

**COUNCIL DECISION****of 15 December 1980****adopting the annual report on the economic situation in the Community (1980) and laying down the economic policy guidelines for 1981****(80/1265/EEC)**

THE COUNCIL OF THE EUROPEAN  
COMMUNITIES,

HAS ADOPTED THIS DECISION:

*Article 1*

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 <sup>(1)</sup>, as amended by Decision 75/787/EEC <sup>(2)</sup>, and in particular Article 4 thereof,

The Council hereby adopts the annual report on the economic situation in the Community (1980) as contained in Section I of the Annex and lays down the guidelines to be followed by each Member State in its economic policy for 1981, as contained in Sections II, III and IV of the Annex.

*Article 2*

Having regard to the proposal from the Commission,

This Decision is addressed to the Member States.

Having regard to the opinion of the European Parliament <sup>(3)</sup>,

Done at Brussels, 15 December 1980.

Having regard to the opinion of the Economic and Social Committee <sup>(4)</sup>,

*For the Council*  
*The President*  
**J. SANTER**

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

<sup>(2)</sup> OJ No L 330, 24. 12. 1975, p. 52.

<sup>(3)</sup> OJ No C 327, 15. 12. 1980, p. 42.

<sup>(4)</sup> OJ No C 348, 31. 12. 1980, p. 30.

## ANNEX

ANNUAL REPORT ON THE ECONOMIC SITUATION IN THE COMMUNITY (1980)  
AND ECONOMIC POLICY GUIDELINES FOR 1981I. THE COMMUNITY ECONOMY AFTER THE  
SECOND OIL PRICE SHOCK

## 1. The external price shock and the world economy

The oil price rise from the end of 1978 to mid-1980 reached a magnitude comparable in real terms to that experienced in 1973/74. The Community's oil import bill has as a result risen from 2.4 % of GDP in 1978 to about 3.7 % in 1980 <sup>(1)</sup> and the mechanical impact on the consumer price level would be about 3.5 % before allowing for rises in other energy prices. The weaker rise in other commodity prices, and the stronger performance of European exchange-rate currencies have, however, meant that the overall terms of trade loss for the Community in 1979/80 has been under half that seen in 1973/74.

Nonetheless the overall depressive influence coming from the external sector is powerful. The growth of world trade, estimated to have been 6.5 % in 1979, is likely to have dropped to 2.5 % in 1980 and is forecast to be some 2 % for 1981. Business cycles in the OECD area have moved more closely into line in 1980, with falls in output approximately coinciding in the United States and the Community in the second quarter: falling or stagnant output is expected in both cases until about the end of this year.

The current account of the Community has as a result of the oil shock and cyclical influences passed from a substantial surplus in 1978 to a very large deficit in 1980. The oil bill alone increased by \$ 60 000 million over these two years. In part this has to be accepted as an inevitable change that will endure for some time. However, the Community economy has at the same time been losing ground in

world markets, and as a result its share in the OECD current account deficit has been increasing from about a third in 1979 to about a half of the much larger totals expected for 1980 and 1981. Thus the Community is taking a bigger role in shouldering the counterpart to the OPEC surplus than the United States and Japan.

## 2. Current trends and prospects in the Community economy

The business upswing that ended in early 1980 lasted about two and a half years, during which the average annual rate of GDP growth was 3.5 %. This growth proved just sufficient to stabilize total, officially recorded level of unemployment at about 5.5 % of the active labour force. However, this figure conceals the fact that labour shortages in key regions and skills tightened considerably over the period, thus pointing to a trend rise in structural unemployment.

While the Commission's forecasts for the years 1980 and 1981 (see Table 1) show continued low growth of 1.3 % and 0.6 % respectively, the more precise cyclical profile expected within these annual averages is one in which the low-point in activity is reached in the second half of 1980, with a gradual resumption of slow growth to emerge during 1981. Total unemployment is expected to rise on average in both years, reaching 6.8 % for 1981 as a whole.

The growth of real disposable household incomes came to a halt in early 1980 as the increased price of oil and other inflationary factors worked their way through to consumer prices, with a less sharp parallel acceleration of wage incomes. Until the second quarter of 1980 a reduction in the savings ratio had maintained the growth of private consumption, but then it seems that a modest compensatory recovery in savings took place, causing reduced levels of real consumption in middle quarters of 1980. Thus, the most important, direct contribution of the slow-down in activity has come from the drop in real private consumption in the middle of 1980. Domestic demand as a whole has slowed down (from 4.6 % growth in 1979 to 1.1 % in 1980) more sharply than exports and production.

<sup>(1)</sup> The hypothetical increase in the Community's oil bill due to the rise in oil prices in dollars between end 1978 and end 1980, assuming no change in the volume of oil imports, represents 3.4 % of Community GDP in 1978, or 3.0 % taking account of the appreciation of the ECU against the dollar. The reduction in oil import volumes and the rise in the Community's nominal GDP between 1978 and 1980 lead to an actual rise of 1.6 % in the oil import bill as a share of GDP in the current year.

A moderate weakening of stockbuilding activity has quickly followed the private consumption trend in 1980. On the other hand, private investment activity has so far remained relatively buoyant (rising 2.1 %

in 1980), and public consumption has likewise continued to grow in volume terms, albeit at a slower rate (2.0 %) than the year before.

