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**THE ECONOMIC SITUATION
IN THE COMMUNITY**

1

MARCH

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1962

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EUROPEAN ECONOMIC COMMUNITY

COMMISSION

The Economic Situation in the Community

MARCH 1962

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I. THE OVERALL SITUATION

The Community's economic growth in 1961 was somewhat less than in the previous year. Industrial production rose by about 6.5 %, after year-to-year growth rates of 13 % in 1960, 7 % in 1959 and 3 % in 1958. The total increase in industrial production over the four years since the entry into force of the Treaty of Rome (i.e. from 1957 to 1961) has been 32 %. For a proper appreciation of this result it must be remembered that up to the beginning of 1959 economic development in the Community was still suffering from the deterioration in the world economic situation which had begun in 1957 with the recession in the United States. On the other hand, the American recession of 1960 and early 1961 affected Europe less severely, largely in consequence of the stimulus provided in that period by the build-up of the Common Market.

Despite rather poor harvests on the whole and consequently only a slight rise in agricultural production, the Community's gross product rose in 1961, partly as a result of the headway made in the services sector—rather more than 5 % in real terms, compared with 7 % in 1960, 5 % in 1959 and 2.5 % in 1958. This gives a total increase of 21 % for the four years since the Treaty came into force.

The slowdown in expansion, which was already apparent in 1960, was mainly due to labour shortages, which have become a fairly general problem in the northern areas of the Community. Furthermore the expansion of demand certainly lost momentum in the course of 1961; in some branches there was even a decline with repercussions on production.

Slower expansion in external demand and in stockbuilding was largely responsible for this trend. Exports in 1961 were up only 5 % in value and 4 % by volume on the previous year. After starting the year at a fairly low level, they showed a definite rise in the second and third quarters, following the economic recovery in the United States, and levelled off towards the end of the year.

Stockbuilding was on a considerably smaller scale than in 1960; in some sectors, particularly the iron and steel industry, manufacturers and dealers made special efforts to reduce stocks.

On the other hand, fixed investment again rose sharply, although the propensity to invest declined in some Member States under the influence of cyclical factors, in particular some pressure on profit margins caused by wage increases without a commensurate rise in productivity, the slower expansion of exports and keener competition from abroad. At first this only affected investment programmes and new orders for capital goods, but in the second half-year the growth of investment expenditure also slowed down somewhat.

Private consumption again rose rather rapidly—by about 6 % in real terms, which is almost as much as in 1960. As compared with 1957 the total increase in consumption amounts to 19.5 % and on a per capita basis about 15 %. The expansion of consumption in 1961 is mainly accounted for by large wage-rises, but the increase in employment, although on a smaller scale than in 1960, also contributed to the increase in consumer expenditure.

Finally, public expenditure on investment and consumption again rose appreciably in all member countries.

As for supply, in addition to the expansion of domestic production, imports from non-member countries again moved upwards—a trend that was particularly marked in finished goods. However, since imports of raw materials were fairly low, owing to the cautious stockbuilding policy of industry and the slowing down in the growth of industrial output, and since the good harvests of 1960 meant a fall in imports of agricultural produce in 1961, imports for the whole year rose by only 5 % in value and 6 % by volume, as compared with 21 % and 20 % in 1960.

Nevertheless the Community's balance of trade deteriorated slightly and closed with a deficit of \$ 29 million, as compared with a \$ 59 million surplus in the previous year. The surplus on the overall balance of payments dwindled considerably, owing to a further rise in capital transactions by the authorities, chiefly in the form of advance repayment of debts to non-member countries and participation by the member countries in the IMF's credit for Great Britain.

The level of consumer prices, which had remained more or less unchanged in 1960, rose slightly in most member countries. This can mainly be attributed to the higher cost of services and a rise in food prices, partly due to government farm support measures. In some member countries the prices of industrial products also rose; in this development the pressure of demand on supply became less and less important, being gradually replaced by heavier wage costs, which manufacturers sought to pass on to the consumer.

Economic development in the Community promises further growth in 1962, but this will be once more at a slower pace. The growth of overall demand may fall off slightly.

External demand as reflected in exports to non-member countries, will hardly rise much faster than in 1961, despite better sales prospects in the United States. The weakening of the propensity to invest already mentioned will lead to a lower growth rate of expenditure on investment. Finally, private consumption also might well advance somewhat more slowly than in 1961, for though further considerable wage rises are expected, they will not be so steep as hitherto; furthermore a slowing down in the growth of employment is likely.

Despite these developments in the demand situation, the position on the labour market is not liable to change radically enough to remedy the shortages which are hampering the expansion of production in some sectors, especially since further cuts in working hours can be expected. Under such conditions the growth of industrial production might reach about 5.5 % while that of the real gross national product in the Community would be 4.5 to 5 %.

If we assume that there will be no marked upturn of the stockbuilding trend in the near future, imports are unlikely to show a much greater advance in 1962 than in 1961, despite a further rise in agricultural imports.

However, since the terms of trade are not expected to improve as they did in 1961, the balance of trade might well deteriorate to a somewhat greater extent. In spite of this, the overall balance of payments should tend to remain favourable.

The monetary and financial policies of the member countries correspond largely to these economic prospects. Further discouragement of the propensity to invest should, however, be avoided. A policy of wage restraint in most member countries and moderation as to profit distribution in some of them would help in this direction and would moreover mitigate the expected increase in prices, especially if accompanied by a more vigorous encouragement of savings.

Furthermore, the economic situation at present and as forecast for 1962 will provide favourable conditions for improving and strengthening the machinery for combating tendencies towards recession. Co-ordination must be improved, especially in view of the need to keep in line other measures designed to build up the economic Community. Important steps in this direction are already being taken and others are being prepared.

A. Trends and results in 1961

1. Demand

As predicted a year ago in the first Quarterly Survey of 1961, overall demand in the Community increased somewhat less last year than in 1960; the growth of exports to non-member countries was smaller, and internal demand at current prices advanced at much the same rate as in 1960, though the real increase was certainly rather less.

These results, based on a comparison of averages for the two years do not, however, give a true picture of the real trend during the year. External demand, which had already ceased to be a factor in expansion by the second half of 1960 and which had continued relatively weak at the beginning of 1961, then recovered till the third quarter; towards the end of the year, however, certain signs of weakness reappeared. The growth rate of internal demand, on the other hand, declined somewhat after the middle of 1961 as the rise in fixed investment and—more particularly—the accumulation of stocks levelled off, while public and private consumption continued to grow rapidly.

The *Community's exports* to non-member countries in 1961 exceeded the 1960 figures by 5 % in terms of value and by some 4 % in terms of volume; the rises recorded in 1960 had been 13 % and 11 % respectively. This slower rate of growth was also predicted a year ago, and the figures show that the estimates were not far out.

The trend in exports from the Community varied widely with the different areas to which it has been selling goods; the recovery recorded in the course of the year was mainly a reflection of the upswing of economic activity in the United States.

The American recession continued until the first quarter of 1961 and then gave way to a vigorous economic upsurge. By July industrial production had already made up the ground lost during the recession and it has continued to grow since, though rather more slowly. From the first to the fourth quarter of 1961, the gross national product and industrial production grew by 7 % and 12 % respectively. As a result of the growth in internal demand, there was a substantial increase in imports : this is the main reason for the appreciable decline in the surplus on current account during the second half of the year. This development was a direct and indirect stimulus to economic activity in the other countries of the world and also led to a recovery in Community exports to the United States. Whereas in the first quarter of 1961 these were still 26 % in terms of value down on the corresponding figure for 1960, they were 19 % up in the fourth on the figure for the last quarter of 1960, though this admittedly had been a poor one. The Community's total sales to the United States for 1961 reached approximately the same level as in 1960.

Developments in Great Britain did much less to encourage the export trade of the Community. Economic activity on the other side of the Channel improved only during the first half-year, spurred by the growth of home demand, whilst exports declined steadily. This trend, further aggravated by speculative capital movements, brought about a

substantial deterioration in the balance of payments. Faced with this situation, the Government took a series of measures to curb home demand; there was already a tendency for industry to run down stocks of raw materials, and the new measures in combination with this tendency led to an appreciable decline in imports. All in all, the Community's sales to Great Britain in 1961 increased by only some 3 % in value, whereas the corresponding figure had been 21 % in 1960.

The outstanding feature of the economic situation in most of the other EFTA countries was steady and substantial growth. The Community's exports to these countries therefore increased substantially once again—by an estimated 11 % over 1960. The biggest increases were in exports to Switzerland and Austria.

Exports to the other European countries also progressed favourably, particularly those to Greece, which raised its purchases from the Community to 25 % above the 1960 figure. The Greek gross national product expanded by about 11 % in 1961, mainly as the result of good harvests and heavy investment. But the steep rise in the national product was also in part the outcome of increased exports, which had been marking time in previous years, and of a noteworthy increase in the services sector : income from invisibles, particularly from tourism and transport, rose sharply.

The Community's exports to the developing countries, the growth of which had already slowed down about the middle of 1960, grew relatively little in 1961; in terms of value the year-to-year increase was only 5 %. These countries evidently found their purchasing power severely undermined in 1961 by the fall in available foreign exchange stemming from relatively low purchases of raw materials by the industrialized countries in Europe and from the weakness of the prices paid for raw materials, itself partly a result of the fact that production capacity in the developing countries had been stepped up too far. Their gold and foreign exchange reserves had in any case shrunk in 1960 despite increased aid from the industrial countries, because they had been buying a good deal more abroad. As for trends in the different areas, the Community's sales to the Latin American countries once again increased appreciably, whereas there was a substantial fall in exports to countries of the sterling area, whose foreign exchange situation was particularly precarious. By contrast, the Community's exports to the associated overseas countries and territories progressed in a very satisfactory manner, if the decline in exports to Algeria and to the Congo (Leopoldville)—the result of exceptional circumstances—is left out of account. Apart, then, from this factor, growth in terms of value was about 18%.

Although the growth of internal demand lost some of its momentum in 1961, it developed faster than did exports to non-member countries.

Fixed investment increased almost as vigorously in 1961 as in 1960; at 9.5 % in terms of volume, its growth rate was once again considerably better than that of the gross national product, so that there was a further substantial increase in the ratio between investment and gross national product.

Gross fixed asset formation by enterprises rose somewhat more slowly than in 1960. The decrease was due mainly to the tendency for growth to level off in the second half of

the year : investment early in 1961 was still mainly the outcome of industrial investment schemes elaborated and partially implemented during the first phase of the boom—1959 to the middle of 1960; these in certain countries, had even been revised upward. But various factors emerged later in the year to slow the pace of investment down : profits were growing more slowly and the expectations in this field were less rosy; partly because of the appreciably higher labour costs per unit of output in some countries, combined with rising taxation and increasing competition from abroad; the growing severity of foreign competition; the effects produced by the revaluation of the German mark and the guilder; the rapid growth of capacity in certain branches as a result of the investment boom of recent years and subsequent doubts whether demand in the sectors concerned would increase *pari passu* with any further expansion of capacity; and, last but not least, the physical obstacles which in certain countries continued to hamper growth, particularly in the sphere of building and construction.

The information available suggests that in *stockbuilding* progress was substantially slower in 1961 than in 1960. About the middle of the year it became apparent that enterprises were being more cautious over the holding of stocks owing to the slower expansion of industrial production (efforts to improve stockholding arrangements also played their part) to the weakness of world commodity prices and to the fact that there seemed to be no likelihood that they would rise appreciably. This caution was particularly in evidence in the attitude to stocks of raw materials imported from non-member countries, but it also affected some raw materials and semi-finished products originating in the Community. The inclination to run down stocks was particularly noticeable among the users of steel. Excessive stockbuilding in the previous period may have had something to do with this, and the considerable increase in production capacity in the steel industry was a further argument, as users could reckon on increasingly prompt deliveries. In certain branches of the textile industry, too, demand was at times weak for much the same reasons, dealers and processors having developed a cautious attitude towards their stocks.

Capital expenditure on building advanced again considerably in 1961 but, mainly because of the bottleneck in manpower, it was quite impossible in several countries to attain a growth rate in line with potential demand, which is only partially reflected in the number of building licences issued. The number of dwelling units completed in the Community in 1961 was about 1 % up on the 1960 figure, whereas the number of licences issued for residential building jumped by 6 %. In the industrial and commercial sector the real increase in building activity was, when compared with 1960, considerably more vigorous than in the residential sector, despite the loss of momentum noted in the second half-year in some countries.

Public expenditure on consumption and investment continued to increase in 1961, though on the whole its growth seems to have been somewhat less than in 1960. In Belgium the volume of public investment scarcely increased at all, but elsewhere, particularly in France and Italy it expanded at a higher rate.

Unlike the trend of investment, the growth rate of *private expenditure on consumption* did not slacken in the course of 1961, and the figure for the full year shows an

increase over 1960. Since, however, consumer prices rose rather more rapidly, the rate of progress in terms of volume was about 6 %, or about the same as the corresponding figure for 1960 as compared with 1959.

As in both previous years, expenditure on services and durable consumer goods grew relatively fast, save in the Netherlands where at times there was evidence of a certain loss of momentum in spending on some of these goods, partly because of stiffer hire purchase conditions. Sales of motor cars on domestic markets climbed at much the same high rate as in 1960; Belgium was the only country in which the figure for the second half of 1960 was not exceeded in the second half of 1961.

The expansion of private consumption was mainly due to an increase in the disposable income of households, which in turn stems very largely from a substantial increase in the total of wages and salaries paid. Not only did the total number of hours worked increase again, though less than in 1960, but pay in industry, on the land and in the services sector also improved substantially. Established and unestablished civil servants were awarded salary increases in all member countries and the total for transfer incomes once again moved up. These factors, all of which made for higher incomes for households, were more than enough to offset certain effects produced by the smaller margin of profits noted in certain member countries, which meant that the sums distributed as dividends increased at an appreciably lower rate than in 1960. In agriculture, too, incomes suffered, save in Italy, from the poorer harvests of 1961; in several countries, however, effective support measures were taken by the authorities.

2. Supply

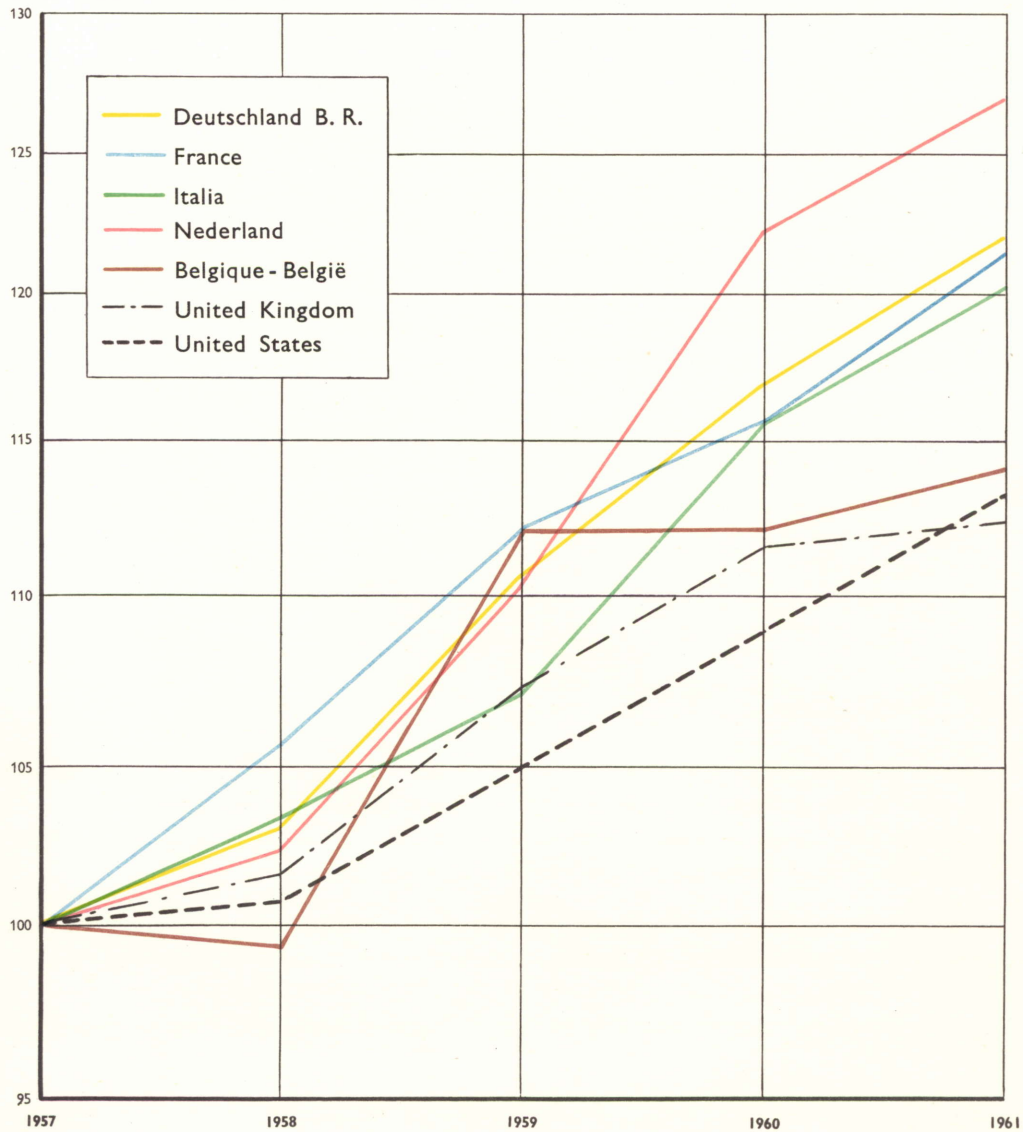
Gross national product in the Community rose by approximately 5.5 % for 1961, whereas the corresponding figure in the previous year had been some 7 %. This is another result which corresponds fairly closely to the prediction (4.5 % to 5 %) made by the Commission's staff a year ago in Quarterly Survey No. 1 of 1961.

The slowdown of the growth rate for production in 1961 was partly due to limited production capacity, but mainly to shortages of manpower in certain countries; of course, the general slowdown in the expansion of demand and even, in certain branches of industry, an appreciable drop in absolute demand, also did something to inhibit growth.

Again, the increase of *agricultural production* was smaller than in 1960. In all Community countries except Italy, yield from crops fell appreciably. The 1961 grain harvests are estimated at 49.7 million metric tons as against 53.7 million metric tons in 1960, and potato crops fell from 49.4 to 45.1 million metric tons. Similarly, the figures for sugar-beet harvests were substantially down, and wine production was 20 to 25 % below the level for both 1959 and 1960. Production of fruit and vegetables would seem to have been almost as high as in 1961. Animal products, particularly dairy products, increased once more.

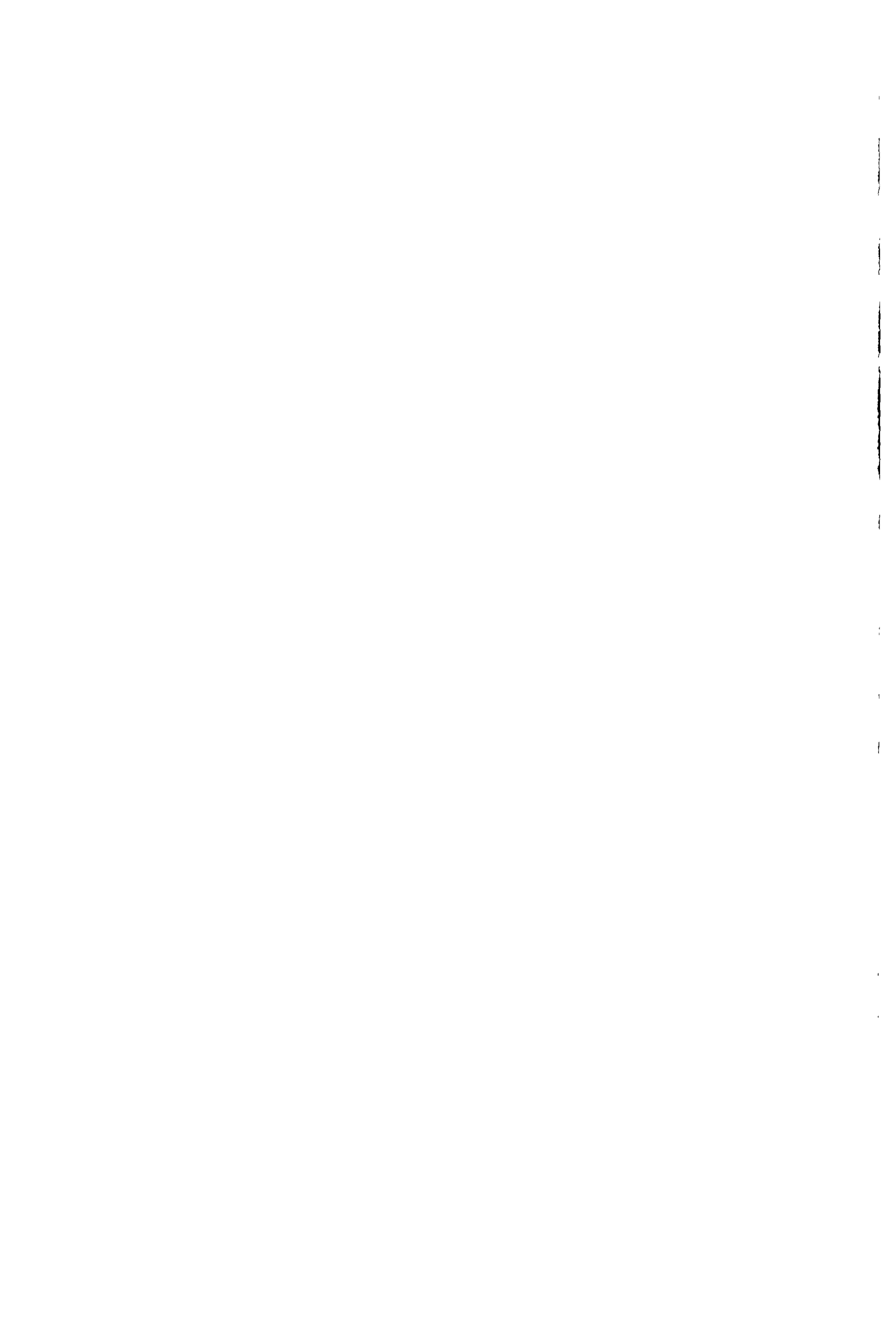
INDICES OF OUTPUT PER MAN-HOUR IN THE MANUFACTURING INDUSTRIES

1957 = 100



Sources: Statistical Office of the European Communities; OECD : General Statistics; Various publications by the Member countries.

The indices of output per man-hour have been calculated on the basis of statistics for production, employment and the length of the working week, which are not always fully representative of the trend in the manufacturing industry. The curves therefore give only approximate estimates of the trends.



The growth of *industrial production* was as expected, considerably slower than in 1960. The index of the Statistical Office of the European Communities showed a 6.5 % increase in 1961 over the 1960 total, which is roughly the figure estimated at the beginning of 1961. In 1960 the growth rate had still been 13 %.

A comparison of these year-to-year growth rates overstates the actual extent of the slackening, since the growth rate of 1960 was partly due to the vigorous upswing in the second half of 1959.

However, there was an appreciable deceleration in economic expansion. After allowance has been made for seasonal variations, the quarterly figures in 1960 still show an average advance of 2 %, but by 1961 the average was only 1.5 %. The loss of pace is mainly attributable to the flattening of the rate of growth in the Federal Republic of Germany since the spring of 1961 and to an actual fall in output in the middle of the year in the Netherlands.

The growth of production slowed down in almost all branches of industry, though for different reasons.

In some branches, the structural difficulties which had already been in evidence for a long time continued to exert a depressive influence on activity. For example, the output of coal fell by almost 2 % in comparison with 1960. Pithead stocks, however, declined slightly. Again the tonnage of shipping under construction was down on the 1960 figure, although the situation did not further deteriorate after the middle of 1961.

In other branches, a weakening of demand led to a slower rate of growth, or even, as the year advanced, to an absolute fall in output. For example, the cautious attitude to stocks adopted by steel users was the main reason for the downturn in the output of the steel industry since the summer. The growth in the output of textiles was also slowed down by reductions in the stocks held by distributors.

The expansion of production in the motor industry was hit by the very substantial weakening in external demand. The extent varied from country to country, but the growth of internal demand, too, was, for the Community as a whole, less vigorous than in 1960. Output of private motor cars in the Community moved up by only 2 % in 1961, whereas 16 % more cars had been manufactured in 1960 than in 1959.

In the capital goods industries physical obstacles—labour shortages and the high rate at which capacity was being used—acted for the greater part of the year as a brake on the growth of production. Towards the end of 1961, however, the slowdown in receipts of new orders, already apparent for some time, also seems to have been exerting some influence on the rate at which production was growing, particularly in the Federal Republic of Germany, although there was still a heavy backlog of orders. Despite all this, the growth of production in these industries represented a further substantial advance over 1960; in mechanical engineering alone the percentage increase for the member countries combined was approximately 12 %.

Chemicals were also affected by some slackening of demand caused in part by stiffer competition from external producers on Community markets. Output was none the less above 7 % the figure for 1960, which itself had shown the exceptional rise of 20 % over the 1959 figure.

For the first time for almost ten years, the contribution to the domestic product made by the *services sector* grew more rapidly than that of industry. This development certainly stems from the fact that on the supply side of some services fields noteworthy progress has been made in mechanization and rationalization of work, and from the fact that others could offer more attractive working conditions than industry, so that they succeeded in securing a bigger share of the available manpower. In addition, output in some other branches of services can often be stepped up more quickly than in industry and is less rigidly tied to the factors of production committed. Obviously, however, exceptionally vigorous growth of the demand for services was also important. It is also clear that the structural trend towards a greater share for services in total expenditure on private consumption has gathered pace. A particularly sharp rise was recorded in expenditure on tourism, on health and hygiene and on the maintenance and servicing of durable consumer goods. In those services branches where activity is closely dependent on the increases in production and external trade, the growth rate proved to be lower than in 1960. Goods transport by rail was only 2 % up on the 1960 figure, which had represented a 7 % increase on that of 1959.

The increase in overall production in 1961 was once again to an appreciable extent the result of improved productivity. The number of *hours worked* appear to have increased only slightly. It is true that the number of wage-earners again rose by about 2 %—roughly as much as between 1959 and 1960—but slightly fewer hours per worker were recorded. In some member countries—Netherlands, Federal Republic of Germany and to an increasing extent even in France—manpower shortages presented an obstacle to any more vigorous growth of output. The dearth of skilled labour continued to be particularly severe, but the market was again short of less skilled and even unskilled workers. Even in the economic sectors in which demand eased appreciably, as happened notably in Federal Germany during the second half of the year, the general situation of the labour market was such that companies were unwilling to dismiss staff. This development had a particularly unfortunate effect on the trend of productivity.

This can be seen most clearly in the way industrial production developed. Here output per man-hour rose by approximately 4 %, whereas the rise in 1960 had been 7 %. Since, however, the number of hours worked in industry increased only 2 % in 1961, two-thirds of the increase in output was none the less due to the rise in productivity.

There were more wage and salary earners in 1961 for several reasons : first, there was an increase in that section of the population which is of working age; secondly, there was an influx of refugees from the Soviet occupation zone of Germany (an influx that was possible on a large scale only until 13 August); thirdly, workers left agriculture; fourthly, persons hitherto unemployed (mainly married women) took jobs; lastly, about one-third of the increase was accounted for by a decline in unemployment.

Migration within the Community and immigration from outside made a substantial contribution to the increase of the total number of persons employed. In the Federal Republic of Germany, in particular, the immigration of foreign workers was substantially higher than in 1960; it amounted in 1961 to about 200 000 persons, as against a figure of 120 000 in 1960. In the Netherlands there was a slight net surplus of immigrants over emigrants, whereas in 1960 the number of workers emigrating had still been greater than that of those immigrating.

Migration within the Community contributed to further reductions of unemployment in those countries where there were still real possibilities of its being reduced. Italy in particular benefited, although here the leading factor in the decline of unemployment was the growth of national production. In Belgium, too, the growth of production was accompanied by a distinct decline of unemployment. In other Community countries, the unemployment rate remained consistently below 1 % of the total labour force.

3. The balance of the markets

Partly as a result of the weakening in the growth of overall demand—in particular of stock accumulation—and partly because of the slowdown in the progress of internal production, the Community's *imports* rose a good deal more slowly in 1961 than in 1960. Purchases from non-member countries were only 5 % in value and 6 % by volume above those of 1960, a year in which they had been 20 % in value and 21 % by volume above the 1959 figures. Developments in the course of 1961 were uneven. The slight increase recorded in the first half of the year gave way in the third quarter to a definite decline, followed by a slight recovery towards the end of the year.

