II

(Acts whose publication is not obligatory)

COUNCIL

COUNCIL DECISION

of 30 April 1976

concerning the adjustment of the economic policy guidelines for 1976

(76/440/EEC)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Decision 74/120/EEC of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community (1), and in particular Articles 1 and 2 thereof,

Having regard to the proposal from the Commission,

Whereas the Council agrees with the analysis of the economic situation contained in the Commission communication of 3 March 1976 concerning the adjustment of the economic policy guidelines for 1976,

HAS ADOPTED THIS DECISION :

Article 1

Member States shall pursue economic policies which conform to the guidelines set out in the Annex hereto.

Article 2

This Decision is addressed to the Member States.

Done at Luxembourg, 30 April 1976.

For the Council

The President

B. BERG

(1) OJ No L 63, 5. 3. 1974, p. 16.

ANNEX

ECONOMIC POLICY GUIDELINES FOR 1976

1. General guidelines

Need to consolidate the revival

1.1. The trends observed in recent months and the latest business surveys substantially confirm the outlook for 1976 set out in the 'Annual Report on the Economic Situation in the Community' (1). Consequently, the general pattern of the economic policy guidelines contained in that report is still valid. The main task is to consolidate the revival by :

— ensuring strict and prompt implementation of the measures already decided upon to stimulate economic activity and, where necessary, prolonging the application of certain measures so as to avoid abrupt pauses in the economic recovery ;

— making further progress in the fight against inflation and curbing the rise in wage costs, an essential move particularly in those Member States with little room for manoeuvre in their balance of payments and budgetary policies, i.e. Ireland, Italy and the United Kingdom.

... but without generating new pressures

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

Budgetary policy to encourage economic activity

1.3 Given the continuing uncertainty as to the strength of the economic revival, budgetary policy should continue to encourage economic activity, by ensuring that deficits are not reduced at an unduly rapid rate and that investment in the public sector is increased. In order to achieve the necessary long-term reduction in deficits, current expenditure should be curbed to create more room for capital outlays. In some Member States, social infrastructure investment is not only the necessary corollary of moderation in incomes policy ; it is also a condition for the essential process of adjustment in the medium term.

Expansionary but cautious monetary policy

1.4 Monetary policy should also encourage sustained economic recovery. However, given that there is so far no reason to question the forecasts of continuing inflation, the expansion of liquidity in the Member States should be kept within narrowly defined limits. To achieve this, the financing of budget deficits must be severely restricted, and the increase in the money supply limited in a manner compatible with macro-economic objectives.

Improvement in profitability of undertakings essential

1.5 If there is to be steady economic growth and a high level of employment, investment of the kind which creates more jobs must be stepped up considerably. An improvement in the profitability of undertakings is therefore essential. Rather than through price increases, this should be achieved by productivity gains resulting from economic growth and by slowing down the rise in production costs.

Need for further progress in the fight against inflation

and for a narrowing of price differences

1.6 The rise in consumer prices must be slowed down further in order to prevent the necessary moderation in wage increases from resulting in a reduction of consumer demand in real terms. This implies that the upward trend of controlled prices must be rigidly contained. The planned increase in indirect taxes in a number of Member States should, where possible, not be taken into account in wage settlements, so as to prevent chain reactions. A narrowing of the price differences between member countries would prevent exchange rate disturbances between the 'snake' currencies and would facilitate the coordination of monetary policies. Stability as far as possible in the value of Community currencies would be of practical help in defending the hard-won achievements in stabilizing prices against the increasing pressure of import prices and world commodity prices.

(1) OJ No C 297, 29. 12. 1975, p. 1.

Complementary role of social and employment policy

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

Joint effort from the various socio-economic groups

1.8 In the current economic situation, to take the medium-term view, it would seem essential to achieve a greater measure of agreement between management and unions on wage targets and the economic conditions under which they can be achieved, so as to overcome as quickly as possible the effects of the deep recession which has just ended, resolve the resulting adjustment problems and put an end to disputes over differentials. It is only by a joint effort to promote confidence that the expansionary factors leading to the creation of new jobs can be strengthened and the upward movement in prices slowed down further.

The continuation of the talks between the two sides of industry, which were launched at the Tripartite Conference in 1975 between representatives of the employers' and workers' organizations, Member States' Ministers of Economic and Social Affairs and the Commission, could be of considerable help in strengthening the economy and restoring the confidence of consumers, investors and producers in the Community's economic future.

