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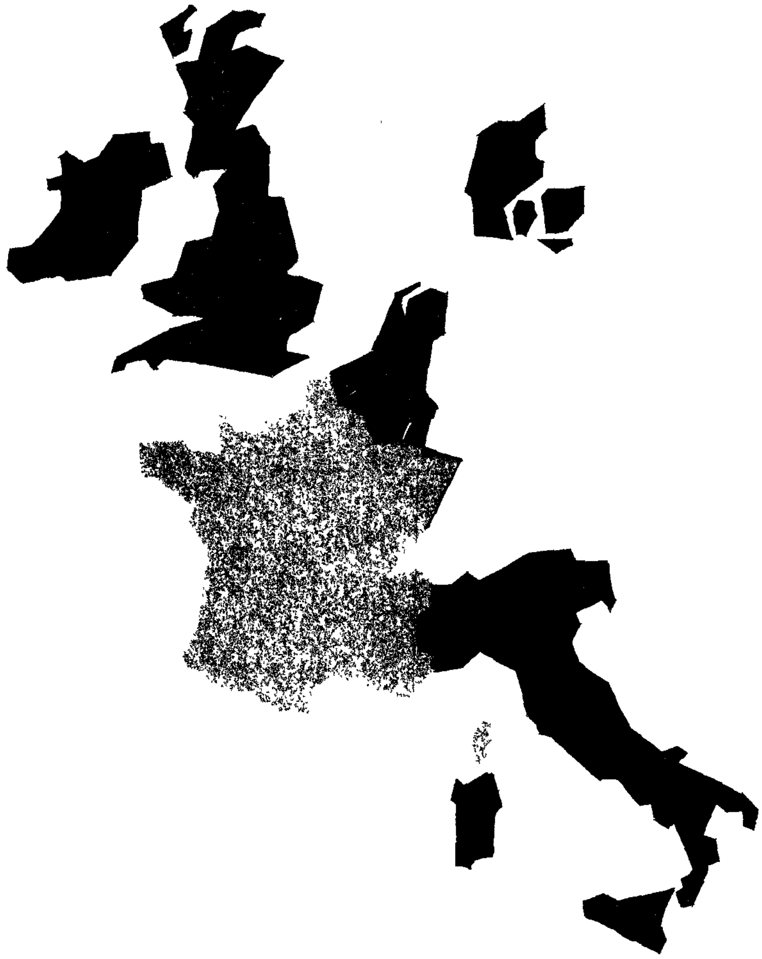

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1977

The economic situation in the Community

Quarterly survey

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

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

Rue de la Loi 200, 1049 Brussels

COMMISSION
OF THE
EUROPEAN COMMUNITIES

The economic situation in the Community

MARCH 1977

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Brussels, 4 March 1977

I — Commission communication to the Council on the adjustment of the economic policy guidelines for 1977

FOREWORD

1. Pursuant to Article 2 of the Council Decision of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States, the Council must adjust as soon as possible in the first quarter the economic policy guidelines for the current year as required by economic developments. To this end, and in accordance with Article 1 of the same decision, the Commission is forwarding this communication to the Council.

2. In accordance with Articles 2 and 12 of the above decision, the Commission is also forwarding to the Council herewith a summary account of the economic policies pursued in 1976 and a report on the implementation of the decision and the degree to which the policies pursued were consistent with the objectives laid down.

3. The five-year projections for the main macroeconomic variables which are referred to in the third paragraph of Article 2 are included in the draft fourth medium-term economic policy programme, which the Commission laid before the Council on 6 October 1976.

4. Preparation of this document was completed on 22 February 1977.

A — RECENT DEVELOPMENTS

1.1. In early 1977, there is little, if any indication in the present economic situation in the Community of a consolidation of the recovery. Although a generally more favourable trend has emerged in the Federal Republic of Germany and the Netherlands, and in spite of the sharp upswing in activity in Italy, industrial output is expanding at the same moderate rate recorded after the pause in the summer (cf. Table 1). Between June and December, the seasonally adjusted index compiled by the Statistical Office of the European Communities rose by only 2.5%, as against 4.5% in the first half of the year. The disparities between the situations in the individual countries have widened, total order books have continued to shorten except in the Federal Republic of Germany, and the degree of capacity utilization has levelled off in most Member States.

1.2. The sluggish nature of the recovery is attributable mainly to the fact that restocking has come to an end. But it also owes something to the lack of buoyancy of fixed investment, the volume of which in 1976 was moreover below its peak level of three years earlier. Business investment was once more inhibited by the uncertainty surrounding the trend in demand, exchange rate movements and the attitude of governments to structural adjustments and also by poor profitability. However, signs of a revival in business investment that were stronger in some countries than others have recently become unmistakable in the Federal Republic of Germany, the Netherlands and the United Kingdom. Lastly, the contribution to growth made by public investment has, generally speaking, continued to weaken.

1.3. Employment has suffered from the depressed business climate. The slight tendency for the number of wholly unemployed to decline, which became apparent in a number of Member countries in the course of last year, came to an end at the beginning of this year, except in the Netherlands. In Italy, Belgium and the United Kingdom, the number of wholly unemployed has continued to rise. In the Community as a whole, the seasonally adjusted unemployment rate [1] has remained steady, at around 4.6% (cf. Table 2), and the average period of registration with employment offices has lengthened. Since the summer, short-time working has again been on the increase.

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[1] Number of wholly unemployed as a proportion of the civilian labour force (Italy: ISTAT figures).

1.4. Although the annual rate of *inflation* has been steadily declining in the Community since 1974, consumer prices in the Community as a whole probably again rose on average by about 10% in 1976. This figure, which is a good deal higher than that recorded by the Community's trading partners, masks marked disparities from one Member State to another. At the beginning of 1977, inflation was still running at a rate much higher than 10% in three Member States (cf. Table 3), while, of the other countries in the Community, the Federal Republic of Germany was the only one to make substantial progress on this front. The heavy pressure on prices stemming from internal costs tended to ease in 1976, whereas the higher prices of foodstuffs and imports had a relatively greater impact.

1.5. From early autumn last year onwards, the lack of vigour in world business trends meant that few Member States were able to expand their exports. Further, since imports have climbed steadily, partly as a result of advance purchases of oil, the rapid deterioriation in the Community's *trade balance* has continued, albeit at a somewhat slower pace (see Table 4). For 1976 as a whole, the deterioration in the Community's current account — which has moved heavily into deficit — is expected to be equivalent to around US $ 10 000 million, compared with US $ 13 000 million in the United States, while an improvement of more than US $ 4 000 million was recorded in Japan.

B — OUTLOOK

2.1. In the Community as a whole, it remains questionable whether in 1977 expansion can be achieved vigorous enough to continue under its own momentum and develop its own scope for acceleration. Firstly, the measures taken to correct the imbalances caused by the energy crises have not as yet been entirely successful. Secondly, the continuing lack of business confidence does not yet hold out any prospect of a revival in investment and employment, without which demand and economic growth will falter.

2.2. As for the international economic situation, the United States and Japan have announced measures which could improve the business climate and export prospects of the other industrialized countries. However, these measures will have neither a rapid nor any very substantial direct impact on the economic situation in the countries of the Community since their effects will take some time to work through and since the Member States' economies are in fact not very much influenced by these countries' foreign trade activities.

Although the steady increase in sales to the OPEC countries may well provide significant stimulus in 1977, the prospects for Member States' exports to other areas of the world will be adversely affected by the size of their deficits and their heavy burden of indebtedness. Overall, Community exports are likely to expand at a less rapid rate than in 1976, probably by some 7% in real terms for the year as a whole. In view of the more sluggish expansion in the volume of imports, the Community's current account, in spite of a slight deterioration in the terms of trade, is expected to show a sharp improvement and move back almost to balance. This improvement will probably contrast with expected developments in the main non-member countries. Nevertheless, for the entire period 1974-77, the Community's current account deficit is expected to exceed US $ 20 000 million, compared with a surplus of US $ 5 000 million in the United States and a deficit of more than US $ 1 000 million in Japan. The problem of a more equal distribution of balance of payments deficits will thus remain crucial in 1977. The deficit countries in the Community will probably be able to reduce their aggregate deficit from US $ 15 000 million to 7 500 million between 1976 and 1977, with the surpluses recorded by the other member countries widening from US $ 5 500 to 7 000 million.

2.3. Within the Community, the difficulties still facing a number of Member States give rise to the fear that, assuming unchanged policies and behaviour with regard to inflation, price trend divergences will remain unduly wide, at least in the early part of the year. Moreover, given the recent rise in oil prices (which is expected to push up consumer prices in 1977 by half a percentage point overall) and the pressures to which the prices of a number of raw materials are subject, the inflation rate in the Community as a whole may not fall sufficiently to allow Member States greater scope for manoeuvre in their fight against unemployment and at the same time to help ease external constraints. An improvement in trends is, however, expected in the second half of the year as a result of the foreseeable disappearance of a number of temporary inflationary pressures. Thus, after once again having exceeded 10% on an annual basis in the first half of the year, the increase in consumer prices in the Community as a whole is expected to be cut back to some 7 or 8% in the second half. Although not as good as could be hoped, this inflation rate would improve the chances of a fresh period of balanced, steady growth in the Community after 1977, particularly if it stems, as is expected, from a significant narrowing of the disparities between Member States.

The key factor as regards price movements is whether, before the anticipated improvement materializes, external strains and, in particular, further upheavals on foreign exchange markets will not jeopardize the recovery.

2.4. In a less bouyant international climate than in 1976, the prospects for *internal demand* will probably remain poor. The compensating impact that increased investment demand might have had is unlikely to be felt in 1977 particularly since a slowdown is expected in the growth of the other components of demand, especially private consumption. There will probably be little, if any improvement in 1977 in the degree of capacity utilization, which at present is rather low in most branches of industry. Furthermore, the slowdown in the increase in per capita wages in the Community as a whole will be of the same order of magnitude as that in productivity gains. As a result, the improved profitability of firms is unlikely to be sufficient to permit a brisk revival in investment. Overall, assuming unchanged economic policies, the *gross domestic product* of the Community as a whole will probably grow in real terms by only 3.5% in 1977, as against 4.3% last year. This rate falls a good way short of the average figure given in the Fourth medium-term economic policy programme, which in turn is lower than the rate the Community could achieve under 'normal' circumstances, judging by past cyclical trends. A return to a satisfactory medium-term growth rate is, therefore, a major problem facing the Community.

2.5. If the actual growth rate were constantly to fall short of the potential growth rate, fresh difficulties are likely to arise on the *labour* market in several Member States. Even in those countries where the situation is relatively favourable, to increase the number of persons in paid employment and to reduce unemployment will doubtless be extremely slow processes. Unlike last year, a slight increase in employment is likely in several Member States, but not sufficiently to bring about a reduction in the numbers seeking work. Excepting the Federal Republic of Germany and possibly the Netherlands, the unemployment rate, as an annual average, will tend to increase relative to 1976 or at least hardly improve. The worsening of the situation on the labour market will be especially noticeable at the beginning of the summer, when a large number of young people will be seeking employment for the first time.

C — GUIDELINES FOR ECONOMIC POLICY

(a) General guidelines

3.1. The objectives adopted for 1977 in the last 'Annual Report on the Economic Situation in the Community' [1] were, for the first time, in keeping with a jointly-agreed medium-term strategy, as established at the second Tripartite Conference [2] and given in the Fourth medium-term economic Policy Programme. [3] For the Community as a whole, they embodied an economic growth rate of 4%, an inflation rate limited to 7 to 8%, improvement of the labour market and a reduction in external disequilibria.

3.2. The trends observed in recent months, and the conclusions drawn from a fresh examination of the outlook for 1977 suggest that, assuming there is no change in economic policy, these objectives cannot be attained. The Community must consequently make a further effort. It will have to see to as rapid a return to internal and external equilibrium as is possible in 1977, so as to improve the basic conditions for lasting growth and a reduction in unemployment in the years to come and to make up for the lost time in reaching the medium-term goals.

