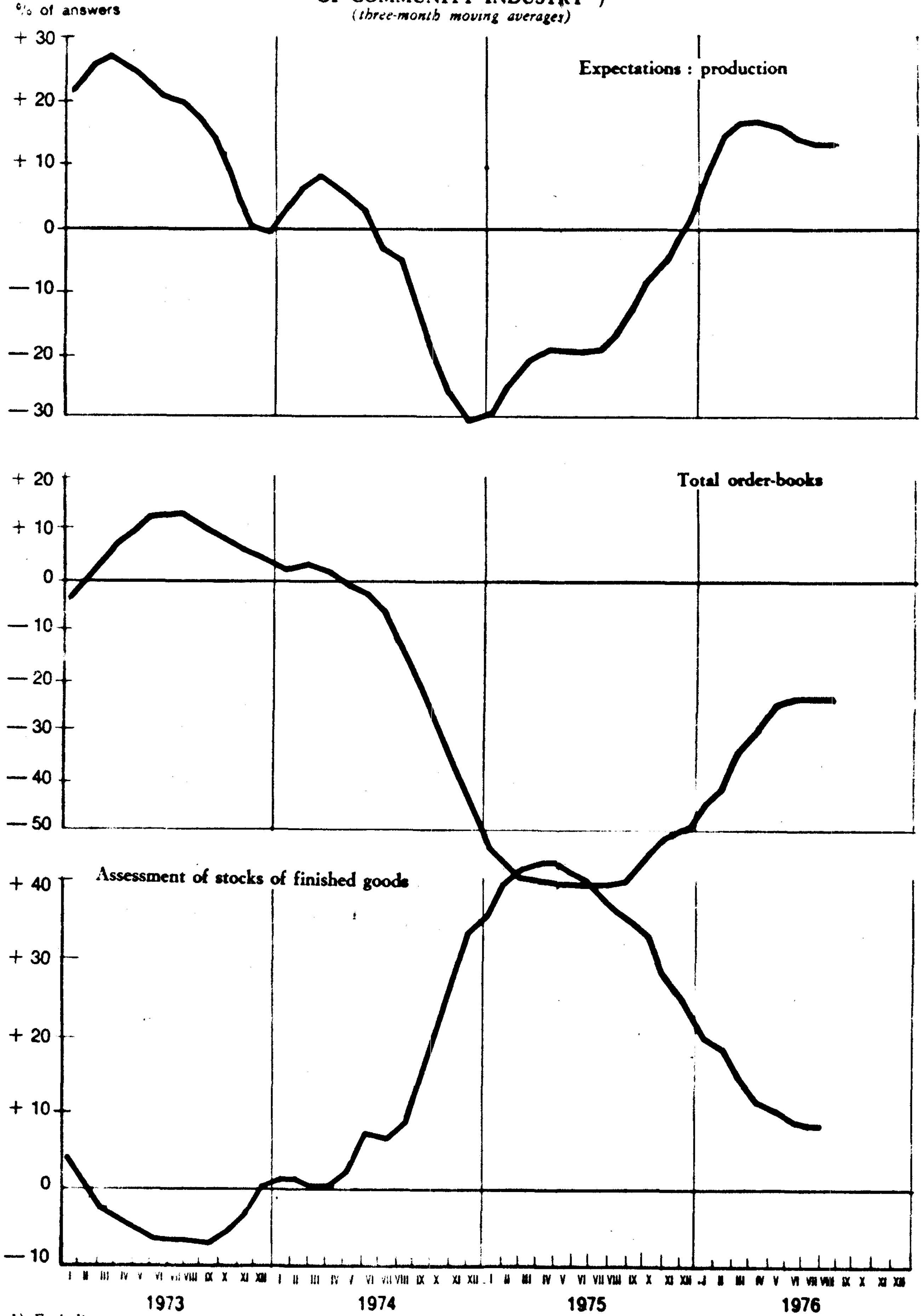
	Gross domestic product (volume					Consumer prices (b)				
	% changes on preceding year									
	Average 1968-72 (c)	1973	1974	1975	1976	Average 68-72 (c)	1973	1974	1975	1976
Denmark	4,8	3,0	1,6	- 1,0	5,0	5,6	8,5	15,0	8,8	9,0
F.R. Germany	5,5	5,1	0,7	- 3,3	5,9	3,8	7,0	7,3	6,1	5,0
France	6,0	5,2	2,9	- 1,3	5,0	5,3	7,1	13,9	11,5	9,5
Ireland	5,0	5,6	0,8	- 0,5	3,5	7,5	11,8	15,1	21,3	18,5
Italy	3,9	6,8	3,4	- 3,7	4,5	5,1	12,1	20,2	17,4	17,0
Netherlands	5,7	4,1	2,9	- 0,9	3,7	6,0	8,8	10,0	10,5	9,5
Belgium	5,4	6,3	4,2	- 1,8	3,7	3,5	6,0	13,0	12,1	10,0
Luxembourg	4,3	7,1	3,4	- 7,7	3,1	3,9	6,1	9,5	10,7	10,0
United Kingdom	2,2	5,3	0,2	- 1,6	3,0	5,6	8,7	15,4	22,0	16,0
Community	4,7	5,2	1,8	- 2,4	4,8	5,2	8,3	12,6	12,2	10,4
	Number of unemployed as a % of the total labour force (b)					Balance on current account ('000 million $) (e)				
	Average 1968-72 (c)	1973	1974	1975	1976	Average 68-72 (c)	1973	1974	1975	1976
Denmark	1,3	0,9	2,4	5,2	4,9	- 0,3	- 0,5	-1,0	-0,5	-1,7
F.R. Germany	0,8	1,0	2,2	4,1	4,0	1,1	4,3	9,2	3,1	2,0
France	2,0	2,1	2,3	3,8	4,3	- 0,4	- 0,7	-7,0	-0,2	- 3,6
Ireland	5,6	6,0	6,4	9,2	10,0	- 0,1	- 0,2	-0,7	0	- 0,4
Italy	3,4	3,5	2,9	3,3	3,5	1,8	- 2,5	-8,0	-0,5	- 2,8
Netherlands	1,6	2,4	3,0	4,3	4,7	0,1	2,3	2,0	1,6	2,2
Belgium	2,3	2,4	2,6	4,5	6,0	0,6	1,1	1,0	1,0	0,8
Luxembourg	-	-	-	0,2	0,4					
United Kingdom	2,9	2,6	2,6	4,0	5,5	0,9	- 2,0	-8,4	-3,8	- 3,2
Community	2,1	2,1	2,5	3,9	4,5	3,7	1,8	-12,8	0,6	- 6,7