TABLE 1

## The Community economy 1960 to 1981

	GDP volume growth	Produc- tivity growth	Rise in consumer prices	Compensation per employee	Current account balance of payments	General govern- ment financial deficits	Savings ratio of households	Monetary supply growth M2/M3	Unem- ployed in labour force
	(%) (1)	(%) (2)	(%) (1)	(%) (1)	(%) GDP	(%) GDP	(%)	(%) (1)	(%)
1960 to 1972	4.8	4.6	4.0	9.3	0.5	-0.3	..	11.3	2.2
1973	5.9	4.8	8.2	14.3	0.1	-0.7	18.1	17.5	2.5
1974	1.7	1.6	12.7	16.9	-1.0	-1.7	18.6	12.4	2.9
1975	-1.4	-0.1	12.5	16.5	0.0	-5.6	19.4	13.2	4.3
1976	5.0	5.2	10.3	12.4	-0.5	-3.8	18.0	12.7	4.9
1977	2.3	2.0	9.8	10.1	0.2	-3.3	16.8	12.7	5.3
1978	3.0	2.6	7.3	9.7	0.8	-4.0	16.8	13.5	5.5
1979	3.4	2.6	8.6	10.6	-0.5	-3.6	17.1	12.2	5.6
1980 (3)	1.3	1.2	12.0	13.1	-1.5	-3.5	16.6	10.6	6.0
1981 (3)	0.6	0.9	9.7	10.3	-1.2	-3.9	16.9	9.0	6.8

(1) % change over previous period.

(2) Per occupied person, whole economy.

(3) Forecasts of the Commission staff on the basis of present or anticipated policies.

The expected resumption of growth in 1981 is based on the assumption that real disposable incomes will be beginning to increase again slowly in the first half of next year, with only a small further rise in the savings ratio, thus contrasting with the sharp rise in savings observed in 1975, which was the main trigger of the severe recession after the first oil shock. The weakening of stockbuilding and investment in 1981 is also likely to be relatively mild, this being consistent with the much lesser erosion of corporate profitability and liquidity in the present cycle, compared again to 1973 to 1975. The balance of foreign demand should also strengthen in the course of 1981. The overall risks in this outlook weigh perhaps more heavily on the down-side.

The acceleration in consumer price inflation, with a rise of some 12 % in 1980 compared to the low-point of about 7.5 % recorded in 1978, has been almost as severe on average as in 1974/75. However, the GDP

deflator and labour units costs, which are more reliable indicators of the underlying rate of inflation, showed a smaller acceleration in 1980. A more marked slow-down in consumer price rises is expected in 1981 (to 9.7 %) than in the case of these other measures. Correspondingly, the divergence inflation performance has been worse at the consumer price level, than for GDP prices and labour costs: the difference between the highest and lowest rates of increase of consumer prices is expected to fall from 15 percentage points in 1980 to some 10 points in 1981.

## II. POLICY ISSUES FOR THE COMMUNITY

### 1. The policy framework

The underlying, medium-term objectives of policy must be to increase employment in conditions of improved stability of prices and competitiveness. In

terms adapted more closely to the immediate economic situation, as it stands in the autumn of 1980, policy in the Community in general must aim to:

- (a) achieve a firm and substantial deceleration in inflation, and a renewed convergence between Member States: some deceleration is now in sight on average, and some aspects of recent price and cost performance have been commendable, but these better features of the situation need to be rapidly consolidated and strengthened;
- (b) prevent the present cyclical down-turn from becoming a cumulative recession, and assure that the likely recovery of growth in 1981 keeps to a sustainable trajectory;
- (c) maintain control over monetary developments within Europe, and help adapt Community and international monetary arrangements to new needs;
- (d) give priority in budgetary policy to adapting public expenditure and taxation to the needs of restoring productive potential;
- (e) proceed rapidly with investment in energy saving and production;
- (f) improve the Community's competitiveness, strengthen investment, encourage the movement of resources into new industries and sectors with continuing growth potential, and sharpen the efficiency of market mechanisms to favour productive investment and employment;
- (g) face the problems of unemployment with a combination of actions to favour the creation of economically viable employment, to adapt the labour force to new needs, and ease the burden of the temporarily unavoidable level of unemployment.

Whilst most of the instruments of economic policy for the pursuit of these objectives lie with Member States, the Community has a substantial role and responsibilities which are of two kinds:

- (a) define a concerted framework for action by Member States, identifying on the one hand,

elements of common policy orientation, and on the other hand, where there is divergence between Member States, in what respects convergence towards a Community norm is desirable;

- (b) apply its own financial, monetary and sectoral policy instruments consistently towards fulfillment of these objectives.

The concerted response to the present general economic situation should be based on the right strategic mix of demand and supply policies and notably the right balance in their application to short and medium-term problems. Short-term adjustments should be more moderate than at times in the last decade, and a heavier weight has to be given to reducing medium-term inflationary expectations and improving supply conditions in the economy.

This in turn means a steadier management of monetary aggregates, exchange rates and budget balances than in earlier economic cycles, and giving a strong twist to the numerous policy variables within the overall structure of public expenditure, taxation and regulation in order to strengthen economic potential.

Diversity in the economic structure in the Member States is in many respects natural and desirable — certainly in the pursuit of maximum comparative advantage and adaptation to local tastes and conditions — although the Community aims at a convergence of levels of economic development. In addition, convergence between Member States in inflation and costs, in the profitability of the enterprise sector, and in financial policies conditioning competitiveness is a matter of vital concern to the Community as a whole. In this regard there is increasing consensus throughout the Community that this convergence needs to be combined with an improvement in the average rate of inflation, average degree of international economic competitiveness, and average rate of investment in the Community; success in each of these respects would be mutually reinforcing.

The Community's own instruments of policy, actual and potential, can contribute to a constructive response to present problems *inter alia* through a coherent management or development of its instruments of policy in the domains of trade, agriculture, industry, competition, employment and the regions. In the present context, two domains of policy at the Community level have a particularly important role: monetary and exchange-rate policy, and energy policy. The European Monetary System is an essential

component in the articulation of compatible, national monetary policies aimed at stability and convergence. It is also an essential bridgehead for the Community in its economic relations with the rest of the world in several ways: the exchange rates between the ECU, dollar and yen are of vital concern to the coherence of the Community's trade policies in the world; the ECU has a potential role in the changing structure of international reserve assets. Common action in energy policy would require further effort in investment and research (supported in part by the Community's own financial instruments such as, loans by the EIB and the use of the new Community instrument) as well as a reinforced concertation of national energy policies in the pricing, fiscal and regulatory domains.