3.3. Taking into account the insufficient progress made in reducing disequilibria — both internal and external — and the disparities between Member States, a large-scale and simultaneous boost to the economy throughout the Community is out of the question. The *fundamental guidelines* for economic policy set out in the Annual Report must remain differentiated according to the circumstances of the Member States. However, since it has not so far been possible to implement, with the necessary vigour, the measures advocated in this connection by the Council, additional efforts are essential:

— The revival of demand and production must be firmly sustained in the Member States with a favourable balance of payments and a relatively low rate of inflation. Given the uncertainty as to the

[1] Council Decision 76/916/EEC of 22.11.1976, OJ L 358 of 29.12.1976.
[2] OJ C 173/1 of 28.7.1976.
[3] OJ C 12 of 17.1.1977.

economic outlook, both internationally and internally, the Community must in particular see to it that the Federal Republic of Germany and the Netherlands achieve an economic growth rate of 5% and 4% respectively in 1977.

— Economic policy must be as restrictive as possible in the countries where the balance of payments is in deficit and the inflation rate is still high, so as to reduce the pressure of costs and break the sequence of currency depreciation and price increases. In particular, the Community must see that Italy, Ireland and the United Kingdom bring their annual inflation rates down to under 15% in the second half of 1977.

3.4. The Community's development and cohesion are endangered by the persistence of inflationary strains created by an excessive and disordered surge of internal costs; these dangers still point to the need, in several Member States, for a social consensus on action aimed at moderating the rise in private incomes and at increasing productivity gains.

It is incumbent on the Member States to promote this consensus by appropriate measures, particularly as regards the developments of prices, taxation, working conditions, the accumulation of assets and workers' participation in the decision-making process. The problem of the convergence of the price and incomes trends within the Community, and that of allocating, at national level, the fruits of expansion satisfactorily between collective needs and private incomes, must be the subject of regular information and consultation.

3.5. Unemployment cannot be scaled down more rapidly and structural disparities within the Community cannot be reduced unless an active investment and employment policy is implemented on a coordinated basis.

In all the Member States, economic policy must be designed to ensure that the willingness to invest is sustained in the medium term and to improve the general conditions for the growth of fixed investment. The scale of investment in 1977 will, however, remain subject to constraints which are not the same in the various countries and which are determined by the persistence of unemployment and substantial budget deficits, and by the fear of renewed bouts of inflation. The need to improve the economic structure is also an important consideration in the formulation of investment policy. In order to reconcile conflicting requirements, it seems advisable to expedite the solution of priority problems such as the energy problem and the fight against pollution. The Member States facing balance of payments difficulties must step up their efforts to reduce their dependence on imported energy and to speed up the reallocation of resources to the export sector. This action is in the common interest, and should be the subject of permanent consultations, especially as regards the contribution the Community might make to financing the investment programmes needed.

In the employment field, obstacles of every kind, particularly tax problems, liable to discourage firms planning to take on workers must be identified and overcome, and decisions on official investment incentives and on the authorization of price increases must reflect more closely the need to create new jobs. However, in order not to delay the elimination of outmoded economic structures, aid designed purely to keep firms that can never pay their way alive must be avoided. Specific measures to combat the problem of unemployment among young people must be strengthened, in particular by speeding up the creation, on a temporary basis, of additional apprenticeships or traineeships.

3.6. In all the Member States, budgetary policy should be designed to reduce the public sector borrowing requirement as a proportion of gross domestic product. However, the countries with a favourable balance of payments should not follow this trend with the same strictness as those which must give high priority to combating the inflation which is jeopardizing their external equilibrium. The former should reconcile their effort to reduce deficits with the urgent need to remedy the inadequacy of private and public investment. The latter, on the other hand, should stand firm in their determination to restrain their expenditure as much as possible and also — in some cases — to bring their tax revenue more closely into line with the scale of their budget commitments.

3.7. The diversity of constraints, particularly external constraints, to which the Member States are subject means that monetary policies must be framed in accordance with these differing circumstances. Nevertheless, the Member States must jointly establish a coherent framework for the growth of their principal monetary aggregates. In accordance with the task already assigned by the Council, work aimed at setting intermediate objectives is proceeding and it is necessary that it come up with effective solutions. In the meantime, several Member States (Federal Republic of Germany, France, United Kingdom and Italy) have already introduced monetary targets which comply with the guidelines set out, in a medium-term framework in the last Annual report on the economic situation in the Community: provided that these targets are observed, this factor will result in progress towards aligning monetary policies within the Community.

Control of the expansion of liquidity provides at the same time a general framework for the movement of interest rates. Within this framework, interest rate policy should be used to further the stability of the foreign exchange markets. It is particularly important for differences in interest rates within the Community, as between the Member States and the major non-member countries, to remain compatible with the individual situation of each currency.

(b) Guidelines for the individual countries

4.1. In *Denmark*, the more restrictive slant which was given the economic policy since the summer of 1976 has been reflected, as was foreseen, in a slowdown of private consumption in recent months. The level of imports has, nevertheless, remained buoyant and exports have only progressed slowly. Thus, the trade deficit has remained very high reaching about DKr 5 600 million (US $ 950 million) in the final quarter. Given in particular the outlook for a moderate development in external demand, growth in 1977 is likely to be slow (+ 2% in real terms) and insufficient to prevent some worsening in the unemployment position. After the temporary price freeze which applies up to 1 March, the danger exists that the underlying factors pushing up prices will again gain momentum as a result of foreseeable upward adjustments.

4.2. In these circumstances, the general guidelines outlined in the Annual Report remain valid and a cautious economic policy is still required. The restrictive nature of budgetary policy in particular should be maintained. Due to the importance of the external constraint, budgetary measures to stimulate consumption, which would result in growth of imports and compromise the chances of an improvement in the balance of payments, should be avoided. On the other hand, measures to support investment in certain sectors may prove necessary during the year. The net borrowing requirement for the 1977 budget should not exceed the relative level attained in the preceding year; in all events it should remain below the norm of DKr 11 500 million (4.5% of GDP) set out in the annual report on the economic situation in the Community. If deficiencies in tax-receipts result from developments in the short-term economic situation they should be compensated for by a reduction in certain discretionary expenditure.

4.3. As far as incomes are concerned, the restrictive guideline fixed last year should be maintained. In this respect, it is appropriate to keep to the norms adopted by the Parliament in August last for the renewal of the pay agreement in March. This condition appears essential in order to achieve the moderate development in costs needed to improve the competitive position of Danish products and bring about a transfer of resources to the export sector.

4.4. As for monetary policy, this should remain in conformity with the guidelines fixed in the Annual report and should be aimed at containing internal monetary creation within those limits compatible with the necessity of financing the current balance of payments deficit. Interest rate policy should be directed at the same objective.

5.1. In the *Federal Republic of Germany*, the factors behind economic expansion have again made themselves felt, after a fairly long lull: the final months of 1976 saw more rapid growth of demand and production; exports and investment in capital equipment being the main beneficiaries.

5.2. The prospects for a continuation of the recovery are now better. It is, however, hard to say how far German exports will be inhibited by the weakness of import demand in the Community's major trading partners. It is also by no means certain that the improvement in the propensity to invest in the private sector will be a lasting one. The tendency for the upward movement of prices to lose momentum will persist. The current account surplus will probably be of much the same size as in 1976: about DM 8 500 million, a figure corresponding to 0.7% of gross domestic product.

5.3. In 1977, the growth rate of gross domestic product should reach 5% in real terms, this goal being the same as that fixed in the Federal Government's annual economic report. There is no doubt that growth on this scale is needed, both to support the recovery in the rest of the Community and to cut down unemployment. None the less, even if this result were achieved, the number of unemployed would still be about 900 000, or 3.5% of the working population.

5.4. With a view to attaining the growth objective fixed, economic policy should now be more expansionary than suggested in the Annual report on the economic situation in the Community. However, if growth is to be lasting and inflation free, additional short-term measures to stimulate private consumption do not appear to be appropriate: about DM 25 000 million — or DM 15 000 million more than in 1976—charged against savings built up under asset-formation legislation (premium saving,

' DM 624 Law ') will be released in the course of the year, and parts of this will boost private consumption expenditure. In these circumstances, it would be preferable to base economic policy more on medium-term support of private and public investment.

5.5. Account must be taken, in any action needed to scale down the budget deficit (which was running in 1976 at DM 47 300 million, or 4.2% of the gross domestic product, for the public sector taken as a whole) of needs dictated by general economic trends. Policy with regard to the expenditure of the public authorities should be designed to bring to a halt the decline in public investment. This means that the budgets should be executed in full.

5.6. The public investment programme planned by the Federal Government for the coming years in order to sustain economic growth, should include for 1977 a volume of investment sufficient to boost activity substantially, particularly in building and construction. The placing of major orders should be accelerated, so as to spur on the economy without encroaching on the implementation of other investment projects sponsored by the Länder and the municipalities. There is a case for certain tax reliefs to give durable incentives to private investment.

5.7. The framework for monetary policy has been set by the Bundesbank's 8% target for the annual average expansion in central bank money. In these circumstances, the liquidity available should suffice to ensure financing of the foreseeable growth in real terms, without hampering efforts to slow down the upward price movement. This policy should, however, be implemented flexibly, as has in fact been the case so far, and should be properly related to current economic trends.

5.8. Action undertaken to improve the general conditions of economic growth and of employment should be supplemented by selected measures with regard to employment. In particular, schemes now being implemented to develop the mobility of labour, to improve occupational training and further training, and to help the groups of the population placed most at a disadvantage in the economy should be strengthened.

6.1. In *France,* the economy is at present going through a period of adjustment. The measures introduced last autumn are beginning to show positive results, with a gradual easing in cost and price rises and in the balance of trade deficit. However, the long-term success of the stabilization programme depends on both the readiness of the two sides of industry to respect the wage and price guidelines and strong and sustained foreign demand (including the absence of disruptive factors in the international situation)

6.2. The growth rate of the economy in 1977 will probably be moderate. However, to some extent, the increase in unemployment could be offset by voluntary withdrawals from the labour market.

6.3. The principle of gradual return to budgetary equilibrium must continue to govern the actions of the public authorities. However, if the level of economic activity proves clearly insufficient, specific measures aimed at promoting job creation could be taken in the potentially most dynamic sectors or where the needs are most urgent. If there is a budget deficit, it must as a matter of priority be financed through borrowing. The extent and basis of each selective support measure must, however, be made dependent on clear progress in reducing inflation.

6.4. The present stance in monetary policy will provide solid backing for the measures being pursued to stabilize the economy. The official targets for the growth of total lending and the money supply have certainly helped to reduce inflationary expectations. As far as interest rates are concerned, the easing of the situation on the money market since the beginning of the year could continue, thus bringing about a reduction in costs in the non-financial sector. This easing of interest rates must not, however, jeopardize the vital objective of maintaining the stability of the franc, an objective which is closely linked to the fight against inflation. Overall the general stance of monetary policy outlined in the Annual report needs to be maintained.

6.5. During the present process of gradually reducing inflation, the continuity necessary in the short-term economic measures already introduced will have to be reinforced by pushing ahead with implementation of the structural reforms announced earlier. The aim of these reforms is to develop potential growth industries, to limit the French economy's dependence on energy imports, to abolish economic rent situations which restrict competition and productivity gains, and to ensure greater cooperation from both sides of industry.

7.1. In *Ireland,* the outlook for 1977 appears slightly more favourable than that foreseen in the Annual report on the economic situation in the Community. Despite a downward revision in expectations for world trade, Irish exports could benefit from some gains in market share, due to more satisfactory developments in costs. In addition, the growth in private consumption and investment will undoubtedly be more buoyant than expected. A marked reduction in unemployment cannot however be hoped for in the near furture. On the other hand, the inflation rate could slow down in the second half of the year.

7.2. The budget presented on 26 January fits well into the framework of the guidelines set out in the annual report. The net borrowing requirement represents 11% of gross domestic product, as against 11.5% in 1976. The measures taken improve, as a result of structural modifications, the chances of better balanced growth and thus create the economic conditions appropriate to further reductions in the deficit in coming years. The budget includes a supplementary effort in the area of employment generating investment, a marked slowdown in the increase of current expenditure commitments, fiscal reliefs for incentive purposes, higher social transfers, the continuation of food subsidies, as well as a transfer to the State of a proportion of local authority rates. Given the important stimulus which is thus given to the economy it will be necessary to ensure that the level of receipts expected is actually attained, i.e., that the Finance Act does not contain concessions which will increase the borrowing requirement and that the supplementary receipts foreseen as a result of the budget stimulus are actually received.

