

## II

*(Acts whose publication is not obligatory)*

## COUNCIL

### COUNCIL DECISION

of 25 April 1977

**concerning the adjustment of the economic policy guidelines for 1977**

(77/340/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 1977 on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community<sup>(1)</sup>, 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 4 March 1977, concerning the adjustment of the economic policy guidelines for 1977,

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, 25 April 1977.

*For the Council*

*The President*

J. SILKIN

<sup>(1)</sup> OJ No L 63, 5. 3. 1974, p. 16.

## ANNEX

## ECONOMIC POLICY GUIDELINES FOR 1977

## 1. General guidelines

1.1. The objectives adopted for 1977 in the last Annual Report on the economic situation in the Community<sup>(1)</sup> were, for the first time, in keeping with a jointly-agreed medium-term strategy, as established at the second Tripartite Conference<sup>(2)</sup> and given in the fourth medium-term economic policy programme<sup>(3)</sup>. 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.

1.2. 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 can be attained only with difficulty. The Community must consequently make a further effort. It will have to bring about 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 time lost in reaching the medium-term goals.

1.3. Taking into account the insufficient progress made in reducing disequilibria — both internal and external — and the present 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 hitherto 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 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.

1.4. The Community's development and cohesion are endangered by the persistence of inflationary strains created by an excessive and disordered surge of internal costs; this danger still points 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 price trends, 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.

1.5. Unemployment cannot be reduced more rapidly nor structural disparities within the Community reduced unless an active investment and employment policy is implemented on a coordinated basis. Such coordination at Community level would help to avoid inconsistencies in national policies for sectoral adjustments which would reduce their effectiveness. But it would also lead to a more rational use of Community instruments for structural change (the Social Fund, the Regional Fund, ECSC and European Investment Bank loans) in the interests of the Community as such.

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 investments. The scale of investments in 1977 will, however, remain subject to constraints which vary from one country to another and are determined by the persistence of unemployment and substantial budget defi-

<sup>(1)</sup> OJ No L 358, 29. 12. 1976, p. 2.

<sup>(2)</sup> OJ No C 173, 28. 7. 1976, p. 1.

<sup>(3)</sup> OJ No L 101, 25. 4. 1977, p. 1.

cits, 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 is essential if the structural deficit *vis-à-vis* the OPEC countries is to be reduced in the years to come. The issue of increasing the opportunities for financial assistance by the Community by raising loans on international capital markets to finance the necessary investment programmes should be discussed again and resolved in terms of a medium-term Community structural programme.

In the employment field, obstacles of every kind (administrative, fiscal and with regard to social security) 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 alive firms that cannot pay their way 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 training posts.

1.6. 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 public spending 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.

1.7. 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<sup>(1)</sup>. 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.

At the same time control of the expansion of liquidity provides 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.

1.8. In the medium term, the Community has to bring about a better distribution of balance of payment surpluses and deficits and progressively reduce the overall deficit with respect to the oil exporting countries. A future effort to expand exports depends as much on commercial policy *vis-à-vis* industrialized third countries (particularly Japan and the United States) as on the development of new markets in the developing countries which produce raw materials. The Community must continue to oppose energetically protectionist tendencies both at the international level and within the Member States.

1.9. The urgent problems regarding employment policy, professional training and investment, structural change as regards regions and industrial sectors, stronger measures to economize on energy and develop new sources and export promotion in the deficit countries must all be tackled within the framework of the Community's Fourth Medium-Term Programme. However, in most countries, the diffi-

<sup>(1)</sup> See the general considerations on this subject outlined in the Annual Report on the economic situation in the Community and the economic policy guidelines for 1977, point 4.6 (OJ No L 358, 29. 12. 1976, p. 10).

culties on both the conjunctural and structural side require immediate decisions. If these are delayed, the problems of restoring the conjunctural situation and of structural change will become even more difficult.

## 2. Guidelines for the individual countries

2.1. In *Denmark*, the more restrictive slant which has been given to economic policy since the summer of 1976 has been reflected, as was foreseen, in a slowing down 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 (\$ 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.

2.2. 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, to the extent that further progress towards an improvement in the balance of payments is possible at the same time.

2.3. 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 European Parliament in August 1976 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.

2.4. As for monetary policy, this should remain in conformity with the guidelines fixed in the last

Annual Report and should be aimed at containing internal monetary creation within those limits compatible with the necessity of financing the deficit on the current balance of payments. Interest rate policy should be directed towards the same objective.

2.5. 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 output; exports and investment in capital equipment being the main beneficiaries.

2.6. 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.

2.7. 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. The tendency for prices to rise should therefore continue to weaken and it is foreseeable that the tendency towards a reduction in the current balance of payments surplus will continue in 1977. Moreover, achievement of this goal is necessary, both to support the recovery in the rest of the Community and to cut down unemployment. Nonetheless, even if this result were achieved, the number of unemployed would still be 850 000 to 900 000, or 3.3 % to 3.5 % of the working population.