(a) 1968-75: actuals; 1976 : estimates.
(b) On a national accounts basis.
(c) Geometric mean of annual changes between 1967 and 1972; unemployment and current balance of payments: arithmetic mean over five years.
(d) As a result of disparities in definition, unemployment statistics cannot be compared between countries but only reflect developments within each country.
(e) Sum of components may not exactly equal total because of rounding differences.

Source : S.O.E.C. and Commission's Departments

Chart A

RESULTS OF THE BUSINESS SURVEY[1] OF COMMUNITY INDUSTRY[2]
(three-month moving averages)



1) *Excluding construction, food, beverages and tobacco.*
2) *Original Community.*

TABLE 2

CHANGES IN INDUSTRIAL PRODUCTION (1)

(as a %, seasonally adjusted data)

	% change on preceding year					% change on preceding half-year		% change on preceding months					
	1973	1974	1975	Jan-Aug 75 / Jan-Aug 76	Aug.75 / Aug.76	1 Sem 75 / 2 Sem 75	2 Sem 75 / 1 Sem 76	March	April	May	June	July	August
	Annual average												
Denmark	3.2	:	:	:	:	:	:	:	:	:	:	:	:
F.R. Germany	7.2	- 1.5	--6.2	7.7	7.9	0.6	6.3	- 3.3	4.5	- 0.3	0.8	- 1.0	1.1
France	7.8	2.4	--8.8	7.8	9.3	- 1.1	8.2	1.7	1.2	- 1.1	0.8	- 0.7	-2.7
Ireland	9.9	3.0	--6.2	:	5.1	0.1	:	:	:	:	:	:	:
Italy	9.7	3.9	--8.8	9.4	14.7	- 1.1	9.0	1.5	-0.6	5.4	-2.2	0.5	-3.8
Netherlands	6.0	3.3	--5.1	5.4	7.7	- 1.2	6.1	0.3	-0.1	- 0.2	0.2	-0.9	-0.2
Belgium	6.2	4.0	-10.0	5.4(2)	6.5(3)	- 3.9	9.2	- 0.5	6.0	- 2.5	2.7	-5.4	:
Luxembourg	12.0	3.5	-21.9	4.7	39.7	-11.6	13.8	1.1	2.8	8.7	-3.3	-8.0	-0.4
United Kingdom	8.2	- 2.6	- 5.0	0.0	3.8	- 3.7	2.7	- 1.7	1.0	1.5	-3.7	2.1	-0.7
Community	7.5	0.5	- 6.9	6.1	8.5	- 1.0	6.3	-1.1	1.8	0.7	-0.2	-0.4	:
Investment goods	6.5	2.7	- 2.8	-1.0 (2)	- 1.8(3)	- 1.7	1.5	- 2.3	2.8	0.9	-1.3	(-2)	:
Consumer goods	6.8	-1.2	- 3.9	6.3 (2)	4.1(3)	1.0	5.5	- 1.6	4.0	0.1	0.5	(-2)	:
Raw materials and producer goods	8.6	0.3	-10.2	8.0 (2)	12.6(3)	- 1.9	8.8	0.3	1.3	1.6	-0.1	(0)	:

(1) Excluding building and construction, and for France the food, drink and tobacco industry
(2) Jan. - July.
(3) July 76 over July 75.

Source : S.O.E.C.

TABLE 3

UNEMPLOYMENT

a) **Number of unemployed persons (as % of the civilian labour force) (1)**

	Annual average			1975				1976				
	1973	1974	1975	March	June	Sept.	Dec.	March	June	July	Aug.	Sept.
Denmark	1.0	2.1	5.2	5.2	5.6	5.5	5.7	4.6	4.9	5.0	4.8	:
F.R.Germany	1.0	2.2	4.2	3.9	4.3	4.5	4.5	4.4	3.9	4.0	4.0	3.9
France	1.2	2.2	3.8	3.4	3.7	4.2	4.4	4.3	4.1	4.1	4.1	4.1
Ireland	5.9	6.2	8.7	8.0	8.8	9.2	9.5	9.6	9.8	9.9	9.9	9.9
Italy	3.4	2.8	3.4	3.2	3.5	3.6	3.8			4.0		:
Netherlands	2.4	2.7	4.1	3.7	4.1	4.4	4.4	4.3	4.4	4.5	4.7	4.6
Belgium	2.8	3.0	4.9	4.2	4.8	5.4	6.1	6.4	6.7	6.9	7.0	6.9
Luxembourg	–	–	0.2	0.1	0.1	0.2	0.3	0.3	0.3	0.3	0.3	:
United Kingdom	2.5	2.3	3.8	2.9	3.5	4.3	5.5	5.0	5.4	5.7	5.7	5.2
Community	2.1	2.5	4.0	3.5	3.9	4.3	4.7	4.5	4.5	4.6	4.6	:

(1) **Seasonally adjusted series** except for Italy : ISTAT figures; as a result of disparities of definition, data cannot be compared between countries.

b) **Vacancies (as % of the number of unemployed persons) (1)**

	1975				1976				
	March	June	Sept.	Dec.	March	June	July	Aug.	Sept.
Denmark	0.7	0.6	0.6	0.9	2.0	1.8	1.7	1.7	:
F.R.Germany	24.4	19.0	17.8	18.7	20.7	23.6	23.3	22.5	21.5
France	14.7	10.3	9.8	10.9	12.3	13.7	14.1	14.3	:
Netherlands	29.6	20.8	18.6	19.2	20.6	20.1	19.0	18.3	:
Belgium	2.7	1.0	1.0	1.4	1.5	1.4	1.4	1.4	:
United Kingdom	25.6	14.7	10.3	8.1	8.8	7.6	7.3	7.8	7.5

(1) **Seasonally adjusted series.** Statistics not available for Ireland and negligible for Italy and Luxembourg.

Source: S.O.E.C. and Commission's Departments.

: Data not available.

TABLE 4

CHANGES IN CONSUMER PRICES (1)

(% changes)