7.3. On the incomes front, the proposed national pay agreement, if it is accepted by the unions and employers, will improve Ireland's competitive position and ensure a better outlook for employment developments. It is necessary that this progress is capitalized on towards the middle of the year and that a smooth transition to a more moderate agreement for 1978 is assured. In this respect it would be useful if the pay negotiations were more closely linked to overall economic strategy. It will be appropriate also to limit in so far as it is possible any increases above the norms so that the more long-term favourable impact of the moderation in costs on employment and prices is not jeopardized.

7.4. As far as monetary policy is concerned, the guideline in the Annual report on the rate of growth of the money supply remains appropriate.

8.1. In *Italy,* the growth of overall activity in 1976 proved far more vigorous than was originally to be expected and than was consistent with efforts to eliminate the main disequilibria. The gross domestic product in fact increased by more than 5.5% in real terms. The consequences included a more rapid increase in wholesale and consumer prices (23% and 16.5% respectively) a substantial decline in the value of the lira (trade-weighted: −16% as compared with 1975) and a current account deficit of about Lit 2 800 000 million (2% of GDP in value).

8.2. Since September, the government has introduced, in various stages, a stabilization programme having the following objectives:

— to hold down household's purchasing power by about Lit 5 000 000 million (3.5% of GDP in 1976) through increases in taxation, public service charges and controlled prices;
— to scale down sharply the heavy Treasury deficit (to Lit 9 800 000 million);
— to moderate the rapid growth in wage costs;
— to slow down the inflation rate, then gathering momentum again, to limit the increase to 16% over the 1976 figure; and
— to achieve a small surplus in the balance of payments on current account in 1977.

8.3. The surprisingly vigorous expansion in production at the end of the year points to a positive, though smaller, GDP growth rate for 1977 (around 3%). This also means, however, that the objectives set with regard to the payments balance are more likely to prove out of reach. The restrictive course of economic policy which corresponds broadly to the guidelines in the latest Annual report must therefore be maintained and even intensified. It is necessary above all that the government and the unions and employers should strive to narrow substantially the gap — now widening at an ominous pace — between Italian cost and price trends and those in the partner countries.

8.4. In view of the rapid growth in the tax receipts in recent months, a cutback in the rate of increase of public expenditure should be one of the methods used to achieve the necessary reduction in the Treasury's and public authorities' deficit, which is one of the main sources of inflation. Measures to reduce the structural deficits of the health insurance authorities, of the hospitals and of the municipalities must be implemented more rapidly.

8.5. Even if, as is the case until the end of March 1977, bank lending is largely subject to ceilings, the very high level of liquidity of the banking sector gives cause for concern, particularly due to the extraordinarily high level of the banks' short-term external indebtedness. The growth of total lending, as defined by article

6, paragraph 1, of the directive 74/637/EEC, [1] should be appreciably smaller in 1977 than in 1976. The maintenance of bank lending ceilings beyond the end of March could facilitate the achievement of this objective. It is also a matter of urgency, given the economic policy commitments to which Italy subscribed for the purposes of the Community loan last March, to cut down substantially the monetary financing of the Treasury deficit, this method been used far too much in 1976. Real interest rates should be maintained at a higher level than corresponding levels in other countries.

8.6. The recent agreements between unions and employers on wage costs and improved productivity conditions point to a better social climate in industry, but are not sufficient alone to bring the rise in unit wage costs to a rate which is comparable with those in principal partner countries. The international competitiveness of the Italian economy can be assured, in the medium term, only if, due to the combined efforts of unions and employers, the average inflation rate for 1977 is kept below the level of the preceding year.

8.7. Supporting structural measures — particularly in the areas of energy, industry and agricultural policy, and with regard to distribution — should help to establish the basic situation needed to enable the economy to be brought back eventually to a phase of more rapid but balanced growth.

9.1. In *the Netherlands,* efforts to slow down the upward price movement seems to have achieved initial success. The relative appreciation of the guilder has been a factor here, because of its impact on import prices, but the upward movement of wage costs has also lost momentum, and this should be reflected in 1977 in a further slowdown in price inflation. On the other hand, on the labour market, where some improvement had been recorded in recent months, mainly as a result of a decline in unemployment, there is little reason to expect any substantial strengthening of the demand for manpower in 1977; the foreseeable growth rate for gross domestic product (3 to 4%) will not in fact, suffice to generate an appreciable increase in total employment. On the average for 1977, unemployment could decline by 10 to 15 000 persons from the figure of 225 000 (4.7% of the active population) recorded in 1976. In view of the prospects of relatively slow growth in world trade and the deterioration in the competitive position of Dutch industry, the expansion of exports will be much less vigorous than in 1976. Nevertheless, the external surplus should once again grow, thanks to the increase in the price of natural gas.

9.2. Although it will fall a little short of the 1976 figure, the support for aggregate demand provided by budgetary policy will remain substantial. In addition, measures taken in the content of the central government budget for 1977 to slow down the increase in social security contributions and to encourage productive investment should improve the profitability of firms and reduce their financing difficulties. The contribution to economic activity generated by these selective measures could well prove stronger than that provided by general measures costing as much. Budgetary policy should therefore strictly observe the limits set in the budget as adopted; any excess expenditure should be offset by retrenchment on other items, so as to avoid jeopardizing the goal, agreed by the Community authorities, of a stabilization of the net borrowing requirement at about Fl 12 000 million. Such a policy would be compatible with a relative contraction, in the medium term, of general government financing requirements.

9.3. Since the current account surplus must once again be offset by capital outflows sufficient to avoid an appreciation of the guilder within the 'snake', interest rates should be maintained below those being charged elsewhere.

10.1. In *Belgium,* where economic trends are still hesitant, the gross domestic product is expected to grow by about 3% in real terms in 1977, a rate slightly lower than the 1976 outturn. The upward movement in consumer prices, which has gathered momentum in recent months, is expected to be a good deal stronger than in the Federal Republic of Germany and in the Netherlands. Unemployment could well continue to grow for several months. Because of the weakness of domestic demand, and in particular because industrial investment is sluggish, the expansion of imports in terms of volume could remain relatively small. The current balance of payments may, as a consequence, show again a small surplus.

10.2. The change which has taken place in the economic outlook for 1977, in the sense of a slower growth of output and incomes, means that forecasts with regard to budget revenue must be reviewed downwards. In order to comply more closely with the guideline concerning the budget deficit fixed in the Annual report on the economic situation in the Community, while still giving some support to economic activity, the government announced in February 1977 a number of measures: these included an increase in the VAT rate

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[1] Council Directive of 17.12.1974 relating to the granting of medium term financial assistance to the Italian Republic, OJ L 341 of 20.12.1974.

for certain goods and services, tax and financing incentives in respect of investment, faster implementation of the public investment programme for 1977, extension of the requirement that firms employ young trainees, early retirement for the elderly unemployed and increased employment by the public authorities of unemployed workers. This set of measures should enable the Belgian Government to keep the budget deficit roughly at the level originally planned, whilst avoiding any undue slowdown in economic growth. On the other hand, failing a change in present arrangements for indexing incomes, the increase in indirect taxation will sharply aggravate the danger of a cumulative sequence in price and wage increases, which could well nullify, in the longer term, the effort now being made to restore sound economic conditions. It is desirable, therefore, to maintain a budgetary policy orientation which will make it possible in the medium term to reduce, in relative terms, the net borrowing requirement of the public sector, by energetic action with regard to current expenditure and especially the increase in transfer payments. This is the only way in which a further increase in the tax burden can be avoided.

10.3. In present economic conditions, and in view of the persistent weakness of industrial investment, general government borrowing should hardly exceed financing possibilities. None the less, a cautious monetary and financial policy should be pursued, in order to encourage the establishment of exchange market equilibrium and lower interest rates, whilst avoiding stimulation of a further bout of inflation through the excessive creation of liquidity.

11.1. In *Luxembourg,* the slowdown in economic activity noted in the Annual report on the economic situation in the Community persisted throughout the second half of 1976. The main reason was a fall in new orders in the steel industry, since only some other industries, such as chemicals, had succeeded in emerging from the cyclical trough. The performance of the economy for 1976 fell short of what had been expected, and this also entailed a review of previous forecasts for 1977. Thus, while the upward movement in consumer prices should probably slow down further, the growth of the gross domestic product is now unlikely to exceed 3%.

11.2. In comparison with the draft budget for 1977, prepared when economic conditions were expected to be more vigorous, the present outlook points to a slower growth in revenue. It would, nevertheless, be preferable to maintain the level of budget expenditure as planned as well as selective measures implemented previously to boost economic activity and employment, especially as it looks very much as if employment problems in the steel industry will become more and more structural in character.

12.1. In the *United Kingdom,* after strong growth in the first quarter of 1976, output stagnated for the remainder of the year and unemployment continued to rise. The deterioration in the balance of visible trade was offset by increased earnings from invisibles, enabling a modest reduction in the deficit of the current account of the balance of payments to be recorded. Despite the success of the Government's voluntary incomes policy, there was little change in the underlying rate of inflation, the depreciation of the pound sterling adding substantially to rising import prices. Public expenditure came under firm control both in cash and in volume terms during 1976.

12.2. The aims of the Government's economic strategy remain the reduction of the rate of inflation, the strengthening of the balance of payments and the establishment of conditions for sustainable growth of output and employment. In pursuit of these objectives, the Government laid down a policy for reducing future levels of public sector expenditure and borrowing, and for maintaining a firm grip on monetary expansion.

12.3. This policy was strengthened when the Government announced:

- on 15 December, targets for the public sector borrowing requirement and for domestic credit expansion; these targets are in line with the guidelines for economic policy contained in the Annual report on the economic situation in the Community and adopted by the Council;
- the decision of the International Monetary Fund to make available, to the United Kingdom, a stand-by credit of US $ 3.9 billion;
- an arrangement with certain central banks and the Bank of International Settlements for a US $ 3 billion credit facility designed to protect the United Kingdom's official reserves.

12.4. In early 1977, following the measures, the sterling exchange rate strengthened, there was a substantial movement of funds into the reserves, and interest rates fell, suggesting a return of confidence in the British economy.

12.5. Because of the fall in the sterling exchange rate in 1976, the present outlook is for no significant change in the underlying rate of inflation (at present about 15%) until the middle of the year when a marked slow-down should occur, resulting from the combined effect of the Government's present voluntary incomes and its tight control of the money supply. To make further progress towards reducing the rate of inflation, the Government should not only maintain its present posture on public expenditure, public sector borrowing and the expansion of domestic credit but should reinforce it with a satisfactory arrangement for the next round of incomes policy, to begin in August 1977. The level of pay increases permitted in a new round of the policy should aim to avoid a rapid increase in average earnings although its form should help to alleviate the anomalies in the structure of relative wages that have occured in the past two years. As part of the general framework for such a policy the Government may need to reduce direct personal taxation and should consider the possibility of allowing the exchange rate to strengthen as a way of reducing domestic inflationary pressures and inflationary expectations.

12.6. The present outlook for growth in 1977 is for a modest rate of expansion of perhaps 1.5%. Factors contributing to the growth in output are a recovery in stockbuilding, an improvement in the non-oil trade balance and, in particular, North Sea oil production. The contribution of North Sea oil to the balance of payments in 1977 will be considerable and this, together with increased earnings from invisibles, should lead to a reduction in the current account deficit to a figure below £ 1 000 million for the year as a whole (0.7% of gross domestic product). However, given the low labour content of North Sea oil production, the growth of GDP foreseen suggests further increases in unemployment through the year. In tackling the unemployment problem, the Government should avoid measures that expand private consumption, but should rather extend its specific employment support policies and continue to tackle the structural rigidities in the employment market.

CONCLUSIONS

Economic developments over the last few months underline the need to apply strictly, and even to tighten further, the guidelines for economic policy which were laid down for the Community and, in particular, for the various Member States in the last Annual report.

