II

(Acts whose publication is not obligatory)

COUNCIL

COUNCIL DECISION

of 26 July 1976

on the preparation of public budgets for 1977

(76/646/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 3 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 23 June 1976 concerning, in particular, the preparation of public budgets for 1977,

HAS ADOPTED THIS DECISION:

Article 1

Member States shall pursue economic policies which conform to the guidelines on the preparation of public budgets for 1977 set out in the Annex.

Article 2

This Decision is addressed to the Member States.

Done at Brussels, 26 July 1976.

For the Council

The President

W. F. DUISENBERG

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

ANNEX

ECONOMIC POLICY GUIDELINES

1. General guidelines

1.1. The Member States and the Community are faced with major economic policy problems:

— the persistence of the recovery is not yet assured;

— employment prospects are only improving slowly;

— the rate of inflation is still too high;

— the excessive divergences from one country to another are in danger of persisting.

Classical economic management instruments are not in themselves sufficient to resolve these problems and to improve the cohesion of the Community. This will entail, moreover:

— the adjustment of income claims to the macro-economic and structural constraints;

— a reorientation of medium-term policy to goals fixed jointly;

— the strict coordination of conjunctural policies in the Community in terms of these objectives;

— the implementation of appropriate structural and regional reforms.

1.2. With a view to safeguarding the current rate of economic growth within the Community and thereby improving the chances of full employment being restored in 1980, the Commission has proposed the implementation of a strategy incorporating specific targets for the Community as a whole: an average real growth rate for the Community of between 4·5 and 5 % in the gross domestic product between now and 1980 and a reduction in the rate of increase in consumer prices to not more than 4 to 5 % on average by 1980. Targets for within this period and for each country could help to smooth out economic fluctuations and influence the actions of economic agents.

1.3. From the second half of 1976 onwards, the weakening of the effects of the temporary measures to stimulate demand and the operation of the built-in stabilizers will probably provide the needed moderating effect on the growth in the economy. In addition, the monetary policy measures take in a number of countries to counteract upheavals abroad will probably work in the same direction, in particular by making it easier for the disparities in the rates of growth of prices to be narrowed.

1.4. Beyond 1976, the attainment of the priority objective of a gradual return to an adequate rate of growth combined with economic stability calls for generally cautious economic policies making simultaneous use of the widest possible range of instruments available. Monetary and budgetary policy instruments should continue to create the general conditions conducive to an easing of price and cost pressures. Ceilings should also be imposed on the growth in liquidity to complete the guidelines adopted each year for the trend in net budgetary positions. Another essential element, which will need to take account of the specific situation in each Member State, should be an appropriate incomes policy designed to moderate the increase of prices and costs. Economic policies will have to be chosen so as to obtain a rapid reduction in unemployment and the necessary switch in the structure in domestic demand towards fixed investment and, in some countries, to exports.

1.5. Proposals have recently been put forward by the Commission to restore full employment and stability in the Community. Nonetheless, the Commission reiterates here that, as regards incomes policy and policy on savings and wealth:

— the State and the other authorities should show restraint in their budgetary management, should apply a fair fiscal policy and should enforce the rules on competition in particular during mergers of businesses;

— workers should take part in the joint effort to reduce production costs, in particular by being more flexible as regards the growth in their money wages, so as to take greater account of the potential of the economy;

— non-wage income recipients should show a corresponding moderation;

— firms should impose upon themselves a strict discipline as regards price increases;

— the governments and both sides of industry should adopt appropriate measures to promote asset-ownership by employees as well as their participation in the decision-making of their firms.

1.6. As regards budgetary policy, the Commission sets out below, in accordance with Article 3 of Decision 74/120/EEC, guidelines for the public budgets in 1977. It also stresses that monetary policy will have to contribute to the effort to reduce the rate of increase of prices through ensuring non-inflationary financing of the economic upswing. To achieve this the expansion of liquidity, which has been too rapid up to the present in several countries, will have to be moderated, especially in those where an improvement in the balance of payments is required. This action must be undertaken within a Community framework. Both internal and foreign savings will have to be channelled more effectively towards investment financing.

1.7. The exchange markets will become more stable as the erosion of domestic purchasing power in several Member States is checked and as the deficit countries' balances of payments improve. But an orderly situation in the exchange markets requires a greater convergence of monetary policy. For this interest rates will have to be kept at a relatively high level in those countries where the disequilibrium is most serious.