## 2. Measures for stabilization and recovery

### (a) *Monetary policy*

The priority objective of monetary stability, both for itself and as a precondition for the resumption of growth, requires that control of the monetary aggregates be kept on a steady course. Policy has in this respect been more effective in the recent period, than for example in 1973 to 1975. Notwithstanding short-run problems of money supply management that have arisen at times, money supply in the aggregate in the Community has decelerated from 13.5 % in 1978 to about 10 % at present, whereas in 1973 it rose to 17.5 %. In the year ahead the growth of money supply should decelerate a little further on average, allowing for some easing in monetary conditions in Member States where performance is below the target range and considerably slower money supply growth in others.

A steady money supply policy in the period ahead is not incompatible with helping assure a recovery in the business cycle. On the contrary, it could be compatible with a decline in interest rates, which has already begun to take place in several Member States. However, the restrictiveness of monetary policy, and the desirability of a concerted easing in interest rates, both depend vitally on a reduction in the rate of inflation. If the rate of inflation is reduced, then the average money supply growth

postulated would not curb a recovery of growth. If the expected, underlying rate of inflation is significantly lowered, in addition to achieving immediate results in terms of prices and costs, the prospects for further significant interest rate reductions would become good, subject also, however, to international interest rate movements.

### (b) *Incomes*

A pronounced slowdown of inflation is a major condition for an improvement of the propensity to invest and a strengthening of the confidence of households, which in turn is required to prevent a precautionary rise in the rate of savings and decline in consumption. Trade unions and enterprises for their part have an important role for securing the necessary process of disinflation. Wage bargaining behaviour must adapt to the constraints set by stabilization policy and to needs of a competitive structure of costs as between industries and countries. If this is done, employment prospects can be improved at the same time as inflation is reduced. If these needs are disregarded, then the employment costs of price stabilization will be made much higher.

Given the need to allocate an increasing share of GDP to investment and to expand the volume of exports relative to the volume of imports so as to reduce the current account deficit, there should be at best in some Member States only a slight increase in real wages in the year ahead. In other Member States where the profitability of the enterprise sector is plainly inadequate, where inflation rates are highest and unemployment rates are rising steeply and where the largest balance of payments adjustments are needed, some decline in real wages is appropriate. Thus in the Community as a whole real wages cannot be allowed to rise fully in line with productivity over the coming years.

Given the priority need to reduce inflation and the little or no scope for real wage increases, nominal wage settlements must on average decelerate in the year ahead. In the past year they have accelerated, although less so than at a comparable period after the first oil shock. Some elements of a better adjustment to the second oil shock, compared to reactions to the first oil shock, have thus been achieved in the past year. In some countries the terms of trade loss has been absorbed in nominal wage settlements. In

some countries with wage indexation practices steps have been taken to modify indexation mechanisms (Denmark) or to suspend indexation temporarily (Netherlands) to prevent the oil price rise leading to secondary cost inflation. But performance in this regard has been uneven. Some other countries have adapted their indexation mechanisms insufficiently, or seen too high nominal wage settlements and these divergences cannot be continued without inflicting real damage on the economy.

It is not appropriate to make simple, sweeping judgments on the effects of indexation mechanisms as such, because they can exist with differences in degree which at the limit become hardly distinct from the problems of general pay bargaining. It remains highly desirable, nonetheless that such indexation mechanisms as do exist are used with sufficient flexibility or limitations to avoid passing on into prices unavoidable terms of trade losses, and to allow other necessary adjustments in income distribution or tax structure without causing extra inflation.

(c) *International financial policy*

Exchange rates as defined in the framework of the European Monetary System are the cornerstone in the implementation of the Community's economic policy guidelines. Exchange-rate stability in the Community over the past year has helped contain divergences in inflation rates, and to limit the uncertainties created by the second oil shock. Monetary policy in the last year, internal and external, has been more convergent than the behaviour of the real economy. The latter must now adjust more rapidly, in ways already indicated above.

The measures to be taken in passing to the second phase of the European Monetary System, as provided by the European Councils of Bremen and Brussels in 1978, should further improve its functioning, and strengthen its role — already important — in stabilizing exchange rate relations. Among the objectives set by the European Council the following may be recalled: the development of the role of the ECU to permit it to be used fully as means of settlement and reserve asset; the consolidation of the credit mechanisms of the system in the European Monetary Fund; the complete membership of all Member States (the United Kingdom has indicated that in principle it envisages its full participa-

tion as soon as circumstances permit); and a more unified position of the Community in international monetary cooperation, including, as soon as possible, the development of a coordinated policy towards the main international currencies, notably the dollar and yen.

The Community should help assure the adequacy of arrangements for the recycling of OPEC surpluses. In addition to supporting the efforts of the international organizations which bring together all groups of countries, the Community should proceed with an adaptation of its own balance of payments borrowing and lending facilities to the new circumstances.

(d) *Budgetary policy*

Given the prevailing monetary and financial constraints there is only little scope for taking global budgetary policy measures to stimulate activity during the cyclical slowdown. The growth of tax revenue is, however, due to the operation of automatic fiscal stabilizers likely to slow down over the next 12 months and the present level of budget deficits could only be maintained through additional expenditure cuts which would tend to depress activity even further. Member States should therefore as a group be prepared to accommodate a certain rise in borrowing requirement of general government in 1981; this nonetheless leaves some Member States obliged to reduce their public deficits in the cases where these have become massively excessive, and prejudicial to monetary stability and efficient resource allocation. The major changes in budgetary policy in the Community as a whole need to come within the structure of public expenditure and taxation. Here priority must be given to strengthening the structural base of the economy and promoting economic growth through adaptation of supply conditions. Governments should pursue efforts to restrict the expansion of expenditure on public consumption, subsidies or transfers financing private consumption in order to provide room in the public budgets for expenditure to promote economic growth through investment.

This means changing trends evident in recent years. While public expenditure in the Community has increased to a record level in proportion to GDP, an

increasing part of this expenditure has been allocated to a financing of consumption either directly in the form of public consumption or indirectly through transfers to finance household consumption. Substantial subsidies or capital transfers to industries in difficulties have also been given priority as stop-gap measures to prevent lay-offs or closures, although this often implied supporting low-productivity enterprises, and blocking necessary structural changes.