These fluctuations were mainly attributable to the trends in imports of raw materials and semi-finished goods for industry and to imports of agricultural produce. The Community's imports of raw materials scarcely increased at all in terms of volume, and their value was actually below the 1960 figure because of the fall in world commodity prices. The slowdown is attributable to the cautious policy of Community businessmen regarding stocks and to the decline in the rate at which industry's current need for raw materials was growing. Much the same factors influenced imports of partly finished industrial products.

Imports of foodstuffs and agricultural produce were declining in the first six months of 1961 and in terms of value they were 2 % below the figure for the first half of 1960. Thereafter, however, they recovered, since crops in all Community countries save Italy were down on the 1960 figures.

Imports of finished goods, especially capital goods, again surged forward. In the first six months of 1961 imports of machines and vehicles were 28 % up in terms of value on the corresponding 1960 figure, although this latter figure itself represented a substantial advance; by the third quarter of 1961 the year-to-year growth rate had reached 39 %.

The trend of Community imports broken down by product is reflected clearly in the changed distribution by areas of origin. For example, imports from industrial countries rose again substantially in 1961: in terms of value the EFTA countries stepped up their sales to the Community by 11 %. Imports from North America also rose. Their growth was, however, at 7 % in terms of value, considerably down on the corresponding 1960 increase over 1959 (43 %); the figures for 1960 were, however, distorted by very large deliveries of aircraft. Moreover, the relatively good harvests of 1960 meant that imports of agricultural products from the United States and Canada fell in the first half of 1961: in the second half of the year they began to recover again.

The weak demand for raw materials depressed imports from the developing countries; the growth rate (in terms of value) fell from 14 % in 1960 to 1.5 % in 1961. Purchases from Latin America for the full year came to much the same total as for 1960; they began by increasing slightly, marked time during the middle of the year and declined during the second half. Purchases from the Middle and Near East were down slightly (2 % in value) compared with the previous year. On the other hand imports from the associated overseas countries and territories were, in terms of value, 6 % up on the 1960 figure; their growth, however, lost momentum as the year progressed.

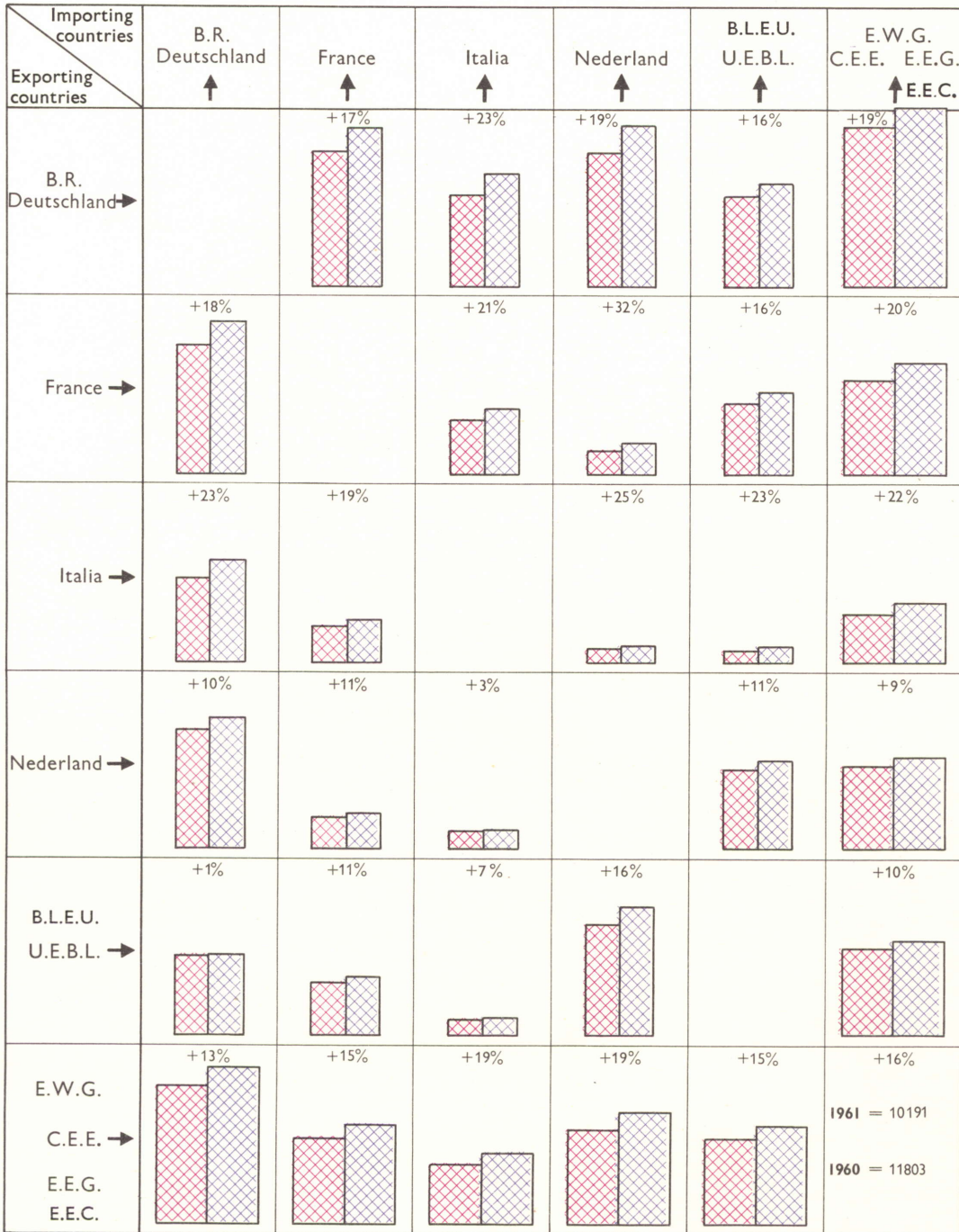
Trade between Community countries also contributed, generally speaking, to an increase in supply and once more helped to reduce the gaps, between levels of economic activity in the Community. There again, however, the slowdown in the economic expansion of the Community made itself felt. In terms of value intra-Community trade in 1961 was some 16 % above the 1960 figure (in terms of volume it rose some 15 %). The year-to-year figures for 1959 to 1960 were 25 % for value and 24 % for volume ⁽¹⁾. None the less, the expansion of trade between Community countries was again substantially greater than that of external trade. The ratio between the growth of internal trade and the increase in industrial production within the Community was again considerably higher than in the years before the Treaty of Rome came into force.

Once allowance is made for the fluctuations in trade in agricultural produce and foodstuffs, which were mainly due to differences between harvests in 1960 and 1961, the trend of trade between the members of the Community was determined by two opposing factors. On the one hand, the growth of trade in raw materials, energy products and semi-finished products was distinctly less rapid as a result of the decline in the growth of industrial production and the reduction in stockbuilding. On the other hand, trade in finished industrial goods grew in 1961 almost as vigorously as in 1960. Throughout the Community final demand again increased appreciably; moreover, shortages on the domestic markets of several member countries boosted purchases of finished goods in other Community countries. The impact of these economic factors was undoubtedly given added force both by the cut in customs duties and the virtually complete abolition of quotas, and by the general psychological effect of the measures intended to complete the establishment of the Common Market.

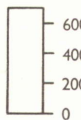
⁽¹⁾ Growth figures for 1959 to 1960 have been adjusted in order to make allowance for the statistical effect of the economic reunion of the Saar with the Federal Republic of Germany.

INTRA-COMMUNITY TRADE

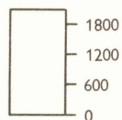
In million dollars



member countries

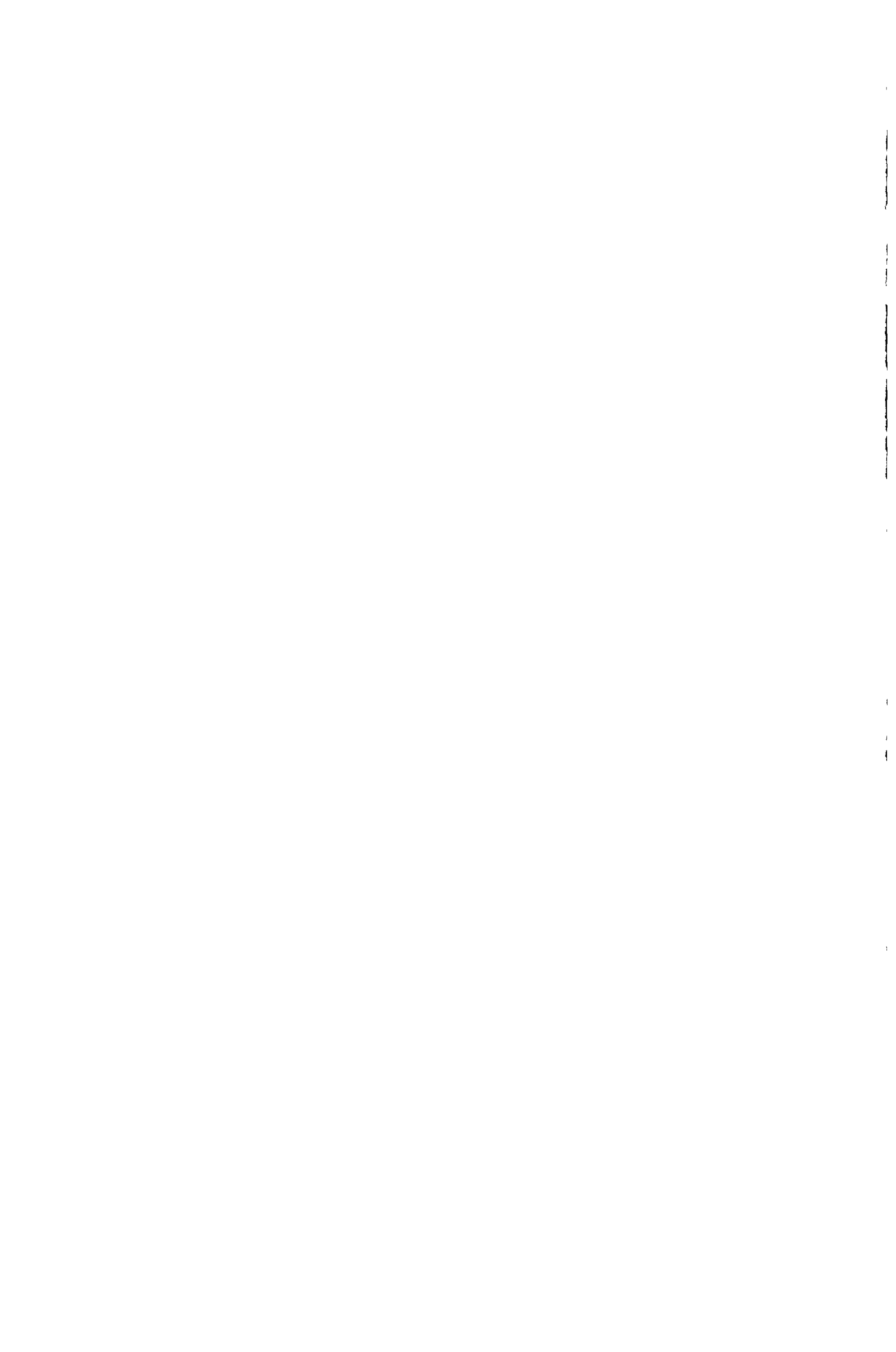


EEC



The figures for each trade flow are based on the average of the customs returns on both sides of the frontier.

The unit used to calculate the growth rates is the dollar (unit of account). Consequently, on account of the revaluation of the mark and the guilder, the rates are higher for West Germany and the Netherlands—except where trade between the two countries is concerned—than they would be if calculated on the basis of national currencies.



Towards the end of the year, it is true, there were clear signs of a slowdown in imports of finished goods, mainly due to the reduction in the propensity to invest recorded in certain member countries. This trend was, however, partly offset by a more rapid expansion of trade in agricultural produce and foodstuffs, since the countries in which harvests were relatively good, particularly Italy, stepped up their sales to the other Community countries.

A more detailed analysis of the trends in intra-Community trade shows that this trade helped to reduce differences between the levels of economic activity in the various countries. Imports of finished goods, for instance, increased vigorously in those member countries—the Netherlands and the Federal Republic of Germany—whose economies were suffering from overemployment, and hence from a relatively steep rise in costs and pressure on prices in several domestic markets. At the same time the development of exports from these countries fell off, mainly, it is true, on account of the slower growth of investment in some Community countries and because of certain special factors like the fall in demand for steel. The revaluation of the German mark and the guilder also had a distinct effect on Netherlands and Federal German trade with the other member countries. For the first time imports to Federal Germany were considerably stimulated by the tariff cuts made in connection with the establishment of the Common Market—previously German tariffs had remained almost unchanged because allowance was made for the tariff cuts introduced in 1957 in connection with the economic situation, whilst German exports had benefited from the cuts made in the tariffs of other member countries. These factors, combined with the steep rise in orders received for capital goods in previous years, still influenced the first half of 1961, with the result that Federal Germany's net surplus on current account in trade with the other five countries again increased substantially in 1961. However, the second half of 1961 brought clear signs of a tendency for the Federal German surplus to shrink. In the Netherlands, the deficit on trade with other member countries showed a distinct increase: exports grew little and imports increased substantially. By contrast, exports from Italy and France, where factors hampering supply were less in evidence, grew more rapidly than those from the other countries. This led to an increase in the French surplus and halted the growth of the deficit in Italy, where imports were moving up appreciably on account of the vigorous expansion of domestic demand. The trade of the Belgo-Luxembourg Economic Union with the other member countries grew relatively little; imports and exports were to all intents and purposes in balance.

In 1961 Community *prices*, which by and large had been reasonably stable in 1960, moved upward despite the slowdown in the growth of overall demand and the continued weakness of raw material prices. An increase in agricultural prices played an important role in this trend. Whereas the prices of crop products tended slightly downwards as far as the summer of 1961, they rose in the second half of the year, mainly because of poor harvests in all member countries, save Italy. Official measures of support for agricultural incomes contributed to the rise in foodstuffs prices, especially in France, where the rise was therefore particularly sharp.

In some member countries the prices of industrial goods increased rather more than they had done in 1960. There is much to suggest that the upward movement in wage costs per unit of output was increasingly responsible for the rise in prices at a time when the rate of growth in demand was slowing down. At any rate the rise in wages in almost all the member countries outstripped the concurrent growth of productivity in the economy as a whole. In many cases firms will have endeavoured to maintain their profit margins and the share of self-financing in their total investment by raising prices. They met with some success, as far as demand and conditions of competition allowed. Part of the increased costs, however, must have been met from profits, which had risen appreciably in the last few years. The price rise was particularly marked in building and construction, where the upward trend in costs became steeper and demand remained buoyant. In the services sector, too, prices rose once more, though here the rise is in part the result of a long-term trend.

Despite the appreciable improvement in the terms of trade—stemming largely from the revaluation of the German mark and of the guilder—the *Community's trade balance* (calculated from customs returns) deteriorated : there was a deficit in 1961 of \$ 29 million, where there had been a surplus of \$ 59 million in 1960. The deterioration was most marked in the first half of the year; in the third quarter there was a quite appreciable recovery, though it yielded to a further tendency for the balance to swing against the Community in the fourth.

Though the surplus on services improved in France and Italy, it declined in the Federal Republic of Germany and, to a lesser extent, in the Netherlands and the Belgo-Luxembourg Economic Union.

All in all, however, it would seem that the Community's surplus on current account was much the same as in 1960.

The surplus on the *overall balance of payments* declined appreciably in 1961 as a result of heavy exports of capital. Though the influx of short-term capital already noted in 1960 continued at the beginning of 1961, the end of currency speculation and the maintenance of a policy of moderate interest rates in the Community halted this trend later in the year. In addition, political events in Germany in the summer of 1961 led to a certain outflow of capital. Official exports of capital were also appreciably higher than in the previous year, because of further prepayments of debts to non-member countries, of an increase in development aid and of the participation of Community countries in the International Monetary Fund's credit to Great Britain.

Total *official gold and foreign currency reserves* in the member countries rose in 1961 by \$ 1 200 million, compared with an increase of \$ 3 200 million in 1960; at the same time the total net external assets of banks and credit institutions declined slightly, whereas in 1960 they had still shown an appreciable increase.

In 1961 the Community's *money and capital markets* benefited considerably less from transactions with abroad than in 1960, when the inflow of funds had been particularly strong. At times, particularly in the second half-year, there was evidence of strain, especially in the Netherlands, Italy, and the Federal Republic of Germany, and this led to a strengthening of interest rates. It was a result in part of the weakening of the inflow into Italy and Federal Germany of liquidity from abroad. Apart from the reduction in the flow to Germany and Italy of funds from abroad, the main factor in this situation was the activity of the public authorities, whose transactions sometimes had the effect not of increasing the supply of funds but rather of mopping it up or at best of not affecting it, while the industrial demand for credit rose sharply because of the growth of investment, of sales, and of the considerable rise in wages. For balance-of-payments reasons and also in an endeavour, made partly for the same reasons, to maintain the expansion of domestic demand, the member countries concerned took monetary and financial measures in the second half-year to ease the situation. This they attempted to achieve through reductions of minimum reserves, by adequate open market operations and by operations on the foreign exchange market.

In the other member countries market trends particularly balance-of-payments surpluses, continued to increase liquidity, with the result that interest rates tended downward. In the autumn the pressure which had been affecting the employment market and prices led the monetary authorities in France to request the banks to exercise restraint in making advances, and towards the end of the year they reinforced this step by raising the liquidity ratio with effect from 28 February 1962. In the Netherlands the expansion of credit was even made subject to quantitative controls and to a maximum which, however, left sufficient room for manoeuvre. In Belgium, where the balance-of-payments situation, unlike that in other countries, continued in the first half-year to provide an argument for a relatively high rate of interest, a gradual scaling down of the bank rate was initiated towards the end of the year, when there had been an improvement in the balance of payments.

In 1961 the *public finance activity* tended on the whole to curb rather than to boost the Community's internal economic activity. The growth of revenue was once again relatively steep, mainly on account of economic developments—in particular the upswing in sales and incomes in the immediately preceding years, whereas the growth of expenditure, though it too gathered speed remained below that of revenue. Consequently the budget deficits in most member countries turned out to be appreciably smaller than was originally expected. There were even surpluses in some countries: temporarily in Italy and, once again, for the full year in Federal Germany, particularly when Government expenditure abroad is deducted from total outlay. In the Netherlands, the Government maintained its policy of mopping up surplus liquidity by floating loans. Belgium was the only country in which the budget deficit was heavier than had been planned at the beginning of the year, since there was a time-lag before the increases in taxation took effect and since it was not found possible to limit the increased expenditure under all headings to the sums estimated.

4. Developments at the end of 1961 and early in 1962

In order to work out the forecasts contained in the following parts of this report, it is important that, alongside a balance sheet of the results for 1961, an analysis should be made of the economic trends which marked the year. To a large extent this has been done in the remarks already made; but the situation and trends towards the end of the year and at the beginning of 1962 are specially important for the making of forecasts, and they are therefore outlined briefly below.

In the third quarter of 1961 the increase in supply from industrial production and imports speeded up somewhat, though this does not necessarily signify a more rapid increase in final demand. The reverse would be nearer the truth.

Exports to non-member countries levelled out after the sharper increases recorded in the second and third quarters : their year-to-year growth rate in terms of value fell from 10.1 % in the third quarter to 3.7 % in the fourth. This trend is accounted for mainly by a decline in exports from Western Germany, where the slowdown of investment in Western Europe is particularly serious in view of the pattern of German exports; these are affected by the weakness in the demand for steel, and by the revaluation of the mark, factors which, together with higher internal costs, are tending to hamper exports.

Fixed investment also advanced somewhat more slowly than before. In France and in Italy, but West Germany and apparently also in Belgium the propensity to invest seemed to step slightly downward. Even in these countries however, the amounts actually spent on investment continued to rise, although in West Germany at least the level of new orders for capital goods from the home market (and even from abroad) continued to decline.

By contrast stockbuilding, particularly of imported raw materials, may well have again become somewhat more lively, as trends in the imports of certain major raw materials also suggest.

On the whole, private consumption seems to have increased at the same fairly rapid pace recorded in the third quarter.

The growth of industrial production regained some momentum after slowing down in the second and third quarters. According to the seasonally adjusted figures in the index of the Statistical Office of the European Communities, the increase from the third to the fourth quarter of 1961 was about 2 %, after a figure of 1 % had been recorded in both of the previous quarters. The year-to-year increase in the unadjusted index was 6.2 % in the fourth quarter. This development was almost solely due to the rapid growth of output in Italy, while in the Federal Republic of Germany, Belgium and the Netherlands the level of output remained more or less unchanged or rose only slightly. Luxembourg, which suffered from the weakness in demand for steel, experienced an actual fall in production.

Imports from non-member countries showed a definite recovery in the fourth quarter from the downward tendencies noted in previous months. The year-to-year growth rate in terms of value climbed from 1.8 % for the third quarter to 6.8 % for the fourth. This development can be chiefly put down to increased imports of grain caused by the poor harvests in 1961, and to the increased purchases of certain industrial raw materials.

Trade between Community countries remained at the level it had reached; sales in the fourth quarter, however, were again almost 14 % up on the corresponding 1960 figure. This stabilization might well partly be due to special factors, in particular the tendency for imports to slacken in anticipation of the tariff cuts between Member States on 1 January 1962.

Price trends seem to have remained much the same. There may however have been less tendency for the prices of industrial products to harden.

As a result of the trends observed in imports and exports, there was an appreciable deterioration in the trade balance for the three last months of 1961, there was a deficit of about \$ 20 million, after surpluses of roughly \$ 290 million in the third quarter of 1961 and nearly \$ 150 million in the fourth quarter of 1960. None the less, the official gold and foreign currency reserves of member countries rose in the fourth quarter by about \$ 360 million, partly because of seasonal movements resulting in the transfer to the central banks of currency which had previously been held by the commercial banks.

B. Outlook for 1962

The economic outlook for the individual Member States, as it appears to the staff of the Commission, is as usual given in Part II of this survey. It has been prepared in close co-operation with experts from the member countries and largely on the basis of estimates from the various countries, especially where they prepare their own general economic forecasts officially. However, even in the latter case, the views on particular points expressed by the staff of the Commission may on occasion differ from that expressed in the official forecasts.

The forecasts in Part II again include estimates made by the Commission's staff—especially for those countries whose own forecasts were not yet available when this survey was being prepared.

Consequently all the predictions made in this report are in the nature of experts' forecasts based on certain hypotheses and taking into account the economic trends that are already apparent or taking shape. They do not represent in any way economic targets for 1962 which the Governments consider desirable or feasible and which they will make more or less vigorous efforts to attain.

For the Community as a whole these forecasts paint a picture of a further slight weakening in the expansion of overall demand, and of internal demand in particular.

In view of the general trend, the strains noted in 1961 should ease off in 1962. However, as the chapters on the individual countries show, the overall picture is substantially more complicated than in previous years, when the main features in the outlook for the various member countries had much more in common. The same is true of the outlook for the different economic sectors, so that the way output develops will depend in some cases on demand and in others on the physical factors governing the growth of production. Although developments in the economic situation as a whole do not seem to be becoming more uniform, they may be leading to a better balance in the level of economic activity and also in that of employment in the Community.

External demand in 1962 and the resultant exports to non-member countries are likely to be just a little above the estimate made at the beginning of 1961 and the actual results registered in that year. Nevertheless orders from abroad could again gather some momentum, and exports may also be boosted by a slackening in the growth of internal demand, particularly for capital goods, and by the expansion of capacity in the Community. It must on the other hand be remembered that the relationship between wages and productivity has in some countries been developing less favourably than in some leading non-member countries and tending to reduce the competitiveness of Community industries, with the result that exports may suffer. All in all the most that can be expected is a slightly more rapid growth of exports in terms of value, and this may not be noticeable before the second half of the year.

The expectation that exports will grow more rapidly is based chiefly on the forecast of higher sales to the United States. Most experts predict that economic activity in that country will continue to climb in 1962, although probably more slowly than in the last three quarters of 1961. The expansion of domestic demand in America, which by the last quarter of 1961 had already caused a clear recovery in the Community's exports to that country, is likely to continue for at least the greater part of 1962. This should lead to a further substantial rise in American imports. On the other hand it is possible that, in view of the substantially less encouraging economic outlook for many other industrial countries in 1962, the growth of United States exports may be relatively small. The surplus on current account, which had already declined in the second half of 1961, may shrink further, though possibly less than before. It is impossible to predict (if only because unforeseen capital movements play a very important part in the US balance of payments) whether and at what time this trend might force the Administration to adopt measures liable to put a brake on the expansion of domestic demand and thus curtail the growth of imports. The Administration may have more room to manoeuvre as a result of the agreement in December 1961 between the International Monetary Fund and ten of its members, which gave the Fund greater powers of intervention to counter any speculative capital movement which might follow a possible deterioration in the balance of current payments. Be that as it may, time would still elapse before restrictive measures could have any real effect on imports. Consequently the Community's exports to the United States are in any case bound to increase considerably, even though certainly not at the high rate experienced between 1958 and 1959, this having been due not only to the prevailing economic situation but also to exceptional developments in the American markets for steel and motor cars.

Exports from the Community to the EFTA countries are on the other hand likely to advance more slowly in 1962 than in 1961. The possibilities of increased exports to Great Britain—where economic prospects are not particularly encouraging—are again decidedly limited. Great Britain's exports, which increased only 4 % in value in 1961, might, it is true, gather momentum in 1962, in view of better market prospects in the United States and the sterling area as a whole. But it looks as though British exports to the other industrial countries of Western Europe, where economic expansion is slowing down, will register only a small advance. Moreover the rise in internal demand in Great Britain, which at best had been small, now seems to have come to a halt. It seems hardly possible to stimulate or permit any notable recovery, since this could rapidly involve a serious threat to the balance of payments, particularly if the rising trend in wages again gathered pace. Certainly the Government is anxious to keep increases in incomes within narrow limits. Even if the stimulus of a cut in Britain's customs duties on industrial goods under the agreement reached within GATT is taken into account, the rise in Community sales to Great Britain will again be relatively small.

Community exports to other EFTA countries are bound to grow more vigorously than those to Great Britain, although probably less than in 1961 since, as already stated, economic growth in these countries seems definitely to be slowing down.

The outlook for Community exports to the developing countries suggests that these exports are hardly likely to rise faster than in 1961. By and large these countries increased their gold and foreign currency reserves somewhat in 1961, and more development aid will be forthcoming from the industrial countries in 1962; but the prospects for deliveries from the developing countries to the industrial countries are by no means encouraging enough to warrant the expectation that on balance there will be a substantial increase in their purchasing power abroad. Finally, hardly any prediction can be made about the trend in exports to Algeria, which takes about 10 % of the Community's exports to developing countries.

While there is some hope that external demand may continue to grow and perhaps even gain speed in 1962, domestic demand might well slacken in pace, especially that for fixed investment. A somewhat lower rate of expansion may also be recorded in private consumption.

Gross fixed investment by enterprises will as a whole advance more slowly than in 1961. This is clearly indicated by the separate estimates for most member countries. The decline will be particularly marked in Germany. In France investment by publicly owned undertakings will rise more rapidly than in 1961, but this will not fully balance the slower expansion that is expected in investment by private enterprise.

Several factors may lie at the root of the weaker expansion in private investment activity, their influence varying from one country to another. These factors include pressure on profit margins, stemming from a greater rise in the cost than in the productivity of labour, coupled with limited possibilities for price increases owing to the slower growth of demand and increasing competition from abroad; similar pressure, especially among small and medium enterprises, as a result of the progressive incidence of taxation; cyclical factors—after years of steep rises in investment and capacity managements in some branches of industry are beginning to have doubts about the ability of demand to keep up with a further expansion of capacity at the pace of the last few years (in several branches the proportion of idle capacity was already higher in 1961); the repercussions of certain reductions in exports caused by the last recession in the USA—these had already become evident in last year's investment plans and are now affecting actual expenditure; more cautious views on the outlook for exports to the developing countries because of the limited foreign currency at their disposal.

On the other hand, the propensity to invest is still being influenced by other positive factors : the outlook for goods and services for private consumption is set fair; activity should again be stimulated by better export prospects to the USA; the Common Market offers expanding markets, but also keener competition. Yet another factor is the shortage of manpower and the effort required to combat the rise in unit labour costs by rationalization. On balance therefore there will still be appreciable growth in fixed investment by enterprises in 1962—provided always the means of financing these investments, especially funds from the capital market, can be obtained on sufficiently reasonable terms. At the same time it must be borne in mind that this growth will partly stem from work on projects already planned or started in 1961.