The economic recovery after more or less marking time in the summer months, strengthened again, particularly in the United States. The plans to stimulate economic activity announced both in the United States and in Japan have increased the chances of an upswing in world trade, although it is unlikely to be as marked as in 1976. In addition, the various factors which contribute to economic growth strengthened, towards the end of last year, in the Netherlands and in the Federal Republic of Germany. However, the results of the latest enquiries concerning the economic situation indicate that industrialists are still very cautious as far as the short-term outlook for demand and production is concerned. The uncertainties and dangers which surround the improvement in the short-term economic situation and the movement towards equilibrium in the medium-term, have by no means been completely removed.

For industrialized countries, the problems to which economic policy must be directed, in 1977 and beyond, are essentially three:

— to make a serious effort to begin, with the help of instruments of demand regulation, the process of adjustment which will lead to a more stable balance of payments situation, both within the Community and at an international level;
— to ensure a progressive reduction in the rate of inflation;
— to re-establish, on a long-term basis, a high level of employment.

In order to achieve such results and ensure their permanence, it is essential that the growth of demand and output takes place over a wide area, so that it becomes self-sustaining and thus leads to a continuous increase in job-creating investment.

Those member countries with balance of payments deficits will still not have, in 1977, any appreciable degree of freedom in the conduct of their economic policy. The size of their balance of payments deficits and their continued high rates of inflation force them to pursue their stabilization programmes, even if the necessary period of adjustment proves to be longer than at first thought. A long-lasting success, of a type to instil confidence, in restoring price stability and reducing balance of payments disequilibria is a pre-condition for strong growth and an improvement in the employment situation during the next few years.

In the absence of a vigorous recovery in foreign demand, the efforts of the deficit countries will be in vain and can only lead to heavy losses as far as growth and employment are concerned. The task of the surplus countries in the adjustment process, therefore, will be to underpin the upturn in economic activity by increasing their domestic demand and their imports. In particular, this must be the priority objective of the Federal Republic of Germany which should not rely too heavily on exogenous growth factors arising from third countries, but should contribute to the expansion of total demand within the Community itself. The Federal Republic of Germany accounts for almost 25% of intra-Community trade and, therefore, its importance as a trading partner in the Community is greater than that of the United States and Japan together within the OECD area (20%).

The surplus on the balance of payments current account of OPEC countries, which will continue for several years, means that the Community must accept its share of the combined deficit of oil-importing countries, if it wishes to contain within reasonable limits the growth of the foreign indebtedness of the non-oil producing under-developed countries. As long as surpluses and deficits are still as unevenly distributed between the Member States as they are at present, the Community would be advised to help — either directly or by international action — its weakest members on condition that they take action to help themselves, to finance that part of their balance of payments deficits that their efforts do not allow them to absorb, in order to limit losses of potential growth. To this end possibilities for increasing the financial role of the Community, as regards raising loans on the international capital market, in order to contribute both to an improvement in the economic situation and the solution of structural problems, should be investigated.

Similarly, at international level, it is in the Community's interest that the import capacity of the developing countries should be increased in a reasonable manner. Conversely, the Community, which is the leading trading group in the world, must firmly oppose any moves towards protectionism with regard to trade. It will be able to escape these dangers within the Member States so much the easier when a real financial solidarity is established.

The lowering of inflation rates can only be achieved gradually, and should be supported by coherent budgetary, monetary and incomes policies. The same is true for the return to a high level of employment, which is currently an essential priority objective common to all industrialized countries. The policy to combat unemployment must at least be based on the following three factors:

— an employment policy which encourages job-creating investment and which would be complemented by traditional policy instrument (assistance to increase mobility, training and professional re-adjustment) and selective measures;
— a growth rate in incomes which is consistent with reducing inflation;
— an industrial policy which encourages the reorganization of our economies rather than the maintenance of jobs at any price in industries which are no longer competitive.

TABLE 1

Industrial production [1]

Country	% change on preceding quarter								% change on preceding month			% change on preceding year
	1975				1976							
	I	II	III	IV	I	II	III	IV	Oct.	Nov.	Dec.	Dec. 75 Dec. 76
Denmark	− 3.4	5.7	−3.2	5.3	5.7	0.3	:	:	:	:	:	:
FR Germany	− 3.0	−3.4	0.3	4.3	2.3	2.8	0.2	1.4	3.3	− 1.8	− 2.6	4.0
France	− 4.1	− 1.1	− 0.9	3.4	5.1	1.5	− 0.0	1.8	− 3.2	3.8	− 0.9	7.9
Ireland	− 3.4	− 0.6	− 0.5	1.3	5.0	2.7	3.2	:	:	:	:	:
Italy	0.4	− 4.4	− 0.3	3.7	4.9	4.8	0.1	6.2	− 1.3	4.4	1.5	20.8
Netherlands	− 2.5	− 3.7	− 2.0	8.4	2.2	0.6	1.2	1.3	− 1.2	− 1.3	3.2	5.2
Belgium	− 3.3	− 5.6	− 1.0	0.9	5.5	6.4	− 1.7	3.8	3.8	− 3.3	− 3.0	12.7
Luxembourg	− 9.4	−11.0	−10.0	9.9	3.7	8.2	− 3.5	0.4	− 3.5	− 6.2	− 1.1	1.8
United Kingdom	1.1	− 6.8	− 0.7	0.6	2.8	− 0.2	0.0	1.4	1.6	0.2	1.0	6.2
Community	− 1.9	− 3.4	− 0.3	3.4	3.4	2.2	0.0	0.8	0.1	0.9	− 0.6	7.4
Of which: investment goods	− 0.5	− 3.4	− 1.0	1.4	0.6	1.1	− 0.4	1.2	1.9	− 0.3	− 3.8	− 0.1
consumer goods	− 0.4	− 2.9	2.0	2.1	2.7	3.5	0.3	3.5	2.1	− 0.5	− 0.6	9.5
raw materials and partly manufactured goods	− 3.3	− 5.2	− 1.7	6.6	4.3	2.3	1.1	1.6	− 2.1	1.3	2.2	10.7

1 Excluding building and construction. Calculations have been based on seasonally adjusted indices of the SOEC.
: Data not available.

TABLE 2

Unemployment [1]

(in thousands)

Country	1975				1976						1977	Rate of unemployment
	I	II	III	IV	I	II	III	IV	Nov.	Dec.	Jan.	Jan.
Denmark	131.9	118.6	128.2	146.6	119.9	120.2	119.2	137.7	119.7	137.7	138.5	5.6
FR Germany	1 022.1	1 143.8	1 180.0	1 178.6	1 142.2	1 031.6	1 007.5	980.7	984.7	980.7	1 002.5	3.8
France	749.0	813.7	842.4	974.6	959.3	914.7	933.1	956.2	952.3	956.5	950.2	4.2
Ireland	91.0	99.6	104.7	108.2	109.5	111.0	111.4	109.9	110.3	109.9	108.5	9.6
Italy	601	667	648	699	681	693	776	777	:	:	:	:
Netherlands	180.1	196.1	212.3	214.1	208.9	214.2	220.5	202.1	208.4	202.1	197.8	4.1
Belgium	171.3	191.0	240.9	251.0	254.5	264.8	277.9	278.8	284.6	278.8	283.5	7.1
Luxembourg	0.1	0.1	0.2	0.6	0.5	0.4	0.4	0.5	0.5	0.5	0.7	0.5
United Kingdom	755.3	912.9	1 115.7	1 407.9	1 289.4	1 403.3	1 444.6	(1 410.7)	(1 414.1)	(1 410.7)	1 423.8	5.5
Community	3 701.8	4 142.8	4 572.6	4 980.6	4 765.2	4 753.2	4 890.6	(4 853.6)	(4 851.6)	(4 853.6)	(4 905)	4.6
Change ('000) on preceding period		+441.0	+429.8	+408.0	−215.4	− 12.0	+137.4	− 37.0	− 52	+ 2.0	(+ 51.4)	.
Rate of unemployment [2]	3.5	3.9	4.3	4.7	4.5	4.5	4.6	4.6	4.6	4.6	(4.6)	.
Unemployed women, as % of total	35.4	35.4	36.9	37.5	37.5	38.2	39.6	40.2	40.2	40.2	40.5	.

1 Data relating to the end of each period; seasonally adjusted except for Italy (source: ISTAT).
2 Number of unemployed as a % of civilian labour-force.
: Data not available.
Source SOEC.

TABLE 3 AND GRAPH

Consumer prices [1]

Country	% change on preceding quarter								% change on preceding month			% change on preceding year
	1975				1976						1977	
	I	II	III	IV	I	II	III	IV	Nov.	Dec.	Jan.	Jan. 76 Jan. 77.
Denmark	1.1	2.3	1.7	− 0.8	5.6	1.1	3.3	2.5	1.1	0.3	0.0	12.5
FR Germany	1.9	2.1	0.4	0.9	1.9	1.3	− 0.1	0.8	0.2	0.5	0.4	4.1
France	2.7	2.4	2.2	2.0	2.7	2.0	2.8	2.1	0.8	0.3	0.3	9.0
Ireland	8.1	6.1	− 0.8	2.7	7.3	6.3	1.5	4.2	:	:	:	20.6 [2]
Italy	2.9	3.0	1.9	3.0	5.4	5.2	3.3	6.5	2.2	1.2	1.4	22.4
Netherlands	2.5	2.2	2.7	1.4	2.4	2.6	1.6	1.5	0.2	0.0	0.3	7.5
Belgium	2.9	2.3	2.6	2.8	1.9	1.8	2.5	1.1	0.4	0.6	1.0	7.7
Luxembourg	3.0	2.6	2.1	3.0	2.0	2.4	1.7	2.1	0.6	0.7	1.0	7.9
United Kingdom	6.4	10.3	2.5	4.0	3.1	3.5	3.0	4.6	1.3	1.3	2.6	16.6
Community	3.3	4.0	1.7	2.2	3.1	2.7	2.0	2.9	0.9	0.8	1.3	12.3

1 Data relating to the end of each period.
2 Ireland: November 1976 relative to November 1975.
: Data not available.
Source: SOEC.

% change in quarterly average on corresponding quarter of preceding year

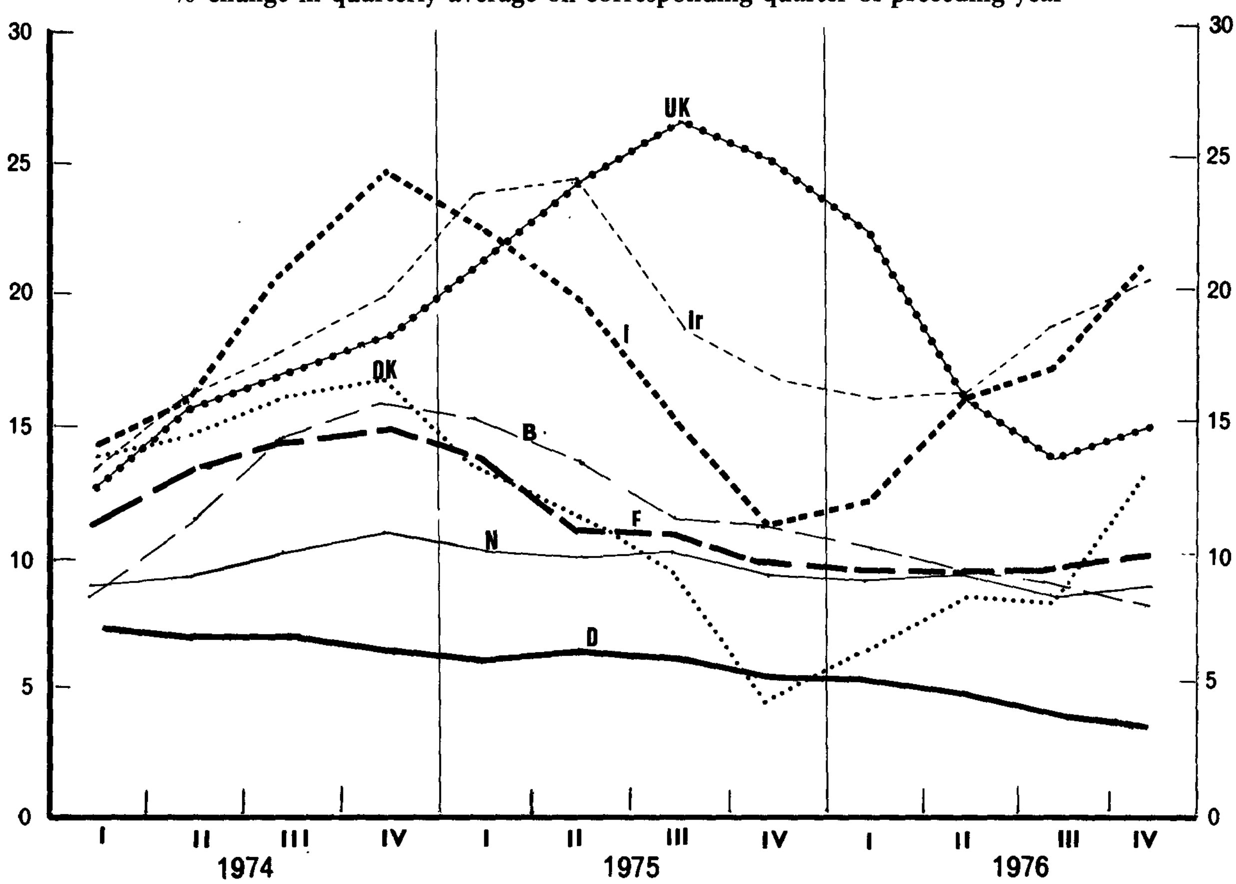

TABLE 4

Trade Balance [1]