Public investment and other categories of non-obligatory expenditure have, on the other hand, been severely restricted in order to maintain the overall budget deficit within limits compatible with monetary and financial stability. Moreover, despite a need for a revival of investment and a strengthening of business confidence, tax systems on the whole maintain a comparatively heavy tax burden on enterprises. Similar reasons explain why budgetary measures aimed at granting tax relief for energy saving investment and stimulating research and development, as well as capital transfers and grants to promote the expansion of public utilities and communications often remain severely restricted.

Thus the structure of public expenditure and taxation needs to be twisted strongly in favour of action to increase productive potential, implying the need to curb the automatic growth dynamics of welfare and consumption expenditures, and rigorously cutting down subsidies which no longer correspond to priority economic needs. Similarly pricing policies in public enterprises should reflect full economic costs. The pure macroeconomic, cyclical demand management function must be more constrained. The objectives of employment and growth have to be pursued from within the given budgetary aggregates by the changing of priorities at the level of individual expenditure programmes and fiscal instruments.

Programmes for investment by public authorities and public utilities take time to prepare, and experience has shown, at least in some Member States, that the lack of mature projects and delay of administrative procedures often exert a more effective constraint upon investment activity than the availability of funds. Member States which do not already possess a certain reserve of projects might now therefore usefully take steps to speed up the planning of investment programmes — not least in the case of projects eligible for Community funds or other financial assistance. In the course of the next half-year it will be evident whether activity will recover sufficiently firmly. The greatest needs for public

investment now typically exist in such fields as environmental improvement, urban renewal and energy saving in housing.

#### (e) *Energy policy*

Energy supply is at present a major constraint upon economic growth. This has led the Council, on 13 May 1980, to adopt new energy policy targets for 1990 as follows:

- (i) reduce to 0.7 the ratio between the growth of energy consumption and the growth of GDP (subsequently lowered to 0.6 at the Western Summit in Venice);
- (ii) reduce the share of oil in total energy consumption to 40 %;
- (iii) increase the share of coal and nuclear power in electricity production to 70/75 %;
- (iv) accelerate the utilization of new and renewable energy sources;
- (v) follow energy price policies appropriate for achievement of these objectives.

While costing around \$ 110 000 million, oil imports in 1980 to the Community are estimated to have fallen in volume from the 1979 level (14 % in the first nine months of 1980 over the corresponding period of 1979). This, however, is to a large extent attributable to the slow growth of activity and to a technical adjustment following the large stockbuilding in 1979 and is not indicative of an adequate energy saving performance. The Commission is currently reviewing the adequacy of national energy programmes, and will make a communication to the Council on this subject shortly. Increased efforts may in fact be needed if the energy policy targets are to be reached at the end of this decade.

There are positive opportunities for investment and employment in energy saving or production. The scale of activity required in energy saving in particular, in both the household and enterprise sectors, is such that it would have some significant impact on overall investment and employment trends. While investment in energy saving is increasingly competitive against the price of energy supplies, the actual scale of investment is so far failing to exploit the opportunities available. A lowering of oil imports



through energy saving investments, the expansion of domestic energy supply, and a reduction of energy consumption for heating and transport will exert a larger stimulus on economic activity than conventional demand management measures which normally are considerably weakened due to the leakage into imports. Much of energy saving investment involves the construction sector, where there is spare capacity at the present time in most countries; but bottlenecks exist in the supply and organization of skills and services for energy saving work.

The principal economic policy requirements for assuring a massive effort to improve energy saving and production lie in the domain of pricing and fiscal policy, and investment financing; on both subjects the Commission has submitted communications to the Council during the current year. In general, Member States have, rightly, adopted harder pricing policies than after the first oil shock: price rises have been passed through quicker to the consumer, and there have been substantial upward fiscal adjustments in the past year in several Member States. Energy consumption prices vary greatly between Member States. Concerted action between national energy policies should be increased, in particular in the prices and fiscal sectors.

In the financing of investment in the energy field, public budgets should give appropriate priority to supporting energy saving and research and development programmes. Outside oil and gas production there are very large loan financing requirements for ambitious investment programmes, for example in nuclear power and coal mining, and in these cases the Community's financial instruments may have a role to play.

#### (f) *Industrial and investment policy*

Since 1974 the rate of fixed investment has been considerably lower than in the 1960's: the ratio of gross fixed investment to GDP has fallen from some 25 % in the period up to 1974 to close to 20 % in 1980. Partly as a consequence of this fall in capital formation, the potential rate of growth output may have declined from around 4.5 % in the period 1960 to 1973 to some 2.5 % in the period since the 1973 oil shock. A gradual return to higher rates of economic growth cannot be realized without an increase of the

part of GDP allocated to gross fixed capital formation. Moreover, the necessary renewal of parts of the production apparatus to reduce energy consumption, comply with anti-pollution regulations, reduce costs, etc., will require at least a temporary increase in the investment ratio without giving an acceleration of the growth of output.

Economic recovery has to be based on the expansion of industries with future growth potential, and an increased investment effort to assure the change of economic structures that this would imply. It is not easy to summarize adequately for the Community as a whole the steps that would achieve these objectives. Some major examples can be quoted together with identification of broad areas of policy that warrant closer attention.

Industries with growth potential are in part new industries, for example microelectronics, in which the Community needs to strengthen rapidly its relative position in the industrial world. The energy saving sector, already mentioned, is one in which there is a massive latent demand that can be supplied by inserting new skills and products into the existing structure of the construction sector and household services.

The Community has its own role in aiding the development of new industries and products. The Commission intends for its part, notably in the area of internal market regulation, to favour the setting of technical norms for new products *ex ante* at the Community level, rather than to rely on *ex post* harmonization of national practices.

It is increasingly recognized that small and medium-sized enterprises offer great scope for employment creation, flexibly adapted to changing market conditions. The Commission will shortly submit a communication to the Council, to open the debate at the Community level, on how best to help the development of enterprises of this category.

