COMMISSION OF THE EUROPEAN COMMUNITIES

COM(76) 81 final.

Brussels, 3 March 1976.

SUMMARY ACCOUNT AND DEGREE OF CONVERGENCE OF THE ECONOMIC POLICIES PURSUED IN THE MEMBER COUNTRIES IN 1975

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

CONTENTS

FOREWORD

Together with its Communication on the adjustment of the economic policy guidelines for 1976, the Commission herewith submits to the Council a report on the economic policies pursued in the Member States last year. In so doing, the Commission is acting in accordance with Article 2 of the Council Decision of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community.

At the same time the report describes, in accordance with Article 12 of the above mentioned Decision, the application of this Decision during 1975 and assesses the conformity of the policies pursued with the objectives set.

The report will also be transmitted to the European Parliament.

A. THE ECONOMIC POLICIES OF THE MEMBER STATES IN 1975

I. The economic context

1.1. The Member States were confronted by an unusually serious challenge at the beginning of 1975; they had at the same time to combat both unemployment and inflation and also, in certain cases, to reduce large-scale balance of payments deficits. The effects of stagflation had reached proportions which were without precedent in the post-war years. Divergences in economic development in the member countries had never been greater since the establishment of the European Community and even threatened its cohesion.

1.2. By the end of 1974, the rise in consumer prices for the Community as a whole had accelerated to reach an annual rate of 14 %. The spread in the annual growth rates between the member countries was from 6 to 26 %. The balance of payments disequilibria of the Member States had also reached unusual proportions. The current account surplus of the surplus countries in the Community (Federal Republic of Germany, the Netherlands, Belgium and Luxembourg) amounted to $ 12 000 million in 1974, while the current account deficit of the deficit countries totalled $ 25 000 million.

1.3. Domestic and foreign demand had declined more and more sharply during 1974 and in the second half of the year had resulted in a worldwide recession which affected all the Community countries, although to varying degrees. The slump in industrial output very quickly led to a deterioration in the labour market situation. At the beginning of 1975, the seasonally adjusted number of unemployed in the Community totalled approximately 3.7 million, or some 3 % of the working population. In most of the member countries, the unemployment rate was close to this average figure, the only significant exceptions being Ireland (9%) and Luxembourg (0.1%).

1.4. The problems and difficulties involved in combatting unemployment and inflation were common to all the member countries, but there were extremely wide differences in the initial situation between the member countries. The reasons for this include: differences in the timing and intensity of the counter-inflation and restrictive policies introduced in previous years, differences in the extent of the conflict between the two sides of industry on the distribution of income, differences in the degree of dependence on energy and raw material imports and in the trend of exchange rates, and differences in the financial positions of firms and the public sector. The considerable divergences which became apparent between the Member States at the beginning of 1975, particularly the rate of inflation and the balance of payments situation, limited in varying degrees the scope for manoeuvre in economic policy in the different Member States.

1.5. The economic policy guidelines for 1975 were based on the principle **that the short-term economic policy of the deficit and surplus countries of the Community should complement one another, so as to be able to meet the challenges on a basis of joint solidarity (1). The surplus countries were to intensify as far** as possible their reflationary measures, so as to stimulate, through increased imports, economic activity in the other member countries. The deficit countries, on the other hand, were to maintain their restrictive policies, **to increase their efforts to contain cost and price inflation, and as for maintaining economic activity to restrict themselves to specific measures.**

1.6. Contrary to expectations, the economic downswing did not gradually bottom out at the beginning of 1975, but worsened even further in the first half of the year. There were several factors behind this: the rapid slump in world trade, intensive stock reduction, restraint on the part of consumers and the over-cautious expansionary policy of the surplus countries. Under

(1) See Annual Report on the Economic Situation in the Community for 1975, OJ C 149 of 28 November 1974, and Communication on the adjustment of economic policy guidelines for 1975, OJ L 162/13 of 25 June 1975.

the pressure of the ever deteriorating economic and employment situation and on the recommendation of the Commission, most of the member countries later introduced further reflationary measures. Only in the autumn of 1975 did economic recovery in the Community begin to make itself felt.

It is against the background of these economic developments that the economic policy measures which have been taken in the various member countries must be assessed.

II. Budgetary Policy

2.1. In all the Member States, public budgets exerted a powerful counter-cyclical influence in 1975. This resulted in part from the operation **of the** built-in regulators : short falls in tax revenue and social security contributions, on the one hand, and increased transfer expenditure on unemployment benefits or on **subsidies in the public** sector, on the other. In addition, there was the effect of discretionary measures taken in most of the countries to sustain or revive the economy, with the timing chosen, in accordance with the guidelines laid down at Community level, to take account of the special features of the cycle in each of the Member States. Thus, the budgetary policy pursued in 1975 was, in most of the Member States, quite different in character from that pursued in 1974, when the line was predominantly cautious, if not restrictive. The only exceptions were Ireland and the United Kingdom, where the previous, expansionary, stance became still more expansionary. All in all, public budgets in 1975 will, therefore, have made a major contribution to limiting the extent of the economic downturn in the Community and to speeding up its reversal.