(Million Eur)

Country	1975				1976						1977
	I	II	III	IV	I	II	III	IV	Nov.	Dec.	Jan.
Denmark	− 153	− 150	− 354	− 468	− 543	− 612	− 717	− 784	− 255	− 266	− 196
FR Germany	+ 3 192	+ 3 117	+ 2 703	+ 2 634	+ 2 418	+ 2 544	+ 2 727	+ 2 938	+ 972	+ 957	+ 730
France	− 183	+ 78	− 396	− 1 095	− 1 206	− 1 344	− 1 815	− 2 470	− 936	− 792	− 661
Ireland	− 135	− 93	− 75	− 153	− 216	− 129	− 168	− 193	− 83	− 72	− 96
Italy	− 459	− 456	− 606	− 1 200	− 1 119	− 1 479	− 1 089	− 1 656	− 696	− 534	− 356
Netherlands	− 285	− 108	− 84	− 75	− 60	− 483	− 186	− 345	+ 176	− 340	:
BLEU	+ 192	− 174	− 336	− 345	− 201	− 159	− 195	− 93	− 189	+ 36	:
United Kingdom	− 1 875	− 1 704	− 2 190	− 1 545	− 1 269	− 1 926	− 2 220	− 2 253	− 826	− 716	− 750
Community [2]	+ 63	+ 297	− 1 605	− 2 490	− 2 601	− 3 744	− 4 278	− 5 322	− 1 979	− 1 773	:

1 Quarterly totals; seasonally adjusted data.
2 Community: extra-Community trade.
: Data not available.
Source: SOEC.

Brussels, 4 March 1977

II — Summary account and degree of convergence of the economic policies pursued in the Member States in 1976

(submitted to the Council by the Commission in accordance with Articles 2 and 12 of the Council Decision of 18 February 1974)

FOREWORD

Together with its communication on the adjustment of the economic policy guidelines for 1977, the Commission herewith submits to the Council a report on the economic policies pursued in the Member States last year. In so doing, the Commission is acting in accordance with Article 2 of the Council Decision of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community.

At the same time the report describes, in accordance with Article 12 of the abovementioned decision, the implementation of the decision during 1976 and assesses the conformity of the policies pursued with the objectives set.

This report is sent to the European Parliament at the same time as it is transmitted to the Council.

A — THE ECONOMIC POLICY OF THE MEMBER STATES IN 1976

(a) The economic situation

1.1. At the start of 1976, Member States of the Community found themselves in the early stages of an economic recovery, but it was difficult to predict how strong it would be or how long it would last. The confidence of industrialists and consumers alike in future economic developments was still not very firm. At the beginning of the year, industrial production in the Community was still 8% down on the record level achieved in mid-1974. It is true that the degree of utilization of production capacity was increasing slowly, but there was still a lot of slack to take up. On the labour market, the situation was improving only very slightly in some member countries, and the Community average unemployment rate remained at the high level of 4.5% of the labour force. The increase in consumer prices expressed as an annual rate averaged over 11 % for the Community, at the beginning of the year, with wide differences between countries, ranging from 5% for Denmark and the Federal Republic of Germany to over 23% for the United Kingdom. There was still a real danger that inflation would flare up once again.

1.2. The Community's economic policy objective, at the beginning of and during the year, was to consolidate the process of economic recovery, to direct the dynamic elements of demand and production towards a lasting expansion and, at the same time, to make progress in the fight against inflation and in moderating the movement of wage costs.

Essentially to reach this goal the stimulatory programmes already adopted need to be pursued and later complemented by additional measures, the stance of budgetary and monetary policy should be prudently expansionist and finally the rate of increase of money wages should be moderated. Demand management had to be accompanied by measures in the fields of social policy and employment and by incomes policies through agreements with both sides of industry.

(b) Budgetary policy

2.1. In the public finance field, the budgetary guidelines were applied more precisely than those for the other instruments of economic policy, given that, in so far as budgetary policy was concerned, the Annual Report on the Economic Situation in the Community contained quantitative targets.

Some important comments are, however, necessary concerning the validity of comparisons between the outturns and the guidelines.

TABLE 1

Development of main macro-economic aggregates in the Community [1]

Country	GDP at current prices			GDP (volume)			Number of unemployed as % of the total labour force [2]			Balance of current account ('000 million $) [3]		
	% changes on preceding year											
	1974	1975	1976	1974	1975	1976	1974	1975	1976	1974	1975	1976
Denmark	11.9	10.7	14.3	1.2	− 1.0	4.8	2.0	5.0	5.0	− 0.9	− 0.5	− 1.8
FR Germany	7.7	4.6	8.7	0.7 [4]	− 3.3 [4]	5.4 [4]	2.2	4.1	4.1	9.5	3.6	3.0
France	14.7	12.6	14.3	2.9	− 1.3	5.0	2.8	4.1	4.6	− 6.0	− 0.1	− 5.4
Ireland	8.5	22.3	24.1	0.1	− 0.5	3.5	5.7	8.0	9.5	− 0.7	0	− 0.4
Italy	20.8	13.2	22.8	3.4	− 3.7	5.8	2.9	3.3	3.7	− 8.0	− 0.6	− 3.4
Netherlands	11.3	9.8	13.0	2.2	− 0.9	3.6	3.0	4.3	4.6	2.0	1.6	2.4
Belgium	17.3	10.1	12.2	4.0	− 2.0	3.5	2.6	4.5	6.1	0.7	0.3	− 0.3
Luxembourg	17.0	− 5.0	9.4	3.4	− 7.7	2.9	0	0.2	0.4			
United Kingdom	13.6	26.2	17.0	0.2	− 1.3	0.9	2.5	3.9	5.2	− 7.7	− 3.8	− 3.5
Community	15.0	11.7	13.9	1.7	− 2.3	4.3	2.6	4.0	4.6	− 11.1	0.6	− 9.4
USA	8.2	7.3	11.6	− 1.7	− 1.8	6.2	5.6	8.5	7.7	− 0.7	11.7	− 1½
Japan	11.6	2.0	13.0	− 1.3	2.4	6	1.4	1.9	2.1	− 4.7	− 0.7	3.7

1 1974 and 1975: outturns, 1976 estimates.
2 As a result of disparities in definition, unemployment statistics cannot be compared between countries but only reflect developments within each country.
3 Sum of components may not exactly equal total because of rounding differences.
4 At 1962 prices.
Source. Commission's departments.

In the first place, it is natural — and the Council decision (74/120/EEC) of 18 February 1974 foresaw this — that the quantitative orientations be altered during the year, either to give the necessary modifications to budgetary policy or to take account of the automatic effects on the budget of differences between the economic forecasts on which they were based and actual developments. The results should thus be judged against the guidelines as modified in March 1976.

Secondly, in order to achieve consistency as between countries, the guidelines, in principle, relate to the central government budget (in the Federal Republic of Germany: consolidated accounts of the Federal Government and the Länder) and to its execution rather than the draft budget as presented. As a consequence, the figures indicated by the Council can differ substantially in certain cases from official national forecasts.

To avoid difficulties resulting from a too formal harmonization of concepts, the text of the guidelines refers sometimes, in particular for Italy and the United Kingdom, to broader definitions that the budget of central government, in cases where such a more general concept is necessary for an understanding of the policy implied in the Communities guidelines.

2.2. In a general way the budgetary guidelines have been more closely adhered to in 1976 than in the course of the two preceding years. This has been facilitated by the slowdown in the rise of costs and prices, the growth of which, in the majority of member countries had strongly influenced budgetary expenditure in 1975, and by the recovery in the economic situation. These two factors have had a favourable influence on the net central government borrowing requirement in those member countries where the magnitude of overall imbalances demanded prudent budgetary management; but all these countries have had to resort to severe contractionary measures on the expenditure side or taxation increases to achieve this result. In the Federal Republic of Germany, the reduction of the net borrowing requirement of the Bund and the Länder, which was considered appropriate for medium term reasons, has been greater than expected.

2.3. A more detailed analysis by country, set out below, of the conformity of outturns to guidelines, is limited to the essential trends and cannot, due to its brevity, stress sufficiently the magnitude of the achievements in 1976 to channel budgetary stimuli correctly or explain adequately the divergences observed.

2.3.1. In *Denmark,* the outturns for the budgetary exercise 1976-1977 will undoubtedly be in conformity with the guidelines adopted in March 1976. The slight improvement in the net borrowing requirement could not have been obtained without substantial efforts on the fiscal side, on account of the heavy burden imposed on the budget by the persistence of a high level of unemployment.

2.3.2. In the *Federal Republic of Germany,* the guidelines implied, in order to sustain recovery, the acceptance of a borrowing requirement slightly less than that in 1975. The result has been in fact DM 10 000 million below the previous year, or lower than the objective fixed. Expenditure remained within the guidelines, due principally to the improvement on the labour market, a slower than forecast rise in prices and the weakness of public investment expenditure.

2.3.3. In *France,* the guidelines only implied a slight deficit but the effects of the recovery plan of 1975 still had a marked effect on the results, despite the supplementary receipts resulting from the 1976 stabilization programme. In total, expenditure was still largely in excess of the initial objectives, the deterioration in the borrowing requirement, however, being limited to some FF 15 000 million, so that globally the budget has continued to support economic activity.

2.3.4. In *Italy,* budgetary expenditure has progressed more rapidly than foreseen in the guidelines which were in accordance with the conditions fixed under the Council decision of 15 March 1976 relating to the Community loan to this country, but the tightening of taxation resulting from the various measures taken during the year has more than compensated for these excesses in so far as the Treasury deficit is concerned. This deficit was Lit 13 100 000 million instead of the 13 800 000 expected. A substantial change of direction, in the stabilizing sense, of budgetary policy appeared during the second half of 1976.

2.3.5. In *Ireland,* the guidelines implied, with the help of an expected improvement in the economic situation, a marked effort towards the restoration of stability, a trend more formally called for in connection with the conditions set for the Community loan in March 1976. The results achieved have surpassed the objectives set in so far as the expenditure side is concerned and receipts have been considerably higher than foreseen, due to greater buoyancy. In total, the deficit has improved by nearly £100 million on the initial guidelines and the stabilizing effect of the budget on the economy, both on a real and monetary basis, has been greater than initially expected.