Investment in building and construction, which of course also covers part of the fixed investment by enterprises referred to above, in 1962 will more or less maintain its slow growth rate. This is limited in most member countries not by demand but rather by the physical factors governing supply. The number of building permits issued in certain countries during the second half of 1961 suggests some slackening in the demand for industrial and commercial buildings, comparable with the reduction to be expected in fixed investment by enterprises. But in housing the increase in effective and future demand shows little sign of slackening, while the volume of public investment in building and construction is certainly going to rise considerably. Building activity as a whole in 1962 may even climb a little more sharply than in 1961, the extent of the climb depending on how far easier conditions return to the labour markets and the flow of manpower from the building trade to other better-paid sectors of the economy slackens off.

It is particularly difficult to predict what will happen in 1962 to *investment in stocks*, as this is so dependent on unforeseeable factors. Some recovery later in the year seems likely in view of the fact that the tendency to run down stocks has already lasted for some time; this likelihood is strengthened by the firmer trend in the prices paid on world markets for raw materials (even though there is no prospect of these prices rising again), by the hopes for a better harvest in 1962 than in 1961, and finally by the possibility that 1962 may see certain branches of industry building up involuntary stocks of their products. If, however, general economic expansion again tails off, there might be a fall in the rate at which stocks of materials held by manufacturers were being built up. In making the estimates contained in this report, it is assumed that in the Community total investment in stocks will be about the same in 1962 as in 1961; at the same time it must be borne in mind that stockbuilding dropped sharply in the course of 1961; the forecast for 1962 therefore implies some corresponding recovery in stockbuilding during the year.

Private consumption may advance rather less briskly than in 1961. Although wages will continue to rise substantially, this movement will probably lose some momentum for the Community as a whole. Moreover employment, expressed in the total number of hours worked, will rise much more slowly, since the total of persons in employment can hardly move up as sharply as in 1961, while further slight cuts may well be made in the number of hours worked per person. Finally, the continuing pressure on profit margins cannot fail to have some effect on the disposable incomes of private households, which on balance are likely to advance more slowly than in 1961, although transfer incomes (pensions, annuities and allowances) once more show a considerable rise. This means that, if there is no great change in the rate of savings by households, consumer expenditure will, as already stated, expand rather more slowly than in 1961. The year-to-year growth rate might well be 5 % in volume, as against fully 6 % in 1961.

Finally, *public expenditure on investment and consumption*, according to the budget estimates for 1962 now available, will again be stepped up considerably, probably at a somewhat faster rate than in 1961.

Growth of *industrial production* ⁽¹⁾ for 1962 is estimated at roughly 5.5 %, which would be a little less than in 1961 when it was almost 6.5 %. Physical limitations, above all labour shortages, will continue to act as a brake on output in some countries and sectors. Moreover, the trend in demand will have an even more decisive influence than in 1961. In view of the probable weakening of demand a slower rate of growth can be expected in the capital goods industry and its ancillaries. The slowing down in the rate of industrial output as a whole may well affect the consumption of energy. On the other hand, growth rates similar to those of 1961 will probably be recorded in the consumer goods industries.

In view of the considerable further rise expected in consumption and the estimated increase in trade with non-member countries, the growth of activity in the *services sector* should be only slightly less than before.

In these circumstances and under normal weather conditions, which would bring about a steeper rise in agricultural production than in 1961, the total real *gross national product* in the Community would be up on the previous year by 4.5 to 5 %.

Such growth, should be possible not only in view of future developments in total demand, but also with overall productivity increasing at a rate similar to that of 1961. Employment in the Community as a whole in 1962 can hardly be stepped up more rapidly than in 1961. For one thing there will be a smaller natural increase in the working population, while labour reserves have sunk so low in some countries that it will hardly be possible to achieve any further reduction of importance. These difficulties will be most pronounced in West Germany, where no increase in the working population can be expected from the natural demographic trend and where further cuts will probably be made in the working week. In the other member countries, on the other hand, it is still possible for the numbers in employment to be increased, sometimes more, sometimes less.

Community *imports* from non-member countries will in all likelihood continue to grow at about the same low rate as in 1961. On the assumption that managements will still follow a fairly cautious stockbuilding policy in the first half of 1962, imports of industrial raw materials will probably still be rather modest. Even if these later show a recovery, the total for 1962 is not likely to exceed the 1961 figure by very much. Purchases of foodstuffs and agricultural produce in the first half of 1962 are, on the contrary, sure to be well above those for the corresponding period of the previous year. The slow-down in the growth of internal demand will probably entail a loss of momentum in imports of industrial products, but these represent only a third of the Community's imports from non-member countries.

Trade within the Community will again tend to have a salutary effect on the equilibrium of particular markets and on the differences in level of economic activity between

⁽¹⁾ Based on the Index of the Statistical Office of the European Communities; excluding foodstuffs industries and building and construction; the contribution of industrial production to the gross product of the Community will certainly decline in volume.

the various member countries, while at the same time boosting investment and output. It may well continue to advance, but again more slowly than in the previous year.

A consideration of the prospects of general equilibrium suggests that a reduction in the pressure on *prices* is possible in 1962. However, since the rise in costs registered in 1961 can be expected to continue in 1962, while agricultural prices are also expected to advance, the general price level will still tend to rise, although the increase may turn out to be less than in the previous year.

The prospects outlined above for exports and imports of merchandise indicate that the Community's *balance of trade* is likely to deteriorate rather more than it did in 1961. This is borne out by the likelihood that the terms of trade will not improve as much as in 1961. Nevertheless, the overall balance of current transactions might well continue to show a definite surplus, but this may be smaller than in 1961.

Clearly, it is impossible to make a reliable estimate of the state of the Community's *overall balance of payments* with non-member countries, although it seems fairly certain that in 1962 there will again be a considerable surplus.

As for movements of private long-term capital, hardly any decisive change in trend can yet be expected, despite the measures envisaged in the United States to encourage capital investment at home and to curb the tendency to export private capital to the industrial countries. The balance should again be in the Community's favour. However, the "basis balance" may be upset, as in 1961, by more or less artificial public exports of capital—artificial because they result from special government decisions and are in part financed by credits from the Central Banks. It looks, however, as though such transactions in 1962 might be on a smaller scale than in 1961. Exports of capital as part of development aid will, on the other hand, probably be stepped up.

C. Economic policy

The new stage which the Community has entered in its advance towards economic integration, and the economic situation in which it will find itself in 1962 set economic policy a number of problems.

As regards economic integration, the current progress made in various fields covered by the Treaty—the further and probably faster tariff reductions and the elimination of the last quotas on industrial goods within the Community, the elaboration of a common agricultural policy, a common commercial policy, etc.—will logically call also for a further advance in the co-ordination of economic policies.

There is an urgent need for further progress in the work of analyzing economic developments, especially the prompt publication of complete and comparable statistics, including the national accounts *ex post*. In these matters action should be taken to hasten the establishment of closer and more effective co-operation between the departments of the Commission, in particular the Statistical Office of the Communities on the one hand, and the appropriate authorities in the member countries on the other.

In collaboration with the appropriate authorities and institutions in the Member States the Commission has already made considerable progress in the analysis and forecasting of economic developments by means of business trend surveys : a joint survey has been introduced, which puts five questions every month, with an additional question once a quarter. So far the use of the EEC trend survey has been formally agreed or accepted in principle by five Member States. It has been in operation in the Federal Republic of Germany and in Italy since the beginning of 1962. France, where certain technical factors are holding up the arrangements somewhat, will follow suit in the spring, when it should be possible to introduce the survey in Belgium also. In Luxembourg, however, the survey will be breaking entirely new ground, whereas in the other member countries it can be grafted onto existing practice.

Clearly such trend surveys, carried out from a common standpoint and in a comparable manner, are extremely useful; not only do they improve the quality of business trend analysis in the Community, but they also help the participating firms themselves, which in return for the information they supply, obtain figures covering their branch of industry in each participating Member State and in the Community as a whole. This usefulness will increase when in the course of time the questionnaire is expanded and subdivisions are made, referring to particular products. It is to be assumed that in view of the increasingly obvious advantages, businessmen in the Netherlands will also decide to participate in the EEC survey. The results of the survey will be published by the Commission in due course, after they have been operating for a while and some experience has been gained—and subsequently at regular intervals in summarized form.

Further considerable progress is also in sight in the co-ordination of short-term economic policies. Early in 1962 the Commission proposed that the practice of preparing each year a general economic forecast, already adopted by the Governments of some Member States, should be extended to all Community countries in the form of sufficiently detailed estimates covering all parts of the economy. The Economic Policy Committee welcomed and supported the proposal made by the Commission. There has already been a meeting of experts to discuss the technical problems involved and agreement has been reached on a framework for the forecasts to be made by each country. Although further efforts are required before the results are really comparable—progress here will depend largely on the success in the endeavours to harmonize statistics *ex post*—it will probably be possible to have such general economic forecasts for 1963, covering each of the member countries, available to the Economic Policy Committee by about the end of 1962. Later, preliminary estimates for the most important sectors are to be prepared each April for the subsequent year. The general economic forecasts are to be brought up to date every six months.

These general forecasts will contain not merely estimates in the form of figures, but also comments on existing policy in connection with the estimates, or on any plans or possibilities for policy in this connection. They are therefore more than just a valuable means of improving the analysis and prediction of economic developments; they will facilitate the domestic co-ordination of economic policy in the individual Member States and make it easier for them to co-ordinate the joint action to be taken in the economic field. Obviously the confrontation of general economic forecasts of this sort will make it easier to see what practical effects will be produced in the other countries of the Community, in the Community as a whole and in non-member countries by the economic developments occurring in each of the Member States and by the economic policy it pursues; it will also make it easier for the Member States to align their policies more and more closely on a common policy. At a later stage the preparation of harmonized forecasts will make it possible to draw up forecasts for the whole Community, and these in turn can supply the technical basis for a more effective co-ordination between the Community and the major non-member countries.

Unlike the general results of business trend surveys, the general economic forecasts are not, for the present at least, to be published.

It is becoming more urgent to devise, develop and install machinery for influencing economic developments as further progress is made in other sectors of economic integration and common policy, for which the Treaty generally provides in more concrete and more mandatory terms. The Monetary Committee and the Economic Policy Committee have for some time been studying the weapons available in the field of liquidity and credit policy, and the policy that could be followed in the event of a recession. The Economic Policy Committee is also dealing with the problem of price increases and the means by which undesirable trends towards higher prices could and should be countered.

All these studies are important from the point of view of the present economic situation and for further developments in 1962. In this context a few remarks on anti-recessional policy may be called for. As the outlook for 1962 given in this report shows, the Community has, it is true, to expect some little decline in expansion, which may be rather more marked in some member countries than in others; but the conditions which are typical of the present situation and will, probably, remain typical of 1962 as a whole, are such that preparations should be made to deal with all eventualities. It should be noted that "eventualities" does not necessarily mean recessional trends only, but may include protracted stagnation or a much too sluggish economic expansion, leading to regrettable underemployment of the factors of production.

Not all these studies have yet been completed by the Committees referred to. Nevertheless the knowledge gained so far of the weapons available to carry out economic policy, the conditions in which they can be used, and their importance for a common policy has already begun to bear fruit. Several Member States have found it necessary to extend or improve the weapons at their disposal, and on the basis of the information already available the Commission is in a position to suggest further appropriate measures.

The prospects sketched in this report for the Community as a whole and for each individual Member State reveal certain problems arising from the present economic situation and from the developments expected in the rest of 1962.

These problems are :

- i) A certain tendency for demand to lose momentum in some countries and some branches of industry;
- ii) Combined with the above, a continued shortage of labour—especially of skilled manpower—which may incline to diminish in some countries, but become more significant or acute in others;
- iii) An almost general though not evenly spread tendency towards higher prices;
- vi) A continuation of the tendency towards balance-of-payments surpluses.

The slower expansion of overall demand in most Member States undoubtedly has, when the drop is not excessive, certain favourable aspects in some of them. This is particularly evident in those countries where the pressure on prices is in the last resort due to high balance-of-payments surpluses and the resultant over-encouragement of investment in the last few years. The pressure on costs already visible in some countries in 1961, and which is likely to continue in 1962, is in greater or lesser degree a direct consequence of this development. If in these countries external trade surpluses and the expansion of internal demand both show a tendency to decline, as they do particularly in West Germany, this is not undesirable from the point of view both of the international balance-of-payments situation and of the domestic economic situation. With the usual time lags the quieter situation thus brought about might have a steadying effect on the development of unit costs and of prices. Finally, these tendencies in demand—easing in those countries which so far have experienced the greatest strain, and continued expansion in the other

Member States—will work for a better harmonization of the level of business activity throughout the Community.

Great care should however be taken that the expansion of investment does not slow down too much or even come to a halt. Otherwise, and in particular if such a combination of circumstances were to prevail in one or more major countries of the Community, important economic stimuli would be lost, not only for other countries of the Community, but also for the non-member countries; the main reasons for this would be that in such a case the Community's imports would not rise enough and that with productive capacity not fully used to supply domestic needs, there might be renewed emphasis on exports.

It is therefore not possible to counteract labour shortages, rising incomes and higher prices by general measures of restraint in the financial and credit fields; these measures would moreover have a direct and undesirable effect on the balance of payments. This does not exclude prudent guidance, or even the imposition of restraints in individual sectors such as building, but on the whole financial and credit policy must contribute to an adequate expansion of overall demand or create favourable conditions for such expansion. It can be said that current trends in the cash position of the public authorities, future developments in this field, as far as they can be deduced from the budgets for 1962, as well as the monetary and credit policy pursued by the monetary authorities of the Member States are in general fully consistent with these requirements. Should it in the course of the year appear that in one or other of the Member States the cash position of the public authorities does after all have unduly restrictive effects—perhaps because of delay in executing public investment programmes—the appropriate corrective measures would have to be taken in good time.

As for the labour market situation, it would appear that there are prospects, which fit in with the trend towards a harmonization of levels of business activity in the Community countries, of a slight easing of the manpower situation in West Germany and the Netherlands, whereas the situation may well tend to become more acute in France and also in Italy, though here perhaps the shortage may be largely confined to skilled workers. Despite the tendency for the shortages of labour to level out, it is evident that they are still a fairly general problem, by which the northern areas of the Community will continue to be the most affected. It should be countered by a further increase in internal migration and especially by a considerably broader and more active development of occupational training.

Obviously measures to increase the availability of labour also tend to check the rise in prices, which in present conditions is in part due to the persistent rise in unit costs and in part to the efforts of industry to preserve profit margins unimpaired where possible.

Indeed, wages policy cannot, in the economic conditions of today, be left out of any discussion or action on matters of economic policy. Any substantial wage increases which appreciably exceed the concurrent rise in productivity could set in train develop-

ments which may not only cause prices to rise, but may have a generally depressing effect on economic activity—the results will depend on the reactions of employers and developments on the capital markets. Rising prices may lead to a reduction of real demand, and where price increases are ruled out by stiffer competition, especially from foreign competitors, there will be direct pressure on profit margins.

It is true that in the boom of 1959 and 1960 profits rose appreciably and that in industry at least wages for a time lagged behind. Another aspect of this development was the higher ratio of investment to consumption in the Community; this in turn has been a decisive factor in the vigorous economic expansion of recent years. It was entirely consistent with the ratio between wage increases and increased productivity that self-financing should have played a considerable part in the financing of the rapidly rising investments.

It is, however, possible that businessmen, many of whom have throughout the period of post-war reconstruction been used to ample facilities for self-financing, might in the end react to any brusque narrowing of the profit margin on sales by slowing down the expansion of their investments or even by making actual reductions. There is a chance of this happening even if profits do not fall in absolute terms but rise more slowly than before and more slowly than wages.

The threat of an excessive squeeze on the growth of investment will be particularly serious if the outlook abroad is assessed with less optimism because of the economic trends prevailing throughout the world and of changes in the sphere of costs, if the expansion of capacity is felt to have been perhaps too rapid after all and if competition from abroad increases appreciably. Of course businessmen may even so be ready, despite the more limited possibilities for self-financing, to go ahead with investments that have been decided on and put in hand, using more borrowed funds both in absolute terms, and in relation to the degree of self-financing. An example of this is to be found in the figures from the Federal Republic's national accounts for 1961, just published by the Bundesbank; these show that despite the increased share of the wages in the national income, there was a considerable growth of investment by enterprises in which the amounts of borrowed money rose considerably in both absolute and in relative terms. At the same time a perceptible reduction of the propensity to invest is reflected in the volume of domestic orders received by firms manufacturing capital goods and in the number of permits issued for industrial and commercial building. The information available in the other countries is less complete, but there are signs that similar, if in some cases less pronounced, tendencies might be developing in some of them.

Whether businessmen will, despite reductions or the threat of reductions in their profit margins, continue to plan for increased investment must, of course, depend on the conditions and the outlook on the capital market. These are not everywhere particularly favourable. In many cases the banking system has ample funds at its disposal and the prospects of obtaining short-term or medium-term advances are not at all bad. But as an

alternative to the use of one's own money this form of credit leaves much to be desired. What managements will want is a sufficiently expanded offer of cheap, long-term capital, in other words of genuine savings. The present outlook scarcely suggests that the offer will arise enough for managements to maintain an appreciable expansion of investment by using mainly borrowed funds of this sort. In fact it is perfectly possible that certain strains may develop on the long-term capital markets. In some countries, such as Germany, rates of interest on the capital market are for "structural" reasons relatively high—one of the reasons being the methods used to finance parts of the residential building done—and this gives rise to difficulties which should not be underestimated.

It may be possible to deal satisfactorily with these problems if workers are ready to increase their present level of savings by adding to it that part of any wage increase which exceeds the concurrent rise in productivity and diverting the money to the capital market, and if at the same time managements are ready to accept the ensuing (relative) reduction in the growth of their own wealth in favour of the growing wealth of the workers without making large-scale reductions in the expansion of their investments. It could then be argued that the wage increases concerned were neither detrimental nor beneficial to economic growth. There would probably be occasions where they would be thoroughly welcome from the angle of greater justice in the distribution of wealth.

Possibly then some action could be attempted on these lines, or existing arrangements might be reinforced. This would apply in particular to State action to encourage saving by workers through fiscal measures or savings bonuses. Such action is advisable not only in order to obtain better distribution and higher levels of investment, but also for reasons of price policy—the expansion in total incomes being perhaps rather too vigorous and the price situation difficult. For mass incomes, i.e. incomes from wages and salaries plus transfer incomes which follow more or less closely the trend in wages, are decisive for the way in which growth of consumer expenditure develops since they make up between two-thirds and three-quarters of the disposable income of private households. The remainder of this disposable income is made up—to a smaller or larger extent, depending on the country—of the incomes that farmers and craftsmen have taken out of their businesses, the incomes of self-employed persons (doctors, lawyers, etc.) and the unearned income of employed persons. The marginal rate of savings, i.e. the proportion saved out of the increase in incomes, appears to be rather low where incomes from wages and salaries are concerned. Thus a substantial increase in the marginal rate of saving out of the incomes of wage-earners would seem to provide part of the desired solution. In view, however, of the savings habits of workers and of certain difficulties in the structural arrangements by which the capital markets of some countries could deal rapidly enough with the increase in workers' savings, it is likely that the results obtained will be limited.

It will take time before these conditions—readiness of managements to use a larger proportion of borrowed capital and of workers to increase their savings—are sufficiently realized. Correspondingly it will during this time be advisable to recommend a certain degree of moderation on wage increases; this and co-operation of both sides of industry together and with the Government would restore the balance between increases in pay and

the rise in productivity, and so assist in maintaining adequate growth both in investment and in the national product as well as reasonable developments in the price field. It will seem preferable to have a comparatively rapid economic expansion combined with a reasonable stability of prices rather than stagnation or even recession, coupled with either underemployment of the factors of production or a period of comparatively rapid price rises, or both; this would seem to be true even if distribution of wealth were not as satisfactory as one could wish. Every endeavour should of course be made to ensure that the restraint exercised by wage and salary earners is matched by that of other income groups. In particular the growth of expenditure on consumption out of company profits or unearned income should be kept strictly within limits—thus favouring the ploughing back of profits in the business sector, of savings in other forms and so the financing of investment. Nor is it possible entirely to ignore the limits placed on price increases by the need to be internationally competitive. The margin offered by the surpluses in the balance of payments is still considerable, but it is already showing distinct signs of shrinking. Anything which reversed the present situation would quickly be followed by a contraction in the economic growth of the Community.

It is, however, hardly possible to confine co-operation in wages matters entirely to questions of pure wage policy. In view of the interdependence of economic phenomena such an attempt would be meaningless. There might therefore be meetings between both sides of industry and the Government, as is already the practice in the Netherlands and as is being attempted in France; at these meetings the range of possibilities and the decisions to be made on the whole field of income policy and growth policy is defined and discussed in relation to the national accounts and to relevant material concerning the economic outlook and the policy envisaged by the Government. Such meetings might produce agreement on a line for ranges which, in the circumstances of today, might be reasonable for all concerned and for the economy in general; this would be a line which succeeded in preventing excessive price rises without hampering economic growth.

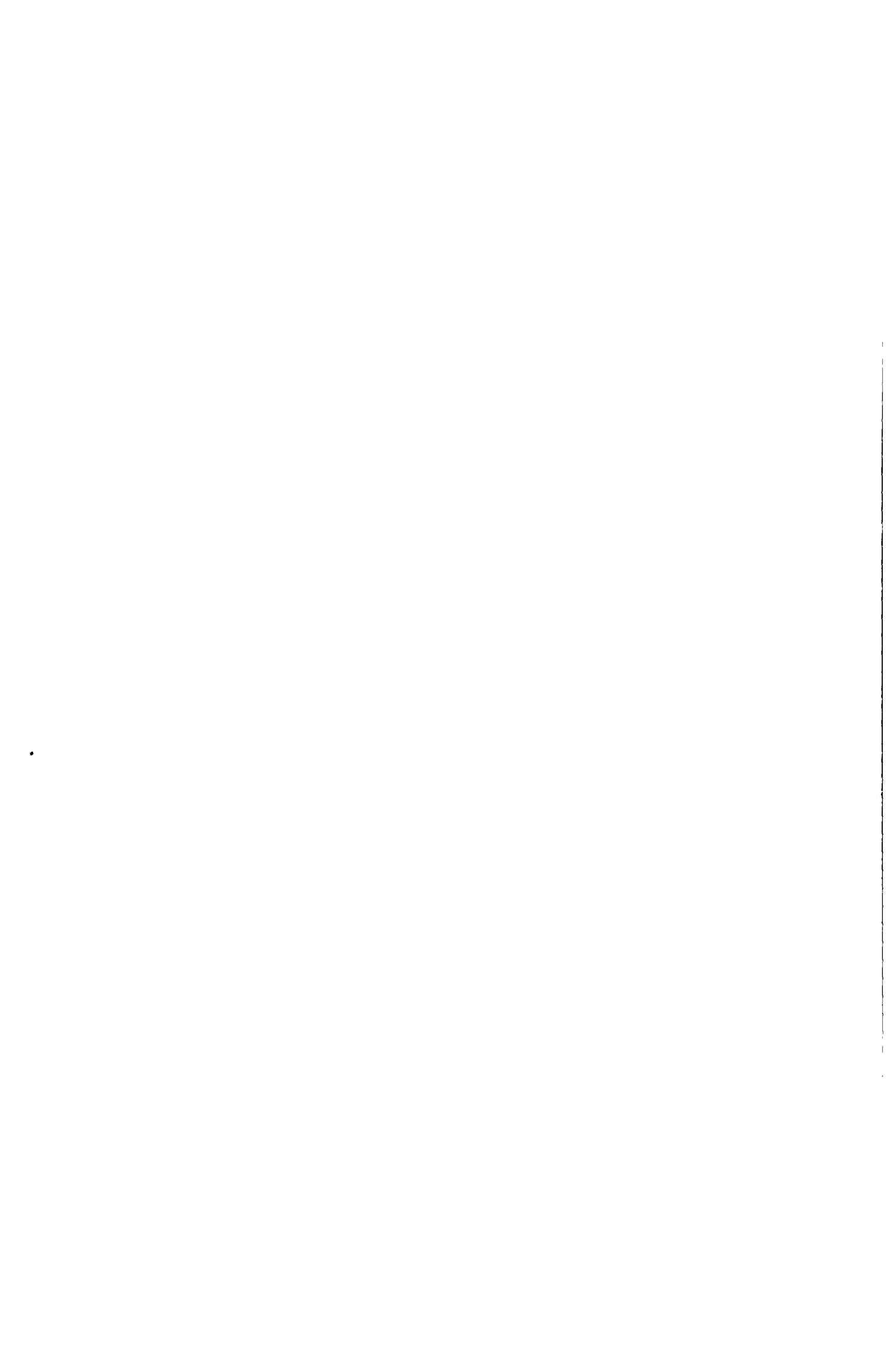
Of course the tendency for price levels to move slightly upward is not exclusively due to the fact that wages have been rising faster than productivity; in part it stems from decisions taken by Governments or parliaments in such fields as agriculture, adjustment of controlled rents and public services, in particular transport rates.

As in the past action can and should be taken to counter rises in the level of prices by increasing the supply of imported goods. Advantage should be taken of any chance to increase imports from other member countries within the Community. For the Community as a whole this will certainly not be detrimental to business activity, and in particular markets it is likely to eliminate tendencies for prices to rise. In this connection attention should be drawn to the impact on prices of the speed-up in the general removal of barriers to trade within the Community, and to the possibility of individual countries deciding in their own interest to take "advance action" on a substantial scale.

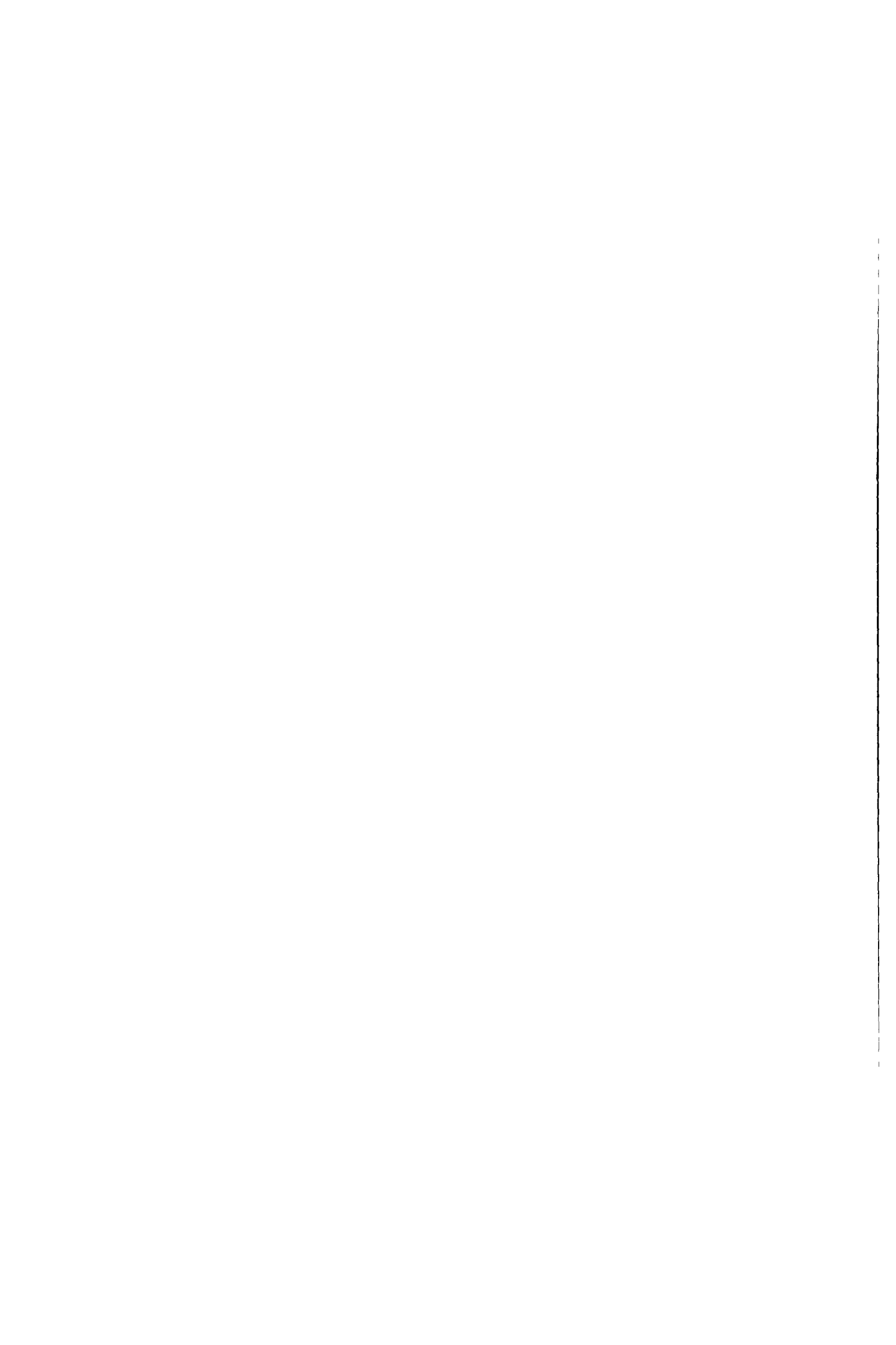
In addition, it seems advisable to continue and intensify the liberal import policy. This seems to be still feasible and desirable from the angle of the balance of payments,

too. The outlook, here, suggests a continued high level of general Government transfers of capital abroad. The slower increase in the total official gold and foreign currency reserves of the Member States which occurred from 1960 to 1961 was largely due to special Government payments, such as advance debt repayments or the credit granted to Great Britain through the International Monetary Fund. If Government transfers of capital abroad were in 1962 to be considerably lower than in 1961, reserves might rise again, despite the small decline that is likely to occur in the Community's surplus on current account.