2.2. The changeover to a stimulatory budgetary policy began first in Germany and the Netherlands. In Germany, this was mainly reflected in the entry into force, on 1 January 1975, of a tax reform easing considerably the burden of personal income tax, and in a series of short-term economic policy programmes launched between September 1974 and August 1975 and mainly designed to raise the level of investment. In the Netherlands too, as from autumn 1974, the authorities adopted a series of budgetary measures aimed at reviving economic activity, combining tax reliefs and supplementary expenditure intended to generate or encourage an upturn in investment and employment. In Belgium, a budgetary stimulus was provided at an early stage too, but it was more limited in its objectives since it only involved an appreciable increase in the public investment programmes provided for in the 1975 budget. In Luxembourg, a programme of special works in the public interest was adopted in July 1975.

In Denmark, budgetary policy began to switch to a reflationary line in spring 1975, in the initial budget for 1975/76, and the new stance was strengthened by additional provisions adopted in June and particularly in September 1975. In France, initial budgetary measures to support economic activity, involving in particular tax aids to productive investment, were passed in April 1975, but the main part of the reflationary plan was **introduced in** September; this took the form of an amending budget involving supplementary aids to families and the aged, the extension of tax payment dates and a special programme for public and industrial investment.

2.3. In Italy, an initial programme of supplementary expenditure was adopted in May **1975. Then in August a major package to** support the economy was brought in, aiming in particular, by means of budgetary transfers, at promoting exports, boosting activity in the building and construction industry and the public works sector, and stimulating investment in a number of other sectors. In Ireland, budgetary policy for 1975 was initially aimed at supporting the economy, principally by means of **a sharp increase in current Government expenditure.This policy was strengthened in** June 1975, with the introduction, under supplementary budget, of consumer subsidies and additional capital expenditure. In the United Kingdom the 1975/76 budget also provided for a marked increase in expenditure, particularly current expenditure, producing an expansionary effect which was only slightly reduced by increases in indirect taxation.

2.4. Although the reflationary budgetary measures introduced in 1975 had only a partial effect on budget management during the year itself, particularly as regards expenditure, they nevertheless contributed appreciably to the tendency towards deficits in public finnace management, a tendency which was very strong in all the Member States. The figures given in the **table 1** illustrate this phenomenon, although they do not reflect it fully, since they relate only to central governments and since, at least, **as far as the six Member States of the original Community are concerned, the consolidation of their accounts with those of the regional and local authorities and social security funds would show an even sharper deterioration.**

2.5 **In all the Member States, expenditure rose at an extremely rapid** pace, not only because of the additional burdens connected with the recession and the measures taken to combat it, but also as a result of the still considerable increase, in terms of annual expenditure, in the cost of public services. In all the countries, with the exception of Denmark, the rates of growth of expenditure thus exceeded, in some of them to a considerable extent, the already very high rates of growth in 1974. Revenue, by contrast, often rose more slowly than in 1974, and in a number of Member States there was actually no increase at central government level. Consequently, very considerable net borrowing requirements developed in countries such as Denmark, Germany and the Netherlands, where budget management in 1974 had produced only small deficits, or again in France, where there had been a surplus. In Ireland and the United Kingdom, where the initial situation was already one of marked disequilibrium, budget management in 1975 only strengthened the previous tendency towards a growing deficit. In Italy, the worsening of the deficit in budget management proper compared with the already very high level of previous years was relatively limited, but there was a much more serious deterioration at the more significant level of the Treasury borrowing requirement. In Belgium, where the deficit is traditionally fairly high, the deterioration of the situation as compared with the previous year was less than in the other member countries.

TABLE 1

DEVELOPMENT OF CENTRAL GOVERNMENT BUDGETS (1973-1975) (1)

	Receipts					Expenditure					Net balance		
	1973	1974	1975	Rate of change 1974/1973	Rate of change 1975/1974	1973	1974	1975	Rate of change 1974/1973	Rate of change 1975/1974	1973	1974	1975
DENMARK (Mrd Dkr)	54,6	60,0	59,7	+10,0	- 0,5	49,1	60,4	72,5	+ 23	+ 20	+ 5,5	- 0,4	-12,8
GERMANY (Mrd DM)	219,8	234,7	236,0	+ 6,8	+ 0,5	222,0	251,5	291,5	+13,3	+ 16	- 2,2	-16,8	-55,5
FRANCE (Mrd Ffr)	220,5	264,8	261,0	+20,0	- 1,4	214,5 (2)	246,4 (2)	301,0 (2)	+14,9	+ 22,2	+ 4,8	+ 5,7	-38,0
IRELAND (Mio Ł)	759,0	899,0	1098,0	+18,5	+22,1	968,0	1234,7	1679,0	+27,6	+ 36,0	-209,0	-335,7	-581,0
ITALY (Mrd Lit	14.858	18.934	23.790	+27,5	+25,6	22.589	25.846	32.422	+ 17,4	+25,4	-7.731	-6.912	-8.632
NETHERLANDS (Mrd Fl)	43,7	49,3	56,2	+12,8	+14,0	44,8	52,0	64,9	+ 16,1	+24,8	- 1,1	- 2,7	- 8,7
BELGIUM (Mrd Fb)	441,2	531,2	635,0	+20,4	+19,5	523,0	604,2	744,0	+ 15,5	+23,1	-81,8	-73,0	-109,0
LUXEMBOURG (Mrd Flx)	19,5	24,1	27,0	+23,6	+12,0	17,1	21,1	27,0	+ 23,4	+28,0	+ 2,4	+ 3,0	0
UNITED KINGDOM (Mio Ł)	24.298	30.140	38.165	+24,0	+26,7	26.520	35.264	46.736	+33,0	+32,5	-2222	-5124	-8571