The propensity to invest and the supply of capital to the enterprise sector depend in part upon the state of demand and activity in the economy but several elements of the system of taxation and financing such as taxation of profits and dividends, depreciation rules, preferential financing, direct subsidies, etc. may also exert a strong influence upon the investment climate. Existing policies in these respects are highly different as between Member States



and extremely complex. Several Member States have recently adapted their aids or tax systems affecting investment, and a more extensive enquiry at the Community level into the most effective techniques in this area would seem warranted. In some Member States there are grounds also for removing subsidies to savings that go into riskless government bonds and other forms of passive investment, which have the effect of depressing the relative profitability of risk-taking capital.

(g) *Manpower policy*

In the immediate future, the combination of factors affecting the labour market are bound to cause some increase in unemployment. On the one hand, the demographically determined increase in the potential labour force will be rising throughout the early 1980s at a maximum rate of two and a half to three million young people entering the labour force each year. On the other hand, the new oil shock has caused a significant loss in economic potential, which will take time, investment, retraining and reorganization to make good. Since this new phase of adjustment is also coupled to the need to reduce inflation, the combination of circumstances would, spontaneously, create a sharply rising trend in overall unemployment. This would hit young people, being new entrants into a weak labour market, particularly hard.

These conditions call for a particular set of priorities to guide the development of manpower policies. These must be addressed to:

- (i) the special problems of increased youth unemployment,
- (ii) the adaptation of vocational skills to the new pattern of demand, and
- (iii) achieving a better balancing of supply and demand in the labour market in ways that are not prejudicial to the competitiveness of industry nor to the need for flexible adjustment of economic structures.

Some Member States, notably Germany, have introduced large-scale vocational training and work-experience schemes for school leavers. Such schemes could be developed more extensively elsewhere, and there is a strong case for directing their expansion towards skills in newly increased demand

like energy saving and many service sector activities. Budgetary constraints on public expenditure are of course severe; however, the desirability of expenditure of the type here in question, compared to increases in either the volume or rates of unemployment benefits, is an example of the type of change in the structure of public expenditure to be aimed at. Only a small part of the age group 15 to 25 benefit from vocational training schemes. In a period of faster structural change there will be a concomitant growth in demand for training and re-training. The Community has contributed to the vocational training schemes and to employment promotion through the European Social Fund, which in 1979 granted 300 million ECU to these purposes.

For adapting labour supply and demand, an accelerated cut in standard working hours would not by itself guarantee a redistribution of the existing volume of work, and could, in addition to risking cost increases, create additional unemployment due to bottleneck problems. There are many other ways, however, in which a more flexible approach to working time may be realized: social security rules and labour market legislation in several Member States restrict the resort to part-time employment and should be reconsidered. While this would in some countries increase labour supply, the overall net impact on the labour market should be positive, as some experiences have shown. A general lowering of the retirement age would not necessarily correspond to the desire of all employees and would moreover go against trends in mortality and health. A more flexible attitude to retirement based on the individual's health, preferences and aptitudes, including a possibility for a gradual retirement through resort to part-time work for persons above a certain age might, however, contribute importantly to the welfare of elder citizens and create additional employment possibilities for young people.

Some Member States have introduced special employment or recruitment subsidies for young people — in some cases to offset the impact of statutory rules on minimum wages and in at least one Member State a direct link between early retirement and appointment of new young employers has been applied during a certain period. Such schemes can have a far more rapid and extensive coverage than individualized schemes for vocational training; however, they should be seen as a possible complementary technique rather substituting for a strong vocational training effort. Specific job creation schemes may give a higher assurance of creating additional employment, but the constraints here are those of budgetary cost, and the objective of limiting public sector employment.

### III. POLICY IN THE MEMBER STATES

In Denmark, the marked deterioration in the balance of payments over the last few years led the authorities to introduce, in December 1979, an austerity programme aiming at an improvement of the economy's competitive position. In 1980, the deterioration continued as a result of the unfavourable development of the terms of trade and the increase in the burden of servicing the external debt, a situation which necessitated, in May 1980, a strengthening of the restrictive measures leading to the adoption of a pluriannual economic programme.

The decline in activity recorded in 1980 (a fall of about 1 % in real gross domestic product), together with an increase in unemployment, is essentially the result of a weakening of internal demand caused, in part, by the effect of the restrictive measures which concern principally private consumption.

The outlook for 1981 points to a gradual deceleration both in the decline of domestic demand and in price inflation; the deficit of the current balance of payment, although expected to be lower than in 1980, will remain an important constraint for economic policy. If a lasting improvement in the external account is to be achieved, it appears inevitable that a reduction in real disposable income *per capita* must be accepted by the population for a number of years. Parallel to the adoption of restrictive fiscal measures, the growth of wages now seems to be slowing down. It is necessary that the social partners continue to adopt a moderate approach when negotiating the new pay agreements which are due to come into effect at the beginning of 1981.

The choice of a sharp internal adjustment as a means of correcting the external situation means that monetary policy must work essentially through a strict control of domestic liquidity which, taking into account other constraints, doubtless implies the persistence, in 1981, of relatively high interest rates.

Budgetary policy next year will contain, in conformity with the recent pluriannual programme, cuts in planned central government expenditure — which nevertheless leaves room for specific measures to sustain employment — and a further rise in direct taxation. Fiscal adjustments might be envisaged particularly within the context of the coming wage negotiations to the extent that they contribute to containing domestic demand.

The net borrowing requirement (on a cash basis) of the central government is estimated at

Dkr 25 200 million in 1981 (6.1 % of gross domestic product) as against Dkr 22 000 million in 1980 (5.8 % of gross domestic product). Strict control seems to be necessary in order to limit the public sector borrowing requirement to 4 % of gross domestic product.

The pluriannual programme for economic recovery provides an appropriate framework for the continuation of the process of structural reform, so as to improve the country's competitiveness as well as the financial position of firms. Furthermore, there is need for an intensification of efforts aimed at achieving a better balance in the supply of energy, in particular by accelerating the development of North Sea energy resources.