There is no conflict between these suggestions for more active encouragement of savings by workers and the line along which it is hoped the balance of payments will develop. Clearly, it is only a matter of changing shares in the formation of monetary wealth, coupled with overall expansion of investment demand (which will even have been helped forward by such measures) and, consequently, of economic activity in the Community.



**II. THE SITUATION IN EACH
OF THE COMMUNITY COUNTRIES**



A. Federal Republic of Germany

Economic expansion, which had already lost some momentum in 1960, slowed down again substantially in 1961. None the less, the average rate of growth of industrial production from month to month was still 5 % and that of the real national product was about 5.3 %.

The slowdown was mainly due to the effects of physical obstacles to growth, particularly the lack of manpower ; in the second half of the year, however, there was a growing tendency in some branches for the expansion of demand to lose momentum or for demand actually to fall. Foreign demand, in particular, grew but little, and this is explained by economic developments in important purchasing countries, by the results stemming from the revaluation of the German mark and by the steady rise of costs at home. These factors, taken in conjunction with certain cyclical stock movements, also contributed at times to the emergence of weaknesses in the expansion of the demand of enterprises.

Labour costs per unit of output again rose, thus contributing the upward price trend. At the same time the slowdown in the expansion of demand and sharper competition from abroad, particularly in the shape of a further big jump in imports of finished goods, prevented firms from passing on increased costs in the form of higher prices. Imports of goods and services grew faster than exports, and this, combined with increased capital exports, led to a deficit on the balance of payments ; the Bundesbank's gold and foreign exchange reserves fell by a little less than DM 2 000 million.

The trends that can at present be foreseen and the information available on business developments abroad and the economic policy likely to be followed suggest that economic expansion will continue in 1962 as a whole.

The expansion of demand might, however, again lose pace ; at the same time, the shortage of manpower will continue and will also limit the expansion of output. Economic expansion is likely therefore to continue slowing down. The rate of growth of the real gross national product might reach 4 %, with expansion remaining probably weaker in the first half, and gathering such speed in the second half, as may be imparted by developments abroad. Although the tendency for surpluses on current account to fall is likely to continue, at least in the immediate future, prices will go on rising.

The unquestionably very difficult task of those in charge of economic policy, faced as they are with these widely varying trends, would seem to consist in maintaining a sufficiently rapid rate of growth of home demand while keeping within bounds the increase in costs, since this increase might not only reinforce the upward thrust of prices but might also have unfavourable repercussions on economic growth.

1. The balance sheet for 1961 and the economic situation at the beginning of 1962

Economic expansion in 1961 again lost momentum. The growth of *external demand* in particular, as reflected in actual deliveries of goods and performance of services, was distinctly less. The seasonally adjusted figure for exports of goods even showed a slight fall in the second half. However, the figure for the full year still showed an increase—6.3 % in value and 5.5 % by volume; the corresponding figures for 1960 had been 16.4 % and 15.1 % respectively. Whereas in the first half of 1961 the expansion of exports was limited almost exclusively by the difficulties encountered by industry in its efforts to expand production, a loss of pace in the receipt of orders from abroad later assumed a role of growing importance. Here the influence of economic developments in other countries was not exclusively responsible, since the revaluation of the mark in March 1961 and the continuing rise in costs at home also played a role.

Trends were even less favourable in the export of services. For the full year 1961 there was even a slight actual fall in comparison with the 1960 figure. Political events and certain economy measures taken by the United States in connection with tourism and expenditure by troops stationed in Germany certainly had something to do with this.

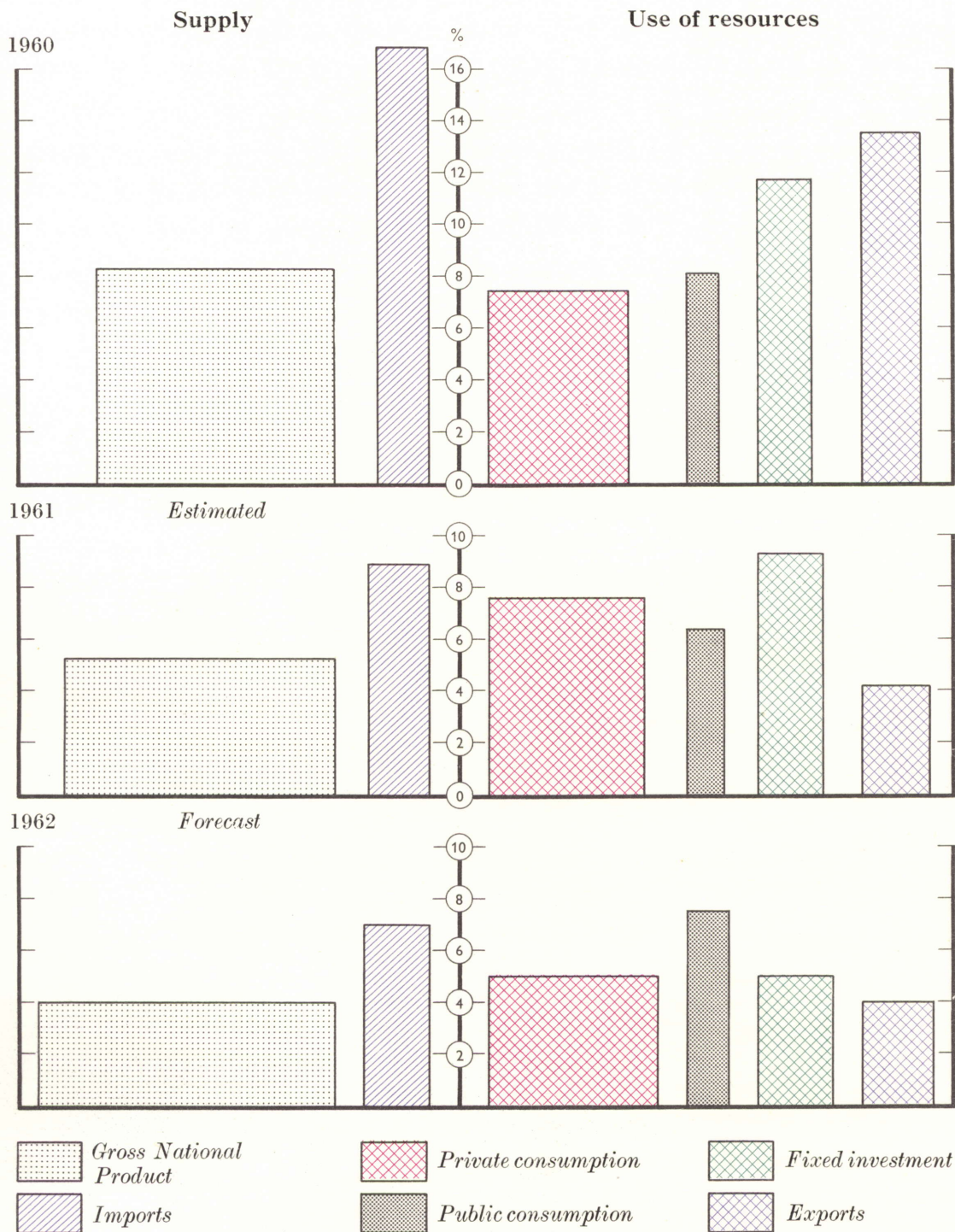
In 1961 total German exports of goods and services, as defined in national accounting, increased in volume by some 4 % as against 13.5 % from 1959 to 1960.

By contrast, domestic demand continued to climb vigorously, at a rate only a little lower than in 1960.

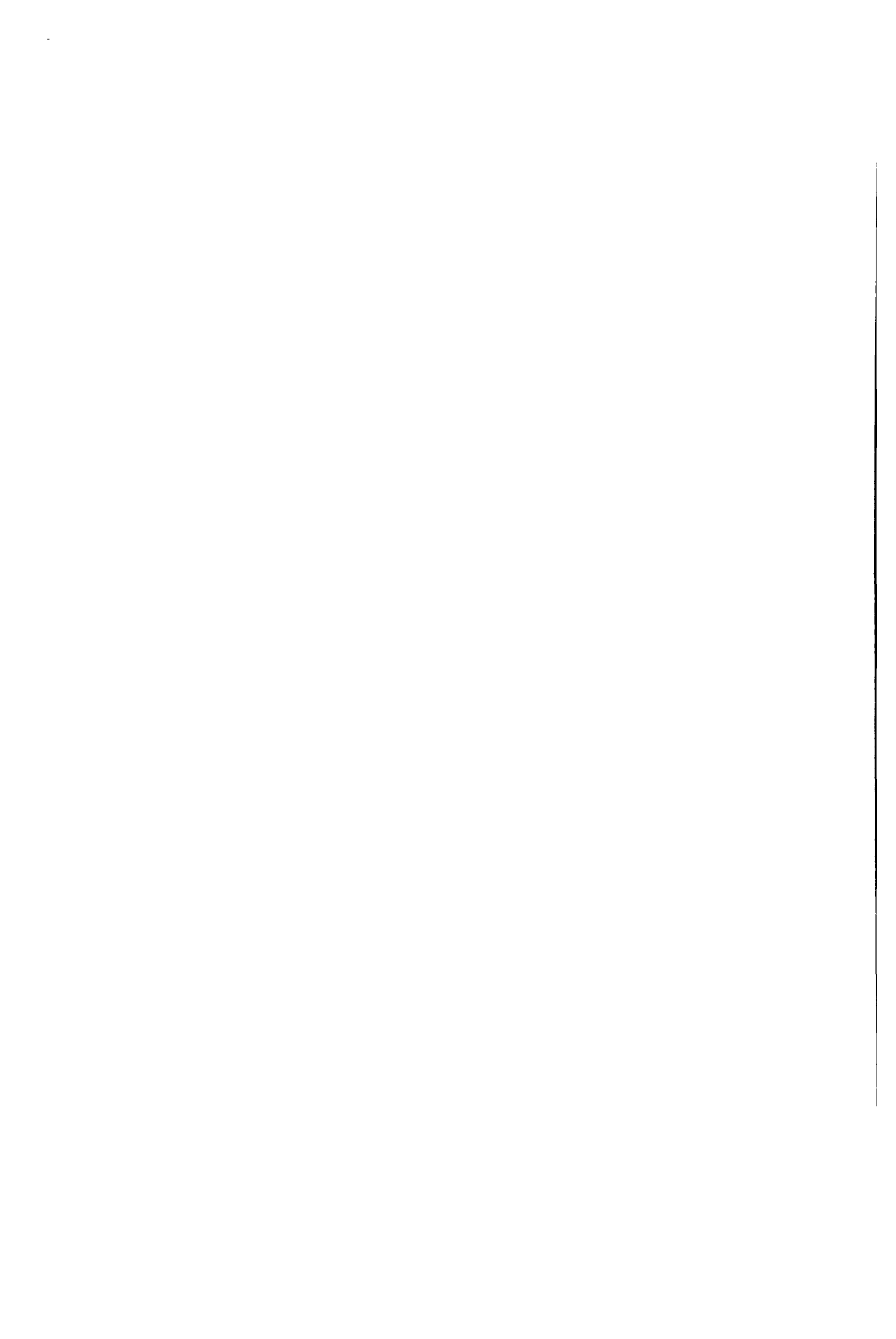
Gross fixed asset formation swelled by about 15 % in value and about 9.3 % by volume, as opposed to growth rates of 16.3 % and 11.6 % for 1960. In this respect, *gross investment by enterprises* in particular would seem to have risen sharply again, even though a very distinct decline in the propensity to invest was betrayed as the year went on by the trend of investment schemes, by the orders being placed with the equipment industries and by the total of permits issued for commercial and industrial buildings.

SUPPLY AND USE OF RESOURCES GOODS AND SERVICES

Change in volume in relation to the preceding year



The width of each column corresponds to the aggregate value for the preceding year. Percentages for 1960 exclude Berlin and the Saar, from 1961 on they exclude Berlin only.



Outlay on investment in equipment and investment in building each grew at much the same rate as the other and with almost the same vigour as in 1960. However, because of increased prices the rate of growth by volume was lower than in 1961; it was about 12 % for investment in equipment (1960, 16.1 %) and 6.3 % (1960, 6.9 %) in building, where the particularly sharp rise in prices experienced in 1960 was repeated in 1961. These figures include fixed public investment and new housing. *Fixed public investment* would seem to have increased even more than fixed investment by private industry. Outlay on new housing also increased sharply; because of strain in the building industry, although and with the size and quality of new dwelling units showing a steady improvement, the number of dwelling units completed was at about 565 500, only just as high as in 1960.

The policy on stocks pursued by industry had, in the main, the effect of curbing economic activity in 1961. Though stocks again increased, investment in the form of *stocks* was distinctly less. This trend was reflected in a cut in the orders placed with several basic materials industries at home and by a perceptible weakening in imports of raw materials and of semi-finished products from abroad.

Private consumption, despite a slight increase in the proportion of the disposable income of households put by as savings, again surged forward vigorously in 1961—more than 10 % in value and about 7.5 % by volume; growth was more rapid than in 1960, when the corresponding figures had already been 9 % and 7 % respectively.

The disposable income of households itself increased more than in 1960. The total of wages, salaries and transfer incomes rose just 11 %, including an increase in gross salaries and wages of almost 13 %, which was somewhat more than in 1960. The number of persons employed grew once again (by 2.4 %) and the increase in wages and salaries per head was about 10 % (1960, about 9 %). Transfer incomes, particularly pensions and disablement benefits also rose appreciably. In addition, the amounts withdrawn from their businesses by self-employed persons and the income from property of wage and salary earners both rose steeply (by about 10 % in 1961 as against almost 8 % in 1960), although the net incomes of firms increased very little (a bare 1 % as against 13 % in 1960).

Public consumption, too, again advanced strongly in 1961, and in value it even exceeded the rate of growth of private consumption.

Although there was in the course of the year a more or less distinct easing of strain in several important branches of industry, the situation on the *labour market* hardly changed at all: if anything, the severity of the manpower shortage increased until the middle of the year, although the number of persons employed, as already mentioned, again increased. This happened not so much as a result of a further cut in the already very low unemployment figures as through heavy recruitment of foreign labour—at the end of September about 220 000 more foreigners were employed in West Germany than at the same time a year before. The substantial increase in the flow of refugees before East Berlin was cut off also contributed to the increase in the number of employed. None the

less unemployment figures did fall, and the unemployment rate ⁽¹⁾ on monthly average was 0.8 % in 1961 (1960, 1.2 %). The number of unfilled vacancies on the books at labour exchanges was more than three times the number of unemployed.

This situation on the labour market is a clear reflection of the continuing pressure of the demand for manpower, aggravated further by the effects of the cut in the working week. Despite an increase of some 3 % in numbers employed, industry was not able to cover its additional labour needs: this development was in the second half-year due in part to a policy whereby firms in branches where activity was slack kept workers on their books. This phenomenon was bound to lead, in these industries, to a very weak increase, or even at times to an actual fall in productivity.

The growth of industrial production again lost pace. The index ⁽²⁾ for the full year was up 5 % on the 1960 figure, which had been 11 % higher than the 1959 results. The year-to-year rate of growth declined appreciably in the course of the year, falling from 7.8 % in the first half to only 2.7 % in the second: the seasonally adjusted output figures suggest that to all intents and purposes growth ceased after the spring.

For the full year it is true that productivity (output per person employed) in industry rose by 2.9 %, compared with 6.4 % in 1960; towards the end of the year, however, there was hardly any further progress under this heading. No exact information is obtainable on the way output per man-hour has developed as there are no figures to show what changes have occurred in the number of hours worked by salaried employees. A calculation of output results based solely on hours marked by wage-earners (for which information is available) would to some extent be misleading, since trends in total employment are in the direction of an increase in the salaried employees' share of the whole.

Agricultural production also grew less vigorously than in 1960, by around 3 % as against 4.8 %, mainly because harvests were distinctly poorer for certain important crops.

The contribution to the *gross national product* made by services rose fairly sharply, and the GNP itself rose by 5.3 % (9.9 % at current prices), compared with a growth of 8.8 % (12 %) from 1959 to 1960.

The growth of *imports* was also distinctly lower. It reached only 3.8 % in value over 1960, whereas the corresponding 1960 figure was 19.3 %. By volume, progress was somewhat more favourable (1961, 7.6 %) than in value owing mainly, it would seem, to the effects of the revaluation of the German mark. The weak growth of imports was mostly attributable to a fall-off in stock accumulation in industry, but was also connected with the loss of momentum in the growth of current requirements in raw materials and semi-

(1) Number of unemployed as a percentage of the total labour force.

(2) Monthly index of the "Statistisches Bundesamt".

finished products, stemming from the fact that industrial output had ceased to expand. Imports of industrial finished products, by contrast, continued very high; by volume the year-to-year increase was about 22 % (1960, 28.5 %).

On the other hand, expenditure abroad on services increased considerably, particularly in connection with tourism and foreign travel. All in all, the 1961 increase in imports of goods and services (as defined for national accounting) may be estimated at 8.9 % by volume, following a growth of 16.8 % in 1960.

The confrontation of total expenditure and actual supply shows clearly that the salient feature of the situation in 1961 was once again a state of disequilibrium which found expression in an *increase in prices*. True, the heavy pressure of demand was no longer the main factor in rising prices after the first half, for in the second the role played by rising costs, at times coupled with a weakening of demand, was more and more important : labour costs per unit of output increased substantially in 1961 as a result of a more rapid rise in manpower costs than in output per man-hour. However, the fact that these higher unit costs were passed on if only in part to prices shows clearly that this "cost-push inflation" phase should be considered as a phase of disequilibrium.

The rise in industrial producer prices was kept within limits, although the average for the year was again 1.5 % up. The modest scale of this increase is certainly attributable in part to the slowdown in the expansion of demand and partly also to the effects of the revaluation of the mark. Moreover, there is no doubt that the fall of world prices of raw materials had a favourable effect on price trends in industry. Agricultural producers' prices, on the other hand, showed a strong upward trend in the course of the year; but on average they none the less remained slightly below the 1960 level on account of the fall which occurred in the second half of that year. The cost-of-living index climbed from the end of 1960 to the end of 1961 by 3.1 % faster, that is to say, than in 1960 (1 %), when the fall in agricultural prices had partly offset the increases elsewhere; for the full year 1961, the cost-of-living index was 2.5 % higher than in 1960. There was again heavy price increases in building and construction : the residential housing index was 7.6 % up on the 1960 figure.

The brisker growth in imports of goods and services meant that the surplus on goods and services fell. Balance-of-payments returns show that on *current account*, including unrequited payments, the surplus declined from DM 4 400 million in 1960 to DM 3 300 million in 1961, although on the *trade-balance* alone there was a surplus of DM 6 600 million, a figure which was appreciably higher than that for 1960 (DM 5 200 million). The accumulation of surpluses took place, moreover, mainly in the first half of 1961 : from the end of the summer there was a tendency for the trade surplus to shrink.

Despite the considerable surpluses still registered on current account the Bundesbank's *net gold and foreign exchange reserves*, which had risen DM 8 000 million in 1960, fell in 1961 by almost DM 2 000 million to a total of DM 28 300 million : the deficit in the

overall balance of payments may well be some DM 1 700 million if it is borne in mind that the commercial banks' foreign currency reserves rose about DM 260 million between the end of 1960 and the end of 1961. Movements of capital, therefore, resulted in a net outflow of about DM 5 000 million. Special factors, such as advance payment of debts, transactions with the International Monetary Fund and loans granted to the World Bank, contributed to the extent of over DM 5 000 million to this increase in exports of capital. Moreover, payments for development aid were stepped up. As for private capital, political factors for a time discouraged foreign investors, and the Bundesbank's policy on liquidity and interest rates was already exerting an influence on the balance of capital movements.

The special government transactions, which were not financed from domestic liquid resources, but by borrowing from the central bank, were substantially larger than the balance-of-payments deficit plus the increase in the assets held abroad by the commercial banks, so the balance-of-payments must once again have increased liquidity in the economy, though to a far smaller extent than in previous years. The very high liquidity of the banks enabled them however to step up their advances, which expanded distinctly more rapidly than did the formation of monetary capital. This increase in advances was certainly not unconnected with the restrictive effects emanating from the *cash position of the public authorities*. Both Federal and Land accounts for 1961 finished the year with cash surpluses. In the case of the Federal accounts, these totalled DM 325 million. If net payments to abroad are also taken into account, the total restrictive effect on domestic liquidity was of the order of DM 4 700 million (1960, DM 1 500 million). Although there was a big jump in public expenditure, the increase in revenue from taxes, though a little less than the previous year, far outstripped the growth of spending. None the less, the situation of the public finances deteriorated considerably in the course of 1961, notably that of Federal finances.

The main feature of the economic situation at the *end of 1961 and the beginning of 1962* was the persistence of tendencies for economic activity to slow down. This is true in particular for exports, which in November-December were 3.5 % and in January down 1.8 % in value on the corresponding figures of a year previously. Whilst the progress of fixed investment by enterprises seems to have slowed down, the expansion of private consumption continued to all intents and purposes unchanged.

On the supply side, too, factors working as a brake on activity continued to exert influence in the last months of the period : there seems to have been no noteworthy improvement in industrial production; its year-to-year growth rate (adjusted for the number of days worked) was 4.1 % for the fourth quarter; in January 1962 the figure was only 2.2 %. Growth of imports (apart from seasonal factors) had picked up a little in the third quarter, but it slowed down once more towards the end of the year. None the less, the surplus on trade in the fourth quarter declined substantially as a result of the drop in exports (DM 1 300 million as against DM 1 800 million in the fourth quarter of 1960). This trend persisted in January.

The slight tendency for consumer prices to increase continued unchanged in the last few months.

2. Outlook for 1962

The national product is again expected to increase in 1962, but the rate of growth will once more be lower than for the previous year.

Despite a heavy backlog of orders, it would seem fairly certain that *exports* will mark time early in the year or may even fall off. Signs of this may be found in the figures for new orders from abroad received by industry in the second half of 1961 : they were 6.4 % below the corresponding 1960 figure. This development reflects the slackening of the investment boom or the reduced availability of foreign exchange in many purchasing countries and also the effects by the revaluation of the mark and the relatively steep rise in costs in German industry. If in the course of 1962 exports should rise appreciably, this will perhaps be due in part to the further boost which the recovery in America could one day give to economic activity throughout the world, in part to the stimulation of exports which is likely to result from the removal of obstacles to trade in the Community. Moreover, the increased payments in the form of development aid might create some additional demand for exports of goods. Lastly, the export drive in the equipment industries may later be stepped up somewhat if domestic investment activity slackens.

The rate of increase in *fixed investment* by enterprises is likely to fall sharply in 1962. All indicators point in the same direction : orders from within the country placed with the equipment industries in the fourth quarter were 2.5 % less than a year earlier, in mechanical engineering about 9 % less. At the same time building licences issued for industrial or commercial building were (in cubic metres) 5.2 % down on the fourth quarter of 1960. The reasons for this fading of the investment boom were various : doubts emerged in some branches as to whether the maintenance of the very rapid increase in capacity would be justified in the future by a correspondingly rapid increase in demand; in those branches where it had not proved possible to pass on to the consumer the full increase in unit costs caused by the wage increases of the past eighteen months—which had gone well beyond the concurrent improvement in productivity, these increases have led to a narrowing in profit margins and consequently of the resources available for self-financing. Since there is less confidence among businessmen as to sales prospects, their own limited resources are not made up by increased use of borrowing, which is in any case still fairly expensive in the Federal Republic.

On the other hand, the factors exerting a favourable influence on the propensity to invest would seem on the whole sufficient to ensure a further growth of investment

expenditure by enterprises. In the main, managements were seeking to streamline their organization because of continuing manpower shortages, high and growing wage costs, and severer competition. In some branches, particularly in the consumer goods industry, the desire to increase productive capacity further is also playing a role.

According to the results of the survey carried out among businessmen by the IFO Institute at the beginning of 1962, the rate of growth of fixed industrial investment might be 7 to 10 % in terms of value, as against just 20 % in 1961.

In *housing construction*, there are no grounds for expecting the situation to ease for the moment. Building permits issued in the last quarter of 1961 showed that planned expenditure was to rise only 10.1 % and the volume of building, in cubic metres, was to be only 1.1 % above the corresponding figures for 1960; however, the amount of building authorized and begun but not yet completed was exceptionally high at the beginning of 1962: the figure was 737 000 units, as against 666 000 a year before.

A big jump in *public expenditure on building and construction* is to be expected in 1962. Admittedly permits issued for public buildings were down in the fourth quarter of 1961 (6.8 % in terms of estimated cost of construction and 6.2 % in terms of space enclosed) on the corresponding 1960 figure, but this is explained largely by exceptional factors such as the adaptation of the budgetary year to the calendar year. In this sector, too, the number of buildings approved or under construction is fairly high. In addition, the 1962 budget estimates provide for greatly increased spending on public building work. Expansion will be particularly heavy in the field of public works since the 1962 budget, apart from heavy credits carried over from 1961, provides for a 12 % increase in expenditure on extension and maintenance of the Federal highway system. Spending by the Länder and the local authorities on the building of roads is also to be stepped up.

All in all, *gross fixed asset formation* will probably increase in 1962 by about 4 to 5 % in terms of volume, as against 9.3 % in 1961. Stockbuilding policy might still have some restraining influence on economic trends, particularly in the first half of the year. It is possible that there will be greater differences of trend between one branch and another; in some sectors there may well be a recovery in the stock position.

Public consumption in terms of value will probably increase by about 9 to 10 %, since there should be a substantial increase in wages and salaries in the public sector, and current budget estimates for 1962 suggest that there will be a big increase in spending on defence.

As managements are increasingly opposed to large wage rises, a slight decline in the rate of increase in the private sector may be expected. None the less the general level of wages is likely to rise again quite sharply. Transfer incomes will also again grow substantially in 1962. *Private consumption* will therefore increase in 1962 too; the rise will be more rapid, both at current prices and in real terms, than the rise in the gross national product, but probably less vigorous than in 1960 and 1961.

The situation on the *labour market* is unlikely to ease appreciably in 1962 : although the number of school leavers will increase by 40 000, natural demographic trends hold out no promise of an increase in the number of persons available for employment. The immigration of manpower from the Soviet occupation zone is no longer possible, and the number of unemployed can hardly be further reduced; the only way, therefore, in which the labour force can be substantially increased is by employing many more foreign workers in the Federal Republic; it is however becoming more and more difficult, at least in the neighbouring countries, to find suitable manpower not already employed. In view of the general optimism shown by managements as to the long-term economic trend, it is very doubtful whether many of those firms which are not working at full capacity will release workers who could then move to sectors where demand and manpower requirements are still growing. Finally, the total of man-hours worked is likely to be affected by cuts in the working week and the longer holidays which will probably be approved on a very considerable scale in the new collective bargaining agreements. These losses will not be made good by means of overtime.

In these circumstances it can hardly be expected that *industrial production* will grow in 1962 by more than 3.5 %. In the first half-year the growth rate might even be appreciably lower, whereas in the second half some recovery in growth is possible. There is more than one reason for this : not only may demand grow again somewhat more vigorously, but new productive capacity will already be available and strain on the labour market might ease. In the latter case, a somewhat more substantial growth in real output would be possible, particularly in building and construction.

In view of the increase in agricultural output which is possible if weather conditions are normal, and of the steady advance to be expected in the services sector, the real increase in *the gross national product* for 1962 will probably be about 4 %.

Imports should also grow once more, at a rate which will be once again higher than that of the gross national product. This can be expected in view of the rise in costs and prices at home, of the fall in the prices paid for imports (due to the revaluation of the mark) and of the tariff cuts which belong to the programme for establishing a common market. Finished goods will be the sector of greatest growth, but agricultural products too, particularly grain, may be expected to show a substantial increase, at least in the first half of 1962, as crops in 1961 were only moderate. The increase in the total volume of goods imported will depend, however, mainly on the way imports of raw materials and semi-finished products develop. These imports in turn depend first and foremost on the moderate rate of increase to be expected in production and on the stockbuilding policy followed in industry. There is much to suggest, in this connection, that factors which slow down activity will persist for some time yet. However, payments to abroad in connection with services will again increase appreciably and the total imports of goods and services will probably increase once again more rapidly than exports.