(1) Denmark and United Kingdom: Fiscal years1973/74, 1974/75, 1975/76.
(2) Excluding the balance of "Special Accounts" with the exception of Advances.
Source: Commission.

III. Monetary Policy

3.1. At the end of 1974 monetary policy had begun to be relaxed in some Member States and throughout 1975 this tendency became more general and gradually more marked. However, the degree of the relaxation and its pattern during the year varied between countries. The Member States which, because of their balance of payments situation and inflation rates, had most scope for manoeuvre were the first to determine on measures of this kind. This is especially the case for the Federal Republic of Germany and the Netherlands.

3.2. The tighter monetary policy pursued in the Member States in the period 1973/74 began to bite only after more or less long time lags; similarly, the increasingly marked relaxation of monetary policy was unable to prevent the gradual worsening of the economic situation in 1975. It would appear, therefore, that the time it takes for the economy to respond to changes in the direction of monetary policy is now longer than in the past. This makes the readjustment process more difficult and monetary control less precise.

3.3. However, the easing of monetary policy improved the conditions for economic recovery. The central banks in the Community increased the monetary base, sporadically to begin with in the autumn of 1974, and then on a larger scale during 1975. This was associated with a big rise in bank liquidity and a fall in interest rates. Later in the year, conditions for a recovery in private investment improved.

3.4. The Bundesbank announced in advance the growth rate in the monetary base aimed at for 1975, while in Italy the growth of bank lending has been subject to defined limits for the same year. In other Member States the central banks have fixed similar targets for monetary growth, but rather less precisely defined.

3.5. **The discount rate was the policy instrument used most frequently for expansion. In most Member States the rate was subjected to sucessive but minor reductions.** In the United Kingdom, however, the Bank of England's minimum lending rate was raised several times between May and October. In France, the Federal Republic of Germany and Belgium considerable amounts of bank liquidity were released by cuts in the compulsory reserve ratios. The requirement that banks should hold a proportion of their deposits in bonds was dropped in Belgium, and eased in Italy. The quantitative limits on the growth of bank lending were also lifted in these two countries. In the United Kingdom the requirement placed on banks in December 1973 to make supplementary deposits with the Bank of England, when the increase in their interest-bearing deposits exceeded a certain rate, was discontinued in March 1975. On the other hand, the Danish National Bank in the final months of 1975 absorbed some of the liquidity resulting from the large deficit of the public authorities.

3.6. The tendency for liquidity to grow more rapidly which was apparent in some Member States from the beginning of 1975 spread from the summer onwards to the whole Community and has in general continued since then. In the Federal Republic of Germany, the Netherlands and the United Kingdom it is only imperfectly seen in the growth of money and near-money (M2 or M3) since in these countries there were major changes in the relative importance of near-money and other financial assets. In certain countries the money supply in the broad sense (M2 or M3) grew noticeably more slowly than the money supply in the narrow sense (M1). On average in the Community the annual growth rate of the latter was of the order of 10% during the first half-year, rising to about 17% in the autumn. In most Member States money creation in 1975 was largely determined by the demand for credit of the public authorities. The degree of liquidity in the Member States at the end of 1975 may be regarded as relatively high.

3.7. The expansionary monetary policy was mainly reflected in a sharp fall in short-term interest rates, which were a good deal lower at the end of 1975 than at the same time a year earlier. However, the Member States with balance of payments deficits moved towards this reduction much more cautiously than those not subject to serious external constraints. The falls in interest rates were concentrated in the first half of the year; subsequently rates became virtually steady.

3.8. Long-term interest rates fell much less than short-term rates, and there emerged a clear margin between them. This revived the capital markets which were swift to take up new share and bond issues.