In the Federal Republic of Germany economic activity fell markedly in the second quarter. As a result, the target rate of growth for 1980 as a whole — 2.5 % of real GNP — will not be fully achieved. The current account deficit, running at an equivalent of close to 2 % of GNP, is not expected to deteriorate further.

A gradual upward trend in activity is expected at the beginning of 1981. In particular consumer demand may soon benefit from the implementation of the tax reform programme, decided in July, which will raise personal disposable income by DM 12 000 million or 1.2 % in 1981.

It is very important that the German economy should remain on a trend of sustained and balanced growth, and this will make it necessary to maintain a favourable climate for investment and to ensure that the stance of budgetary policy is not modified too suddenly. The tax package recently agreed, together with measures to stimulate energy saving and to develop energy sources other than oil, are all conducive to reaching this objective. The removal of administrative and fiscal obstacles and moderation in wage claims would also make a particularly important contribution.

The current account deficit is likely to be significant in 1981, although less than that recorded for 1980; it will continue to be a constraint on monetary policy. In view of the need to finance this deficit at least partly through private capital inflows, there seems to be only limited scope for a relaxation of the present stance. Nonetheless, the available margin for manoeuvre should be used to the maximum, to ensure that the level of interest rates on financial markets does not inhibit investment and the activity in the construction industry.

The stance of budgetary policy should be such as to effect a stepwise reduction in the trend of the deficit although in the short term an increase should be tolerated with a view to offsetting the effects of the recession. It is necessary to accept the revenue shortfalls resulting from a slowdown in economic growth, so as to avoid a strengthening of such a trend.

Under these circumstances, the public sector financial deficit (including social security), and expressed as a proportion of gross national product will considerably exceed, in 1981, the 3 % currently forecast for 1980.

Budgetary expenditure — for which the increase in 1981 (4 to 5 %) will be more moderate than in previous years — should, where possible, give priority to public investment. However, it would be appropriate to consider reducing significantly subsidies to enterprises to the extent that they are helping to maintain outmoded industrial structure.

If, in 1981, wage and salary demands stay on the moderate side, it should be possible to reduce further the rate of inflation. Indeed this would meet one of the most important conditions for economic growth.

In France, economic policy should aim at reconciling the restoration of equilibrium and the renewal of economic growth which has been interrupted since the second quarter of 1980. This strategy must take into account the need to maintain the competitive position of the economy, which could be affected by the continuation of the price trends observed until the summer months. Indeed the progressive reduction of the external deficit which has developed since the end of 1979 requires that the recovery in domestic demand now expected is accompanied by an even more marked recovery of the real external trade balance. The priority objective is to accelerate the process of squeezing out inflationary pressures which will leave only a limited margin of manoeuvre for measures to support demand.

Nonetheless, budgetary policy will give some stimulus in this regard. The budget for 1981 will contain tax incentives for corporate investment, while the overall burden on households of taxes and social security contributions will be somewhat reduced, both by slightly lower taxation, which is one of the hallmarks of this budget, and above all by the removal, early in 1981, of the special social security contribution surcharge introduced in 1979. Thus, despite the firm approach towards public spending, the general government financial deficit should increase from below 1 % of gross domestic product

in 1980 to more than 1.5 % in 1981. The budget also foresees the possibility of making supplementary investment expenditures should the short term economic situation require them.

In contrast, the stance of monetary policy should become more restrictive. Indeed, the authorities intend to reduce even further the liquidity ratio of the economy by fixing the upper limit for the rate of growth of the money supply at 10 % in 1981. Keeping to this objective implies maintaining a substantial margin between short-term interest rates on the one hand and medium- and long-term interest rates on the other so as to further increase the underlying propensity to save.

The desired return to sufficiently well sustained economic growth, largely depends, moreover, on the speed with which economic structures can adjust to developments in the international context. The main requirements for adjustment are restraint in energy consumption and reduced oil dependence, the restructuring of industry around the most promising sectors, and, above all, a higher technological level for production methods. Appropriate policies have already been implemented to this effect; they should continue to be pursued with determination. The success of these efforts is crucial for any long-term improvement in the employment situation. They should be accompanied by specific measures in the field of vocational training and by certain changes in employment conditions consistent with the constraints of competitiveness.

In Ireland, economic growth has continued to slow down over the past two years and more recently unemployment has moved on to an upward trend; the outlook for growth in 1981 is not encouraging. Although the current account of the balance of payments has improved in 1980, the deficit is still expected to be large (some 7 % of GDP, as against 10 % in 1979).

The deterioration in the terms of trade, the limited contribution of national sources of energy and the very slow growth of western economies have made it impossible to achieve the medium-term objectives for the economy fixed some years ago. At the same time, domestic causes such as the steep progression of costs and prices (23 % for compensation of employees per head and 18 % for consumer prices in 1980) as well as the persistence of high budget deficits, have also contributed to the imbalance on the external account.

Some adjustment in the stance of overall economic policy in 1981 and the introduction of measures with a longer time horizon would be desirable so as

to take account of recent changes in the economic environment. The authorities are, in this context, faced with the results of the recent conclusion of a draft National Understanding, which still provides for a very rapid increase in wages, and has been accompanied by certain tax and other concessions.

It would be necessary, nevertheless, that the net borrowing requirement of Central Government set for 1981 should, while taking account of the need to maintain investment and support employment, be reduced as compared to the probable outturn for 1980, now expected to be at least 13 % of GDP. Such an objective would, given the considerable slippage observed so far in 1980 in the Government accounts (which can only partly be attributed to the operation of built-in stabilizers in the economy) and the full year costs of certain tax concessions granted in February 1980, imply severe curbs on public expenditure and probably new tax measures. It will be particularly important to reduce the current budget deficit to leave more room for infrastructural investment, since the public capital programme, to which the Community makes a significant contribution, accounts directly for about half of total capital formation and influences the remainder significantly. Within this programme special attention should be given to measures designed to improve the energy balance.