2. Guidelines for each Member State

2.1 In *Denmark,* the economic recovery which began in the closing months of 1975, following the expansionary measures taken in September, is likely to become well established in 1976. It is likely that the main elements in this recovery, the expansion in private consumption and residential construction, will result in an increase in investment in other areas and in exports. Unemployment could, therefore, show a reduction during the year. Certain inflationary pressures could make progress in controlling prices and costs more difficult than has hitherto been the case. Consequently, the incomes policy which was successfully pursued in 1975, will have to be continued in order to ensure a balanced recovery.

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

2.3. In the monetary field, the expansion in domestic liquidity should be contained so as to make it possible to hold interest rates at a level compatible with the restrictive situation resulting from an increased balace of payments deficit. To achieve this, the central Government's borrowing requirement should be met by public loan issues.

2.4 In the *Federal Republic of Germany,* the combined effects of the reflationary measures already taken by the Government and the Federal Bank and the marked recovery in export demand produced a distinct change in the economic situation in the second half of last year. Judging from the information currently available, the recovery will gather momentum in the coming months, with the result that real gross national product can be expected to grow by an average of 4 to 4½ % in 1976. In such circumstances, the authorities responsible for economic policy should be content to await the full effects of the measures already taken to stimulate the economy.

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

2.6 As regards monetary policy, the Federal Bank has adopted as its target for 1976 an average growth of 8 % in the central bank reserves. Since the money in circulation increases rapidly in a period of economic expansion, this rate of growth should be sufficient to finance the estimated rise in production and employment at the same time as gradually lowering the rather too high existing level of liquidity in the economy, and continuing to reduce the scope for price increases.

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

2.8 Budgetary policy should continue to encourage the recovery in activity. In particular, in order to stimulate private sector fixed investment, the authorities should aim to improve the liquidity position of undertakings. Fiscal reliefs, for example the postponement of tax payments, could again be used.

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

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

2.11 The present monetary policy seems well suited to this current recovery phase. But the rapid rate at which the money supply has been expanding in recent months will have to be gradually reduced.

2.12 In *Ireland,* a revival of activity may take time to materialize. Exports could grow at a slightly slower rate than in 1975 as a result particularly of the drop in the volume of sales of agricultural produce. Private consumption is expected to rise only slowly. While investment should increase as a result of higher public capital expenditure, the employment situation is unlikely to improve until the second half of the year. The rate of price increases should slacken but the extent of this slow-down will depend on the success of the incomes policy. Economic policy should therefore centre on this aspect of the situation. In this respect, an incomes freeze up to the end of 1976, as proposed, could well be the essential condition for a gradual return to internal balance which would stimulate the longer term prospects for growth and employment.

2.13 The budget presented on 28 January 1976, which in general conforms with the guidelines fixed in the annual report on the economic situation in the Community, should contribute to a large extent to the realization of these objectives. Its main features are considerable cuts in current expenditure, an appreciable increase in taxation and a large increase in public sector capital expenditure, calculated to have a positive effect on employment. Overall, the borrowing requirement of central and local government, expressed as a percentage of gross domestic product, is expected to stabilize although remaining high. This would represent a break in the trend observed in the past few years.

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

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

2.16 The strong pressure on the lira in January forced the monetary authorities to stop intervening on the exchange markets. As a result, between 20 January

and 2 March, the lira depreciated, allowing for weighting, by some 13 %. On the assumption that this downward course is maintained, the Italian balance of payments, which in any case would have worsened during the period of economic recovery, would have to bear the additional burden of a deterioration in the terms of trade. Such a possibility is all the more likely since in Italy, which is an important processor of raw materials, the scope for elasticity in imports in relation to their price is rather limited.

2.17 A further depreciation of the lira and its harmful effects on the wage-price spiral can only be avoided, as would be desirable, by an economic policy aimed at eliminating the State budget deficit and stemming the rise in unit wage costs. To restore balance to the economy both internally and externally the Italian authorities must apply an economic policy even more stringent than that presented in Council Directive 75/784/EEC of 18 December 1975 adapting the conditions laid down for the grant of medium-term financial assistance to the Italian Republic [1]. A restrictive policy should be followed on Government expenditure, the Treasury deficit and credit expansion.

This implies a comparatively high level of interest rates, together with appropriate fiscal policy measures. In any case, an important contribution from the two sides of industry to achieving a more moderate increase in nominal incomes is essential.

In following such a policy, with the aim of fighting inflation and restoring equilibrium to the balance of payments by a suitable rise in exports, the Italian authorities would also be serving the interests of the Community as a whole. To this end, the Community should provide assistance, in the form of a Community loan, on condition that the authorities do not take any measures, either direct or indirect, which could impede or disturb trade between Member States.