TABLE 2

DEVELOPMENTS IN THE MONETARY SITUATION

(as at end of December, unless otherwise indicated)

	Money supply (1)						Short-term bank credit			Interest rates					
	Annual growth rates, %									Short-term (2)			Long-term		
	1973		1974		1975 (3)		1973	1974	1975 (4)	1973	1974	1975 (5)	1973	1974	1975 (6)
	M_1	M_2	M_1	M_2	M_1	M_2									
Denmark	10,0	12,7	5,9	8,9	26,1	25,1	15,4	7,1	- 2,4	-	12,7	4,5	12,2	15,2	13,2
F.R. Germany	1,8	13,8	10,9	5,2	13,5	-0,1	5,4	8,5	- 3,9	11,9	8,4	3,9	9,7	9,9	8,6
France	9,7	14,3	15,2	16,8	15,0	18,4	-0,8	18,3	11,4	11,2	11,9	6,5	9,8	10,9	9,9
Ireland	7,1	25,7	5,3	20,2	19,5	21,8	22,9	15,5	13,3	13,5	11,3	10,9	13,5	16,9	14,6
Italy	24,5	23,3	10,7	15,4	7,4	20,3	19,2	20,1	11,5	8,2	17,5	8,6	7,4	11,4	10,5
Netherlands	-0,2	22,0	12,2	20,0	21,9	6,4	34,5	25,4	7,3	8,8	7,0	4,4	7,9	7,6	7,7
Belgo-Luxembourg Economic Union	8,4	14,8	8,7	11,3	14,3	14,8	19,5	10,0	11,8	7,2	9,0	3,9	7,8	9,0	8,5
United Kingdom	4,5	28,5	8,3	11,9	20,1	8,0	53,6	27,1	17,9	12,8	11,3	10,2	12,5	17,2	14,8

(1) M_1: Notes and coin in circulation plus demand deposits. M_2: (M_3 for Ireland and the United Kingdom): M_1 plus near money.

(2) Interest rate on overnight loans; United Kingdom: Treasury Bills yield.
(3) Italy: September; France: October; Ireland and Netherlands: November.
(4) Denmark, Netherlands and F.R. Germany: November; France and Italy: October; Ireland and B.L.E.U.: September; United Kingdom: March.
(5) December except France and United Kingdom (November), Ireland and Italy (October).
(6) December except Italy (November).

Source: Services of the Commission.

IV. Exchange rate policy

4.1. Despite a striking improvement in the current account of the Community as a whole (from a deficit of $ 13 billion in 1974 to a position of approximate balance in 1975), and of most individual member countries too, the underlying tendency during the year was for Community currencies to weaken against the US dollar. This trend can be explained largely by the return on the dollar becoming relatively more favourable as the year progressed, since the monetary policy of the Member States was still aiming at a reduction in interest rates, while they began to rise in the United States. At the same time the turn-around in the US balance of payments has been equally if not even more spectacular than that of the Community.

The four currencies which participated in the Community exchange rate system throughout the year depreciated against the dollar by between 7 and 8½ per cent during 1975, but these figures do not reflect the very substantial fall in these currencies since the spring. After first rising against the dollar by about 4 - 6 per cent in January and February, the snake currencies then fell steeply by 12 - 14 per cent during the remaining ten months of the year. Between January and December 1975 sterling depreciated by about 14 per cent against the dollar, and the lira by about 5 per cent. Only the French franc just about maintained its value over the year as a whole (-1%).

4.2. Since early in the year Community central banks have been intervening more actively with a view to smoothing out day to day movements against the dollar. Subsequently, at their meeting on 17 December at Rambouillet, the heads of governments of France, the Federal Republic of Germany, Italy, the

United Kingdom, Japan and the United States agreed to move further in this direction and to instruct their central banks to intervene in the markets with a view to controlling erratic exchange rate movements over a somewhat longer time-span. A Community position on, in particular, the revision of the quotas of Member States in the International Monetary Fund and the problem of gold was reached for the meeting which the Interim Committee of the IMF was to hold in Jamaica at the beginning of 1976.

4.3. The changes in exchange rates of Community currencies on a trade-weighted basis were substantially smaller than the changes in nominal rates against the dollar, although for most countries they moved in the same direction as nominal rates (see graph). The two exceptions to this general rule were the French franc and the lira. The former registered an effective appreciation between the beginning and the end of the year of 3½ per cent. The latter showed virtually no change at all over the year, as a result of selective intervention by the Banca d'Italia.

4.4. The major feature of the trends in Community currencies was the rapid recovery of the French franc, which climbed back by about 7 % between January and June against the currencies in the Community exchange rate system which it rejoined on 10 July 1975 after an absence of about one and a half years. The position of the lira against the Community currencies scarcely changed in 1975, but, by contrast, sterling fell a further 8 % against the average of the other Community currencies.

4.5. The Community exchange rate system was not subject to pressure during 1975. Intervention in Community currencies to maintain them within the 2.25 per cent margin was much less extensive than in previous years, and indeed during the last five months of 1975 there was no intervention. The improved cohesion of the snake currencies came from a closer convergence of economic policies between the member countries together with a policy of more active intervention in dollars.