	% change on preceding year				% change on preceding half-year		% change on preceding month					
	1973	1974	1975	Aug. 75 Aug. 76 (3)	1st Sem.75 2nd Sem.75	2nd Sem.75 1st Sem.76	April	May	June	July	August	Sept.
Denmark	12.6	15.5	4.3	7.7	0.9	6.9	0.3	1.0	- 0.2	0.1	0.7	:
F.R. Germany	7.9	5.8	5.4	4.0	1.3	3.2	0.6	0.4	0.3	- 0.4	0.4	0.0
France	8.5	15.2	9.6	9.5	4.3	4.7	0.9	0.7	0.4	1.0	0.7	:
Ireland (2)	12.6	20.0	16.8	18.9	1.9	14.0	:	6.2	:	:	1.5	:
Italy	12.5	24.5	11.2	17.0	5.0	10.8	2.6	2.0	0.5	0.5	1.1	:
Netherlands	8.2	10.9	9.1	8.3	4.1	5.0	2.1	0.4	0.0	- 0.5	1.0	1.1
Belgium	7.3	15.7	11.0	9.3	5.4	3.7	0.9	0.7	0.2	0.8	0.4	1.3
Luxembourg	6.1	11.2	10.9	9.4	5.1	4.5	1.4	0.6	0.1	0.8	0.8	0.1
United Kingdom	10.6	19.1	24.9	14.3	6.5	6.8	1.9	1.1	0.5	0.2	1.4	1.3
Community	9.5	14.8	11.8	10.2	4.0	5.8	1.3	0.9	0.4	0.3	0.8	:

(1) Data relate to the last month of each period.
(2) Ireland: quarterly data.
(3) F.R. Germany, Netherlands, Belgium and Luxembourg: September 76 over September 75.

Source: S.O.E.C.

TABLE 5

DEVELOPMENT OF BALANCES OF TRADE

(Million US dollars, seasonally adjusted)

Country	1973	1974	1975	1974 I	1974 II	1974 III	1974 IV	1975 I	1975 II	1975 III	1975 IV	1976 I	1976 II
Denmark	- 1720	- 2313	- 1770	- 688	- 722	- 492	- 411	- 308	- 393	- 418	- 651	- 732	- 660
F.R. Germany	+12366	+19645	+13990	+5112	+5131	+4532	+4870	+4838	+2975	+3181	+2996	+3516	+3397
France	+ 1435	- 3373	+ 1607	+ 623	-1071	-1097	- 582	+ 584	+1120	+ 495	- 592	- 446	- 254
Ireland	- 625	- 1159	- 714	- 248	- 379	- 362	- 170	- 227	- 184	- 174	- 129	- 306	- 174
Italy	-5587	-10664	- 3548	-2977	-3101	-2628	-1968	- 897	- 722	- 501	-1428	-1739	-1937
Netherlands	+ 127	- 195	- 43	- 21	+ 13	- 193	+ 6	- 188	+ 261	- 211	+ 95	+ 252	- 259
B.L.E.U.	+ 359	- 1549	- 1910	- 501	- 446	- 487	- 115	- 89	- 587	- 779	- 432	- 675	- 746
United Kingdom	-5616	-12276	- 7109	-2916	-3275	-2945	-3140	-2033	-1583	-2098	-1395	- 940	-1764
Community	+ 739	-11884	+ 503	-2862	-3850	-3672	-1500	+1680	+ 887	- 505	-1536	-1070	-2397

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

TABLE 6

EXPENDITURE, RECEIPTS AND NET BORROWING REQUIREMENT OF CENTRAL GOVERNMENT

	Expenditure		Receipts		Borrowing requirement			
	% change				Value (1)		as % of G.D.P.	
	1975	1976	1975	1976	1975	1976	1975	1976
Denmark (2)	+20.1	+ 10	+ 3.0	+ 14½	-10.7	- 9	- 5.2	- 3.8
F.R. Germany	+15.6	+ 6	+ 1.6	+ 8½	-54.7	- 52	- 5.2	- 4.5
France	+26.7	+ 8	+ 3.4	+ 17	-37.7	- 17.5	- 2.7	- 1.1
Ireland	+35.5	+22½	+21.9	+ 30½	-601	- 644	-16.9	-14.6
Italy	+25.5	+24½	+25.6	+ 29½	-8632	-9600	- 7.7	- 7.0
Netherlands	+ 24.2	+18.2	+15.4	+ 11.8	- 7.2	- 12.1	- 3.5	- 5.2
Belgium	+ 24.1	+16.7	+19.0	+ 16.1	-116.6	- 140.0	- 5.0	- 5.3
Luxembourg	+21.8	+14½	+10.4	+ 8	+ 0.9	- 0.6	+ 1.1	- 0.6
United Kingdom (2)	+30 ½	+16½	+23.2	+ 20½	-8800	-8900	- 8.6	- 7.4

(1) Thousand mio. Dkr, DM, Ffr, Lire, Fl, Fb, Flx; Mio £.
(2) 1975/76, 1976/77.

Source: Commission's Departments.