2. Budgetary policy guidelines

2.1. The economic outlook for the second half of 1976 and for 1977 calls for prudent budgetary management.

For 1976, the governments have taken appropriate steps to soften the stimulus given to the economy by the public budgets, by seeking to reduce or at least to stabilize the scale of the net borrowing requirement as a proportion of the gross domestic product. This line must be firmly maintained in the second half of the year, particularly in those Member States which have balance of payments difficulties.

This policy of gradually reducing public deficits will have to be pursued in 1977. It is essential for the re-establishment of equilibrium in the medium term, even if it means coordinated action on incomes. Given the requirements posed by such an objective, the relative reduction of deficits should be based not only on higher growth in tax revenue, already achieved in 1976, but in particular on appropriate curbs on public expenditure. If this strategy were unsuccessful, moderation of the growth of taxes and impositions of a like nature, generally considered necessary over the years ahead, would almost certainly remain an illusory goal. The risk would also be reduced of excessive public deficits having to be financed through the creation of too much liquidity, which, together with the growth of credit necessary for the recovery of investment, would pose dangers for the monetary equilibrium of the economy.

These general guidelines do not preclude, and may indeed necessitate, specific and limited measures of tax relief, to the extent that such measures would help restrain cost and price rises and promote the recovery of private investment in countries where such a recovery is slow to develop.

Denmark

2.2. The economic upswing should continue during the second half of 1976 thanks to a strengthening of investment demand together with a growth in exports and despite a reduced level of private consumption compared with a particularly high level in the early months of this year. The outlook for 1977 appears to show some slackening of growth mainly due to weaker home demand. At the same time, between now and the end of 1977 unemployment should continue to decline gradually and price and cost increases should slow down. On the other hand the current account deficit will probably greatly exceed that for 1975 both in 1976 and 1977, and will remain at a worrying level, although it should decline from the second half of 1976 onwards.

From now until the end of 1977 economic policy should have the objectives of improving the current balance of payments and the employment situation and assisting the slowing down in the rate of price increases. To achieve these aims action should be taken to restrain income growth and to cast budgetary policy in as strict a mould as economic circumstances permit. This means that rather than seeking a significant increase in the total tax burden, the policy should be strictly to limit the growth of expenditure. In such circumstances the net borrowing requirements of central government which will increase slightly in 1976/77 and reach almost 5 % of the gross domestic product could be stabilized in 1977/78 at the same absolute level and show a relative improvement. A further objective in the two fiscal years should be to increase the non-monetary means of financing the deficit as far as possible.

Germany

2.3. The recovery has continued to gather momentum over the past few months, and although some degree of slowing down is expected during 1976 as the direct impact of the recovery programmes begins to wear off, economic activity should still expand strongly. Growth should continue in 1977 with a progressive reduction throughout the year of the number of unemployed.

In order to achieve the desired growth and to reduce unemployment the main aims of economic policy should be to limit the rate of growth of prices and costs even further and to obtain a sufficient level of investment. This implies, besides a reasonable pricing policy on the part of firms and an appropriate growth in incomes, a monetary policy which sets limits to nominal increases. This also implies a public finance policy which endeavours to achieve a gradual reduction in the net borrowing requirement by restricting the growth of expenditure. Indeed, the second half of 1976 should see the introduction of a more restrictive line in expenditure policy by the Federal, Land and local authorities, particularly at Federal level where the budget was still providing stimulus to the economy at the beginning of the year. Despite a more substantial increase in tax revenue, however, there should be hardly any reduction, in comparison with the previous year, in the deficit of the Federal, Land and local authorities in 1976. The central government deficit should be a little under the DM 55 000 million recorded in 1975, that is about 4·5 % of the gross domestic product. Maintaining the restrictive line planned with regard to expenditure should make it possible, in 1977, to reduce this figure as a result of increased revenue due mainly to growth and without taking account of the proposed increases in value added tax. With regard to social security, on the other hand, the deficit is, if anything, likely to increase, so that efforts to economize in this sector should be pursued.

France

2.4. During the second half of 1976 and in 1977, economic activity will continue to receive considerable stimulus both from domestic demand (particularly private consumer demand) and from exports. The tendency for prices to rise is likely to remain strong *(risque d'être encore forte)*, while the balance of payments on current accounts is improving.

Following the massive recovery programme carried out in 1975, budgetary policy in 1976 reverted to the strict management principles previously applied. Although the central government budget was balanced when it was tabled and passed, the out-turn will probably show a still sizeable deficit of about FF 15 000 million, as a result of the carry-over into 1976 of a number of measures introduced in September 1975 to support the economy, particularly the tax assistance on investment and the special capital expenditure undertaken in 1975.