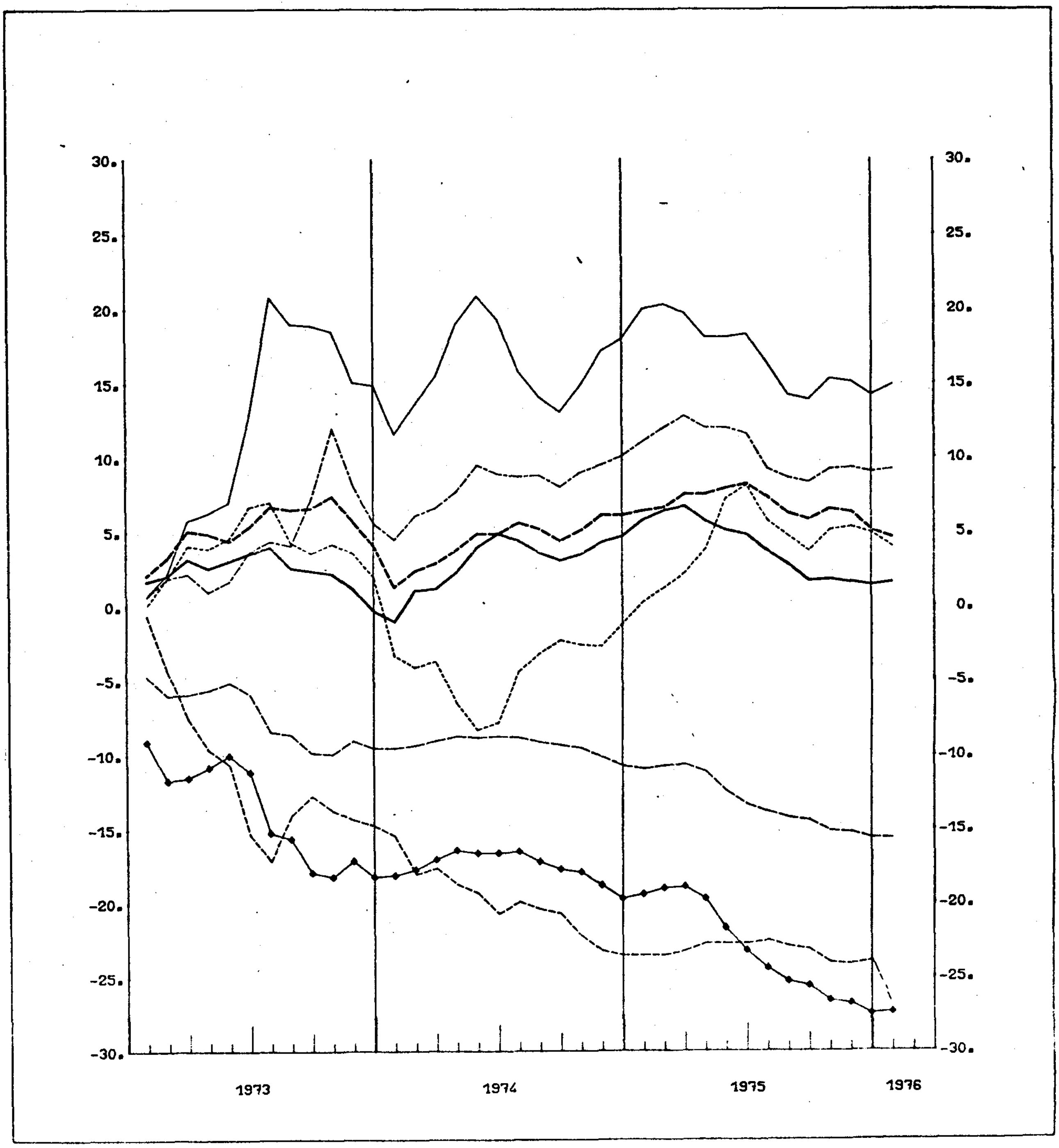
Besides the enlargement of the Community exchange rate system, changes were introduced relating in particular to the automatic renewal of debts and the methods of settlement. In addition, after the Council authorized the rules for the placing of Community loans to finance the balance of payments deficits of Member States, the Commission started negotiations for the issue of an initial loan.

4.6. There was very little change in the Community's total official foreign exchange reserves during the year although there were significant shifts in reserves between member countries. The United Kingdom, Italy and the Federal Republic of Germany were obliged to draw on their reserves to support their currencies, while the French authorities added substantially to their holdings of foreign currency by buying dollars in the foreign exchange market.

WEIGHTED APPRECIATION OR DEPRECIATION OF THE CURRENCIES OF MEMBER COUNTRIES IN %

(Reference period: "Smithsonian Agreement", December 1971; weighting according to the structure of foreign trade)

GERMANY (F.R.)
FRANCE
ITALY
NETHERLANDS
B.L.E.U.
UNITED KINGDOM
IRELAND
DENMARK



V. Prices and incomes policy

5.1. The generally expansionary guidelines for demand management policy have given a greater role in 1975 to incomes policy in the controlling of cost push inflation. As the close link between inflation and unemployment became more clearly recognised, interventions in the incomes policy area and cooperation between the two sides of industry improved.