TABLE 2

Total public sector budgets (1974-1976)

Country	Receipts 1974	Receipts 1975	Receipts 1976	Receipts % rate of change 1975/1974	Receipts % rate of change 1976/1975	Expenditure 1974	Expenditure 1975	Expenditure 1976	Expenditure % rate of change 1975/1974	Expenditure % rate of change 1976/1975	Net balances 1974	Net balances 1975	Net balances 1976
Denmark (DKr '000 mio)	90.05	92.90	108.35	+ 3.5	+ 16.5	80.75	96.80	110.55	+ 19.9	+ 14.2	+ 9.30	− 3.90	− 2.20
FR Germany (DM '000 mio)	424.7	437.3	488.8	+ 2.9	+ 11.8	437.2	498.6	536.1	+ 14.0	+ 7.5	− 12.5	− 61.3	− 47.3
France (FF '000 mio)	513.2	594.9	704.4	+ 15.9	+ 18.4	505.3	627.7	728.0	+ 24.2	+ 16.0	+ 7.9	− 32.8	− 23.6
Ireland (£ '000 mio) [1]	1 064	1 307	1 730	+ 22.8	+ 32.4	1 329	1 800	2 180	+ 35.4	+ 21.1	− 265	− 493	− 450
Italy (Lit '000 mio)	34 579	39 526	51 090	+ 14.3	+ 29.3	40 589	52 754	61 660	+ 30.0	+ 16.9	− 6 010	−13 228	−10 570
Netherlands (Fl '000 mio) [1]	97.30	109.78	124.92	+ 12.8	+ 13.8	95.55	113.77	131.27	+ 19.1	+ 15.4	+ 1.75	− 3.99	− 6.35
Belgium (FB '000 mio) [1]	824	983	1 131	+ 19.3	+ 15.1	865	1 073	1 265	+ 24.0	+ 17.9	− 41	− 90	− 134
Luxembourg (Flux '000 mio) [1]	37.7	42.1	47.1	+ 11.5	+ 11.9	33.9	41.9	48.5	+ 23.7	+ 21.6	− 3.8	+ 0.2	− 1.4
United Kingdom (Mio £)	32 947	42 229	48 918	+ 28.2	+ 15.8	36 649		55 962	+ 29.6	+ 17.8	− 3 702	− 5 268	− 7 044

[1] 1976: Estimates of the Commission's departments.

2.3.6. In the *Netherlands*, the guideline set for policy implied a continuation of its supportive role and included the acceptance of a further worsening compared with 1975, of the borrowing requirement. The results seem to have been very close to the objectives as far as expenditure is concerned, but higher for receipts, so that the borrowing requirement will be somewhat less than the. 1975 and March 1976.

2.3.7. In *Belgium*, the guidelines foresaw a prudent policy which, at the same time encouraged the growth in activity and implied quite a high deficit partly as a consequence of the measures taken in 1975. The results have exceeded the objectives as far as receipts are concerned but on the expenditure side the growth was even more marked due principally to the more rapid increase than foreseen in costs. In total, the effective deficit will be around FB 20 000 million higher than the guidelines set.

2.3.8. In *Luxembourg*, budgetary management seems to have followed closely the guidelines, which accepted the need for a moderate deficit.

2.3.9. In the *United Kingdom*, the guidelines, which were again of a restrictive nature, were respected more closely in 1976 than in the preceding year. The persistence of a rate of inflation higher than forecast led to a somewhat higher level of receipts than initially expected, but the introduction of cash limits enabled the authorities to restrain considerably the growth of expenditure. For the public sector as a whole the borrowing requirement for the 1976-1977 financial year will indoubtedly be below the official forecasts and even slightly under the guideline advocated by the Community institutions.

(c) Monetary policy

3.1. In its guidelines for 1976, set out in the annual report at the end of 1975, [1] the Council underlined the necessity for a monetary policy which would be flexible in the sense that an expansionary policy should in general be maintained in order to support economic recovery but should, nevertheless, be conducted with prudence. This approach was substantially confirmed by the decision of 30 April, 1976, adjusting the guidelines for economic policy. [2]

Nevertheless, monetary policy actions assumed a restrictive character, especially in the spring and autumn, owing to external factors and especially the need to support exchange rates. In addition, restrictive measures were in certain cases required by the persistence or even aggravation of inflationary pressures.

3.2. The relatively expansionary posture which was observed in 1975 has, therefore, been replaced by greater restraint in monetary and credit developments.

In general, the expansion of the money stock, broadly defined (M2, M3), and in domestic credit has noticeably slowed down, while the disparities existing in this area as between the Member States have been reduced. With the exception of the Netherlands, the rate of expansion of the money stock has not exceeded that of domestic production in nominal terms (Federal Republic of Germany, Italy, the Belgo-Luxembourg Economic Union) and in some cases (Denmark, France, Ireland, the United Kingdom) has remained below that limit.

Interest rates have also developed in a relatively coordinated way, if one takes into account not only nominal rates but also real rates of return.

3.3. The Council, in December, 1975, invited the *Federal Republic of Germany* to pursue a monetary policy which should permit the economy to expand, [3] while taking due care to prevent the emergence of inflationary tensions. Thanks to the absence of external constraints, the Federal Republic was in 1976 the only Member State which did not increase the discount rate; long term interest rates even continued to decline. Capital inflows, however, led the authorities to increase the required reserve ratio on two occasions, in March and June, so as to avoid excessive monetary growth. Despite these measures, the growth of ' central bank money ' revived in the second half of the year. As a result, the 8% norm which had been mentioned in the Council decision of 30 April, 1976 [4] was exceeded by one point on an annual average basis. This development tended in the direction required by the conjunctural situation.

[1] OJ C 297 of 29.12.1975, p. 8.
[2] OJ L 119 of 6.5.1976, p. 12.
[3] OJ C 297 of 29.12.1975, p. 9.
[4] OJ L 119 of 6.5.1976, p. 15, point 2.6.

TABLE 3

Money supply, credit, and interest rates

Country	1974 December		1975 December		1976 March		1976 June		1976 September		1976 December	
	Money supply [1 2]											
	M_1	M_2	M_1	M_2	M_1	M_2	M_1	M_2	M_1	M_2	M_1	M_2
Denmark	5.9	8.9	26.0	25.5	26.7	27.0	18.4	22.2	13.4	17.4	6.2	11.5
FR Germany	10.9	5.2	15.7	– 0.1	11.7	0.2	12.2	7.8	7.6	8.6	1.9	5.0
France	15.2	16.8	12.7	17.7	17.0	19.4	16.6	19.9	12.5	17.4	7.7	14.6
Ireland	5.3	20.2	20.3	20.7	18.1	18.0	18.3 [4]	19.7 [4]	16.6 [5]	15.7 [5]	16.6	14.3
Italy	10.7	15.4	12.5	23.6	22.2	25.2	23.2	23.4	20.0	21.4	21.5	23.1
Netherlands	12.2	20.0	19.7	5.7	21.1	8.9	11.5	12.2	3.9	21.9	6.8	22.7
BLEU	8.7	11.3	14.3	14.8	12.0	14.3	10.8	14.3	9.2	13.7	6.9	10.9
United Kingdom	8.3	11.9	21.4	8.1	22.6	8.3	14.1	9.6	15.6	12.6	13.6	11.4
	Bank lending to private sector [2]											
Denmark	7.0		14.3		16.3		15.7		15.7		:	
FR Germany	6.5		4.6		5.4		7.4		9.1		9.4	
France	16.9		14.2		15.3		15.2		15.4		:	
Ireland	15.5		16.3		16.6		21.0 [4]		29.2 [5]		:	
Italy	22.4		17.0		24.8		22.8		24.3		:	
Netherlands	17.9		12.2		13.8		17.9		21.4		:	
Belgium	13.5		13.9		16.2		17.5		18.0		:	
United Kingdom	18.3		0.7		– 0.1		2.6		7.4		11.7	
	Interest rates [3]											
	short term	long term	short term	long term	short term	long term	short term	long term	short term	long term	short term	long term
Denmark	12.7	15.2	4.5	13.2	6.6	14.4	9.9	14.5	17.9	15.8	13.4	15.2
FR Germany	8.4	9.9	3.9	8.6	3.6	7.8	4.3	8.3	4.3	8.1	5.0	7.4
France	12.0	11.2	6.5	10.2	7.6	10.3	7.6	10.4	9.3	10.7	10.4	11.0
Ireland	11.3	16.9	10.9	14.5	8.5	14.1	11.5	13.9	13.3	15.2	14.8	15.5
Italy	17.5	11.4	8.3	10.5	14.8	11.5	19.7	12.6	16.1	12.4	16.8	13.1
Netherlands	7.0	7.6	4.4	7.7	2.0	7.3	4.9	8.6	8.7	8.6	6.4	7.5
BLEU	9.0	9.0	3.9	8.5	7.6	9.0	7.2	9.4	12.2	9.2	7.4	9.3
United Kingdom	6.8	17.2	10.2	14.8	7.4	13.9	9.8	14.1	10.7	14.8	13.8	15.5

1 M_1: Notes and coins in circulation and deposit money; M_2 (Ireland and United Kingdom: M_3): M_1 and near-money.
2 Percentage change on same period of previous year.
3 Short-term rates: day-to-day money rate, long-term interest rates: yield on fixed interest securities.
4 May.
5 October.
: Data not available.

3.4. In the case of France, [1] the Council had recommended a supervision of the monetary aggregates designed to avoid the emergence of inflationary pressures. In the event, monetary expansion slowed noticeably in the course of the year, owing to a weakening in the demand for credit, to the pressure resulting from a reduction in foreign currency holdings and, in addition, to the measures adopted, namely: an increase in the banks' reserve ratio in respect of the last 4 months of the year and a ceiling of 9 points in the authorized growth of credit. Moreover, both short- and long-term interest rates were increased under the influence of exchange rate developments.

1 OJ C 297 of 29.12.1976, p. 10.

3.5. The monetary guidelines fixed for *Italy* in the Annual Report of end-1975 were amended in a restrictive sense in the Council decision of 30 April, 1976. The monetary financing requirement of the Treasury have reached Lit 9 100 billion, whereas they should have been limited to Lit 5 700 billion according to the Council decision of 15 March 1976[1] (setting out the economic policy conditions to be observed by the Italian Republic). They have thus contributed to the excessive expansion in the monetary base and, accordingly, of bank liquidity. The authorities attempted to neutralize this, in part, by requiring deposit to be made in respect of foreign currency purchases and by increasing the required reserve ratio. Monetary developments were not, however, more effectively controlled until October, following the limitation on credit. The ceiling put on the expansion of credit was, nevertheless, surpassed; at the end of the year the figure of Lit 33 000 billion had, in fact, been reached, although the Council decision [1] mentioned a total of 29 500.

3.6. In so far as the *Netherlands* is concerned—the only Member State where the rate of monetary expansion exceeded that of domestic production—the Council took care to recommend a monetary policy favouring capital exports. [2] Nevertheless, under the pressure of foreign exchange market developments, the authorities were obliged to effect limited increases in the discount rate. As for the substantial expansion of the money stock, it does not reflect any particular easing in monetary conditions but rather a transfer from savings to time deposits, as well as a growing preference for liquid assets on the part of institutional investors. It remains true, however, that money creation in the public sector was above the level of 1975.

3.7. In *Belgium,* constraints imposed by exchange-rate considerations have not permitted a monetary policy stance destined to support economic activity, as recommended by the Council. [3] In particular, it was not possible to bring about a reduction in interest rates, and the discount rate even reached its highest-ever level (9%). On the other hand, credit expansion was relatively well sustained.

3.8. In the *United Kingdom,* (minimum lending rate) was raised to a record level, namely 15%, in the period from October to mid-November (as happened in Italy (15%) in early October and in Ireland (14.75%) in November) in order to reduce exchange-rate pressures. While this increase was of an unexpected magnitude, this measure corresponds with the recommendation of the Council.[4] Moreover, throughout most of the year, the expansion of the money stock was controlled, sometimes by severe measures such as an increase in special deposits and, as from November, controls on the growth of interest bearing liabilities.

3.9. In the context of monetary policy, the Council again recommended that many Member States finance the treasury deficit by domestic borrowing. *Denmark* [5] and *Ireland*[6] engaged in external borrowing on a substantial scale. But this policy represents, in effect, a method of financing the balance-of-payments deficit.