For 1977, the main aim of economic policy should be to reduce significantly the rise in costs and prices, using both direct action on incomes and applying a monetary policy and a strict budgetary policy. In this latter area, the growth of central government expenditure should be reduced to a level close to the growth rate of the gross domestic product, so as to avoid providing too strong a stimulus to domestic demand, which is already sufficiently dynamic. In view of the underlying trend of revenue, this is the only possible means of achieving a return to government finance equilibrium without recourse to major tax increases in 1977, which could well lead to increased pressure on costs and prices. Under these conditions the budgetary out-turn could be close to one of balance. The financial position of social security could worsen and call for action to keep it in balance.

Ireland

2.5. The upturn in economic activity in the second half of 1976 should grow progressively stronger in 1977 whereas the rise in prices will not slow down until the second half of the year. Unemployment will remain at a high level. For 1977 as a whole, despite an increase in exports, the current balance of payments will probably only show a slight improvement over 1976.

The 1976 budget out-turn of central government should show a net borrowing requirement a little less than the figure of £ 679 million originally forecast, this slight improvement being due to an increase in revenue exceeding the expected additional expenditure.

In 1977 budgetary policy should aim at a further reduction in the central government net borrowing requirement as a proportion of the gross national product, in conformity with Council Decision 76/323/EEC of 15 March 1976 fixing the economic policy conditions to be observed by Ireland [1]. This can be achieved, in conjunction with an appropriate incomes and prices policy, by a strict limitation on salaries and social transfer payments, and by a rigid scrutiny of other items of current expenditure, together with, possibly, a modest increase in the tax burden. Furthermore, the proportion of monetary financing of the borrowing requirement should be reduced.

[1] OJ No L 77, 24. 3. 1976, p. 15.

Italy

2.6. The weakening of economic activity which seems probable in the second half of 1976 should be followed in 1977 by a new upswing, whereas the increase in prices and the evolution of the balance of payments will continue to give cause for concern.

In view of the developments on the balance of payments account, budgetary policy for 1976 has again taken on a more vigorous tone. Due to an especially strong growth in revenue the net budget deficit should reach only Lit 9 600 000 million and the adjusted Treasury borrowing requirement only Lit 13 800 000 million, i.e. 10 % of the gross domestic product as against 12 % in 1975, in conformity with Council Decision 76/324/EEC of 15 March 1976 fixing the economic policy conditions to be observed by Italy [1]. These steps towards a more balanced management of public finance are, however, dependent not only on maintenance of the rate of public expenditure within the limits forecast, but also on an absence of delay in the receipt of expected tax revenue. They will not be possible unless the government uses all means necessary to achieve these two objectives. Particular care must be taken to see that the treasury borrowing ceiling is not exceeded since there is a risk that this could only be covered by simply increasing the money base.

Determined action appears vital in 1977 to reduce the rate of cost and price increases and to avoid a new deterioration in the balance of payments. These objectives will not be achieved unless incomes rise much less rapidly than can as yet be forecast, and unless budgetary policy seeks to moderate home demand so as to reduce further the treasury net financing requirements as a proportion of the gross domestic product. This means that the slow down foreseen in the growth of tax revenue must be offset as far as possible by the institution of effective measures to reduce tax evasion. In addition public expenditure must grow at a rate substantially less than the gross domestic product in value terms, which can be achieved by reconsidering certain expenditure items. Parallel with these measures there must be an attempt to reduce further that part of the treasury net financing requirement which is met by increasing the money base.

Netherlands

2.7. As a result in particular of the rapid upswing in external demand, production should increase during the second half of 1976 and in 1977 at a rate approaching the underlying growth of the trends in productive capacity, without however bringing about any appreciable fall in unemployment. There should be a substantial increase in the current balance of payments surplus. The rise in prices could well remain high and the propensity to invest inadequate unless there is a marked slowing down in the rise of costs.

Central government budgetary policy for 1976 has been marked by the deferred effect of many important measures to support the economy and combat structural unemployment introduced earlier and by the growth of large-scale current transfer expenditure. Since the growth of revenue, both fiscal and non-fiscal, has proved lower than forecast, the net borrowing requirement will be in the region of Fl 15 000 million, that is nearly 6·5 % of the gross domestic product, as compared with 3·8 % in 1975. This figure presupposes that the excess expenditure already carried out can, as forecast, be entirely offset by similar reductions. Strict management at central government level is all the more necessary as the deterioration of local authority and social security finances is tending to increase and as the financing of the public deficit as a whole will necessitate considerable recourse to monetary means.

[1] OJ No L 77, 24. 3. 1976, p. 16.