5.2. The measures introduced to restrain the rise in personal incomes came up against many difficulties. The dividend controls imposed in the United Kingdom and the changes in direct taxation introduced in the Federal Republic of Germany, Denmark and Ireland did, however, create more favourable conditions for a slowing-down in wages. In general, it was evidently not possible, either in the private sector or the public sector, to achieve a sufficient slowing-down in the increase in nominal pay; in addition, in view of the fall in production, the pressure of wage costs was necessarily stronger in 1975 (see Tables 3 and 4). In the Federal Republic of Germany the consensus achieved between the social partners resulted in a more moderate development in salaries and prices without direct intervention by the authorities. In the other Member States, the results of the measures adopted in 1975 to limit the rise in salaries were not immediate or similar. In the United Kingdom as in Denmark where the indexation system was modified in a restrictive direction, the measures had a marked effect on inflation. In Italy and Luxembourg, on the other hand, the indexation system was widened in 1975.

5.3. Further measures were taken to assist the lowest paid. Social security benefits were increased in most of the countries; old age pensions, inter alia, were raised in the Netherlands, the Federal Republic of Germany and France, and were indexed in Italy. Similarly, minimum wages were increased and unemployment benefits readjusted, in particular by extending the range of those eligible, by lengthening the compensation periods and by raising the amounts paid. Lastly measures were taken to protect small savers by indexation, in particular in the United Kingdom and Ireland.

5.4. In addition to efforts carried out in the incomes policy field, the authorities were led to act directly on the level of prices in the majority of Member States. A range of measures was involved, from the control of prices of a limited number of goods and services (Italy and Luxembourg), to a general price freeze, such as was introduced in Belgium in May 1975 and gradually eased thereafter. A freeze on profit margins was introduced in France and Denmark, and in this latter country, and also in Ireland, the granting of subsidies and temporary reductions in value added tax were also used as part of prices policy. In the United Kingdom and the Netherlands, where the monitoring of prices had remained very strict, some relaxation of controls was introduced during the year, especially so as to safeguard private investment. A limited number of countries, and in particular the Federal Republic of Germany, refrained from all direct intervention in price formation.

Table 3

Some Indicators of the growth of incomes, prices and costs

(% increase from previous year)

	G.D.P. in value		Price of G.D.P.		Price of National Expenditure		Price of Private Consumption		Wage and Salary Bill		Wage and Salary Bill per head		Wage and Salary Bill as % of G.D.P.		Wage and Salary Bill per unit of output	
	1974	1975	1974	1975	1974	1975	1974	1975	1974	1975	1974	1975	1974	1975	1974	1975
Denmark	11,9	10,5	10,2	11,5	14,4	10,5	15,0	9,5	18,5	11,5	19,0	14,0	56,3	56,9	16,6	12,9
F.R. Germany	7,4	4,4	6,8	8,3	8,6	6,2	7,3	6,1	9,6	4,1	11,6	7,8	54,8	54,7	8,9	8,0
France	15,4	10,2	11,4	12,5	14,5	12,0	13,7	11,8	19,8	14,3	17,6	15,2	51,0	52,9	15,4	16,8
Ireland	8,5	20,8	8,1	25,3	19,2	24,3	17,3	20,9	17,2	22,0	15,3	24,6	54,2	54,8	16,7	26,6
Italy	20,6	16,0	15,6	19,9	21,6	18,1	19,6	17,0	24,1	20,5	20,6	19,0	54,9	57,0	20,0	24,6
Netherlands	12,5	9,4	9,4	11,3	11,8	11,4	10,0	10,8	15,0	12,5	15,5	13,5	60,0	61,7	12,8	14,4
Belgium	17,0	10,5	12,7	13,1	13,9	13,1	12,3	12,4	19,8	15,8	17,5	17,3	55,2	57,8	15,3	18,8
Luxembourg	16,5	- 4,8	12,5	3,1	11,7	12,0	9,5	10,5	24,8	13,4	20,6	15,1	56,3	67,0	20,6	22,9
United Kingdom	13,4	24,4	12,6	26,3	17,9	24,0	15,2	21,5	20,6	28,7	19,8	31,7	64,2	66,4	19,8	30,5
Community	12,7	11,3	10,5	14,3	12,8	13,0	12,6	12,5	16,9	14,4	16,3	16,4	56,0	57,5	14,6	17,5

Source: **Estimates** by services of the Commission

TABLE 4

WAGE COSTS IN INDUSTRY PER UNIT OF GROSS VALUE ADDED AT CONSTANT PRICES

(including construction)