The consequent deterioration in the balance of current payments, taken with the expected weakening in the expansion of demand, will make a major contribution to the task of restricting within certain limits the growing tendency for prices to be marked up by rising *costs*, or will at least help to prevent this tendency from being as pronounced as it would have been but for the export and import developments described above.

However, the persistence of the strong upward trend in costs remains a major problem for economic policy. Where increased costs are reflected in prices, they tend to offset the foreign trade surplus on goods and services; this tendency can to some extent still be welcomed as beneficial to the international payments and currency position, but there is a danger that the process will, if continued, eventually cause the "parity costs level" to be exceeded. Though it is true that this may lead to considerable deficits on the balance of payments, this would not of itself be regrettable; in view of its ample foreign exchange reserves, the Federal Republic can without difficulty carry considerable deficits for several years. But the effects on expansion and possibly on employment could be serious. Since foreign competition limits the possibility of raising prices in line with higher costs, profit margins may continue to dwindle, and the reduction may be so fast as to lead to a substantial fall in investment. A reduction in self-financing combined with a generally sound advance in investment may be welcome from the angle of policy on the distribution of income and property, but to obtain such results through wage increases which exceed concurrent increases in productivity will be possible only if a number of fundamental conditions are fulfilled: businessmen would have to be willing to offset a further considerable limitation of their profits by making greater use of borrowing; the workers would have to be willing to make funds available for borrowing through a correspondingly greater savings effort and to offer these funds on appropriate terms.

For some time to come, moreover, it will be inadvisable, if indeed possible, to combat increased costs by general restrictive measures in the monetary and financial fields. Such measures would not only make it more difficult to bring the balance of payments into equilibrium, they would also obviously be inappropriate at the present juncture. They would only place too sharp a brake on real economic growth without having the rapid effect on prices that was desired.

It seems that what on the contrary is needed is the establishment of conditions in which it would be easier for home demand, particularly investment demand, to expand at a pace acceptable from the angle of both growth policy and balance-of-payments policy, while other measures were used for the careful guidance and timely limitation of the increase in domestic costs.

It is consequently reasonable, indeed it is to be welcomed, that in 1962 the operations of the public authorities will, to judge by the estimates put forward and the probable evolution of the cash position of the authorities, inhibit demand and liquidity at home less than they did in 1961. Obviously a watch will have to be kept in the financial field too to make sure that the trend in expenditure does not in the longer term move up

too steeply. In addition, carefully selected measures can be used to curb the upsurge of prices in certain sectors, such as building, which are not easily affected by variations in foreign trade. For this purpose, measures designed to reduce demand will be more effective than, for example, attempts at quantitative control; in any case, peculiarities in the present methods of granting subsidies are helping to maintain the rate of interest on capital at a high level, and this is having an unfavourable effect on both the investment trend and on the trend in exports of long-term private capital.

Moreover, the increase in prices can still be countered by measures to encourage imports and this at the same time contributes to a better equilibrium in the balance of payments. Here attention should once again be drawn to the opportunities provided by the EEC Treaty, particularly in its Article 15 (2). There is no need to emphasize that, both from the angle of price policy and from that of the balance of payments, measures to curb imports would be undesirable, even in limited sectors. All measures to encourage even more the immigration of foreign manpower are to be welcomed.

Lastly, and this point is not the least important, wages policy itself must take into account the new economic perspectives and the problems connected with them. It is becoming increasingly urgent to achieve better co-operation between the two sides of industry and closer collaboration between them and the Government.

B. France

In 1961, economic activity in France once again expanded fairly briskly.

The increase in the gross national product may be put at 4.5–5 %, with fixed investment and private consumption showing more than average rates of growth. Although total employment rose only slightly, industrial production grew by 6 %. In addition, the supply of finished goods was supplemented by particularly heavy imports.

Despite more severe competition from abroad, firms were to some extent able to pass on in higher prices the increase in costs, caused largely by wages rising faster than productivity. After sagging slightly early in the year food prices moved upwards from the summer onward under the influence of agricultural policy decisions and of poor harvests. The average level of consumer prices in 1961 was 3.3 % over that for 1960, and the end-of-year comparison showed an increase of 4 %.

The balance of foreign transactions in the national accounts showed a somewhat smaller surplus than in the previous year. However, the balance-of-payments, surplus of the franc area as a whole vis-à-vis other currency areas again went up sharply. The increase in official gold and foreign exchange reserves was about \$ 870 million, a clear \$ 500 million higher than in 1960.

The prospects for 1962 are that the expansion of overall demand will continue. International competition will probably become keener, but French industry is still in a relatively favourable competitive position and should continue to command a substantial share of foreign markets. In view of the prospects opened up by the Fourth Plan, and also the imperative need to reduce costs and save on manpower, fixed investment will no doubt again increase appreciably, although certainly not as much as in 1961. Private consumption will also be higher as a result of the expected rise in personal income.

Despite a reserve of production capacity in certain branches, manpower shortages are likely to hold the growth of industrial output down to about 6 % and the increase in the gross national product to about 5 %. Since imports should certainly increase somewhat more rapidly than exports, some reduction of the surplus on current payments could help to ease the internal market situation.

Nevertheless, it will still be difficult this year to achieve the aim of price stability. Since there can hardly be any question of a restrictive monetary and fiscal policy—which would hinder economic growth and frustrate endeavours to reduce the

high surpluses on the balance of payments—the best way of channelling development in the desired direction is by taking measures to increase imports and the availability of manpower and to improve collaboration on wages policy between management and labour and between these and the government.

1. The balance sheet for 1961 and the situation at the beginning of 1962

The trend already noted in 1960 for various components of domestic demand to replace foreign demand as the driving force in economic expansion continued and became particularly evident from the results for the full year 1961.

The expansion of *foreign demand* has slowed down. According to foreign trade statistics, merchandise exports were only 5.2 % in value and 5.6 % by volume above the level in 1960, when the growth rate was still about 22 % at current prices and almost 17 % at constant prices. However, the high growth rate for 1960 is mainly attributable to the vigorous upsurge of exports in 1959, while the moderate results for 1961 reflect the fall—of 8.3 % in value and by volume—in deliveries to the franc area. Countries outside the franc area increased their purchases over 1960 by 11 % in value and 12.3 by volume. The partner countries of EEC in particular took more French products, followed by the EFTA countries, while the United States, although their purchases advanced strongly from the second quarter of 1961 onwards, bought only little more from France in the full year than in 1960. Purchases by the developing countries outside the franc area did not increase at all.

The export of services in 1961 also went up much more slowly than in 1960. The growth in exports of goods and services in 1961 (in terms of national accounting, including factor income from abroad) was about 5.5 % in value and 6 % by volume, following growth rates of 16 % and 14 % respectively in 1960.

The pillar of production and employment in 1961 was the investment activity of industry. Private firms, which in 1960 had already stepped up their *gross fixed investment* by about 11 %, considerably intensified their efforts to enlarge and rationalize the apparatus of production in face of growing strains on capacity, increasing manpower shortages and rising labour costs. According to an INSEE survey, investments (in terms of value) were about 18 % and real investment 15 % higher last year than in 1960. Thanks to the high liquidity in the business sector and in the banking system these investments were financed without difficulty, even in branches where profit margins were under

pressure and resources for self-financing declined. In 1961 the propensity to invest appears to have increased markedly in agriculture too, so that despite the only modest increase in the investment activity of public undertakings, total business investment on building and equipment has risen some 12 % in value and 9 % by volume in relation to 1960.

The rate of increase of direct *fixed investment by public authorities* was apparently higher—i.e. about 15 % in value and 14 % by volume. On the other hand, private investment in housing again showed only a moderate increase. The number of dwelling units completed in 1961, including publicly financed or subsidized *housing*, was no higher than a year earlier; the number of new housing units started were, however, up about 6 % on 1960.

All in all, gross fixed investment in 1961 seems to have been about 11 % higher in value and almost 8.5 % by volume than in 1960, as against growth rates of 7.5 % and 6 % a year earlier.

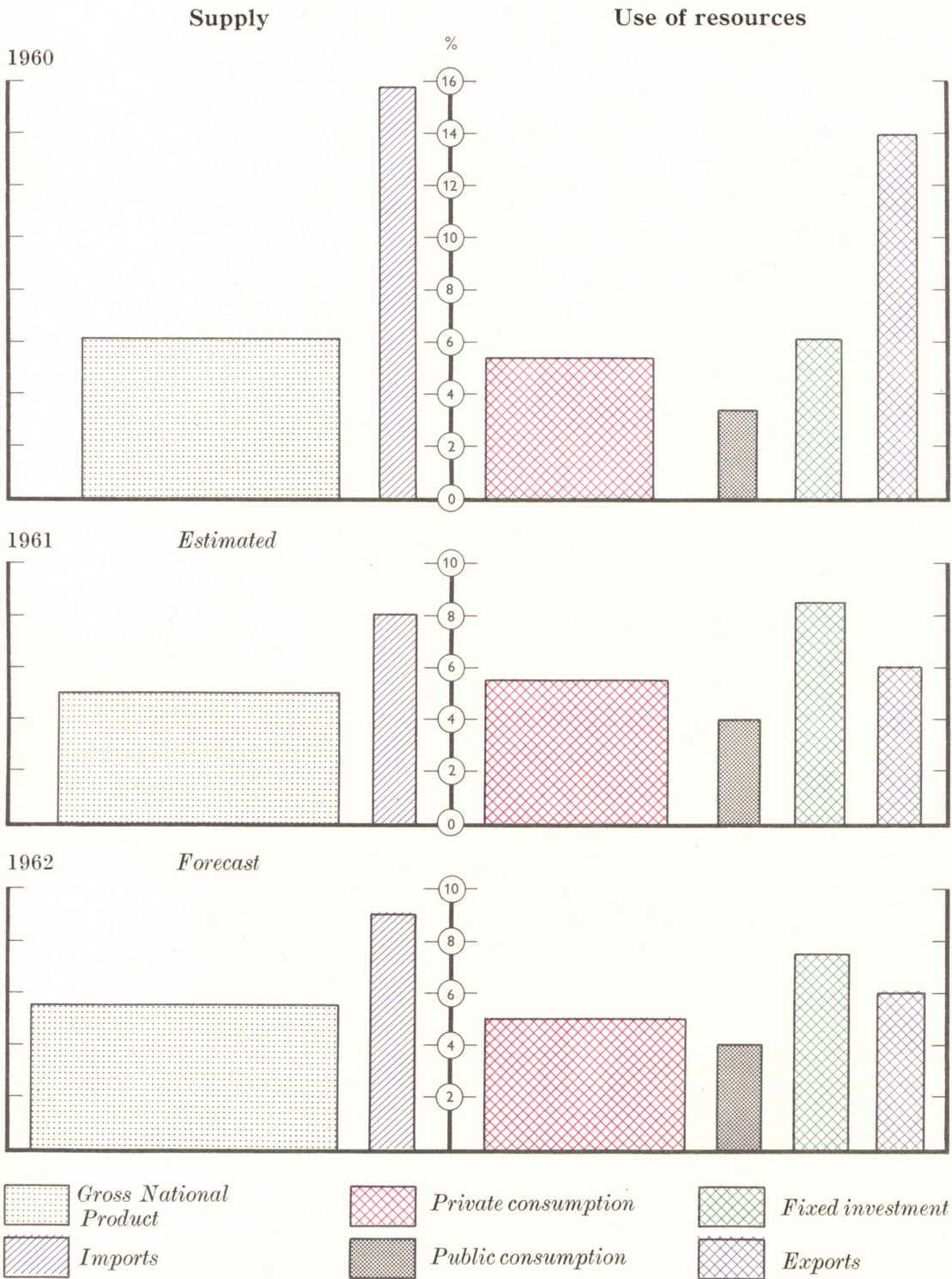
No special impetus was provided by *investment in stocks*; on the contrary, these increased much more slowly than in 1960. Not only did industry show little inclination to increase its holdings of raw materials, but in many cases stocks of semi-finished and finished goods—in particular steel products and motor vehicles—were deliberately run down. Stocks of agricultural products also declined because the harvests of some crops were poor.

The growing pressure on available labour caused a further speed-up in pay increases in 1961. In private industry hourly wage rates per workers over 18 years of age on the annual average were up 7.5 % on 1960, and in nationalized industry almost 8 %. Actual hourly earnings have risen even a little more. As the pay of workers and employees in public services also improved considerably and transfer payments were very substantially increased, mass income rose sharply—by about 10 %, although overall employment increased only slightly. On the other hand incomes of self-employed persons and from property (interest, dividends, etc.) did not increase quite so appreciably; income from dividends, for example, rose by approximately 5.5 %. Total disposable personal income, after deduction of tax, may nevertheless be put at 8.5 % higher than in 1960.

Private consumption expenditure increased more than income—i.e. by some 9 %. The savings ratio (the proportion of disposable personal income not spent on consumption) clearly declined. Despite the further rise in consumer prices, the real increase in private consumption therefore was about 5.5 %, as in 1960. It is noteworthy that a larger share of the increase in consumption expenditure, particularly on consumer durables—cars for example—was for the purchase of imported goods. In addition, the proportion of services in total consumption seems to have risen further.

SUPPLY AND USE OF RESOURCES GOODS AND SERVICES

Change in volume in relation to the preceding year



The width of each column is in proportion to the corresponding figure (in terms of value) for the preceding year.



The growth of *public consumption* speeded up somewhat in 1961. In particular a sizable increase in wages and salaries in the public services raised the rate of growth at current prices to about 10 % (1960, 6.9 %). The expansion of consumption in real terms was, however, still relatively low—some 4–4.5 %.

In general supply was sufficiently elastic to cope with this development of demand, so that signs of strain were confined to certain markets.

Agricultural production was only slightly (about 1 %) below the exceptional results of the previous year; output of livestock products was considerably more than in 1960, but crops—particularly of grain—were poor owing to unfavourable weather conditions.

Industrial production (1) in 1961 grew by about 6 % over 1960. The year-to-year comparison, however,— in 1960 the rate of increase was more than 11 %—indicates a slowdown which does not give a true picture of economic development through the year; this was practically identical in 1961 with what it had been in 1960. The high year-to-year growth rate in 1960 was in fact partly the result of the rapid upsurge in the second half of 1959. However, industrial trends in 1961 showed somewhat more differentiation than in the previous year. While growth rates were above average over the whole range of capital goods industries and the chemical industry, in other branches there was little or no expansion of production owing to difficulties in sales abroad (textiles and motor vehicles) a more cautious policy with regard to stocks (coal, steel) or a heavy increase in imports (certain consumer durables). Despite a recovery in the course of the year, production of passenger cars and commercial vehicles finished 11 % and 7 % respectively below the 1960 figures.

Building was up by about 7 %—a considerably higher rate than in 1960. It received a strong stimulus from demand for industrial building and from increased public expenditure on roads.

In close relation with the generally greater activity of industry and increased private consumption, the services sector increased its contribution by about 5.5 %.

Despite the fall in agricultural production, the rise in the *gross national product* in 1961 probably reached the rate forecast at the beginning of the year—4.5–5 %. Improved productivity played a decisive part in this growth, for *employment* rose only very slightly. Despite a substantial increase in immigration, the number of wage- and salary-earners in industry and commerce rose in fact by only 0.7 %, and the hours worked per worker showed no advance on the record figure of 1960. Strains on the labour market increased and in certain branches of industry labour shortages appear to have slowed down the growth of production appreciably.

(1) INSEE index.

In 1961 *imports* grew at a much lower rate than in 1960. According to foreign trade statistics the increase in merchandise imports was 6.3 % at current prices and 8.9 % at constant prices. The corresponding rates of growth in 1960 over 1959 were 23.4 % and 19.4 %. As in the case of exports, however, this year-to-year comparison is somewhat distorted by factors dating from 1959. Encouraged by increasing liberalization and the two customs reductions made in the light of the economic situation, purchases of industrial finished goods especially showed another considerable increase in 1961. Imports of semi-finished goods were also higher than in the preceding year, while those of raw materials were up only a little on the 1960 level and imports of foodstuffs did not even reach it.

As imports of services also rose in 1961, in particular because of the greater tourist traffic to foreign countries, the import of goods and services as a whole (in terms of national accounting including factor incomes to abroad) was about 6.5 % in value and 7–8 % by volume higher than in 1960. In 1960, however, the respective increases over 1959 were 16.8 % and 15.8 %.

In 1961 the general *price* level was about 3.5 % higher than in 1960, the rise being faster in the second six months. In December the wholesale price index was up 3.5 % and the consumer price index 4 % on the corresponding level of the previous year ⁽¹⁾. Not only rising costs and disequilibrium in some markets but also administrative decisions, particularly on agricultural policy, contributed to the higher cost of living. Retail prices for finished consumer goods rose by 2.7 % between the end of 1960 and the end of 1961. In the case of investment goods the rise appears to have been somewhat more pronounced, while building costs were up only slightly on 1960.

As imports of goods and services increased more than exports, the surplus of foreign transactions in the national accounts—at constant prices—fell fairly substantially in 1961. The difference at current prices compared with 1960 was not very marked, however, since the terms of trade swung in favour of France.

On the other hand the *balance of payments*, which covers only transactions with countries outside the franc area, showed a much higher surplus—about \$ 900 million—on current account than in 1960. The terms of payments having moved in favour of France, the goods surplus (on a payments basis) rose from \$ 40 million to about \$ 400 million, while the high surplus on services continued practically unchanged. As in 1960 the capital transactions again showed a slight deficit but only because exceptional exports of public capital more than offset net private imports of capital. If these special government transactions—advance repayment of debts to an amount of \$ 320 million—and transactions with the International Monetary Fund totalling \$ 234 million (mainly in favour of Great Britain) are left out of account, the surplus on the balance of payments was as much

⁽¹⁾ Index of retail prices, 250 articles, Paris.

as \$ 1 400 million. In 1961 official gold and foreign exchange reserves increased much faster than in 1960—by \$ 870 million as against only \$ 350 million in 1960. The net foreign exchange position of the commercial banks deteriorated by about \$ 100 million.

With the greater inflow of funds from abroad, the *money and capital markets* remained exceptionally easy despite increasing calls from business and private persons. Without recourse to the Central Bank, the banks were in a position to make short- and medium-term advances of such volume that the monetary authorities recommended a policy of restraint. On the capital market successful new issues were made, mainly by industry amounting to almost NF 9 000 million, at average interest rates below the 1960 level. In 1960 the total of new issues was about NF 7 000 million.

Although after two reductions in the compulsory taking up of Treasury bills by the banks the Treasury received less funds than in 1960 from this source, it again abstained from issuing loans on the capital market.

For the first time since 1958 advances from the Banque de France were used—although only to a slight extent—to finance the *Treasury deficit*. This was somewhere between NF 4 500 and 5 000 million if debt redemption is left out of account, and between NF 7 500 and 8 000 million inclusive of redemption. Thus it was considerably below the estimate, as was the case in 1960.

The dominant trends which shaped the total results for 1961 held on through the *final months of the year and into early 1962*. Investment activity of private enterprises continued very lively. Private consumption expenditure in the second half of the year seems to have risen even more quickly than the disposable personal income. There are good grounds for thinking that the appreciable rise in the cost of living ⁽¹⁾ (4.5 % between June and December) accounted for the reduction in the rate of personal savings.

Foreign demand, however, was far from expansive towards the end of the year. While seasonally adjusted figures for deliveries to the franc area, declined little further and the revival in exports to the United States continued, exports to the other EEC countries were at times less lively.

Despite more acute shortages of labour, industrial expansion was somewhat more rapid during the final months of the year : on the seasonally adjusted figures, production rose by 3.2 % in the fourth quarter of 1961, after an increase of 1.1 % in the previous quarter. Imports increased very considerably and were up 9.8 % in value on the corresponding period of 1960 (1.4 % in the third quarter). Nevertheless, the trade balance for the fourth quarter still showed a surplus of NF 754 million.

(1) Index of retail prices, 250 articles, Paris.

2. Outlook for 1962

A further rise in production and employment is to be expected for the year as a whole. But it will be more difficult to achieve this growth without a certain strain, for while the margin of internal supply has become less elastic—chiefly as a result of the pronounced labour shortage—a relatively strong expansion of total demand is to be expected.

Hence a further increase in *exports* may be predicted, as the prospects in many purchasing countries are generally encouraging and the relatively strong competitive position of French exports will not yet be too greatly impaired by the continuing rise of internal costs. The complete abolition of quotas and the further reduction in customs duties which took place on 1 January of this year for industrial products should have a favourable effect on exports to Community countries. But it is improbable that total exports to countries outside the franc area will increase in 1962 at the same high rate as in 1961. The damping effect of last year's decline in exports to franc area countries may, however, be considered to have abated. Forecasting is difficult because of the uncertainty of future developments in Algeria, but there are good grounds for expecting that in trade with the franc area as a whole it will at least be possible to maintain the level of 1961.

All in all, the volume of exports of goods and services (in terms of national accounting, including factor income from abroad) should increase in 1962 at about the same rate as in 1961—approximately 6 %.

The strongest stimulus to economic growth will again be provided by home demand, especially demand by enterprises.

Fixed investment by enterprises should on the whole go up by about 7 to 8 %. It is true that the propensity of private industry to invest seems now to have receded somewhat after the strong wave of investment in 1960 and 1961. The more limited prospects of self-financing have probably induced heads of medium and small firms in particular to be more prudent in their initial investment programmes for 1962. On the other hand public enterprises, whose investment activity hardly grew at all in 1961, intend to spend more this year on building and equipment. The amounts actually invested should be up 6 to 7 % on 1961 and the authorization of new programmes, which determines the placing of contracts with investment goods and construction industries, by as much as 24 %. In addition, the possibility is not to be excluded that private industry will revise its investment projects in an upward direction later in the year, as incentives to invest are not lacking. First, manpower shortages and the resultant rise in labour costs may well stimulate further modernisation and rationalization. Secondly, in many sectors investment will also be prompted by expectations of increased demand, particularly as the long-term prospects offered to private industry by the Fourth Plan are very favourable. Weighed against this, the problem of financing investments which results from the decline

in possibilities of self-financing—which may well continue—should be of small moment. In any case firms have so far been quite prepared to finance a greater portion of their fixed investment from external resources and this should not be too difficult in 1962 either.

Investment by public administrations will also continue to advance vigorously. For private *housing*, however, to judge by the smaller number of building permits granted in 1961, there is not great prospect of expansion. Nevertheless, the real growth rate for total housing investment, including housing financed by public funds, should be about 3 %.

In the aggregate the volume of gross fixed investment in 1962 may well rise by about 7.5 %.

Investment in stocks will probably give a greater boost to the economy this year, since industry and commerce followed a very cautious stock-holding policy in 1961. In particular stocks of agricultural products should again rise if harvests are normal.

Private consumption will once more go up sharply this year. It is true that, because of the limited supply of manpower and the impossibility of further increasing the number of hours worked per worker, no great contribution to the expansion of total personal income can be expected from a rise in employment. However, further appreciable pay rises will no doubt be granted. To these must be added more liberal social benefits and increased incomes for the self-employed, especially farmers, so that total disposable personal income in 1962 should increase as much as in the previous year. On a year-to-year comparison, however, purchasing power is again likely to be affected by rising prices. The growth of real consumption might therefore be about 5 %, or somewhat less than in 1961—unless consumers again prefer, as in 1961, to meet price rises by saving less.

The increase in *public consumption* at current prices in 1962 will be mainly determined by the appreciable rise in the wages and salaries of persons employed in the public services. The real increase, however, will probably again be relatively small—about 4 %.

In 1962 domestic supply will probably find it a little more difficult to keep pace with this expected expansion of overall demand than was the case in 1961. Given normal harvests, supplies of agricultural products should more than suffice to cover requirements, but domestic production of industrial goods and services might be relatively inelastic. The expansion of production will be limited, not so much by capacity—although here also there is probably no appreciable margin in some important sectors, particularly the investment goods industries—but rather by manpower shortages which are more and more likely to hinder the growth of production. In the course of this year only a very small increase in total employment is to be expected from the natural increase of the working population. The possibilities of reducing the already very low level of unemployment are also limited, particularly because of a lack of mobility. It can, however, be expected

that the immigration of foreign workers will increase more rapidly in 1962, but no substantial relief is to be expected from this.

The decisive factor in the growth of production should therefore be an improvement of productivity. The high tide of investment which has been running now for more than two years will surely have its effects; nevertheless, on balance the advance of productivity will probably be no more than 4.5 % to 5 % in industry and about 4 % in the economy as a whole. In these circumstances it would seem difficult to achieve in 1962 any growth of the real *gross national product* above 5 % without excessive strain on the factors of production. Industrial production should go up about 6 % on 1961.

Given this pattern of demand at current prices and real domestic supply, a further increase of *imports* must be expected in 1962. In particular imports of industrial finished goods will probably again go up appreciably, the more so as on 1 January full liberalization vis-à-vis the OECD countries was attained in principle and quotas for a great number of other countries were eased. Imports of raw materials and semi-finished goods, which were affected in 1961 by the slowdown in stockbuilding, will certainly also increase, so that the total volume of goods imported in 1962 may be about 10 % above 1961. Taking services into account, the overall volume of imports (in terms of national accounting, including factor income from abroad) should rise by about 9 %.

Although foreign supplies should help to maintain market equilibrium, the level of *prices* will probably again rise a little. Towards the end of 1961, the atmosphere tended to favour rising prices. The French distribution system, which is still comparatively rigid in structure, seems to allow of price increases even when they are not justified by the market situation. Furthermore, high domestic liquidity perhaps makes it rather too easy for firms to find the money for wage increases in excess of the advance of productivity. Thus prices for industrial products and for services continue to be driven upwards by rising costs. Finally the trend of farm prices this year will most probably be influenced by government measures to improve agricultural incomes.

Although prices will in all probability rise more slowly in the course of the year than in the second half of 1961, taking an average over the whole year an increase in consumer prices of about 4 % over 1961 is to be expected.

Since imports of goods and services seem likely to increase in 1962 more rapidly than exports, some further fall in the high surplus on current account may be reckoned with, if it is assumed there will be no significant movement of the terms of trade. The fall may be expected especially in trade with countries outside the franc area, so that the overall *balance of payments* may close with a rather smaller surplus than in 1961.

This tendency to reduce the foreign trade surplus is to be welcomed in the interest of the international balance of payments and also from the point of view of smooth growth in the French economy. If the movement in this direction is not strong enough,

it should as far as possible be encouraged by economic policy. Among measures which would make for equilibrium of the balance of payments and for price stability, the first to suggest itself might be further cuts in customs duties, which would increase domestic supply and hold down prices through the play of competition. A continued increase of public exports of capital, in particular the further advance repayment of debts, would also contribute to a better equilibrium of the balance of payments.

The Government is making commendable efforts to increase the availability of manpower and distribute it more rationally among different trades and different regions. Further encouragement of the immigration of foreign workers and speedier training or re-training of the fully or partly unemployed could help to make production more elastic and in particular to curb the rise of wages.

A noteworthy beginning has been made with a policy for keeping wage increases within economically justified limits through closer co-operation between both sides of industry and with the Government. Pursuance of these efforts in the direction of a genuine wages policy might offer more chance of success than a policy of severer credit restrictions—which in any case does not seem to be the intention. It is true that at the end of February this year the special minimum reserve ratio of the banks (*coefficient de trésorerie*) was raised from 30 % to 32 %, but the prime aim of this measure was to steer funds away from short-term and more in the direction of medium-term credits. In fact, a sharply restrictive credit policy might jeopardize the investment needed to ensure growth and maintain competitiveness and might increase the inflow of foreign currency. In the unlikely event that reasons of price policy should necessitate some curb on the expansion of total demand, certain fiscal measures would certainly be preferable—either a more cautious public spending policy or heavier burdens on private consumption. Greater encouragement to private saving could also provide a counterweight to the rise in wages and facilitate the financing of investments from outside sources at a time when possibilities of self-financing are tending to decline. For this, however, private savings would need to be tied up for longer periods than hitherto. Measures establishing closer links between the very liquid money market and the capital market would be particularly welcome in this connection.

C. Italy

In Italy economic expansion continued unabated in 1961, progress being particularly striking in the second half of the year.

There was a slight fall-off in the year-to-year growth rates in exports and gross fixed investment, whereas private and public consumption increased at about the same pace as in 1960. Stock movements would seem to have had restraining effect.

The growth of industrial production over the year was less rapid, though it was 9.5 % above the 1960 figure which was itself a gain of 15.5 % on 1959. On the other hand, expansion in the building sector was much greater than in 1960, and thanks to favourable weather agricultural production (value added) rose by 6 % after a fall of nearly the same percentage in 1960. With a vigorous expansion in the services sector, the increase in real gross national product attained some 7.5 % (6.9 % in 1960).

The advance of imports was considerably less than in 1960 and was also lower than that of exports: the trade gap therefore narrowed slightly. As a result of increased income from the services sector and a marked rise in the net inflow of capital, there was a large surplus on the balance of payments; the gold and foreign exchange reserves of the monetary authorities alone went up \$ 339 million to almost \$ 3 500 million.