(d) Prices and incomes policies

4.1. In 1976, the achievement of a deceleration in price and cost inflation, and a reduction in the disparities between rates of increase in this field, were high priority objectives. In order to achieve these aims, the Council had recommended, these aims, the Council had recommended, in addition to appropriate policies for the regulation of demand, social affairs and employment, a high degree of caution on the part of firms when setting their prices and an attitude of moderation on the part of trade unions when making their wage claims.[7] In countries, such as the Federal Republic of Germany, where such cooperation between social partners has been obtained, an appreciable degree of success has been recorded in slowing down the rate of inflation. In other countries, where it was necessary, in particular, to moderate the growth of real incomes, the results have been varied and any progress that has been recorded has often been achieved by means of a tight prices and incomes policy.

4.2. The disparities in the growth of wages between Member States have been slightly reduced, when considered in a general context which has been characterized, for the first time since the energy crisis, by

1 OJ L 77 of 24.3.1976, p. 16.
2 OJ L 119 of 6.5.1976, p. 16, point 2.21.
3 OJ C 297 of 29.12.1975, p. 12.
4 OJ C 297 of 29.12.1975, p. 13.
5 OJ L 119 of 6.5.1976, p. 14, point 2.3.
6 OJ L 119 of 6.5.1976, p. 15, point 2.14.
7 OJ C 297 of 29.12.1975, p. 8, point 4.4 and OJ L 119 of 6.5.1976, p. 14, point 1.8.

TABLE 4

Wage and salary earners, compensation of employees and labour productivity [1]
(% changes on preceding year)

Country	Wage and salary earners			Compensation of employees – Nominal – Per wage and salary earner			Compensation of employees – Real [3] – Per wage and salary earner			Gross domestic product at constant prices		
	1974	1975	1976	1974	1975	1976	1974	1975	1976	1974	1975	1976
Denmark [4]	– 0.3	– 4.0	0.3	18.0	15.0	10.5	2.6	5.7	1.9	1.5	3.1	4.5
FR Germany	1.8	– 3.3	– 0.8	11.4	7.7	8.1	3.8	1.5	3.4	2.6	0	6.1
France	1.5	– 1.3	0	16.5	17.2	14.5	2.3	2.8	4.8	1.4	0	5.0
Ireland [2]	1.7	– 2.2	:	17.0	24.1	19.2	1.1	2.3	1.0	0.1	– 0.5	3.5
Italy	1.9	1.3	1.1	22.3	18.6	21	1.7	1.0	3.2	1.5	– 4.9	4.3
Netherlands	0.2	– 0.7	– 0.3	15.6	13.5	9.5	5.2	2.7	0.1	2.0	– 0.2	4.0
Belgium	2.0	– 1.4	– 1.5	16.9	15.6	12.6	3.5	3.1	4.0	1.9	– 0.6	5.0
Luxembourg	3.2	0.7	– 1.5	22.0	14.1	10.4	11.4	3.1	0.5	– 0.1	– 8.3	5.5
United Kingdom	0.5	– 0.6	– 0.8	20.4	30.6	16.3	3.1	6.1	0.7	– 0.3	– 0.7	1.7
Community	0.4	– 1.2	– 0.3	16.3	15.9	13.2	2.8	2.9	2.8	– 1.3	– 1.1	4.6
USA	1.8	– 2.2	3.2	8.5	7.4	7.5	– 2.2	– 0.6	2.0	– 3.3	– 0.5	2.9
Japan	0.4	0.4	0.5	16.2	25.5	11.7	3.8	3.8	1.9	– 0.6	2.4	5.4

1 Gross domestic product at constant prices per wage and salary earner.
2 Excluding agricultural workers.
3 Adjusted by consumers price index.
4 Full time workers.
: Data not available.
Source: Commission's departments.

growth in the total wages and salaries bill which has, overall, been slower than that of gross domestic product in value terms (cf. Tables 1 and 4).

The continuation, in June 1976, of the dialogue between the social partners, which had been begun at Community level on the occasion of the first tripartite conference in November 1975, has had beneficial effects on the social climate. A particularly large reduction in the rate of growth of wages has been recorded in the United Kingdom, where the Government was able to move on to the second phase of its counter-inflation policy, as well as in Denmark, where a strict limit on wage increases was introduced by legislation. In these countries, as well as in Ireland, the Netherlands and Luxembourg, the increase in gross incomes of wage-earners, both in nominal and in real terms, slowed down, sometimes to a very appreciable extent. Per capita wages grew at the same rate in 1976 as in 1975 in the Federal Republic of Germany — where the constructive attitude of the social partners had led to a significant reduction in the rate of growth in 1975, but the rate of growth of nominal per capita wages only slowed down slightly in France and in Belgium, whilst a slight acceleration was even recorded in Italy (cf. Table 4). Indeed, in this latter country, the relative moderation in wage increases in the previous year gave way, in 1976, to a significantly faster rate of growth, both in real and nominal terms, which was contrary to the guidelines adopted by the Council. This development necessarily affected the general balance of the economy and resulted in the introduction of the austerity programme of last October, which included in particular adjustments to the system of indexation as regards the higher levels of earnings. As in Belgium, the inflationary effects of indexation were temporarily reduced by 'freezing' that part of any salary which exceeded a given level.

Overall, although the growth of the total wages and salaries bill only decelerated slightly in 1976, the upturn in production nevertheless led to a marked slowdown in the rate of increase of unit labour costs (cf. Tables 5 and 6).

4.3. In most countries, the relative share of non-wage incomes in the gross domestic product grew between 1975 and 1976, although it remained below the level reached before the crisis, and it did not result in the desired increase in the propensity to invest. In addition, the progress that was achieved in controlling domestic costs varied so much from country to country that new divergences appeared in the development of prices and exchange rates. In these conditions, price control policies had to be considerably re-inforced in the majority of Member States, particularly in Denmark and Ireland. In Belgium, the Economic Recovery Law froze dividends, professional fees and rents from 1 April to 31 December. As the slowdown of inflation, in general, did not proceed sufficiently rapidly, more restrictive measures were decided upon by several countries during the second half of the year. In France, a counter-inflation programme, including a price-freeze until the end of the year, was introduced in September. In Denmark, a similar decision was taken in December, with a life of three months. In the same month, strict control of prices was introduced in the Netherlands, which was to be followed by a limited period of price surveillance.

Elsewhere, measures to increase controlled prices, and the inclusion of increases in indirect taxes in sliding-scale salary mechanisms, which were introduced in certain Member States in 1976, were instances of policies which were not entirely in conformity with the increased convergence required by the Council. [1]

(e) Exchange rate and balance of payments policies

5.1. In 1976, changes in exchange rates and developments in the balance of payments for the Community have been determined, not so much by clear and precise economic policy aims, but more by persistent differences in prices and costs, together with a lack of coordination of economic policy in the Member States.

5.2. After a period of relative stability during the previous year, the exchange rates of the currencies of Member States have diverged sharply (cf. Table 5 and the graph).

The disturbances that have occurred in the exchange markets have had various repercussions on the system of Community exchange rates. Despite substantial interventions in the exchange markets, the disturbances were the reason for the French franc leaving the snake (15 March) and the suspension of the Benelux agreement of August 1971 which limited to 1.5% the range of fluctuations between the currencies of the

[1] OJ L 119 of 6.5.1976, p. 13, point 1.6.

TABLE 5

Development of price and cost indicators and of exchange rates (annual averages)
(% changes on preceding year)

Country	Implicit deflator						Compensation of employees per unit of output [1]			Effective exchange rate changes [2]		
	of GDP			of private consumption								
	1974	1975	1976	1974	1975	1976	1974	1975	1976	1974	1975	1976
Denmark	11.2	11.8	9.1	15.0	8.8	8.5	16.3	11.6	5.9	0.6	3.4	2.2
FR Germany	6.9	8.2	3.3	7.3	6.1	4.5	8.6	7.7	1.9	5.9	1.9	5.8
France	11.5	14.1	8.9	13.9	11.4	9.3	14.9	17.3	9.0	— 6.5	9.9	— 3.6
Ireland	7.2	22.9	19.9	15.7	21.3	18.0	18.9	22.7	15.0	— 2.5	— 5.5	— 10.2
Italy	16.8	17.5	16.0	20.2	17.4	17.0	20.5	24.7	15.7	— 9.5	— 4.1	— 17.0
Netherlands	8.7	10.7	9.1	9.9	10.5	9.4	13.3	13.7	5.4	5.5	2.6	2.8
Belgium	12.7	12.4	8.4	12.9	12.1	8.3	14.7	16.3	7.3	1.9	1.5	2.1
Luxembourg	13.2	2.9	6.3	9.5	10.7	9.8	21.9	24.5	5.7			
United Kingdom	13.4	27.8	16.0	16.8	23.1	15.5	20.8	31.6	14.3	— 3.2	— 8.1	— 14.7
Community	11.2	14.3	9.3	13.1	12.6	10.0	14.8	17.2	8.1	.	.	.
USA	10.0	9.3	5.1	10.5	8.0	5.0	11.7	7.7	4.0	2.3	— 0.9	5.2
Japan	20.7	7.1	6.2	21.5	10.9	8.5	26.2	13.6	6.0	— 6.4	— 2.6	4.5

1 Gross wages and salaries + employers' actual social contributions + imputed social contribution / Gross domestic product (volume).
2 Weighted by structure of exports.
1976. Estimates.
Source. Commission's departments.

TABLE 6

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

Country	Increase on preceding year (%)						1970-1976	1970-1976
	In national currency			In Eur (%)			Cumulative increase. in national currency (%)	Cumulative increase. in Eur (1) (%)
	1974	1975	1976	1974	1975	1976		
Denmark	17.7	16.4	3.7	17.7	16.4	2.8	75.5	72
FR Germany	8.0	7.8	− 1.1	11.6	7.8	− 0.8	39.5	59
France	15.7	16.9	4.3	6.9	23.7	− 2.2	75.5	61
Ireland	18.9	25.9	8	13.8	12.6	− 8.6	116	27.5
Italy	20.3	32.3	9.5	8.0	24.6	− 10.1	133.5	38.5
Netherlands	11.2	14.2	2.5	15.2	14.2	2.6	56	68.5
Belgium	16.2	13.9	1.5	16.3	13.9	1.6	59	63.5
United Kingdom	23.5	33.7	13.9	18.2	19.6	− 3.7	136	39.5
United States	15.0	9.3	− 1	13.8	3.6	3.0	34	5.5

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

countries concerned). Afterwards, there were further pressures within the snake until a realignment of central rates was decided on 18 October. [1]

On the basis of the effective exchange rate, the currencies in the snake appreciated considerably for the year as a whole (from 7.4% for the Danish crown to + 15.4% for the Deutsche Mark) [2] thus supporting the efforts made by the Member States to eliminate the increases in the prices of imports and the cost of primary products. [3]

5.3. The exchange rates of those Community currencies which float independently, that is to say the Lira, the Pound sterling and, since 15 March, the French franc, suffered a considerable fall in 1976. Thus the weighted exchange rates for the Lira and the Pound have shown an actual devaluation of 21% and 17% respectively.[2] To begin with this depreciation was a consequence of the more rapid rate of cost and price inflation, compared with that observed in the trading partners of the countries in question. This depreciation then became itself an independent source of inflation.

Developments in wage and salary costs per unit of industrial output (see Table 6) show that the exchange rate changes particularly for the Lira, have overcompensated for the differences in prices and costs. As a consequence, the strong upward pressure on import prices experienced by the United Kingdom and Italy has reversed the clear tendency towards a slow-down in the rate of inflation observed in the first six months of the year. The increase in import prices, together with the accompanying depreciation of the French franc, also affected the French economy, and its external position deteriorated significantly during the second half of the year.

The Member States concerned have endeavoured to escape from this process by severe measures as well as restrictive budgetary and monetary policies. It has thus not been possible to rely entirely upon exchange rate flexibility as a means of resolving difficulties of adjusting the balance of payments. The need to adapt domestic policy eventually became an indispensable complementary policy.