	% increase on preceding year						1970-1975	1970-1975
	In national currency			In EUR (1)			% increases in national currency	% increases in EUR (1)
	1973	1974	1975	1973	1974	1975		
Denmark	12,2	18,9	19,0	12,1	18,9	19,0	+ 80	+ 78
F.R. Germany	7,3	9,0	6,5	12,9	12,6	6,5	+ 41	+ 60½
France	9,5	16,1	21,5	9,5	7,3	28,7	+ 74	+ 70
Ireland	6,1	14,0	29,0	- 9,3	9,2	15,7	+ 87	+ 30½
Italy	12,8	21,0	34,0	- 2,3	8,5	26,2	+115½	+ 56
Netherlands	9,0	12,3	15,0	10,6	16,3	15,0	+ 56	+ 68½
Belgium	6,5	14,9	21,5	6,5	14,9	21,5	+ 61	+ 65½
United Kingdom	8,5	20,9	33,0	- 7,2	15,6	19,1	+102	+ 41
United States	3,1	7,9	8,8	-10,4	7,9	3,0	+ 24	- 6

(1) Calculated on the basis of figures in national currencies, adjusted for exchange rate variations in relation to the EUR.

Source: Estimates by Commission's departments.

B. CONVERGENCE OF ECONOMIC POLICIES IN THE COMMUNITY

VI. Application of the Council Decision of 18 February 1974

6.1. The Council Decision of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the Community provides for a number of fixed periods and consultation and examination procedures whose observation is assessed in the following.

6.2. In application of Article 1, the Council regularly examined the economic situation and adopted guidelines on economic policy in the Community at a total of eight meetings[1] in 1975. The economic and social situation in the Community was discussed at each of the three meetings of the European Council[2]. Finally, at two meetings held in the autumn, the Ministers for Finance of the Member States drew up a common position in preparation for the international monetary conferences. The Member States belonging to the "snake" met on a number of occasions for consultation, at which the other Community countries were not present.

In November, the Ministers for Economic Affairs and for Employment, the Commission and representatives of the two sides of industry met for the first time and had full and frank discussions on the economic and social situation in the Community and on the future outlook.

6.3. The examination provided for in Article 2 took place during the first quarter at the Council meeting held on 18 March. The decision on the adjustment of the economic policy guidelines was not finally adopted until 16 June.

The second examination, provided for in Article 3 , took place at the Council meeting held on 10 July on the basis of a communication from the Commission on the economic policy to be pursued in 1975 and on the drawing up of the public budgets for 1976. It proved difficult to fix quantitative guidelines for the draft public budgets, because of the uncertain economic outlook

---

[1]Dates of meetings: 17 February, 18 March, 21 April, 20 May, 16 June, 10 July, 22 September and 17 November.

[2]European Council: 11 and 12 March, 16 and 17 July, 1 and 2 December.

in the spring of 1975.

Because of the lack of adequate information on economic trends up to the summer, it was not until the middle of October that the Commission presented the annual report on the economic situation in the Community fixing the guidelines to be followed by each Member State in its economic policy for the following year, though these were scheduled for the end of the third quarter under Article 4. The annual report and the guidelines were adopted by the Council in November[1].

The Commission intends to present the draft of the annual report for 1976 in September this year once again, so that it can be taken into account in the budgetary debates in the national parliaments.

6.4. The draft of the fourth medium-term economic policy programme for the Community is at present being prepared, and it will be presented to the Council before the summer.

6.5. As provided for in Article 7, the prior consultation on exchange rate alterations was observed when the French franc returned to the Community exchange rate system. The consultations on the strengthening of cooperation between the central banks of the Member States, with the aim of promoting the continual coordination of their monetary policies, especially as regards the development of the money supply and bank liquidity, the conditions for granting credit and the level of interest rates, take place regularly within the framework of the Committee of the Governors of the Central Banks and the Monetary Committee.

---

[1] See OJ C 297 of 29 December 1975

6.6. In the standing consultations on the general economic policy measures envisaged by the Member States and on their conformity with the economic policy guidelines, the Coordinating Committee on Short-Term Economic and Financial Policies largely confined itself to an exchange of information on economic developments in the member countries. Prior consultations have only taken place in a limited number of cases.

VII. Conformity of the policies pursued with the objectives set, and success of the efforts at coordination undertaken within the Community

7.1. In the first Report on the Application of the Council Decision of 18 February 1974, the Commission stressed that the coordination of economic policies in 1974 had been insufficient and regretted the fact that in the surplus and deficit countries the necessary measures had been undertaken with a lack of whole-heartedness and had achieved only limited effectiveness(1). In view of the major disequilibria existing within the Community and the uncertain outlook for world trade, there was "no reason to expect that production will start rising again in the Community countries before the autumn (1975)"(2). However, the decline in economic growth proved sharper in the first half of the year than expected, since export demand in all the member countries fell drastically. In the Recommendation of 23 July 1975 concerning the measures to combat the recession, the Commission asked the Federal Republic of Germany, the Benelux countries, France and, to a lesser extent, Denmark and Italy to take additional measures to stimulate the economy and reduce unemployment. In August and September 1975, five Member States, particularly France and the Federal Republic of Germany, decided to adopt extensive short-term economic policy programmes, which were closely coordinated as to content and timing and which were also announced at about the same period.