The number of persons employed rose by 1.5 %, i.e. rather more slowly than in 1960. There was again an appreciable fall in unemployment. Even more than in 1960 the economic expansion was attributable to improved productivity.

Boom conditions and a certain strain on the labour market in some sectors favoured further wage increases, which were not quite offset by a corresponding increase in productivity. This forced prices up—particularly for services—and cut down profit margins. The cost of living rose by 3.8 % from December 1960 to December 1961—mainly owing to increases in controlled rents and higher food prices.

The particularly rapid expansion of economic activity in the fourth quarter of 1961, the prospects of further growth and the fact that supply is still relatively elastic justify expectations of a considerable growth in industrial production and—assuming normal weather conditions—in the total national product in 1962. For both of these, growth could be approximately at as high a rate as in 1961. This is not a particularly optimistic estimate; it even allows for a certain slowdown of the economy in comparison with the second half of 1961.

The increase of private capital expenditure may be rather less than in 1961; public investment should go up more steeply, and private consumption will again rise appreciably.

Despite the continued favourable prospects for the balance of payments, the monetary authorities will be obliged to maintain their policy of increasing liquidity if strains are to be avoided, in view of the growing extent of borrowing by firms and by the Government. It is particularly desirable that the investment plans in the public sector be put in hand without delay. In view of the surplus on the balance of payments it would be advisable to combat pressure on prices chiefly by measures to promote imports.

1. Balance sheet for 1961 and the situation at the beginning of 1962

Foreign demand gave a powerful stimulus to the economy practically throughout 1961 but particularly in the second half of the year. Nevertheless, the year-to-year growth rate of exports (14.8 % in value and about 19 % ⁽¹⁾ by volume according to customs statistics) was distinctly lower than in 1960, though the results in that year were only to a slight extent determined by an expansive trend; they were due almost exclusively to developments in the second half of 1959.

The biggest growth rates in exports were again seen in capital goods—such as machinery and vehicles—and in chemicals. Half way through the year, however, agricultural exports began to go up sharply, too, since the harvest in Italy, in contrast to many other countries, was very good.

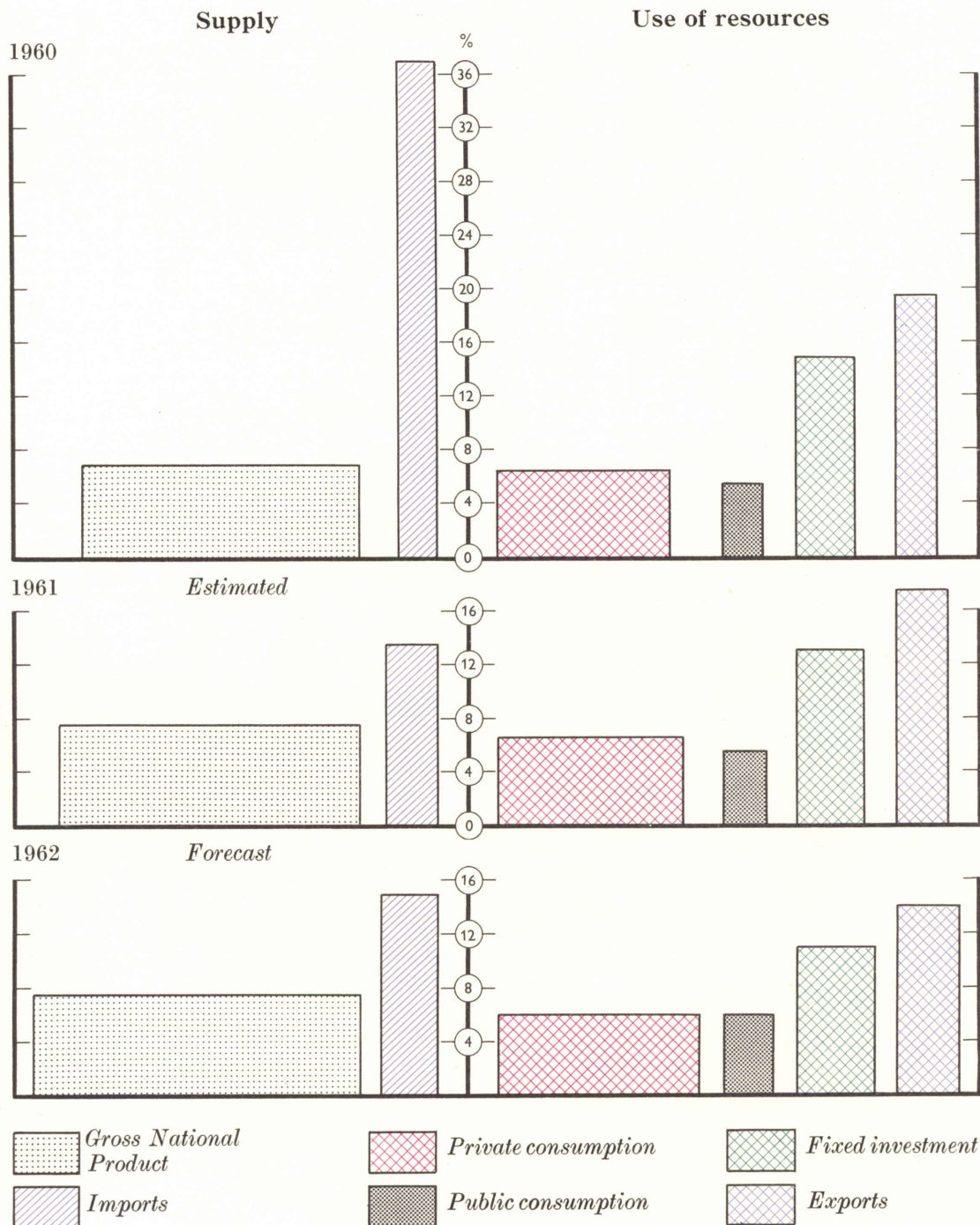
As regards the destination of exports, the greatest increase was again in those to other Community countries. The growth rate in sales of goods to other industrial countries and to underdeveloped countries was considerably less. Although exports to the United States showed a distinct upward trend during 1961, for the whole year they did not quite reach in value the level of 1960.

Exports of services—particularly the tourist trade in Italy—also went up sharply. Total exports of goods and services in terms of national accounting exceeded the 1960 figure by 17.5 % in volume—as against a growth of 19.6 % in 1960.

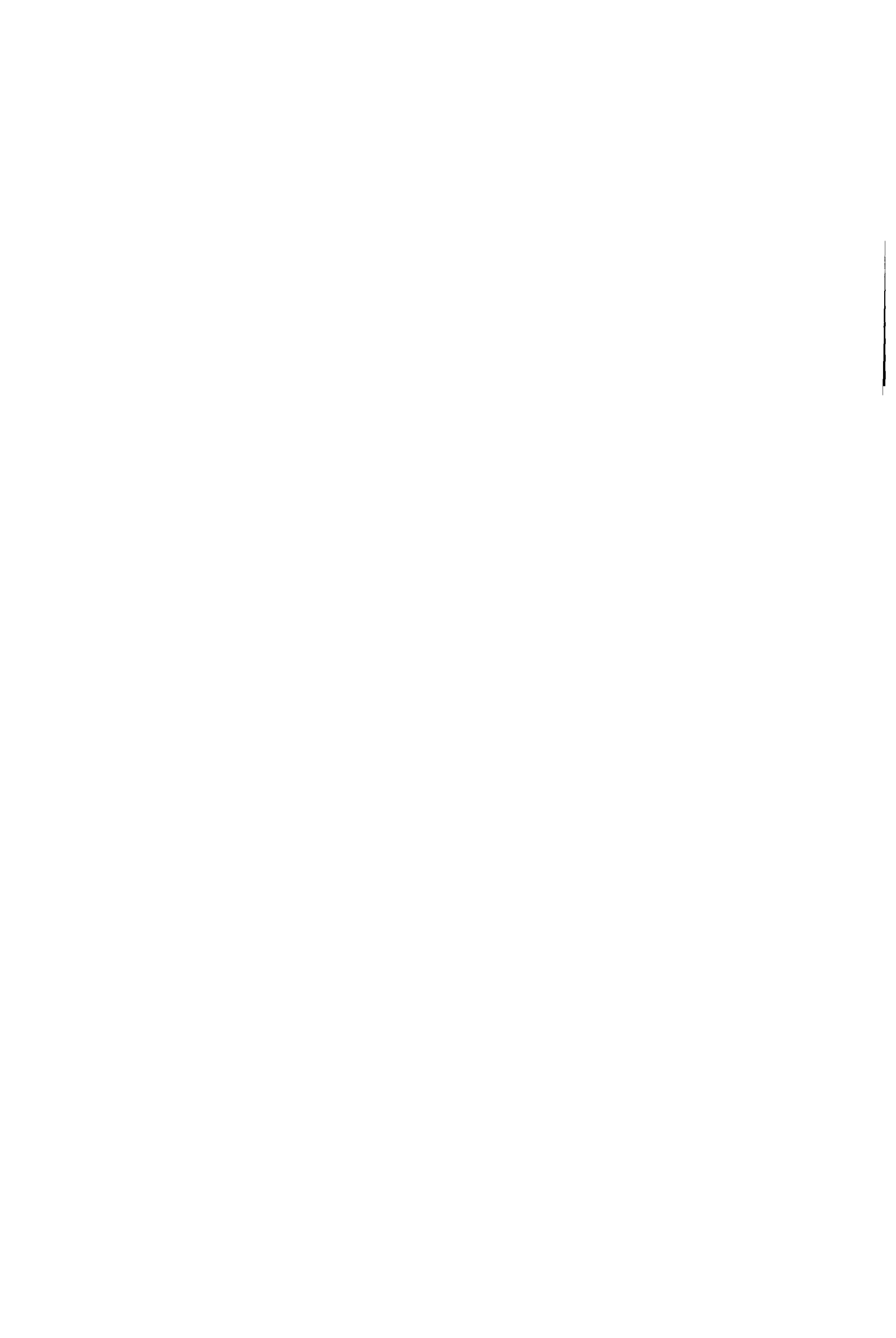
⁽¹⁾ Estimate of the Commission. All figures on the origin and use of the national product in 1961 are also estimates of the Commission; official Italian figures are not yet available.

SUPPLY AND USE OF RESOURCES GOODS AND SERVICES

Change in volume in relation to the preceding year



The width of each column is in proportion to the corresponding figure (in terms of value) for the preceding year.



The growth of home demand was again very satisfactory in 1961 and less varied as regards individual items than in 1960. *Gross fixed asset formation* probably exceeded the 1960 figure by 15 % in value and 13 % by volume, a somewhat smaller increase than that of 1960 over 1959 (16.5 % and 14.9 % respectively). In contrast to 1960, housing construction and public works advanced strongly in 1961. The rate of commercial and industrial building too forged ahead, at least in the first three quarters. The growth of capital expenditure on equipment, on the other hand, was substantially less than in 1960, though the slowdown of the second and third quarters was followed by a revival towards the end of the year.

In contrast to 1960, stock movements would seem to have had a restraining effect.

Public consumption went up at about the same rate as in 1960—about 5.5 % by volume.

A sharp rise in employment (particularly in the first half of the year), substantial wage increases, a readjustment of wage zones, rising incomes in agriculture and higher family allowances resulted in a considerable rise in disposable household income. Despite larger savings, *private consumption* went up 8 % in value and 6.3 % by volume—about as much as in 1960.

Thanks to favourable weather conditions, the grain harvest was fairly good. The harvest of fruit and vegetables (which are important Italian exports) was also well above that of the year before, which it is true had been affected by bad weather. On the other hand, the production of wine, tobacco and olives was lower than in 1960. Livestock products further increased. Total *agricultural production* (value added) rose by about 6 %, whereas in 1960 it had dropped by nearly 5 %.

The increase in *industrial production* was again substantial though its year-to-year growth rate of 9.5 % was below that of 1960 (15.5 %) (1). As in the case of exports, however, the trend in 1961—particularly from the middle of the year—was more expansive than in 1960.

Thus production in Italy again expanded more rapidly than in the other Community countries; the growth was particularly vigorous in capital goods, motor vehicles, petroleum products and chemicals. Even steel production was 11 % above the 1960 level, though exports of steel—in contrast to 1960—fell off considerably.

Thanks to favourable weather, *building* (value added) showed in all probability a marked increase (12 % as against only 2 % in 1960). There was again a particularly vigorous expansion in commercial and industrial building; and in contrast to 1960 housing and public works also advanced considerably.

The product of the *services sector* rose about 5.5 % by volume, as against 7.2 % in 1960. The *real gross national product* in 1961 rose some 7.5 %, an even better figure than in 1960 (6.9 %). In three successive years, then, the increase has not only far surpassed

(1) ISTAT index; monthly average.

the target of 5 % set by the Vanoni Plan as an average for 1955-1964; it has also been well above the growth rate that a few years ago was regarded as probable for the period 1960-1965.

The rise of output in 1961 can again be attributed mainly to increased productivity. Despite the great expansion of investment in recent years, there has been a further increase in the utilization of capacity, except in the consumer goods industry. According to the sample survey made by the ISTAT, the total number of persons employed increased only by about 330 000, or just over 1.5 %, as against 2 % in 1960. Moreover, the average number of hours worked per employee did not rise further but even fell off somewhat. According to the survey, the fall in unemployment was about 120 000 or 14 %—rather less than in 1960 but still a substantial figure. The scarcity of skilled workers became more acute; in some areas there was even a shortage of unskilled workers. However, the large numbers of unskilled workers unemployed, and in particular those of underemployed workers, still constitute a considerable labour reserve.

The vigorous expansion of demand led in 1961 to a further advance of *imports*: according to customs statistics, 10.5 % in value and 14 % by volume. In 1960, however, the growth rates had been much higher (40.3 % and 43.7 % respectively) as a result of large investments in stocks and the necessity of importing grain.

Imports of capital goods expanded particularly strongly, whereas for raw materials—at least in the first six months of 1961—the increase was insignificant. In line with this divergence, it was mainly purchases of goods from within the Community and from other industrial countries that expanded, while the value of imports from underdeveloped countries was below that of 1960. Again, agricultural imports began to fall off half way through the year as a result of the plentiful harvest.

The total volume of imports of goods and services (in terms of national accounting) rose by 13.5 %, as against 36.9 % in 1960.

Wages under collective agreements in industry went up nearly by 4 %, actual wages almost certainly by more; the concurrent rise in productivity may have been about 3 %. In trade and in the transport sector, agreed wages rose by 5 % and almost 7 % respectively. Although wages in 1961 thus increased more sharply than productivity, overall supply and demand again balanced out without disturbing the relative stability of *prices*. A further drop in import prices favoured this development. At the end of the year wholesale prices were only 0.8 % above those at the end of 1960. On the other hand, the increase in controlled rents and the rising price of services and some foodstuffs—particularly wine—led to a not insignificant rise in the cost of living. In December 1961 the cost-of-living index was 3.8 % above December 1960, when the increase over December 1959 had been only 1.8 %.

Despite the again very vigorous expansion of the domestic economy, there was a considerable improvement in the balance of payments. As a result of the faster growth rate of exports in comparison with imports, the deficit on *trade* dropped slightly

(from \$ 1 077 million in 1960 to \$ 1 035 million in 1961, according to customs statistics). Calculated on the basis of payments, however, the deficit increased slightly, probably because there were sizable repayments to be made on the import credits granted to Italy the year before, and because the increasing share of equipment goods in the total business of Italian exporters led them to extend their terms of payment.

As the increase of the deficit on trade was only moderate and that of the net surpluses arising from services was again pronounced, there was a rise of some \$ 90 million—to \$ 363 million—in the net balance of transactions (on a payments basis). Since there was also a substantial and growing net inflow of capital, the surplus on the *total balance of payments* went up by \$ 135 million to \$ 577 million; if Italy had not made advance repayment in 1960 of debts amounting to \$ 56 million, the surplus would have been fully \$ 630 million (1). The official gold and foreign exchange reserves rose \$ 339 million, as against \$ 127 million in 1960. The \$ 3 419 million at the disposal of the Italian monetary authorities at the end of 1961 constituted the third largest gold and foreign exchange reserves in the free world.

In 1961 the surplus on the balance of payments was reflected more in the official reserves and less in the change in the net foreign exchange position of the commercial banks than had been the case in 1960. In fact, the exchange policy of the monetary authorities towards the banks was modified to allow the surplus on the balance of payments to exert a greater effect than before on home liquidity. The continuing heavy demand of enterprises for credit had considerably cut down *bank liquidity*, particularly as movements in the Government's cash position were having the effect of curtailing, and no longer expanding liquidity. The tightening of the money and capital markets, which, though slight, was undesirable from the point of view of the development of both investment and the balance of payments, had not quite eased at the end of 1961. Consequently, the monetary authorities decided to lower the minimum reserve rate from 25 to 22.5 % at the end of January 1962; the available bank liquidity thus rose by Lire 190 000 million.

The statistics available for the fourth quarter of 1961 and the most recent business survey carried out by ISCO-Mondo Economico indicate that the trend at the *end of 1961 and the beginning of 1962* continued to be one of pronounced expansion.

The fourth quarter of 1961 saw a sharp rise (22.6 %) in the year-to-year growth rate of the value of exports. According to the above-mentioned survey, it is true, industrial concerns expected a decline in exports for the first quarter of 1962. However, the survey, in contrast to 1961, also indicates an increase in the backlog of orders from abroad for the same period. The results of the "Forum" survey in business circles also presented an optimistic overall picture for the first half of 1962.

Capital expenditure on equipment too remained lively, to judge, at least, from the progress of production of, and foreign trade and home turnover in, important capital

(1) The drawing of \$ 175 million on the Italian contribution to the IMF, on the other hand, had no influence on the overall balance of payments.

goods. In building activities, on the other hand, according to the incomplete information available there has perhaps been less expansion. The results of the "Forum" survey also argue a further expansion of fixed investment in general. Investment in stocks seems to have picked up somewhat; imports of raw materials—which had long been declining—at least showed a clear gain in July to November 1961 over the same period in 1960. There was in all probability a further increase in private consumption also.

As regards supply, a faster rate of growth in industrial production was evident from the middle of 1961 and was particularly pronounced in the last quarter. The production index was 12.3 % above the figure for the corresponding period of 1960. The above-mentioned surveys also showed favourable prospects for the growth of production in the early months of 1962. The year-to-year growth rate of the value of imports rose from 7.5 % in the third to 9.8 % in the fourth quarter; in the first three quarters it had declined.

2. Outlook for 1962

The economic trends at the end of 1961, among other things, lead one to expect that 1962 as a whole will again see a vigorous expansion, though the pace will perhaps be rather slower than in 1961.

Foreign demand will again be an important factor. The continued effect of the 10 % tariff reduction made within the Community on 1 January 1962, which may be followed by another cut half way through the year, and—to a lesser extent—of the abolition of the quotas on industrial products in trade between Member States constitutes a powerful stimulus. Another point is that the import of certain fruits and vegetables, which are a large item in Italian foreign trade, into the other Community countries are to be liberalized from 1 July 1962.

The international competitive position of Italy will remain strong : labour reserves are still relatively large and satisfactory elasticity of supply is also ensured by a margin of productive capacity, which has been steadily stepped up by the high rate of investment in past years. Again equipment, according to a recent study, is particularly up to date, at least as regards machine tools. It is true that a rather sharper upward trend of costs and prices must be expected, but as there will also be similar developments in other countries this should hardly affect Italy's position on export markets. The new government export credit guarantees, and to some extent the contemplated speeding up of procedure for refunding turnover tax on exports will tend to improve Italy's competitive position.

The generally still satisfactory economic prospects in important countries of the Community and the recovery in the United States which will probably continue, also promise a further expansion of Italian exports. As for exports of services, another boost

to the tourist trade can be regarded as practically certain. Total exports of goods and services may therefore go up some 14 % in 1962.

The growth of home demand will continue, even if perhaps at a rather slower pace than in 1961. This applies chiefly to the *gross fixed investments* of enterprises. According to a special survey conducted by ISCO-Mondo Economico, industrial enterprises in January expected their capital expenditure to increase less in 1962 than in 1961. Nevertheless, expansion of investment will probably continue, mainly in view of the increasing utilization of productive capacity, the growing scarcity of labour and the prospect of further rises in wage costs per unit of output. Another factor is that competition is expected to become keener at home—as a result of the customs and quota measures mentioned above—as well as on important foreign markets.

The prospects for *housing* and especially *public works* also point to a fair degree of expansion. In fact, public works will probably expand rapidly in the second half of 1962 when some of the government schemes decided on in 1961 are carried out. The capital expenditure budgeted for in the financial year beginning 1 July 1962 represents an increase of over 15 % in value.

In all, gross fixed asset formation in 1962 will thus go up 11 % by volume in comparison with 1961.

After the—probably restraining—influence of stock movements in 1961, *investment in stocks* may become somewhat more important in the course of 1962.

Public consumption will probably increase at about the same rate as in 1961.

Private consumption will continue its vigorous growth, though the increase in employment may be a little less. There may also be a rather slower rise of disposable household income as a result of the tax increases that came into force at the end of 1961 and others planned. In addition, the propensity to save will grow stronger as individual incomes increase. On the other hand further considerable wage increases must be expected, and transfer incomes will again rise. The growth of private consumption could therefore reach some 6 % by volume.

In view of these prospects for overall demand, the seasonally adjusted index of *industrial production* may well show a slower increase than it did in 1961. Nevertheless, a somewhat higher year-to-year growth rate of some 10 % may be attained, since expansion in the last quarter of 1961 was extremely vigorous.

The expansion in *building* (value added) will certainly continue, mainly because of extensive public, commercial and industrial building. The year-to-year growth rate may however decline to 10 %. The product of *services* (value added), on the other hand, may increase more vigorously than in 1961 and register a growth rate of about 6 % by volume.

The growth of the total gross national product in Italy depends far more than in the other member countries on the progress of *agricultural production*. It is precisely in this sector, however, which contributes no less than 17 % to the gross national product, that

reliable forecasts are obviously impossible. All that is certain is that—in contrast to 1960—there was good weather for the grain sowing in the autumn of 1961 and that there is still room for improvement in the harvests of various important crops. Granted normal weather conditions, agricultural production (value added) may rise by about 4 % in 1962. The *real gross national product* would then gain some 7.5 %.

The somewhat weaker growth of total demand in comparison with 1961, the still relatively large reserves of productive capacity and the possibility of increasing total supply by boosting imports make it seem at least possible that supply and demand will be brought into balance without excessive strain.

Imports may indeed increase by about 15 % by volume—rather faster than in 1961. This growth rate assumes a certain revival in imports of raw materials; the recovery should be more marked however in imports of industrial finished goods, not least on account of tariff cuts which will have a fairly substantial effect because of the relatively high level of Italian basic duties.

Nevertheless, *prices*—at any rate the level of consumer prices—will probably rise again. Not only are controlled rents to be put up once more, but wage increases very likely in excess of any gain in productivity will mean higher costs and will tend to force prices up.

If these assumptions are correct, the *balance of trade* will probably deteriorate. Despite the further expected rise in income from services—particularly the tourist trade—the surplus on the balance of current account may decline slightly. But as the net inflow of capital—not least as a result of the full non-resident convertibility introduced at the end of 1961—will presumably increase, large surpluses on the balance of payments are again to be expected.

In this event, there will also tend to be greater liquidity at home. An adequate supply of funds seems indeed to be one of the most important conditions for maintaining industrial investment at substantially the same pace. The fact that profit margins have narrowed and may well narrow again will probably afford an additional stimulus to firms' demand for credit. Strains resulting from this will have to be avoided. In this connection the effects of movements in the public authorities' cash position will be important. Once some of the big programmes of structural improvement have got well under way as planned in the second half of 1962, the public cash position should in any case tend towards a deficit.

It is therefore important for the Central Bank to continue its policy of expanding home liquidity at least until then—whether by a foreign exchange policy tending to make money easier, by further reductions of the minimum reserve rates or by other means at its disposal.

In spite of this, the estimated slackening in the growth of firms' investments will hardly be completely avoidable. It is all the more vital that the authorities succeed in promptly increasing the public investments planned as part of structural policy. Should

there be any delay here some care ought to be taken—as was at times necessary in 1961—at least to keep any consequent increase in public funds within the banking system, so as to prevent a corresponding decline of liquidity.

In the interests of combating pressure on prices, all efforts to increase elasticity of supply are particularly welcome. In view of the scarcity of skilled labour, occupational training should be encouraged even more than before. It is also desirable to seek every means of promoting imports. One way of doing this—apart from making additional voluntary tariff cuts as provided for by the Treaty of Rome—would perhaps be to expedite the procedure for issuing import licences. Moreover, certain inflationary factors could doubtless be neutralized by pressing forward the rationalization of trade channels. It might be useful to increase the existing fund for granting low-interest advances to small and medium-sized commercial enterprises for modernization purposes and to extend the validity of the relevant law for several years.

D. Netherlands

In the Netherlands boom conditions continued in 1961 though growth in real terms was slowed down appreciably, especially by physical limitations, particularly the complete exhaustion of labour reserves and heavy cuts in working hours.

While foreign demand rose relatively slightly, there was a significant increase in home demand, chiefly under the stimulus of expenditure on fixed investment.

A marked drop in the index of industrial production in the middle of 1961 resulted mainly from the reduction of working hours, and this was only just made good by the end of the year. Consequently, the year-to-year growth rate was only 1.5 %—as against 13 % in 1960. Although agricultural production fell off slightly owing to weather conditions, the real gross national product still went up by 2.5 %, thanks mainly to an increase of production in the services sector.

The vigorous expansion of imports was maintained and led to a reduction of the surplus on current account. As the public and private export of capital was also considerable, the combined effect was a slight deficit on the overall balance of payments. Nevertheless, the official gold and foreign exchange reserves, expressed in dollars, showed scarcely any decline.

Prices rose slightly, partly because wage increases exceeded the increase in productivity.

In 1962 economic growth will probably be rather more rapid, though still moderate. Exports may go up again, though foreign demand may become less lively and competition on foreign markets keener. There will still be a somewhat vigorous growth of investment demand.

The expected rise in industrial wages, the rise in the basic salaries of civil servants, the proposed increase in old-age pensions and the tax reduction that is to take effect on 1 July will have an appreciable influence on private consumption. Although total demand may again increase, weaknesses may become apparent in some sectors.

The labour shortage will continue to make itself felt in the first six months of the year; only thereafter will the situation be easier as more young people leave school. The domestic supply of goods and services will therefore probably further increase—thanks also to the effects of investment on productivity during previous years—

so that a rise of about 4.5 % in industrial production and of about 4 % in gross national product should be possible.

Equilibrium between supply and demand will scarcely be attained without the surplus on the balance of current payments being reduced again and here a certain deterioration in the terms of trade will also play a part.

A rather sharper increase of wage costs without a corresponding rise in productivity is expected to send production costs up again. This may accelerate the tendency towards higher prices. The Government is therefore endeavouring to make its wages policy work effectively to combat the rise of prices. This policy should be accompanied by a careful guidance of the expansion of credit and government spending and by measures to combat rising costs by increasing labour availability and boosting productivity.

1. The balance sheet for 1961 and the situation at the beginning of 1962

Despite the continuing boom, economic expansion in 1961 was limited even more than in 1960 by an insufficiency of the factors of production, particularly a shortage of labour, which was aggravated by an increasingly rapid shortening of working hours.

The growth of demand, however, was also rather slower than in 1960—particularly that of *foreign demand*. Goods exported in 1961 (according to customs statistics) exceeded the 1960 level by only 2.7 % in value and 3.7 % in volume. But since the export of services increased more notably, the volume of total exports of goods and services—in terms of national accounting—still rose by 4.5 %. In 1960, however, the increase of exports had been 13 %.

A greater increase of deliveries abroad was prevented mainly by the lack of elasticity in supply. But in some sectors a weaker trend of demand—that was perhaps partly a result of the revaluation of the guilder—slowed up the rise of exports somewhat in the course of the year. In finished products, particularly machinery, transport equipment and clothing, clear advances in exports were still made, though they were less than those of the year before; on the other hand, exports of iron and steel, non-ferrous metals and agricultural products, particularly meat and dairy produce, suffered a pronounced reduction.

As for geographical distribution, exports to the other EEC countries, particularly B.L.E.U. and France, continued to rise, though the increase was less marked than in previous

years. At the same time, deliveries to EFTA countries slackened off somewhat, mainly as a result of a drop in sales to Great Britain. Exports to most countries outside Europe also fell off; in particular, the decline in exports to the United States continued.

The expansion of home demand continued in 1961 and was the main factor in the development of the economy, despite growth rates in some components of demand having gone down in comparison with 1960.