TABLE 7

OUTPUT AND TRADE IN THE WORLD ECONOMY

(% change on preceding year)

	Real GDP (1)					Volume of imports (goods)				
	1969–73 average (2)	1974	1975	1976	1977	1969–73 average (2)	1974	1975	1976	1977
USA	3.3	– 1.7	– 1.8	6½	5½	6.9	– 3.4	–11.3	20	10
Canada	5.3	2.8	0.6	5	5½	10.0	10.0	– 5.2	10	11
Japan	9.6	– 1.2	2.1	6	7	14.9	– 0.7	–13.9	8	14
Other developed countries (excl. EEC)	6.0	3.7	0.1	2½	4	8.9	11	– 7	4	8
Total developed countries (excl. EEC)	4.6	– 0.4	– 0.6	5½	5½	9.2	3½	– 9½	11	10
EEC	4.7	2.0	– 2.5	4.8	4	10.3	– 1½	– 5	12	8½
Total developed countries (incl. EEC)	4.6	0.4	– 1.2	5½	5	9.8	1	– 7½	11½	9½
OPEC countries						7.4	38	45	20	15
Other developing countries							13	–2	2	7
Centrally planned economies						8.4	10	6	4	6
World (excl. EEC)						8.6	9	–2	8½	9
World (incl. EEC)						9.2	5½	–3	10	9

(1) Real GNP for USA, Canada and Japan.

(2) Compound growth between 1968 and 1973.

Sources: National statistics and Commission's Departments.

Chart B

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)