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

2.19 Budgetary policy must therefore continue to encourage economic activity. For the time being, the central Government budget for 1976 must remain in line with the original guidelines, which prescribed that the 1975 reflationary programmes be maintained. In financial terms, the net borrowing requirement will show a marked increase over last year's figure.

2.20 As capital outflows will probably be insufficient to offset the surplus on current account, it must be assumed that the overall balance of payments will remain in surplus. As a result, the money market will probably be able to operate without constraint.

2.21 To reduce the risk of a resurgence of inflation at a later stage of economic recovery, it would be advisable to finance the Treasury deficit as far as possible by long-term borrowing, at the same time taking steps to maintain capital outflows.

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

2.23 In *Belgium,* where activity picked up fairly rapidly in the fourth quarter of last year, mainly as a result of a rise in domestic demand and in exports, demand should continue to grow during the first half of 1976. This recovery will mainly be based on several factors : restocking, increased public investment, and the expansion of residential building ; the growth in private consumption may however only be slight.

2.24 For most of the year, the rate of expansion will depend partly on the impetus provided by public investment. There is therefore no need to change the general guidelines for budgetary policy set out in the annual report on the economic situation in the Community, which are in any case made clear in the central Government budget for 1976. The authorities could, in addition, encourage business investment by effectively removing the burden of value added tax from such investment, and ensure that the subsidised housing programme is strictly implemented.

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

[1] OJ No L 330, 24. 12. 1975, p. 48.

2.26 The continued rise in prices gives cause for concern. Some reduction in prices and costs would seem to be a prerequisite for any lasting improvement in the economic situation and particularly in the labour market. The measures envisaged as part of the recovery programme are a move in this direction, but will only be fully effective if applied without delay. The same is true for the new procedure for the prior notification of price increases and strict control of profit margins.

2.27 In *Luxembourg,* where activity seems to be picking up again in a number of newly-established exporting industries although the order situation in the iron and steel industry is only slowly improving, it will probably be several months before the economy shows signs of a significant recovery.

2.28 Pending the entry into force of the new law creating an unemployment fund, it would seem desirable to maintain on a temporary basis selective measures for avoiding short-time working in particular. There is no need to change the budgetary policy guidelines laid down in the annual report on the economic situation in the Community. The central Government budget for 1976 will no doubt provide for a large net borrowing requirement. However, although the existing budgetary reserves have already been substantially drawn upon to finance, among other things, the costs of implementing schemes in the public interest which occupy the unemployed, there should not be much difficulty in financing this deficit in the immediate future.

2.29 Despite the considerable progress made recently in the *United Kingdom,* in reducing the rate of inflation and the deficit on current account, the annual rate of price inflation remains a source of concern. Given the unforeseen depth of the recession and a higher rate of inflation than was originally expected, public expenditure rose to a higher level than planned, leading to a larger public sector borrowing requirement. Although the financing of this deficit did not prevent a slowing down in the growth of the main monetary aggregates in 1975, it might well result in a more rapid expansion of the money supply in 1976.

2.30 Prospects for 1976 point to a small but gradual recovery in output, mainly on account of a sharp reduction in the rate of destocking, a rise in consumer expenditure in the second half of the year and an overall improvement in the balance of payments, mainly due to the contribution from North Sea oil. The rising trend in unemployment is not expected to come to an end before the second half of the year. As a result of the policy of income restraint, combined with continued controls on prices, there are good prospects that the rate of inflation will continue to drop in the months ahead. To ensure the continued success of the counter-inflation policy, new arrangements will be needed to replace the present pay limit from the end of July 1976. These arrangements should be compatible with the over-riding objective of bringing the rate of wage inflation closer to that obtaining in the United Kingdom's principal competitors. This is an essential precondition for a return to higher levels of employment in the foreseeable future.

2.31 Despite the very high, and still rising, level of unemployment, three important constraints — the balance of payments deficit, inflation, and the scale of public sector borrowing — make it necessary for the authorities to continue to resist the growing pressure to reflate the economy.

If the recovery in economic activity were in fact to gather momentum during the course of the year, it would be both necessary and feasible to start reducing the borrowing requirement. To this end, it would seem advisable to implement strictly the stated policy of extending the system of cash limits for wage rises in the public sector, and allowing no further increase in public expenditure between 1976/77 and the following three financial years.

2.32 The basic aim of monetary policy must be to ensure that, when private sector demand for credit starts to rise more rapidly, the rate of growth of the money supply as broadly defined (M3) remains sufficiently low so as not to constitute an obstacle to the achievement of the Government's target for inflation. Such a policy would help maintain interest rates at a level consistent with the need to finance the continuing external deficit.