Overall *gross fixed investment*, which had been expanding very sharply since 1959, moved up in 1961 by about another 8.5 % in value and 7 % in volume—after a rise of 11 % and 10 % respectively in 1960. The increase was fairly steady throughout the year.

Gross fixed investment by enterprises went up 8 % in value and 6.5 % in volume (11 % and 10.5 % respectively in 1960). The slackening-off of the increase in investment in 1961 can be attributed mainly to physical limitations. The demand of enterprises for capital goods moved strongly upwards, stimulated in particular by the complete exhaustion of labour reserves, the rapid reduction of working hours and a certain rise in production costs. As a result of the rationalization schemes in industry the growth rate of investment in this sector remained at the 1960 level. Much of the machinery and equipment required had to be imported. While investment in trade and agriculture moved ahead, there was a definite reduction of investment in the transport sector: investments in ships and aircraft (in which wide fluctuations are normal) dropped well below the level of 1960, when they had in any case been unusually high.

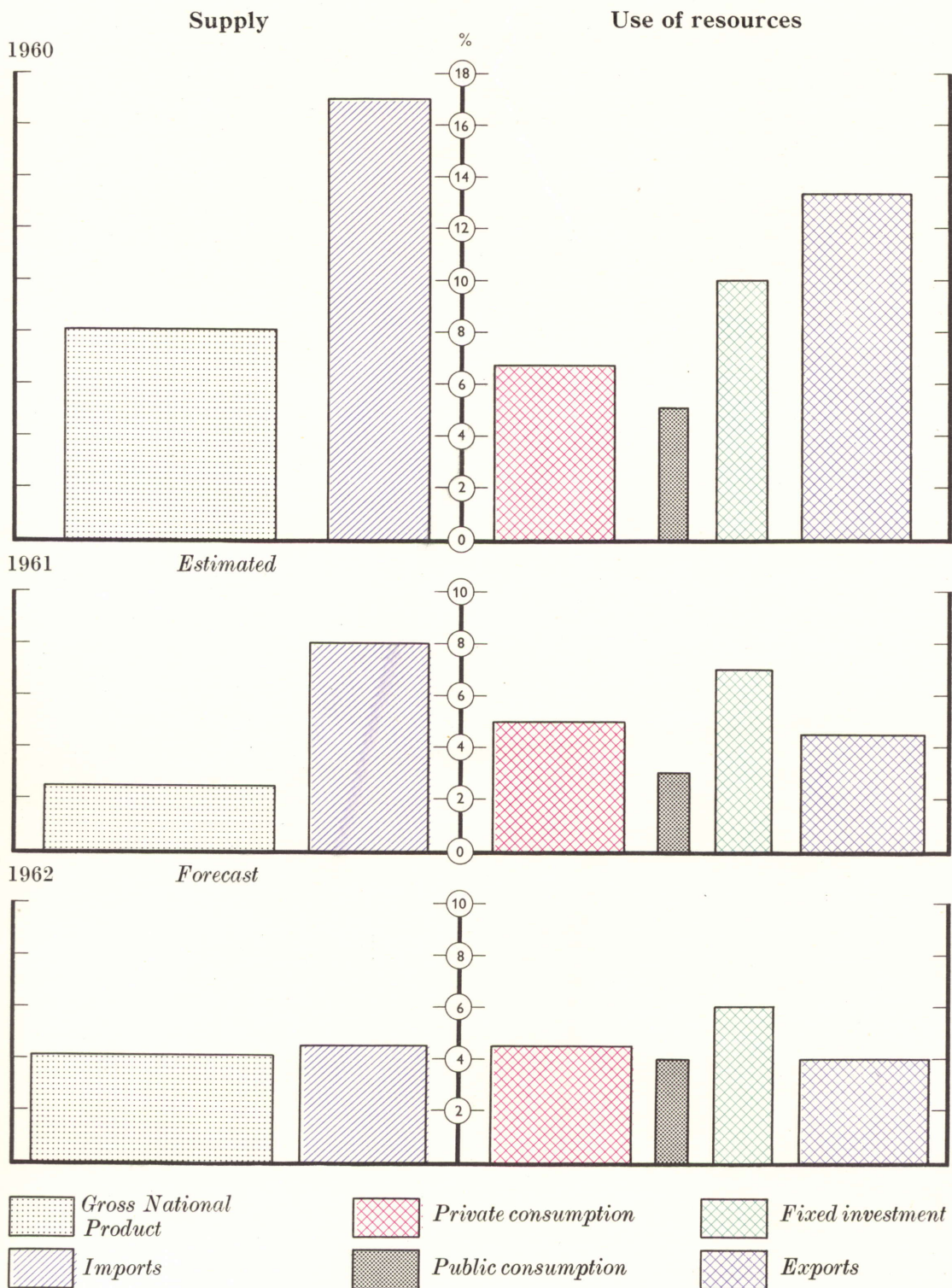
The *building sector* was again under pressure, which was partly reflected in prices. Demand for commercial and industrial buildings remained very lively, and some projects had to be postponed as a result of bottlenecks in labour and materials. There was also a boom in demand for housing. The number of dwellings completed during 1961 was in fact rather less than in 1960 because of limited capacity, but the number of housing construction permits issued exceeded the 1960 figure by almost 20 %, despite government restrictions. The number of houses under construction at the end of the year was about 20 % higher than at the end of 1960.

In spite of the efforts of the authorities responsible for economic policy to prevent government spending from giving rise to additional strains, *public investment* expanded faster than the national product; the increase was about 10 % by volume. It is obviously not the intention of the Dutch authorities' system of priorities, even if boom conditions continue to postpone for any length of time public investments such as the building of schools and hospitals and investments in infrastructure.

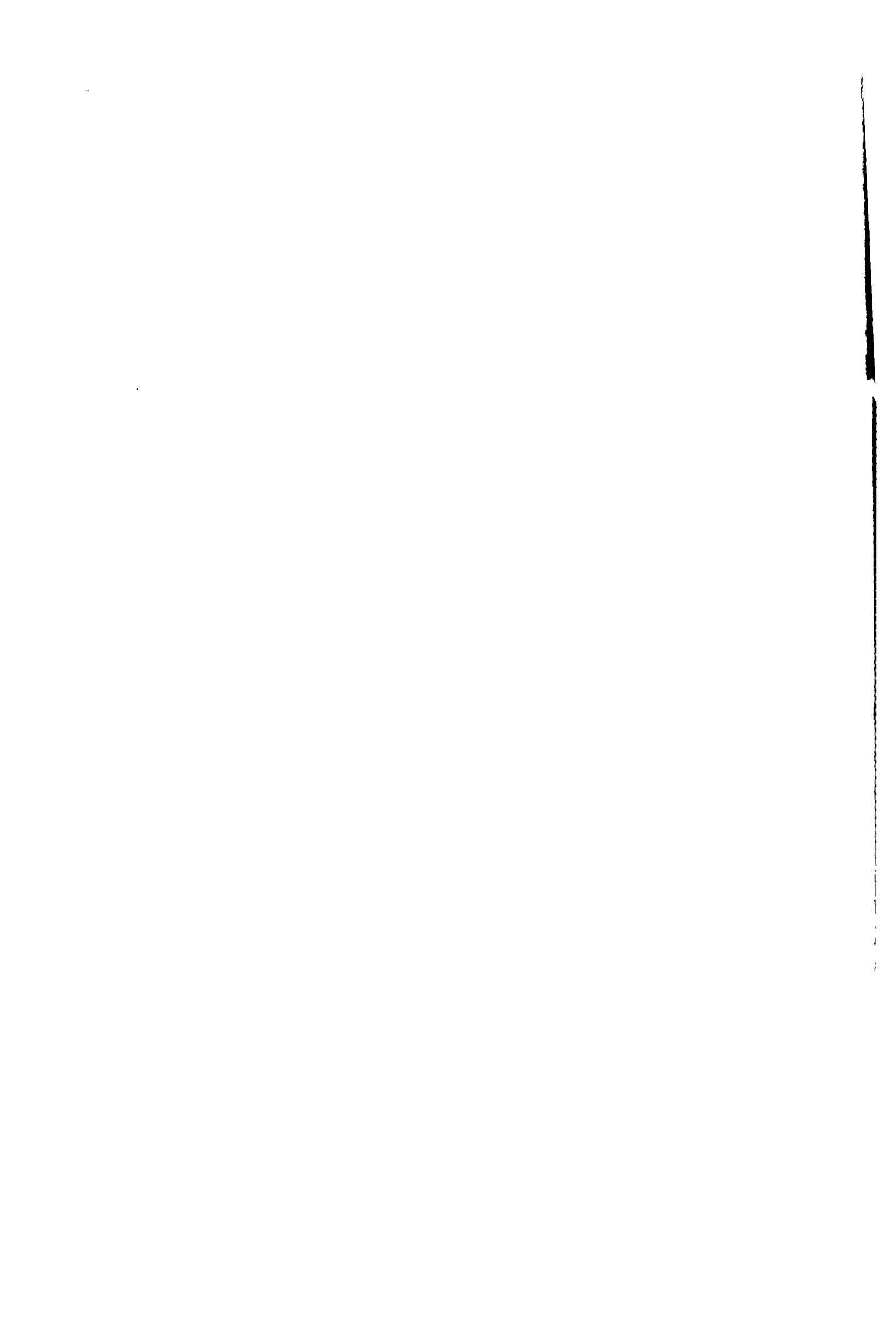
Investment in *stocks* made no marked contribution to total demand. A tendency to run down stocks was evident from the middle of the year onwards, and its effect on demand for raw materials and semi-finished products may have been accentuated by the slackening of growth in industrial output. This development was also reflected in a conspicuous drop in imports of raw materials.

SUPPLY AND USE OF RESOURCES GOODS AND SERVICES

Change in volume in relation to the preceding year



The width of each column is in proportion to the corresponding figure (in terms of value) for the preceding year.



Owing to a smaller rise in total income, *private consumption* also rose more slowly in 1961—by 6 % in value and only about 5 % by volume, as against 8.5 % and 6.5 % for 1960. The comparatively modest rate of expansion, however, continued only until the autumn, when it appears to have gathered momentum. Purchases of durable goods, in particular, on which certain restrictive measures had been imposed in the middle of the year, speeded up after November.

Trends in incomes other than wages and salaries (profits of enterprises, income of self-employed and from property, i.e. interest, dividends, etc.) which taken together remained unchanged, contrasted with the development of wages, which rose again, though rather less sharply than in 1960. The wage and salary bill of enterprises increased by more than 7 %. The number of employees was about 2 % higher than in 1960 and wages per employee increased by an average of 5 %; 2.5 % of this was due partly to wage increases exceeding the agreed rates and partly to normal structural changes. A shorter working week meant that hourly wages climbed more steeply.

Public consumption went up about 3 % by volume.

Domestic supply was not elastic enough in 1961 to meet increased demand. The *labour market* was again extremely tight; labour shortages became still more pronounced. The monthly average figure for unemployment was only 35 000, less than 1 % of wage and salary earners. In contrast to 1960, there was a slight excess of immigrants over emigrants (2 000 workers). Nevertheless, the number of vacancies remained high (more than 100 000 on average); over the whole year vacancies outnumbered the unemployed by at least three to one.

The labour shortages was aggravated by extremely rapid cuts in working hours. For all enterprises the reduction can be estimated as at least 3 %, or 1½ working hours per week. In industry the reduction was even more pronounced.

In these circumstances the growth of industrial production ⁽¹⁾ in 1961 reached only 1.5 %, as against over 13 % in 1960. Half way through the year a definite decline was registered, as a result of the reduction in working hours. Since the employment figure went up nearly 2 %, productivity per person employed cannot have risen. Advances in productivity per man-hour were, however, about equal to the average of recent years.

Agricultural production was about 3 % below that of 1960, when it had, however, been extremely high. On the other hand, considerable progress was again recorded in the services sector. The gross national product rose in real terms by 2.5 % in 1961—after a growth of 8 % in 1960.

(1) According to the index of the CBS (Central Bureau of Statistics).

The strong growth of demand brought about a further increase of *imports*. According to customs statistics, they gained 8 % in value and 9 % by volume; this is less than the increase attained in 1960 (15 and 16 % respectively), owing mainly to the appreciable fall in imports of raw materials resulting from the slowdown of production and the hesitation in ordering new stocks.

Calculated in terms of national accounting, the rates of growth for imports of goods and services in 1961 were 6 % and 8 % respectively (18 % and 17 % in 1960).

Purchases from the member countries of the Community continued to show a high rate of growth; in 1961 they accounted for almost half of Dutch imports (46 % in 1960). Imports from EFTA countries stood at the same position or higher, whereas the share of imports from the United States went down.

Despite increased imports and the Government's efforts to keep *prices* down, a slight rise in the level of prices could not be avoided. After being fairly stable in the first half of 1961, the cost-of-living index at the end of the year was 2.5 % higher than at the end of 1960; expressed as an average of the monthly figures for the year the increase was 1.7 %. The Government tried various measures to strengthen its policy of stabilizing consumer prices. Wholesale prices, on the other hand, remained remarkably steady, thanks partly, no doubt, to the fall in import prices consequent upon revaluation.

The heavy increase of imports in relation to exports was reflected in the *balance of trade* (customs statistics), which deteriorated considerably in comparison with 1960, the deficit rising by more than 1 000 million guilders. The *overall balance of current payments*, however, fared better, since services and other items developed favourably; it still closed with a surplus of 500 to 600 million guilders, as against 1 200 million guilders in 1960.

The *overall balance of payments*, however, showed a slight deficit. This can be attributed mainly to an extensive capital outflow following a restricted opening of the Dutch capital market to foreign issues (just under 550 million guilders) and advance repayments of public debts. If the credits granted through the International Monetary Fund are taken into account, total gold and foreign exchange reserves dropped by some 800 million guilders. This included a fall of nearly 120 million guilders in the reserves of the monetary authorities, but at the end of the year these still exceeded 6 000 million guilders. At the same time the net foreign exchange position of the commercial banks deteriorated by about 680 million guilders. Expressed in dollars, the fall in reserves was less, since the revaluation of the guilder involved a book-keeping reduction of the reserves calculated in guilders. On this basis the fall of official reserves amounted only to some 30 million dollars.

There was still ample liquidity on the money and capital markets; it was only in the fourth quarter that temporary strains were felt. An agreement between the Central Bank and the other banks limited the total increase in credits for the private sector; in fact, credit expansion was kept consistently below the permissible increase of 15 %.

The authorities persisted in their policy of mopping up surplus liquidity. Although the budget deficit was heavier than that of 1960 (some 800 million guilders, excluding increased expenditure with no effect on the domestic situation, such as the compensatory payments for the Central Bank's revaluation loss and the IMF loans), government transactions continued to have a restrictive effect on liquidity, since recourse to the capital market exceeded real financial needs. In addition, local authorities again reduced their short-term indebtedness.

During the *latter part of 1961 and early 1962* there does not appear to have been any significant change in the economic climate. Economic growth in real terms remained very limited.

The results of the *business survey* carried out among firms, which were published for the first time by the CBS, show a slight upward movement during the last months of 1961 in orders received from abroad. Exports in the fourth quarter, however, only just rose above those of the corresponding period in 1960. Consumer demand has certainly risen again; it will probably be stimulated further by the wage increases now under negotiation. Investment appears to have remained lively.

Industrial production continued to rise in the fourth quarter, but without fully offsetting the reverse recorded early in the year; output fell just short of that in the fourth quarter of 1960. Imports again rose appreciably, and the deficit on trade was considerably larger than a year before. The labour market was still tight; contrary to the seasonal tendency, there was no rise in unemployment in January.

2. Outlook for 1962

In 1962 the economy may again show a higher rate of growth than in the previous year, but the growth rates of 1959 and 1960 are unlikely to be attained.

Whether *exports* will advance will depend not only on the material possibilities of increasing production but also—and more especially—on the state of the order books. Competitive capacity will become more important: the progress of foreign sales could be affected more seriously than before by the trend of costs and export prices. In addition, the after-effects of the revaluation of the guilder will also have some influence.

Exports to the other Community countries will certainly go up—partly as a result of the new tariff cuts. But the rather modest economic prospects in the B.L.E.U. and the Federal Republic of Germany, the Netherlands' most important trade partners, make a strong expansion of exports to those countries improbable. On the other hand, it is not

impossible that the slackening of exports to non-member countries observed in 1961 will be partly offset by a recovery of deliveries to some of them—particularly the United States and certain developing countries.

Under these circumstances the export of goods may rise about 4 % by volume, and this growth rate is not likely to be substantially exceeded by the export of services.

Gross fixed investment will probably increase by about 6 % in real terms, or rather less quickly than in 1961. On the one hand, the prospects of growth in home demand, the continuing labour shortage and the probable increase of wage costs may encourage the propensity to invest.

But, on the other hand, dwindling profit margins and reduced possibilities of self-financing may have a damping effect. In 1961, wage costs per man-hour rose much more than productivity per man-hour, and these cost increases were only partly passed on in prices. The steps taken in 1960 to put a brake on investment by changing the rules governing depreciation for tax purposes and the extent to which new investments could be allowed as deduction from taxable profits will have an effect similar to the reduction of profit margins, for these measures will put up the tax bill to be paid by firms in 1962. Also, the slight falling-off of demand noticeable in some sectors may discourage enterprises from investing.

Together these factors will probably cause investment to lose pace somewhat, particularly in industry. Demand in the building sector, on the other hand, will probably remain lively; the number of dwellings built is likely to reach again the limit imposed by current production factors, despite sizeable price increases. Total investment in building in 1962 is likely to rise by no more than 2 % by volume.

As there is no likelihood of the growth in production and turnover speeding up very much, *stock-building* in 1962 will hardly stimulate the domestic economy much more than in 1961.

Public investment may go up 8 % by volume, the relatively greatest increase being in infrastructure and State-financed establishments for scientific research and teaching.

The trend of *private consumption* will be affected by a growth of income that will probably be more rapid than in 1961. The substantial increase in wages after the conclusion of numerous new wage agreements in the first half of the year and after other wage adjustments, as well as the expected increase in numbers employed in the second half, will send the wage income up further. Mention should also be made of civil servants' salaries; they will go up at least 10 %, on average, in 1962 as part of a salary increase of 8 to 40 % that is to be effected by stages over four years. Old-age pensions are also to be increased by 15 % on 1 July if the Government Bill for that purpose is passed. The reduction of wage and income tax with effect from that date—the difference being estimated at 525 million guilders in a full year—will also stimulate private consumption.

As the level of consumer prices will rise again, partly as a result of the 10 % rent increase that is expected to take effect on 1 July (though this has not yet been fixed) and doubtless also because of the increase in production costs, private consumption will not rise in volume as much as by value—though the rise in volume will still be 4 to 5 %.

Public consumption could also exceed the 1961 figure by 4 % in volume, particularly as civil servants' wages and defence expenditure are to be increased.

In 1962—especially in the second half—there may again be more elasticity in production. For one thing, the number of school-leavers will be greater than in previous years. To a lesser extent, the labour supply may also be increased by the tax relief on married women's earnings and the first step towards equal pay for men and women that is planned for half way through the year. A net increase of immigration is also to be reckoned with. Furthermore, productivity will doubtless improve as a result of outlay on rationalization. On the other hand, working hours will again be reduced in some sectors and the after-effects of the cuts made in 1961 will still be felt.

In view of these factors and the probable movement of demand—which in some sectors may be relatively weak—*industrial production* may expand by some 4.5 %.

As *agricultural production* might increase slightly and a further considerable rise can be expected in the contribution made by services, the real *gross national product* could gain about 4 % on the 1961 figures.

As production—at least in the first half of 1962—will presumably grow less quickly than demand, *imports* will advance once more. This tendency will be accentuated by the rise of production costs in the Netherlands and by the effect of revaluation on import prices—in so far as costs and prices do not rise abroad as well. The Government's endeavours to keep prices steady and the cautious policy of firms as regards replenishing their stocks of raw materials—which will perhaps continue for some time yet—will have a counteracting effect. The real increase in imports of goods and services might be 4 to 5 %.

The expected development of exports and imports of goods and services may again produce a surplus on the *balance of current payments*, but once more it is likely to be less than in the previous year.

A certain drop in the liquid assets of firms, as a result of the shrinking of profit margins, may stimulate their demand for credit. As bank liquidity is very high, it is important that credit expansion should continue to be kept within bounds. The agreement between the Central Bank and the other banks to limit the amount of new advances the banks may grant to private borrowers has in fact been extended to the early months of 1962. At the same time, it would appear necessary to keep the expansion of liquidity under control, particularly if there is no sizeable deficit on the balance of payments. The part to be played by government financial policy is also very important; according to the

budget estimates, the deficit is to be reduced and can easily be covered by drawing on the advance subscription account of pension funds, without recourse to borrowing. In addition, the Government will again issue loans to drain off surplus liquidity at home. A loan of 300 million guilders was at any rate issued in March.

The most important problem of economic policy in the Netherlands in 1962 seems again to be to counter rising costs and prices and to prevent any development that in the longer term might jeopardize the balance of payments and economic growth.

The authorities in the Netherlands, unlike those in other countries, have at their disposal means of implementing a direct policy on wages and prices. However, it will probably be impossible in the coming year to keep wage increases within the limits of productivity increases and to prevent prices from going up. It is true that a new and improved formula for wage policy has been agreed, which is serving as the basis for current negotiations and provides that a quarter of the general rise in productivity (estimated at 2 % for 1962) be taken into account when wage increases are fixed in the various branches of industry.

But it is very questionable whether the wage increases agreed on this basis, coupled with the practically unavoidable rise in wage costs due to structural changes and certain adjustments of wages to the labour market situation, will not in fact lead to a considerable overstepping of what would be justified by the increases in productivity. Besides, a further wage increase can be expected as compensation for the raising of controlled rents planned for 1 July, though on this occasion employers have agreed to bear the increased costs out of profits. The wage bill will almost inevitably go up in some sectors if women's wages are brought partly into line with men's on 1 July, and at least in the short term it will hardly be possible to balance this rise by an increase in productivity.

Under these circumstances prices will continue to move up, and this may very well be at a faster pace. It is doubtful whether there is enough margin for price reductions in those branches that have shown a relatively rapid increase in productivity. Only such "compensatory" price reductions can offset price increases in those sectors in which productivity rises relatively slowly and where price increases must be permitted if enterprises are not to work at a loss. In general, it appears to be difficult to bring prices down in the current economic situation, even in those sectors of the economy where reductions seem feasible.

How far price rises can be checked depends on the effectiveness of the price policy. The Government's powers in this sphere were confirmed by the Price Law that came into force in 1961.

The authorities responsible for economic policy will certainly be careful to ensure that higher costs and controlled prices do not make too great inroads into profits. Otherwise the propensity to invest may in time suffer and this could endanger the short term

of the coming evolution. Price policy will, therefore, still have to be accompanied by measures to prevent costs from rising by improving the supply of labour and encouraging increases in productivity.

In this situation it might be worthwhile to relieve the pressure on the building industry by issuing fewer permits for a time, thereby reducing the number of buildings under construction (which has gone up sharply) in comparison with those completed. The present state of affairs seems to be hampering the rise of productivity and to be conducive to higher prices; the increase of total building output has therefore tended to be smaller than would otherwise have been the case.

The authorities also intend to guard against an uncontrolled rise in public demand—particularly that of the municipalities. The Government recently introduced a Bill on the financing investment by municipalities; it provides for fixing—whenever the economic situation so requires—a ceiling valid for twelve months, on long-term municipal loans, which in future will be the only permissible means of financing municipal investment.

E. B.L.E.U.

Belgium

Economic expansion in Belgium lost some momentum in 1961. Although demand picked up after the January strikes, which had substantial repercussions on output and exports, some slowing down was again apparent in the second half of the year.

The major factor in expansion was fixed investment, which appears to have risen by about 9 %. In this expansion foreign investment played a substantial role. On the other hand exports went ahead much more slowly than in 1960, while private consumption again recorded only a modest increase.

Correspondingly, supply also made slower progress than in 1960. The real gross national product seems to have grown by about 3 %, and industrial production by a good 4 %. Imports also expanded less vigorously than in 1960.

The number of gainfully employed rose by some 1.5 %, and unemployment dropped appreciably. Although skilled labour was in short supply, there was no general strain on the labour market comparable with that experienced in neighbouring countries. The situation on the labour market contributed to the fact that in 1961 the rise in wage costs remained slightly below the rise in productivity. This trend, combined with the limited pressure from demand and the high elasticity of supply, made it possible to maintain a more or less stable price level.

Despite a serious deterioration in the deficit on trade—due partly to the strikes—equilibrium in the overall balance of payments was ensured by the more favourable turn taken by the other items in the balance of current payments and of capital transactions. The level of liquidity on the money and capital markets was high.

Economic activity is unlikely to gather much momentum in 1962. With the disappearance of special factors which affected the 1961 figures, however, the national product may grow by as much as 3.5 %—somewhat larger advance than in 1961. Exports and private consumption may well expand rather more vigorously, while the growth of investment will probably tend to slacken.

A more pronounced decline in the upswing of investment should be prevented. Investment in Belgium must be ensured rapid growth on the right lines over a longer term, this being the only way to obtain sufficient expansion in economic activity as a

whole. To bring this about it would seem that existing measures to encourage investment, must be maintained and improved, new measures introduced, such as the establishment of a national investment corporation endowed with the necessary funds and powers, and both the capital market and the fiscal system reformed. It would certainly help if the measures now being prepared or already before Parliament were put through rapidly in a form consonant with the requirements of growth policy.

The balance sheet for 1961 and the situation at the beginning of 1962

Although all the components of overall demand advanced in 1961, it was the more rapid growth of private fixed investment that provided the driving force in expansion.

According to customs returns, the year-to-year growth rate of *exports* fell off considerably in 1961: sales abroad rose only 3.8 % in terms of value as against 14.6 % in 1960, while in terms of volume they probably rose roughly 4.5 %, owing to the fall in export prices after their slight improvement in 1960. After suffering a considerable setback at the beginning of 1961 on account of the strikes, exports again resumed their expansion.

The fall in the year-to-year growth rate of exports in 1961 can chiefly be put down to the appreciable drop in European demand for iron and steel products and to shrinking markets for chemicals, certain textiles, and some other products as flat glass.

Exports to other Community countries again advanced more vigorously than those to EFTA. While deliveries to West Germany merely inched upwards following the appreciable fall in demand for iron and steel products, the same growth rate was recorded for exports to the Netherlands as in 1960, thanks to large sales of equipment goods. The recovery in exports to the United States, after the fall registered in 1960, mainly benefited the iron and steel industry and mechanical engineering.

Exports of services seem to have progressed rather more slowly than those of goods.

Of all the components of demand, *gross fixed asset formation* recorded the highest growth rate in 1961, rising about 9 % in volume, compared with 6 % in 1960. This advance was largely due to the very rapid expansion of fixed investment by enterprises. Further incentives to invest were doubtless the high level of business activity in recent years in neighbouring countries, particularly West Germany and the Netherlands, and the

prospect of keener competition but also higher sales in the Common Market. It has been easier for Belgian firms to obtain the necessary finance partly because, in absolute terms but even more by comparison with developments elsewhere, the ratio between increases in wages and increases in productivity has been satisfactory and has therefore increased the scope for self-financing; partly, too, because of the effects of the legislation passed in July 1959. Finally, the growth of total expenditure on investment by enterprises benefited, to an extent that could hardly have been anticipated, from foreign investment; this was twice as high as in 1960.

The figures available on investment during the year give the impression that expansion is gradually slowing down. The same tendency also emerged in *housing construction*, where the increase of 7 % for the full year, obtained from the average monthly figures, can be almost wholly attributed to the brisker activity in the first half of the year. The number of dwellings completed in the second half-year was again much the same as in 1960.

Public investment in 1961 did little to stimulate economic activity, its volume having hardly changed compared with 1960. Although the budget made considerably less funds available in 1960, there was no drop in expenditure in 1961. The appropriations for public works again rose in 1961. The increase in public consumption was more vigorous than in 1960, though less brisk than that of overall demand.