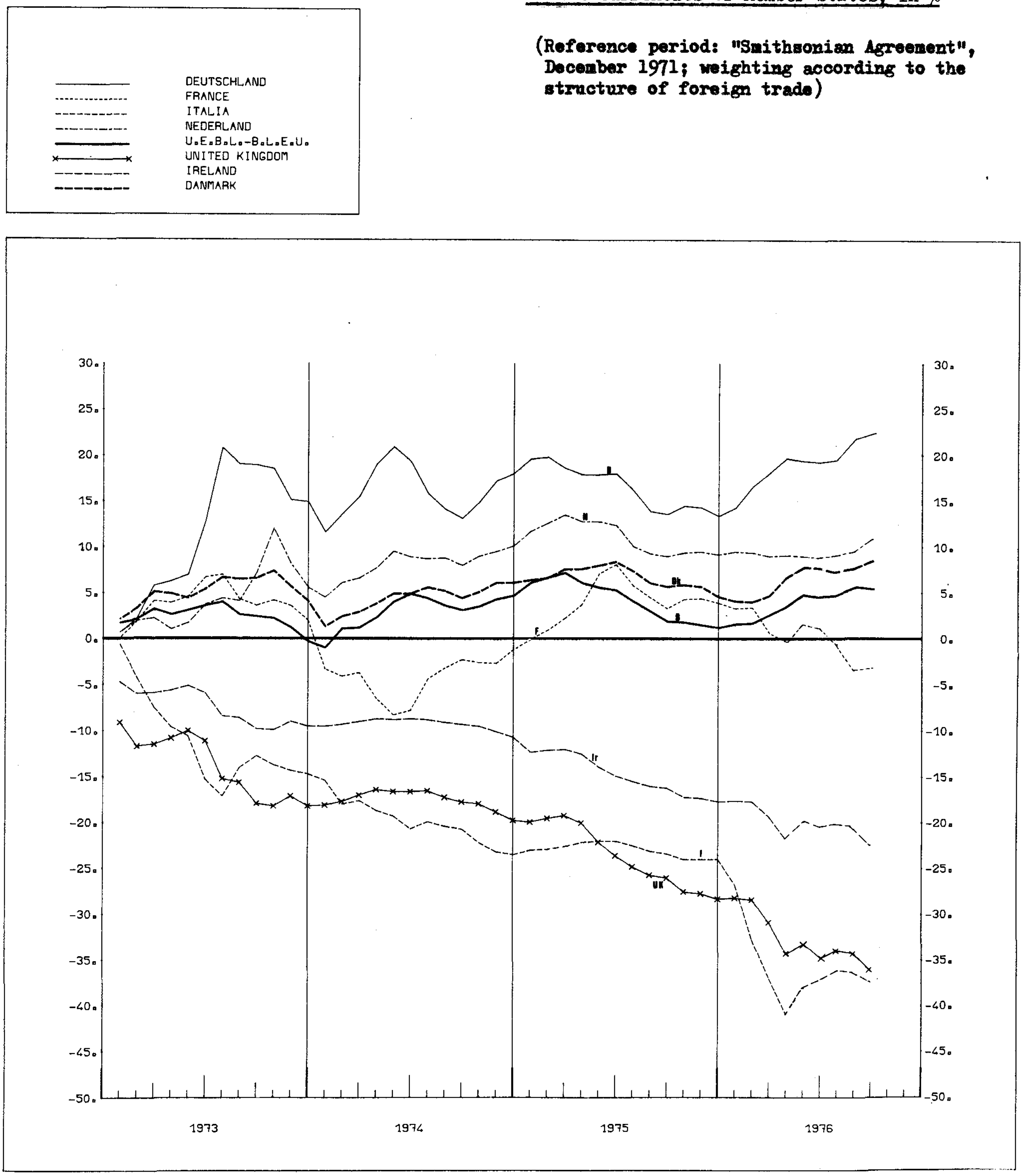


TABLE 8

Monetary Developments

	Denmark	F.R. Germany	France	Ireland	Italy	Belgium	Nether-lands	United Kingdom
Money Supply (M_1) (1) % Annual rate of increase (2)								
Last 36 months	13,1	9,5	12,3	10,5	15,8	10,7	10,6	14,7
Last 12 months	23,5	13,9	15,8	19,0	13,3	13,3	20,4	19,2
Last 3 months	20,0	11,4	18,5	18,6	24,3	12,4	15,3	14,4
Month of observation	July	August	June	May	May	June	June	August
Money Supply (M_2) or (M_3) (3) % Annual rate of increase (2)								
Last 36 months	15,6	5,4	16,4	21,3	20,6	13,3	15,8	15,3
Last 12 months	24,4	2,8	18,7	20,9	22,0	14,1	8,1	9,2
Last 3 months	22,9	7,9	20,6	20,9	25,5	15,0	10,7	10,3
Month of observation	July	August	June	May	May	June	June	August
Bank lending to Private Sector % Annual rate of increase (4)								
December 1973	15,4	9,6	18,2	22,9	27,7	15,1	22,6	38,4
December 1974	7,0	6,5	16,9	15,5	22,4	13,5	17,9	18,3
June 1975	8,8	4,1	14,5	8,6	15,6	11,2	15,8	7,3
December 1975	14,3	4,6	13,9	16,3	17,1	13,8	12,2	0,7
Latest month of 1976 available)	16,5	8,8	13,6	16,4	21,7		13,3	5,3
Short-term interest rates (5)								
1973 IV		11,3	11,2	14,3	7,9	7,1	8,2	9,6
1974 IV		8,3	12,5	12,2	17,4	9,2	7,1	7,8
1975 I		5,6	10,2	14,3	13,5	5,3	6,4	8,8
II		5,0	7,8	16,6	10,7	4,5	2,3	8,1
III		3,4	7,1	12,0	9,6	4,8	1,4	8,8
IV		3,5	6,6	12,2	8,5	4,1	4,4	10,5
1976 I		3,5	7,1	9,6	10,8	5,7	3,0	8,7
II		3,6	7,5	9,7		7,1	3,9	9,0
July		4,5	8,3			7,1	5,2	10,5
August		4,2				10,3	7,8	9,3
September							8,7	
Long-term interest rates (6)								
1973 IV	11,4	9,7	9,7	13,1	7,4	7,7	8,4	11,9
1974 IV	14,9	10,5	11,5	16,2	11,2	9,0	9,5	16,6
1975 I	12,8	9,1	11,4	14,2	10,7	9,0	8,9	14,7
II	12,8	8,6	11,0	13,8	10,7	8,4	8,6	14,3
III	12,6	8,6	10,7	13,5	10,5	8,2	8,9	13,9
IV	13,2	8,7	10,9	14,5	10,5	8,5	8,8	14,8
1976 I	14,1	8,1	10,7	13,9	10,9	8,8	8,4	13,7
II	14,8	8,1	10,8	14,1	12,2	9,2	8,8	13,8
July	14,7	8,4	11,0		12,5	8,9	9,6	14,2
August	15,5	8,3				8,8		14,3
September		8,1				9,2		14,8

(1) Notes and coin in circulation and sight deposits.
(2) Year-to-year change : average of monthly figures.
(3) Money and near money.
(4) Year-to-year change.
(5) Day-to-day money rate, average of period.
(6) Average of period.

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