The stance of monetary policy, supported by an improvement in public finances, should not be relaxed in 1981 but should continue to be directed towards the achievement of an improvement in the external balance.

In Italy, the primary aim of economic policy must be to reinforce existing developments which are tending towards the easing of inflationary pressures and the reduction of the external deficit and which are presently facilitated by the weakening of economic activity. The expectation that costs and prices will decelerate in 1981 and with a year-on-year increase still close to 15 % for consumer prices is unlikely to guarantee that the expected upswing in consumption will be associated with an adequate recovery in the balance of trade in real terms. The combination of strict demand management and direct action on costs is indispensable in order to speed up the necessary squeezing out of inflation. Such management will have to be all the more rigorous in that, without adding to inflationist tensions, it will have to enable the necessary resources to be found for the reconstruction of regions devastated by the earthquake in November 1980.

The results to be expected in 1981 from budgetary management, in this context, will nevertheless be necessarily limited because of the contrast between the deferred effects of the buoyancy of prices on expenditure, and the immediate effects of the slow-down in the trend of nominal values on current receipts. Likewise, expenditure on the reconstruction of the devastated regions will place a heavy burden on public financing. In these circumstances, the general government borrowing requirement, expressed as a proportion of gross domestic product, will probably increase compared with 1980, but in any case it should remain below 10 % and the deficit of the public sector as broadly defined <sup>(1)</sup> ought not to exceed 12 %. These objectives imply the need for additional austerity measures to those proposed by the Government in July. Even if these limits are adhered to, the public sector deficit will impose serious strains on financial markets, particularly as the fight against inflation requires determined efforts to reduce the liquidity rate in the economy. It would be appropriate, therefore, to intensify efforts to ensure that an increasing part of government and company borrowing is effected by non-monetary means, and to maintain, or reinforce, ceilings on bank credit.

This policy, together with the high interest rates that it implies, will impose financial constraints on enterprises which will make it necessary for them to reduce the burden of their other costs; this could be effected by an appropriate adjustment to the indexation mechanisms, or by other methods with equivalent effect.

Finally, it would also be desirable to ensure that productive investment does not suffer any lasting negative effects from this adjustment process. The adaption of economic structure to the international environment, which will determine the future growth possibilities for the economy and which implies, amongst other things, a reduction of the dependence on oil, redeployment of industry towards high technology sectors, an intensified research effort, and a better distribution of productive activity between regions, will not be possible without increased investment by enterprises. This objective, together with the consequential need for vocational training to be adapted to meet changing requirements, must be given priority when establishing the general direction of medium-term policy. More specifically it should be taken into account when considering policies with respect to government aid.

<sup>(1)</sup> Community definition.

In the Netherlands, an improvement in economic activity — which will show virtually zero growth in 1980 and probably also in 1981 — poses, in the first instance, the problem of changing economic structures which still rely substantially on the availability of relatively cheap energy resources and requires, as a consequence, a very substantial amount of investment.

Likewise, the development of prices, which was relatively moderate in 1980, despite higher oil prices and real costs, will have to be kept within strict limits, both in order to maintain external equilibrium and to improve the employment situation. The measures envisaged by the Government following the failure of the pay negotiations (limitation of the automatic adjustment of wages, compensated for in part by tax concessions, and an increase in certain social security benefits) go towards this end.

Budgetary strategy for 1981 should be centred on reducing the deficit. A reduction in the budget deficit, at the very least as a percentage of gross domestic product, should enable private investment to be financed without excessive difficulty, and by its macroeconomic effect on production and incomes contribute to the equilibrium of the current balance of payments.

A strict limitation on expenditure, operated principally in the fields of social transfers and public consumption should, as well as creating a certain room for specific measures in favour of employment, energy and housing, enable the authorities to avoid, taking into account the constraint of the budgetary balance, higher taxation or increases in social security contributions.

As is foreseen in the draft budget for 1981, the profitability of firms will be improved by channelling the surplus in receipts in 1981 resulting from the repricing of exports of natural gas into tax concessions and direct investment incentives. In total it will be desirable to contain the net borrowing requirement of general government within the limit of 4.8 % of gross domestic product.

The current stance of monetary policy should broadly be maintained in order to control the growth of domestic liquidity and to ensure, by the use in particular of interest rate policy, that an appropriate position of the guilder is maintained within the European Monetary System.

In *Belgium*, the balance of payments on current account has continued to deteriorate in recent years; it could well reach 5 % of gross domestic product in 1981, in spite of the expectation that there will be almost no growth and that inflation will decelerate.

Such deficits could gradually become an insuperable obstacle to achieving a satisfactory rate of economic growth and a reduction in unemployment which is expected to rise further in 1981.

Taking into account the causes of the external imbalance — an inadequate concentration on fast growing exporting sectors and high production costs — the necessary measures must be put into effect over a number of years if they are to succeed.

The measures must first of all be concerned with the budget of the central government, the deficit of which must be reduced in order to ease the pressures due to consumption demand and in order to change the structure and overall conditions of production.

With these needs in mind, the Government's intention to reduce the cash deficit of the general government sector, as a percentage of gross domestic product, by one percentage point in 1981 should be confirmed. The reductions and the redeployment of expenditures which such an action implies should help to moderate the growth in personal disposable incomes. The budgetary proposals for central government for 1981 which aim for a reduction in the net deficit from 254 000 million francs in 1980 (7.3 % of gross domestic product) to 242 000 million in 1981 (6.6 %), will not be sufficient in themselves to reach this objective, all the more so as tax receipts are tending seriously to fall short of initial estimates. It is a matter of priority that these austerity measures should be extended to other parts of general government, and in particular to putting the finances of the social security fund onto a sounder footing.

Monetary policy should remain restrictive in order to avoid excessive divergencies, compared with other currencies, within the European Monetary System, which would have an adverse impact on wage and price developments. This policy can only be relaxed when financial markets have reacted favourably to significantly reduced deficits for the public sector and the balance of payments.