7.2. Monetary and credit policy in 1975 was almost generally along expansionary lines. The effects became apparent only in the subsequent trend of economic activity and reinforced the impetus of the built-in growth of budget deficits and public budget programmes. The greater convergence of monetary and budgetary efforts in the Community strengthened monetary cohesion. With the exception of the pound sterling and the Italian lira, the exchange rates

(1) Report on the Application of the Council Decision of 18 February 1974, Para. 2.1. (doc. COM (75) 93 final/2)

(2) Commission Communication to the Council concerning the adjustment of the economic policy guidelines for 1975, O J L 162/13 of 25 june 1975, Para.1.5.

of the Member States drew closer together up to the endof the year. With the return of the French franc into the Community exchange rate system, the area of monetary policy stability in the Community was enlarged once again.

7.3. In March 1975, as a result of the rapid success achieved in reducing its balance of payments deficit, Italy was able to lift the cash deposit requirements for imports which had been introduced the previous year. The monetary and budgetary policy ceilings, which were imposed on Italy in connection with the granting of medium-term assistance for 1975[1], were considerably exceeded, particularly towards the end of the year, mainly because the economic downswing proved much sharper than expected and necessitated stimulatory measures. However, the possibility cannot be ruled out that, amongst other factors, the exceeding of these ceiling contributed to the fall in the value of the lira in January 1976.

7.4. The United Kingdom and Ireland were at first hesitant in following the restrictive economic policies provided for in the Community guidelines,

as is shown in the rapid rise per capita in wages and unit labour costs (Table 3 and 4). It was not until later in the recession that energetic incomes policy measures were taken to reduce price and cost pressure, so as to counteract the rapid worsening of the balance of payments and inflation.

The improvement in the economic situation seems to have been clearest in those countries which responded most rapidly and most vigorously to the numerous calls for voluntary cooperation between the two sides of industry.

The Tripartite Conference held in November 1975, at which the Ministers for Economic and Social Affairs and, the Commission and the two sides of industry met, was an important basis for developing the exchange of ideas on the short and medium-term problems facing all the Community countries, which can only be solved on a Community basis and through cooperation.

(1) Council Directive of 17 December 1974 on the granting of medium-term financial assistance to Italy.

OJ L 341/51 of 20 December 1974.

7.5. The success of the efforts at coordination undertaken within the Community cannot be measured simply by the number of Council, committee or working party meetings, nor simply by the result of the overall economic trend in the form of comparisons of annual average figures. 1975 was not only a year of marked unfavourable tendencies. The improvement in the external trade disequilibria within the Community and - in the second half of the year - also in the internal economic situation was noteworthy and can without doubt be attributed to the more vigorous short-term economic policy efforts undertaken by the member countries at Community and international level.

7.6. All the deficit countries, particularly Italy and France, were able to reduce their current account deficits as a result of a sharp decline in imports. The total deficit of these countries was $ 5,000 million at the end of the year/ On the other hand, the Federal Republic of Germany maintained a high level of imports despite a decline in economic activity and was able to reduce its current account surplus by two-thirds to almost $ 3 000 million as compared with the previous year.

7.7. The reduction in inflation rates during the year became particularly distinct during the second half of the year in all the member countries except for Belgium, Luxembourg and the Netherlands. Unit labour costs, which have gone on rising and have accelerated in almost all the Member States except Denmark and the Federal Republic of Germany, are a cause for concern (see Table 3). These tendencies have been reversed only in the last few months in the United Kingdom and Ireland as a result of the prices and incomes policies introduced.

7.8. The downward trend in industrial production bottomed out after the summer and production has since then begun to recover in most of the member countries. At the end of 1975, all the Community countries except Luxembourg, Belgium and the United Kingdom, had either regained or indeed exceeded the level of the previous year. The labour market situation, which usually reacts to the recovery of economic activity with a time lag is already improving in some countries, if seasonal influences are disregarded.

The climate of confidence among consumers and firms is improving steadily. The chances of a general recovery in economic activity and of sustained growth are becoming more favourable.

CONCLUSIONS

Although the coordination of economic policies between Member States still leaves a lot to be desired, some progress has been realised in this respect as compared with the previous year. Inflationary trends eased, disequilibrium in the balance of payments was reduced surprisingly rapidly, and, finally, the likelihood and indeed the basis for a new upswing in the economic situation have improved considerably. Cooperation between Member States at European and international level has without doubt helped to check the recession quickly and to set off a recovery in demand and production. However, it has not been possible to hold back the worrying increase in unemployment. Besides, although the divergencies in the development of inflation rates and balances of payments have lessened in the Community, differences still persist.

The main problems for 1976 will be to secure steady growth without giving a further push to inflation, and to reduce the high level of unemployment. It will be possible to see from the approach adopted to these problems to what extent the great willingness to cooperate which has been shown by governments and the two sides of industry is due to a lasting recognition of their mutual interdependence rather than to the pressures from the most serious recession since the war.