For 1977, it is necessary to reduce the central government net borrowing requirement so as to move towards the medium-term objective envisaged. This policy implies effective implementation of the provisions planned by the government and presented to Parliament in June 1976 to modify the medium-term trend of expenditure. This is all the more true because the measures to stimulate investment, proposed at the same time, have a significant budgetary cost. In view of the deficit of the other government sub-sectors, whose underlying deterioration can be slowed down only by reviewing a number of priorities, the public deficit as a whole will still require monetary financing, whose scale should be limited as far as is possible.

Belgium

2.8. In the second half of 1976, the strengthening of domestic and external demand should ensure the rapid expansion of production which should continue at a slightly slower rate in 1977. Unemployment should fall only slowly. The slowing down in cost and price increases could be jeopardized in 1977 if the measures of restraint at present in force are not renewed. The balance of payments surplus on current account could, nonetheless, remain in surplus.

In view of the slowdown in revenue growth resulting from the measures to accelerate tax collection carried out in 1975, budgetary policy in 1976 has endeavoured to bring about an appreciable reduction in the growth of expenditure, despite a further increase in unemployment expenditure and the carry-over into 1976 of investment expenditure decided on previously. Provided expenditure under the supplementary budget is contained within very strict limits, the central government net borrowing requirement could be kept down to Bfrs 140 000 million, higher in absolute terms than the 1975 figure, but the same proportion of the gross domestic product. A further deterioration in the finances of the social security and local authority sectors, and in some public undertakings, seems inevitable, so that the financing of the public deficit taken as a whole could well give rise to an increase in the monetary base.

For 1977, it is essential that determined action be continued to reduce the rate of cost and price increases. Furthermore, in the budgetary field, so as to offset as far as possible the probable worsening of the deficits of social security, local authorities and some public undertakings and to avoid excessive tensions on the financial markets, efforts should be made to achieve a relative reduction in the central government net borrowing requirement by limiting strictly the real growth of current expenditure and transfer payments. Similarly, energetic action should be undertaken to control the trend of social security benefits and the freedom of action of the local authorities so as to avoid any lasting damage to the financial structures of these sub-sectors and to the medium-term objectives sought for general government as a whole.

Luxembourg

2.9. The recovery in external demand should continue to support economic activity throughout the present year, though a temporary slowdown seems probable in the second half of the year and during part of 1977. The rise in prices should continue to moderate slowly.

Despite the appreciable deceleration in the growth of expenditure, the budget out-turn in 1976 will probably show a deficit of the order of 0·6 % of the gross domestic product. As economic activity gradually returns to normal, revenue will for the most part not revert to such a high growth rate as in the past and the yield from corporation tax will reflect the losses suffered by the iron and steel industry in 1975. Provided there is prudent management of operating expenditure and transfers of income, the budget out-turn in 1977 should come close to achieving equilibrium, in accordance with the

desirable medium-term trend. A slight deficit could however persist as a result of the carry-over of losses which will continue to affect the yield of corporation tax. As in 1976, the long-term financing of this deficit seems assured by institutional investors.

United Kingdom

2.10. During the second half of 1976 the chief source of growth will continue to be exports while, apart from stocks, domestic demand will remain relatively weak. In addition the recent decline of the exchange rate will not only have an unfavourable effect on prices, which can no longer be expected to decelerate substantially, but also on the deficit on the current balance of payments which might well increase in the short term. In 1977 appreciable progress should, on the contrary, be made in these fields provided that the exchange rate is stabilized, that incomes restraint is continued, and that the money supply is suitably controlled. The rapid growth of exports combined with a modest increase in internal demand is likely to ensure a steady rate of growth.

Budgetary policy for 1976/77 has been fashioned in such a way as to exercise moderation on internal demand and on the increase in costs. Provided that the ceilings imposed on a large part of expenditure during 1976/77 are respected, the borrowing requirement of the central government and the public sector may be below the initial forecast (£ 10 400 million and £ 12 000 million respectively).

The elasticity of personal income tax should remain high and corporation tax should reverse its recent decline. Even if the public deficit does turn out to be smaller, its financing will require careful handling, given the need for a strict monetary policy.

The budgetary policy for 1977/78 should aim at a substantial reduction in the public deficit and a continuing moderation of income growth. The maintenance of strict ceilings on expenditure will be all the more necessary as the contribution to receipts of personal income tax will be less buoyant and the yield of corporation tax is subject to considerable uncertainty. The reduction in the public deficit will diminish the risk of excess liquidity joepardizing the return to stability and external equilibrium.