A vigorous approach with a view to improving the supply conditions so as to permit the adaptation of

economic structure should aim especially at a reduction in production costs which should improve both the competitiveness of Belgian products and company profitability and their capacity to invest. To this end the Government is proposing a series of measures aimed at stabilizing real wages for two years.

In Luxembourg, economic activity slowed down in 1980, and will continue to do so in 1981, as a result of an unfavourable external situation — particularly in the iron and steel industry — which has the effect of aggravating problems of the labour market. In contrast, price inflation should decelerate significantly in the coming months. The central government budget, which has recently been proposed, includes a net borrowing requirement equivalent to 1.7 % of gross domestic product (compared to 1 % for 1980). It would be appropriate for this limit not to be exceeded in order to strengthen the trend towards a better internal equilibrium whilst introducing supplementary measures to encourage employment and additional provisions to stimulate the diversification and the strengthening of industry and to maintain a high level of public investment.

In the United Kingdom the objective of economic policy is to achieve a marked reduction in the rate of inflation, which is considered to be a precondition for an improved performance by productive industry and a return to economic expansion. The instrument of monetary control, used within the framework of a medium-term financial strategy, which aims at a gradual reduction in the growth of the money supply, has a dominant role in this policy.

In 1980, this policy is taking effect against a background of a reduction in activity and strong inflationary pressures.

Real gross domestic product may fall by almost 3 % in 1980. At the same time, average earnings have been increasing at an annual rate of about 20 %. Price inflation, over 20 % at an annual rate in the earlier part of 1980, declined markedly thereafter. The fall in output has been accompanied by a marked improvement in the United Kingdom's external position as import volumes have fallen, whilst export growth has remained relatively buoyant, despite the strength of sterling. Taking also into account that the United Kingdom, unlike other industrial countries, is enjoying a substantial favourable movement in the terms of trade, the current account is expected to be in surplus in 1980. In

response to the decline in activity unemployment has begun to rise sharply.

A further fall in output, of about 1 %, is forecast for 1981. However there is now clear evidence that the strength of recessionary forces, together with the high level of sterling, is helping to moderate wage and price increases, and a further decline in retail price inflation can now be foreseen for 1981.

Monetary and fiscal policies have been less restrictive than previously thought. According to the latest official estimates, the Public Sector Borrowing Requirement (PSBR) for the financial year 1980/81 will be considerably greater than the figure of £ 8 500 million envisaged at the time of the March budget. The rate of growth of sterling M3 remains significantly above the target range of 7 to 11 %, at an annual rate, for the period February 1980 to April 1981. This development has been due in part to the removal of 'corset' restrictions on bank lending. Interest rates have remained at a high level. A number of factors have contributed to the strength of sterling, including North Sea oil, the Government's firm fiscal and monetary policy, inflows of OPEC funds, the turnaround in the current account and high nominal interest rates in the United Kingdom.

Fiscal policy for the next financial year must be considered within the framework of the Medium Term Financial Strategy (MTFS) which emphasized that the reduction in monetary growth should not be achieved by too great a reliance on high interest rates, and that the trend in public sector borrowing, as a percentage of GDP, must be downward. As a consequence, the room for manoeuvre in 1981/82 is very limited. However, against the background of a further decline in output and inflation it may be possible to allow an upward cyclical deviation of the PSBR in 1981/82 compared with the trend figure of 3 % indicated in the MTFS.

The return to balanced economic growth requires an improvement in company profitability and, as a result, an easing of cost pressures, in order to encourage investment of the kind necessary to transform industrial and commercial structures.

On their side, the authorities should increase public sector infrastructure investment, which has fallen significantly in volume terms in the last few years, to the extent that it has a favourable impact on productive potential.



Economic policy guidelines for Greece will be drawn up for the first time after the new Member State's accession to the Community on 1 January 1981, on the occasion of the Council's first examination of the economic situation in 1981.

#### IV. CONCLUSIONS

The economic situation is manifestly serious enough to demand an active rather than passive policy stance. However, the policy mix has to be carefully judged, since ill-considered policy reactions could certainly make matters worse.

On the basis of the present outlook the policy mix should be strong in efforts to reduce inflation, save on oil imports, and pursue the other needed structural changes in the Community economy, and only moderately supportive in terms of cyclical demand management.

The outlook in fact suggests a rather more successful absorption of the second oil shock than the first one in 1973, in terms of the loss of output and the degree of acceleration and divergence of inflation suffered. If the Community economy manages to get back, at the beginning of 1981, onto a path of gradually increasing output and decelerating and converging inflation rates, this will represent a first positive element in the long process of adjustment that lies ahead.

It may be asked whether more could be done to achieve better results already in 1981 and for the longer-run future.

If by this would be implied a considerably more rapid or marked relaxation of demand management

policies, the answer — in the view of the Commission — is for the time being no. The dangers of restimulating inflation and oil prices in particular, especially in present circumstances of partly interrupted oil supplies, would be very great. Re-excited inflationary expectations could well, sooner or later, reduce demand by leading to increased precautionary savings by households.

There is on the other hand, much to be said in favour of a more rapid adjustment of the Community economy, in terms of the intensity of efforts to economize and substitute oil, to make market mechanisms work more efficiently, and to increase the scale of investment in new productive enterprises, with supporting action to provide an adequate infrastructure and a strengthening of education in skills directed towards new needs. Pressures towards protectionism in a situation of a fundamental and painful economic changes should be opposed because they are inefficient, short-term palliatives. However, this also requires a comparable access to the markets of our trading partners. The efforts of positive adjustment must also include extensive reforms in public finances (especially of certain Member States). A large responsibility falls on the social partners for achieving a slowdown in inflation and for assuring a distribution of income adequate to stimulate the growth of productive potential; in these respects adjustment to the realities of the new oil shock have not yet been accepted in all Member States.

The Community in the months ahead will be concerned in more detail with the adequacy of these efforts and of the plausible level of ambition for medium-term adjustment (notably in the examination of national energy programmes aimed at the Community's 1990 targets, and in the preparation of its fifth medium-term programme for 1980 to 1985).