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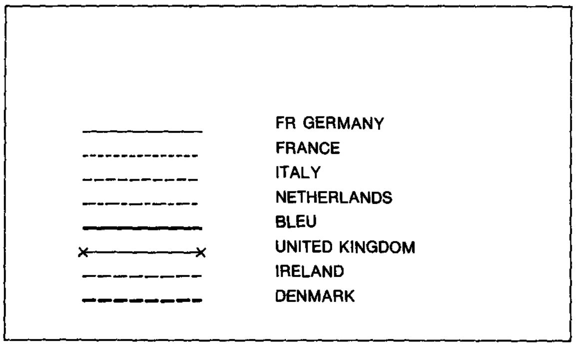
1 2% revaluation of the Deutsche Mark against the European Monetary Unit of Account. 1% devaluation (3% with respect to the Deutsche Mark) of the Swedish and Norwegian crown's and a 4% devaluation of the Danish crown (6% with respect to the Deutsche Mark). The central rates for the Belgian and Luxembourg francs remained unchanged giving a devaluation of 2% with respect to the Deutsche Mark.

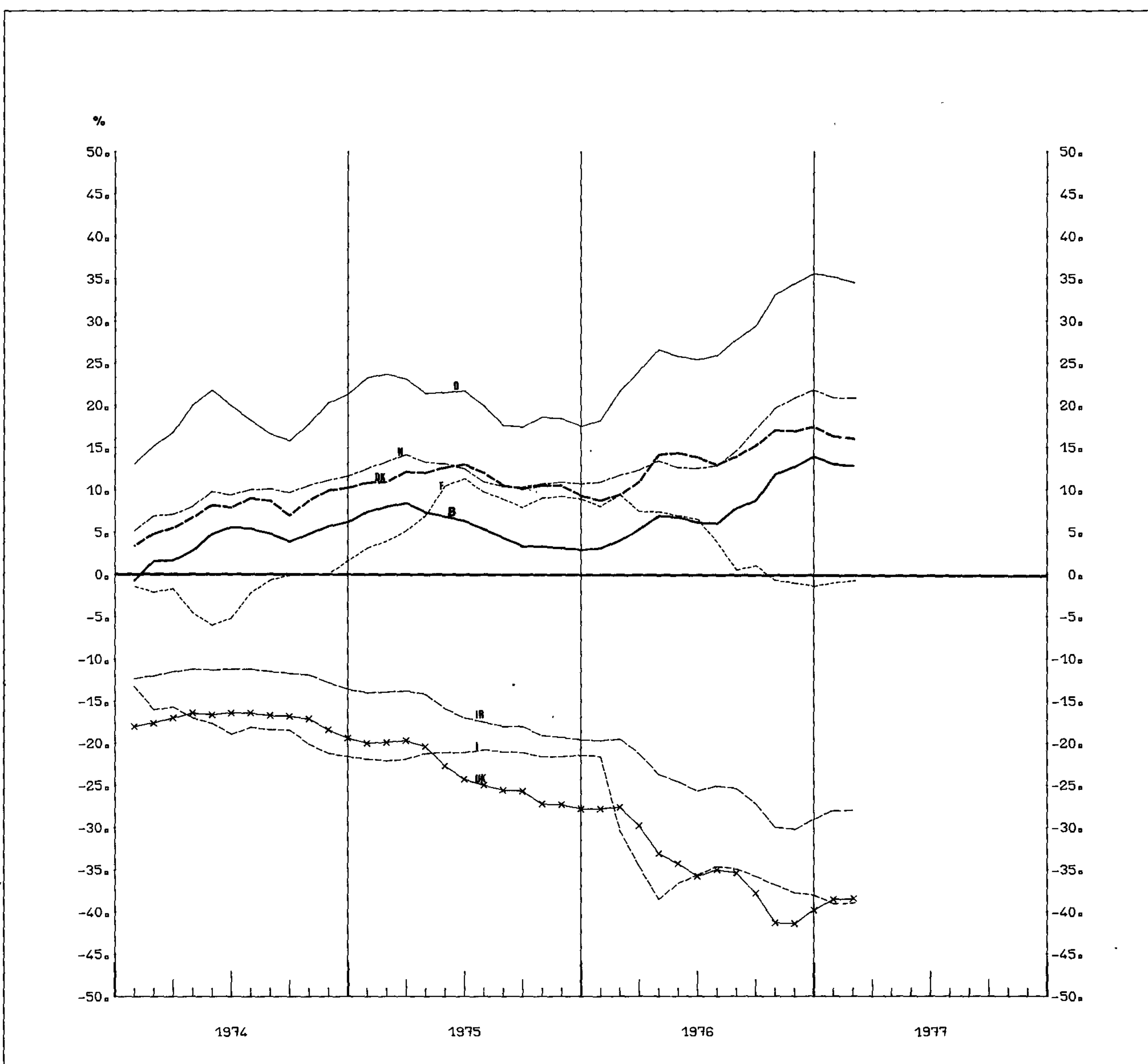
2 Between December 1975 and December 1976.

3 OJ L 119 of 6.5.1976, p. 12, para. 16.



Exchange rates

(weighted change in % since 1st Quarter 1972; weighting according to structure of exports)



5.4. The growing disparities of costs, prices and exchange rates were reflected, in 1976, in developments of balance of payments deficits. The deterioration in the current account of the balance of payments for the Community, — approximately US $ 10 billion when compared with the previous year — is entirely due to the deficit countries, the situation of the other countries having remained relatively unchanged.

The worsening of the external position occurred principally in Denmark, Italy and France, whilst the United Kingdom continued to register a significant deficit. Reductions in these excessive deficits has been the principal objective of the recovery and stabilization programmes introduced in these countries since last September. They will remain one of the essential concerns of economic policy in 1977.

5.5. Member States largely financed their external deficits by recourse to international financial markets. The Community has also played an important role in this regard. In particular, the first medium term Community loan, for US $ 1.1 billion and DM 500 million, was issued. The funds from this issue have been transferred in the same currencies and under the same financial conditions that applied to the original loans, to the central banks of Ireland and of Italy to the extent of US $ 300 million and 1 000 000 million respectively.

B — IMPLEMENTATION OF THE COUNCIL DECISION OF 18 FEBRUARY 1974

6.1. The Council Decision of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the Community establishes procedures and an annual timetable. Under Article 12 of the Decision, the Commission is required to report to the Council on Member States' compliance with the procedures and the timetable.

6.2. As in the preceding year, the Council held eight meetings in 1976[1] to examine the economic situation in each of the Member States, in the Community and in the rest of the world. In addition, on each of the three occasions it met,[2] the European Council also considered the major problems raised by the monetary, economic and social situation. In the spring, the Ministers of Finance of the Member States met[3] to discuss, in particular, the steps to be taken to restore orderly conditions on the foreign exchange markets. The meetings of ministers of the countries participating in the Community exchange rate system did not take place within a Community framework.

A second Tripartite Conference took place on 24 June 1976; like the Conference of November 1975, it brought together the Ministers of Economic Affairs and of Employment, the Commission and representatives of the two sides of industry. At the end of the Conference, a joint statement was adopted concerning, among other things, the economic policy objectives to be pursued in the medium term and the corresponding strategy to be followed.

6.3. The first examination of the economic situation, which, according to Article 2, must take place during the first quarter of each year, was held on 15 March. On that occasion, the Council, acting on a proposal from the Commission, approved a Decision adjusting the economic policy guidelines. However, the Decision was formally adopted only on 30 April.[4]

In accordance with Article 3, the Council undertook the second examination of the economic situation in the Community on 26 July, when, acting on a proposal from the Commission, it adopted a Decision on the preparation of public budgets for 1977.[5]

Under Article 4, as amended by the Council Decision of 18 December 1975, the Commission conveyed to the Council, on 21 October, its proposed Annual Report on the Economic Situation in the Community,[6] together with the economic policy guidelines for 1977. The Economic and Social Committee and the European Parliament discussed both texts on 27 and 28 October[7] and on 16 November[8] respectively. The Council definitively endorsed the Decision adopting the Annual report[9] on 22 November.

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[1] On 16 February, 15 March, 5 April, 17 May, 26 July, 20 September and 8 and 22 November.
[2] On 1 and 2 April, 12 and 13 July, and 29 and 30 November.
[3] On 26 April 1976.
[4] OJ L 119 of 6.5.1976.
[5] OJ L 229 of 20.8.1976.
[6] OJ C 286 of 3.12.1976.
[7] OJ C 297 of 16.12.1976.
[8] OJ C 293 of 13.12.1976.
[9] OJ L 358 of 29.12.1976.

6.4. After examination by the Economic Policy Committee, the draft Fourth medium-term economic policy programme was adopted by the Commission and forwarded to the Council on 6 October 1976. [1]

On 25 November, the Economic and Social Committee gave its opinion on the 1976-1980 programme. The Committee gave a general endorsement to the choices made by the Commission. In mid- February, the opinion procedure was still under way in the relevant committee of the European Parliament.

6.5. Regular meetings and thorough discussions took place during 1976, within the consultative bodies — the Monetary Committee, the Economic Policy Committee and the Coordination Group. The work programme of these bodies was substantial. In addition, mention should be made of the frequent consultations between the Community bodies and the member countries concerning financial assistance (medium-term aid, Community loans).

6.6. In several cases in important circumstances the prior consultation requirement under Article 7 of the Council Decision of 18 April 1974 was not complied with by the Member States. The decisions about the Community exchange rate system (exit of French franc in March, change in intervention points for some snake currencies in October) were not preceded by Community consultations. The stabilization and restriction plans introduced in some countries were the subject, in the best of cases, of no more than an exchange of information.

CONCLUSIONS

Despite a number of efforts on the part of the Member States to improve economic policy coordination and to observe the economic policy guidelines laid down by the Council, 1976 did not show any particularly marked progress in achieving convergence in the economies of the Community.

While it is true that in most of the Member States, the upward movement of the economies was vigorous during the first part of the year—partly because of measures to stimulate activity adopted jointly in 1975 — it is also true that the lull in the summer was longer than had been expected originally so that doubts arose once again as to whether the factors contributing to expansion were of a lasting nature. The period of weakness, which was quite marked, was partly a technical adjustment of the original phase, which was very strong, in the cycle, but it was also the result of diverging trends as between the Member States. For example, in some countries, the balance of payments deteriorated rapidly, while at the same time, the reduction in surpluses came to a halt in 1976 in the Federal Republic of Germany and in the Netherlands.

Similarly, those responsible for economic policy failed to bring cost and price trends sufficiently under control. Denmark, France, and Italy were compelled to alter their original economic policies from the beginning of the second half of the year onwards, i.e., to pursue a restrictive course in respect of overall management, while at the same time other countries, such as the United Kingdom, were forced to strengthen gradually their stabilization policies. The results of this policy of curbing domestic demand on inflationary tendencies are only gradually becoming apparent.

All in all, each of the Member States made some progress in 1976 towards reducing inflation rates, compared with 1975, as they also did with regard to the reduction of nominal wage costs per unit of output. It is a pity that divergences in cost and price trends as between the Member States were not reduced more substantially in 1976 and that they even grew more marked in the second half of the year. Divergent trends led to a further and substantial change — in comparison with 1975 — in the exchange rates of the three currencies floating independently. A number of adjustments in exchange rate relationships also had to be made in October within the Community intervention system.

In 1976, annual average growth of the gross domestic product, in real terms, ranged from 5.5% to 3% — with the exception of the United Kingdom, where it was 1%. These relatively high rates are seen, however, to be less satisfactory if the performance of the economies over the course of the year is considered, or if the trend through several years is the criterion chosen. Since 1974, the year in which the crisis began, the real gross domestic product of the Community has increased overall by a little less than 4%, i.e., at a rate slightly higher than 1% per year. It is therefore not surprising that the numbers of unemployed have steadily increased, even in 1976 (except in the Federal Republic of Germany).

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[1] OJ C 12 of 17.1.1977.

The achievement of simultaneous progress in the fight against internal and external disequilibria, with a view to vigorous and lasting growth and an improvement in the employment situation, requires a joint and unflagging effort by all the Member States, at European and international level. Postponing concerted action would mean jeopardizing the results achieved with so much difficulty so far with regard to economic consolidation and making the overall and structural adjustments, which will eventually prove necessary, an even more painful process.