2.8. 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. The prime objective of current economic policy should be to improve the basic conditions for the achievement of vigorous medium-term growth, accompanied by further progress towards stabilization. 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 part 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.

2.9. 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.

2.10. 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.

2.11. 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 rise in prices. 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.

2.12. Action undertaken to improve the general conditions of economic growth and of employment should be supplemented by selective 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.

2.13. 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, salary 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 more stable conditions on the international scene).

2.14. 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.

2.15. The principle of gradual return to budgetary equilibrium must continue to govern the actions of the public authorities. 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.

2.16. 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.

2.17. 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.

2.18. In *Ireland*, the outlook for 1977 appears more favourable than that foreseen in the latest Annual Report on the economic situation in the Community. Despite a downward revision in forecasts 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 very likely be more buoyant than expected. While there will be an improvement in the employment situation, the unemployment rate will, nonetheless remain high. On the other hand, the inflation rate could slow down in the second half of the year.

2.19. 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 slowing down 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 proportion of local authority rates. In view of the fact that the borrowing requirement, despite the sharp fall recorded in 1976, still represents a substantial proportion of gross domestic product, it will be necessary to ensure that the level of receipts expected is actually attained.

2.20. On the incomes front, the recently concluded national pay agreement 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 linked to overall economic strategy, as has been the case until now. It will be appropriate also to limit as far as 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.

2.21. As far as monetary policy is concerned, the limit adopted in the annual report for the growth rate of the money supply remains valid.

2.22. 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 2 500 000 million (almost 2 % of GDP in value).

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

- to hold down households' 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.

2.24. The surprisingly vigorous expansion in production at the end of the year points to a positive, though smaller, GDP growth rate for 1977 (around 2 %). This also means, however, that the objectives set with regard to balance of payments and prices policy 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.

2.25. 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.

2.26. Even if, as was the case until the end of March 1977, bank lending remains largely subject to ceilings, careful attention will have to be paid to the level of liquidity of the banking sector and the extraordinary high level of the banks' short-term external indebtedness. The increase in total lending, as defined by Article 6 (1) of Council Directive 74/637/EEC of 17 December 1974 granting medium-term financial assistance to the Italian Republic<sup>(1)</sup>, should be 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 commit-

<sup>(1)</sup> OJ No L 341, 20. 12. 1974, p. 51.

ments 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 having been used far too much in 1976. Real interest rates should be maintained at a higher level than corresponding levels in other countries.

2.27. 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 in particular to the combined efforts of unions and employers, the inflation rate at the end of 1977 is lower than that for the preceding year.

2.28. 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.

2.29. In the *Netherlands*, efforts to slow down the upward price movement seem 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 slowing down 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 should be about 4 %. In 1977, unemployment on average could decline somewhat 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. The external surplus on current account will diminish slightly.

2.30. 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 context of the central-government budget for 1977 to slow down the increase in costs (including 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, to limit the net borrowing requirement to not more than Fl 12 000 million. Such a policy would be compatible with a relative contraction, in the medium term, of general government financing requirements.

2.31. 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.

2.32. In *Belgium*, where economic trends are still hesitant, the gross domestic product is expected to grow by between 3 to 3.5 % 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. 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.

2.33. 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 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 slowing down in economic growth. On the other hand, failing a change in present arrangements for indexing incomes, the increase in indirect taxation threatens to aggravate the danger of cumulative price and wage increases. To remedy this situation, the Government has made a careful choice of the products and services for which the rates of VAT will be increased. Notwithstanding this, it is desirable 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.

2.34. In present economic conditions, and in view of the persistent weakness of industrial investment, general government borrowing should hardly exceed financing possibilities. Nonetheless, 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.

2.35. 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 likely to exceed 3 %.

2.36. 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.

2.37. 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 voluntary incomes policy, the rate of inflation has hardly declined, the depreciation of the pound sterling adding substantially to rising import prices. Public expenditure came under firm control, in terms of both cash and volume, during 1976.

2.38. 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.

2.39. This policy was strengthened when the Government announced :

- on 15 December 1976, 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 £ 3.9 billion ;
- an arrangement with certain central banks and the Bank of International Settlements for a \$ 3 billion credit facility designed to protect the United Kingdom's official reserves.

2.40. 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.

2.41. 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 slowing down should occur, resulting from the combined effect of the present voluntary incomes policy and tight Government 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 occurred 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.

2.42. 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 GDP). However, given the low labour content of North Sea oil production, the growth of gross domestic product 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.

### 3. Conclusions

3.1. 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.

3.2. 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.

3.3. 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.

3.4. 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.

3.5. 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.

3.6. 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 %).

3.7. 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 underdeveloped 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.

3.8. 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.

3.9. 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 instruments (assistance to increase mobility, training and professional readjustment) 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.