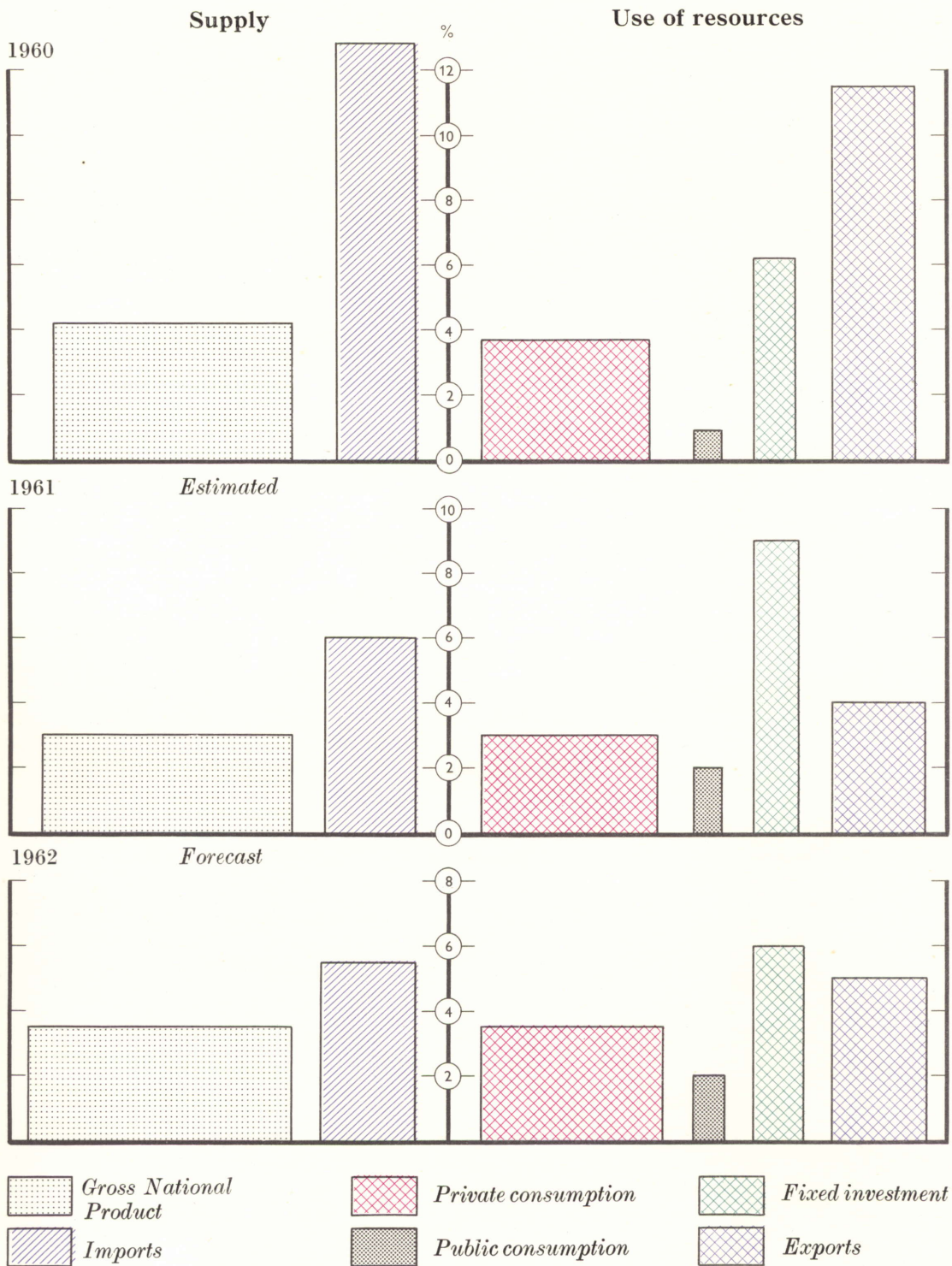
The slower growth rate of *private consumption* noted in 1960 was also a feature of 1961, when it probably did not exceed 3 % in real terms. The rise in the incomes of private households, which was checked by the strikes early in the year, later picked up as total wage bill again increased. This increase was however, small, owing to the modest growth of employment and the limitation of wage increases to a few industrial sectors. Various indicators, such as slower growth of sales by the department stores and motor dealers, suggest that consumption expanded more slowly than in 1960.

A leading feature in the development of internal demand was the absence of any noteworthy strains : *industrial production* advanced by only just over 4 % in 1961 (as against 6.3 % in 1960) ⁽¹⁾, owing in the main to the weakening in demand from abroad and the repercussions of the strikes. Had there not been the strikes, the increase would probably have amounted to about 5 %. The slackening of expansion was accompanied by wider variations between the ways the different economic sectors developed : while coal output fell once more and production by the foodstuffs industries rose only slightly, relatively vigorous growth was recorded in mechanical engineering, chemicals and some branches of textiles. Reduction of stocks in the Belgian processing industries, combined with the weakening of external demand, contributed to the fall in output of the iron and steel industry.

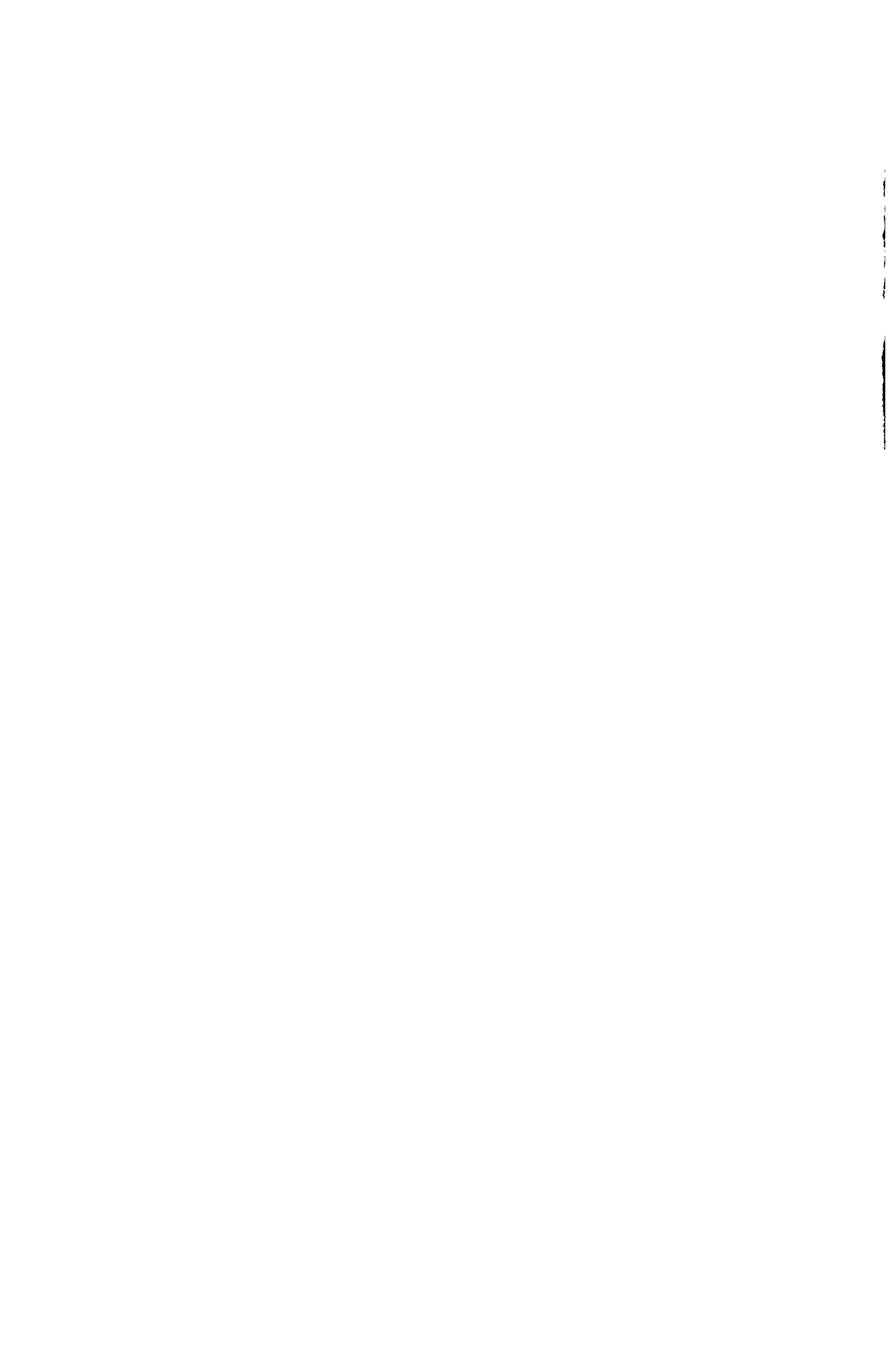
(1) According to the I.R.E.S. Index.

SUPPLY AND USE OF RESOURCES GOODS AND SERVICES

Change in volume in relation to the preceding year



The width of each column is in proportion to the corresponding figure (in terms of value) for the preceding year.



The tendency noted in the first six months for industrial output to gather momentum yielded in late autumn to a more hesitant growth trend as the inflow of orders slowed down in various important industrial sectors (the metal, textile and chemical industries). The year-to-year growth rate of industrial production, which was 6.5 % in February-June fell in July-November to 4.3 %.

Agricultural production continued at least on the 1960 level. Much poorer harvests, particularly of sugar beet (— 12 %) and grain (— 5 %) seem to have been offset by an increase in the output of livestock products, especially dairy produce. Despite the stagnation of agricultural production, the progress recorded in industrial output and in the *services sector* in 1961 gave rise to a growth rate of about 3 % in the *gross national product*, as opposed to 4.2 % in 1960.

A feature of the *labour market* in 1961 was a slight increase in the numbers gainfully employed. The total rose by almost 1.5 % : part of this increase was covered by manpower reserves, which therefore fell, and the rest was accounted for by persons returning from the Congo who were assimilated into industry. The greater part of the increase in output was therefore again due to higher productivity.

The number of unemployed totalled 128 000 on average for 1961, which was 19 % less than in 1960. The shortage of skilled labour, which was particularly evident in the second quarter in such sectors as metal processing and in building and construction, was relatively limited and evidently did not hamper the development of supply. *Imports* suffered in the course of 1961 from the gradual weakening of the factors which had been promoting economic expansion. Their growth rate fell in terms of value (according to customs returns) from 15 % in 1960 to 6 % and in volume from 15.2 % to 5.2 %. Business activity in Belgium in 1961 was marked by a heavy increase in purchases of equipment goods and stagnation in imports of certain consumer goods.

Purchases from Community countries, particularly France, continued to rise steeply. By contrast imports from non-member countries marked time, owing in the main to a fall in purchases from the United States.

Imports of services seem to have followed more or less the same trend as imports of goods.

In view of the limited pressure of demand, the existence of excess production capacity and the probable slight fall in labour costs per unit of production, *prices* remained more or less stable in 1961, despite increases in indirect taxation. Slightly higher prices for agricultural produce were offset by a fall in the import prices of raw materials and semi-finished industrial goods, so that the wholesale price index at the end of 1961 stood at the same level as in December 1960. The index of retail prices was up by 1 % on 1960, chiefly as a result of higher prices for foodstuffs and certain services.

Despite some slowing down in the rate of expansion compared with 1960 and the considerable elasticity of domestic supply, a large adverse *balance of trade* in goods was recorded in 1961; the deficit of Bfrs. 14 000 million (according to customs returns) was the largest for 10 years, being nearly Bfrs. 5 000 million more than in 1960. Exports advanced at a much slower rate than imports, particularly in the first six months. This development was obviously influenced by the strikes (the deficit in the first quarter already amounted to Bfrs. 7 500 million), as well as by the fact that the brisk domestic demand for equipment goods was not offset by any improvement in the exports of iron and steel products. Finally, the rather low level of steel prices, together with declining prices for various chemical products, helped to swing the terms of trade against Belgium.

The impact of the unfavourable trend in visible trade during the first half of the year was further aggravated by large exports of public capital, so that the total deficit on the balance of payments amounted to Bfrs. 7 600 million at the end of the first six months, as against a surplus of Bfrs. 5 100 million in the corresponding period of the previous year. After June the improvement in the current account, combined with imports of short-term money, led to a surplus on foreign transactions, so that the overall balance of payments even showed a slight surplus for the whole year. This leaves out of account the Belgian currency placed at the disposal of Great Britain through the IMF, but includes treasury bills worth Bfrs. 1 500 million taken up in Belgium by the Bank of England. The official gold and foreign currency reserves went up from Bfrs. 71 100 million at the end of 1960 to Bfrs. 82 900 million in December 1961.

Public expenditure rose by 4.2 % in 1961 as against 6.6 % in 1960. Thanks to the substantial increase in the yield of taxes as a result of the increase in business activity and to higher revenue produced by the fiscal provisions in the "loi unique", the deficit on the budget was smaller, but it still amounted to Bfrs. 22 300 million, compared with Bfrs. 26 700 million in 1960. The issue of long-term domestic loans fell off from Bfrs. 27 200 million to 15 200 million and the Treasury made more frequent calls on the money market. Government borrowing from the Central Bank rose slightly and at the end of the year was some Bfrs. 3 500 million below the authorized ceiling compared with 4 000 million at the end of 1960. The issue of Treasury bills expressed in foreign currency fell sharply from Bfrs. 10 500 million in 1960 to 1 200 million in 1961. The operations undertaken early in the summer to consolidate short-term indebtedness to foreign countries were continued in the following months. In this way an estimated Bfrs. 10 000 million of short-term indebtedness abroad has been consolidated or repaid in 1961, leaving a debt of 22 000 million at the end of the year.

Liquidity on the money and capital markets benefited greatly from the method used to finance the National Debt and, in the second half of the year, from the surplus on current transactions. The high level of liquidity on the *money market* was evidenced by the reduction in the use made of the Central Bank's rediscounting facilities and by a clear downward trend in day-to-day rates. Three cuts of 0.25 % in bank rate—from 5 % on

27 August 1961 to 4.25 % on 18 January 1962—reflect the Central Bank's policy of adapting the system of fixed interest rates to the state of the market and of seeking to avoid outflows of capital caused by too sudden a reduction of the gap between Belgian and foreign interest rates.

Although demand from abroad particularly for iron and steel products, picked up at the end of 1961 and in *early 1962*, the outlook for the coming weeks suggests that only a moderate advance in production can be expected. While private consumption is apparently rising somewhat faster at the moment, the slow rate at which domestic orders are reaching the mechanical engineering industry indicates a certain weakness in the propensity of managements to invest. Finally, in building and construction the number of starts on dwellings and industrial and commercial buildings levelled off towards the end of 1961.

2. Outlook for 1962

The prospects for the various components of overall demand indicate that expansion is on the whole likely to continue in 1962. However, there seem to be hardly any grounds for expecting economic activity in Belgium to rise much faster than in 1961.

The trend in *exports* may continue upwards, although no very startling rise is likely. The outlook for business activity and tariff policy in the United States suggests that fresh expansion is possible; steel exports should benefit particularly. However, what happens in this sector will to some extent depend on the stockbuilding policy followed by the American steel processors, and this, in turn will be based on the views concerning the possibility of a strike in the steel industry—where it is very difficult to make forecasts. A further source of benefit to Belgian exports will be the tariff reductions within the Community. Measures recently announced for stepping up export credits, especially for long-term financing, should provide an incentive to Belgian sales abroad. Belgium's export prospects have also improved because wage increases in recent years have been modest, while those in many other countries were large—larger than the increase in productivity; this has placed Belgian exports in a stronger competitive position. The revaluation of the mark and the guilder is still proving helpful too. Finally, the recovery in exports to the Congo looks like being maintained. Other factors, however, are less favourable, such as the poor outlook for Belgian products in certain important markets, above all in Federal Germany and Great Britain; the uncertainty as to the line that European steel users will take on stocks and the keener competition to which some other Belgian export goods, such as certain textiles and chemicals, are exposed. All in all, Belgian exports can hardly be expected to rise much more than 5 % in 1962.

The trend in demand from abroad is thus unlikely to afford a very strong additional incentive to the *investment of enterprises*. At the same time the level of production capacity which has resulted from the rapid growth of investment in the last two years is considered sufficient to meet any likely expansion of demand. Finally, foreign investment in Belgium is hardly expected to make such rapid strides as in 1961.

Investment will none the less continue to expand as programmes already under way or planned are carried out. Moreover managements may well react to the wage increases of 1962, which are likely to be heavier than those of recent years, by a decision to invest more in rationalization of equipment. The overall growth rate of fixed investment by enterprises in 1962 might touch about 6 % (by volume)—a somewhat lower figure than in 1961. The growth of housing construction is likewise expected to be rather weaker than in 1961.

As a result of heavier expenditure by the State, on the other hand, *public investment* may in 1962 provide some stimulus for the economy. *Public consumption* should advance about as rapidly as in 1961.

In 1962 the main influence on *private consumption* will probably be a rather faster rise in the income of wage-earners. The trend in the incomes of households will be affected by the greater increases in pay rather than by higher employment figures. At the end of 1961 a new wage scale came into force for office staff in the private sector; the wage rises granted at the same time in various branches of the foodstuffs industry will be followed by higher wages in such important sectors as coalmining and mechanical engineering. The salaries of civil servants are to be raised by 3 % from July 1962. As for transfer incomes, the budget provides for a 10 % rise in the appropriation for pensions.

In view of the probable trend in the various components of demand the expansion of domestic supply can be expected to continue. *Industrial production* may maintain roughly the growth rate recorded between February and November 1961, when it averaged about 5 %. Given a normal harvest and average expansion in the services sector, the *gross national product* in 1962 will probably show a 3.5 % increase in real terms, thus slightly exceeding the 1961 figure, which was forced down by a number of random factors already mentioned.

Employment is likely to advance more slowly than in 1961, so that any increase in production will depend first and foremost on higher productivity. Attempts to cut down unemployment may well meet with less success than last year, in view of difficulties likely to be encountered in integrating some of the unemployed. It is not out of the question that more foreign labour will be called in, especially in such sectors as coalmining where manpower was already in short supply in 1961.

The growth rate of *imports* will in all probability be weaker than in 1961; it may well also remain below the forecast for exports, since imports suffered less from the strikes early in 1961 than exports.

Apart from the more favourable figures anticipated on the *trade balance*, the most important contribution to the improvement in the balance on current account is likely to come from a favourable trend in net earnings from services and transfers, which should benefit in no small measure from the probable recovery of transactions with the Congo. Although capital transactions as a whole could prove to be less favourable than in 1961, it is not impossible that the *overall balance of payments* will show some small surplus.

Prices are unlikely to be exposed to any special strain in 1962. However, wage increases and the hardening of import prices may exert a stronger upward pressure on the price level than in 1961.

The recent endeavours to reorganize the *money and capital markets* should also continue during the year. Since the beginning of 1962, when the reform of the money market became effective—and in particular since the interest rates previously tied to bank rates were freed—short-term interest rates have tended to fall with the rise in liquidity. How far these monetary measures will prove effective in stimulating economic activity seems however to depend decisively on additional measures being taken. In this connection stress should be laid on the need to improve the structure of the capital market and to carry on with the reform of public finance.

The reform of the capital market now being prepared may well make for greater flexibility of bank rates. It should not only facilitate the formation of risk capital but also play a decisive part in ensuring that the recent fall in short-term interest rates extends to the capital market as well.

In *public finance* the monetary reform has meant that the obligation of the banks to hold part the increase in their deposits in Government securities has been relaxed. As a result the banks' role as an automatic source of funds for the Government has been curtailed. It is very important for the authorities to strengthen its cash position further, so that they should not be forced to go to the banks for additional funds after all. Budget estimates for 1962 put the overall deficit at Bfrs. 15 000 million. Only if this figure is not exceeded will there be a real improvement in 1961. A deficit of Bfrs. 15 000 million also figured in the 1961 estimates, but according to the latest figures it may well have been as much as Bfrs. 22 000 million.

For this reason it is most important that any excessive increase in current government expenditure should be avoided and that measures to bring in more revenue should be adopted. It is to be hoped that the tax reform now before Parliament will help to speed up the increase in revenue. However, care must be taken to see that the heavier tax load resulting from the reform shall have the least possible effect on private savings and on the readiness to invest them at home. Otherwise, economic growth, which is after all the only sound basis for a steady and lasting increase in government revenue, might be hampered.

In the present circumstances it seems important to continue encouraging savings and their investment at home. Here a necessary pre-condition still seems to be the maintenance and, if necessary, reinforcement of official incentives to invest. In view of the existing structural conditions in Belgium it will hardly be possible to divert investment fast enough along the lines likely to promote a lasting expansion of economic activity, unless the authorities provide some kind of stimulus, such as the creation of a national investment corporation with sufficient capital and effective powers. Acceleration of economic growth, which has been comparatively slow up till now, seems desirable and in view of the reserves still available, it could be achieved without undue strain. In addition to this promotion of private investment a corresponding increase in public investment should be secured on the basis of a long term programme.

Luxembourg

Economic growth slowed down appreciably in the course of 1961, mainly as a result of the weakening steel markets in the countries which are Luxembourg's most important customers. Exports went up only slightly and the growth of private consumption was no more than moderate. Although investment, particularly by the public authorities, continued to increase, the growth rate of the real gross national product probably dropped from 7 % in 1960 to 3 % in 1961. In view of the very great dependence of the country on foreign trade, the decline in export prices and certain increases in import prices—that is a deterioration of the terms of trade—led to an even sharper drop in the rate of increase of the gross national product at current prices.

Even if, as is perhaps to be expected, the demand for steel picks up again some time this year, the outlook for 1962 will be largely determined by these downward trends, which were especially noticeable in the second half of 1961. In these circumstances it is fortunate that public investment expenditure has again risen sharply and that private investment, too, is likely—partly as a result of official measures of encouragement—to move upwards.

1. The balance sheet for 1961 and the situation at the beginning of 1962

In the course of 1961 economic expansion slowed down considerably.

In particular *demand from abroad*—in terms of actual sales—was little higher than in 1960. Deliveries of rolled steel products were up by only 1.5 %—the growth rate from 1959 to 1960 had been 10.3 %. If we consider the way the situation developed in 1961, the tendencies that became evident in the second half of the year are even clearly recessive. Moreover, deliveries in this period were partly the result of the backlog of orders; in terms of volume orders on the books had by the end of the year declined 20 %. The cause of the fall in new orders was the tendency noted in certain member countries of the Community for users of steel in particular, to run down their stocks; but new orders from non-member countries also fell off : it was only possible to book them at all by reducing prices considerably.

Home demand developed more favourably. *Public fixed investment* in particular increased, and it was mainly thanks to the speed-up in public works that in 1961 the total investment in building and construction was probably more than 11 % higher than in 1960.

Fixed investment by enterprises, on the other hand, seems to have risen only little—in contrast to 1960.

Following further increases in the income of households, *private consumption* again went up, although no doubt less than in 1960. Wages and incomes were up partly because employment in industry rose by 1.2 %, partly because wage increases were granted in the most important branches, and also because the 1960 bonuses in the steel industry, paid out in May 1961, were more than 30 % higher than in the previous year. Finally, transfer incomes and the incomes of self-employed persons also rose.

Expenditure on services and certain consumer durables again expanded considerably. Purchases of motor vehicles were up about 14 %, and of television sets about 23 %, on the corresponding level of the previous year.

In general, production had no difficulty in keeping up with demand, although shortages on the *labour market* increased. It is true that the proportion of foreign workers in industry rose from 28.9 % in 1960 to 29.9 % in 1961, but this growth was clearly insufficient to meet the increased demand for manpower in branches other than steel, which, for its part, did not release any workers. The growth of production is hampered mainly by the increasing difficulty of recruiting foreign manpower in the present circumstances.

The year-to-year growth rate of *industrial production*—8.5 % in 1960—was a mere 2.9 % in 1961. Apart from seasonal variations, production has been practically stagnant since May—if, indeed, there has not been a slight tendency to sag.

In 1961 crude steel production was 4 110 000 tons; its growth rate, which was still 2.3 % during the first six months, was only 0.7 % for the full year.

On the other hand, it proved possible to step up considerably—by 8 %—the extraction of iron ore thanks to the increased use of domestic ores and lower imports. Various other industries of less importance, however, also expanded their output sharply. Among these were footwear (+ 12 %), non-metallic mineral products (+ 9.3 %), food, beverages and tobacco (about + 8 %) and chemicals (+ 4.4 %). The production of electricity, which until a short time ago depended solely on the rhythm of production of the steel industry, rose by 3.7 %. This was probably due in part to the entry into operation of two dams on the Sure.

At 2 % the growth in output per worker in industry was appreciably lower than in 1961, when it had been about 7 %. The slackening of the growth of productivity (production per man/hour) was perhaps less marked.

Agricultural production appears to have increased. A decline in crop production—which according to the information at present available may have amounted to about 4 %

for grain and potatoes and 8 % for fruit—was more than offset by a rise in the output of livestock and livestock products, sales of which account for about 4/5 of gross agricultural receipts.

In the *services sector* as a whole activity was fairly lively. Several branches, especially those connected with tourism and information services, expanded with particular vigour. However, the decline in iron and steel made itself felt at the end of the year in the tonnage handled by the railways.

On the basis of these trends in its component parts the *real gross national product* for 1961 can hardly have grown more than 3 %. In value it was even smaller, because of the deterioration in the terms of trade.

Imports probably advanced less rapidly than in 1960. It is true that considerably more consumer and equipment goods were bought abroad, but imports of raw materials and semi-manufactures remained at practically the same level.

Except in the steel industry, prices showed a slight tendency to inch up in 1960. The official cost-of-living index—not, however, a very good barometer—records an increase of something under 1 %. The rise was partly attributable to higher prices for certain imported goods—in particular following the revaluation of the German mark—and to higher wages and prices in the services sector. Higher wages made themselves felt even more in building costs.

2. Outlook for 1962

Although there is no reason to be pessimistic about the long-term future of Luxembourg's economy, the outlook does not suggest any great expansion in the short run. It may be that in the countries which are the main customers of the Luxembourg industry users of steel will in 1962 tend to reverse their present policy on stocks and that *exports* of Luxembourg steel will pick up, but the decline in orders observed in the second half of 1961 will still probably affect the growth rate of the gross national product for 1962 as a whole. There is, however, no reason to expect stagnation, first because the exports of other branches of industry, encouraged to some extent by the credit insurance scheme established at the end of 1961, might rise more strongly and even more because domestic demand can be expected to expand further. None the less, the increase in domestic demand is also likely to be somewhat smaller than in 1961.

Fixed investment in 1962, however, may rise even more vigorously than in 1961. In public investment—the transport network, dams, works undertaken by local autho-

rities, the Moselle canal scheme—the planned increase is nearly 20 %. Private investment might also be somewhat higher than in the previous year, because of the plans to modernize and expand the iron and steel industry and to create several small enterprises. On the other hand, demand for housing still seems to be at a saturation point to judge by the statistics of building permits issued in 1961.

While investment activity as a whole should then be quite satisfactory, the trend of *private consumption* will largely depend on developments in the iron and steel industry. The bonuses on the business year 1961 will be paid in May 1962, and these will probably be a little smaller than in the previous year; in addition, no wage increases of any size are to be expected in this industry before the renewal of collective agreements at the end of the year. In certain other branches of the economy, however, such as building and construction, some pay rises must be expected. Should the sliding wages scale come into play, this would also stimulate private consumer expenditure. Finally, the new pay system proposed for public servants might be introduced before the end of 1962, with consequent considerable improvement in their wages and salaries. On the whole, therefore, private consumers' expenditure could after all tend to move slightly upwards in 1962.

Save in the building industry, supply should doubtless be sufficiently elastic to cope with growing overall demand.

The growth of *industrial production* will be largely determined by the activity of the iron and steel industry, which counts for 2/3 in the weighting of the overall index. In the first half-year steel production will hardly be higher than in the second half of 1961, but it might liven up later. During this year, too, production will begin in many new firms were established as a result of the fiscal measures devised to encourage investment; at the outset, however, this will probably influence the growth of industrial production to a limited extent only.

Despite the planned 5.5 % increase in expenditure, and the inroads made in the yield of taxes as a result of the measures to encourage investment and the deterioration of the steel market, the *Government's cash position* will probably continue to be favourable. At any rate the draft budget provides for an increase of 6.3 % in revenue from taxation. In addition, the budget includes a first instalment of the payments to be made by the Federal Republic of Germany under an agreement recently concluded. Finally, there is considerable scope for Government borrowing operations.

The *trend of prices* on the other hand is a source of some worry, particularly in the services sector, where increased wages are causing pressure, and also in the food sector. Food prices are weighted to represent more than one half of the cost-of-living index—a proportion which is certainly too high. Higher prices, for imported grain in particular, will have their effect; the granting of certain price claims by home agriculture and an increase in processing margins might also play a part. The level at which the sliding scale of wages comes into operation will therefore probably be passed in the course of the year.

The *labour market* provides a further problem. Despite the turn for the worse in steel, the shortage of manpower is unlikely to ease, for while the longer-term sales outlook remains favourable, the industry sees no reason to release any workers. Manpower shortages are also particularly acute in building, where they even threaten to delay the completion of certain public programmes, and in the services sector. It is, therefore, a matter of urgency that those responsible for economic policy should re-examine the problem of the recruitment and settling of foreign workers and should take the measures demanded by the situation.

Finally, the efforts being made by the Luxembourg authorities to facilitate the implantation of new firms and thus to broaden the basis of the country's industrial structure are of importance in economic policy : the implementation of these plans can help, in the medium term to reduce the excessive dependence of the economy on developments in iron and steel. It is much to be hoped that the outline law for the introduction and co-ordination of the relevant measures will soon be voted, so that the least possible time be lost in providing better conditions for balanced economic expansion.