II

(Acts whose publication is not obligatory)

COUNCIL

COUNCIL DECISION

of 12 December 1983

adopting the annual report on the economic situation in the Community and laying down economic policy guidelines for 1984

(83/674/EEC)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Decision 74/120/EEC of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community (1), as amended by Decision 75/787/EEC (2), and in particular Article 4 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament (3),

Having regard to the opinion of the Economic and Social Committee (4),

HAS ADOPTED THIS DECISION:

Article 1

The Council hereby adopts the annual report on the economic situation in the Community, contained in sections 1 and 2 of part I of the attached report, and lays down the guidelines to be followed by the Member States in economic policy for 1984, as contained in sections 3 and 4 of part I and in part II of the report.

Article 2

This Decision is addressed to the Member States.

Done at Brussels, 12 December 1983.

For the Council

The President

G. ARSENIS

(1) OJ No L 63, 5. 3. 1974, p. 16.
(2) OJ No L 330, 24. 12. 1975, p. 52.
(3) OJ No C 342, 19. 12. 1983, p. 66.
(4) Opinion delivered on 23 and 24 November 1983 (not yet published in the Official Journal).

1983/84 ANNUAL ECONOMIC REPORT

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PART I

THE COMMUNITY ECONOMY

1. Introduction: the central issue

The present annual economic report for 1983/84 is submitted to the Community institutions in accordance with established procedures [1].

The present short-term forecasts indicate only a hesitant and patchy recovery. The recession of three years, 1980 to 1982, was exceptionally long and damaging to the employment situation. These developments follow a whole decade of failure to achieve any substantial growth in employment alongside the rapid growth of population of working age. This report is therefore addressed to the central issue of economic policy now facing the Community: how to devise policies that will foster a stronger and durable recovery in the growth of production and employment in the European economy.

These questions have been highlighted by requests made in the conclusions of the European Council at Stuttgart on 17 to 19 June 1983. The European Council requested the Commission:

— to prepare a detailed analysis of the nature and extent of the recovery and what the authorities are already doing to support, consolidate and accelerate it,

— to make full use of Community financial instruments in a coordinated manner to sustain and consolidate the economic recovery,

— on this basis to indicate what new factors the Member States and the Community can bring forward to underpin the recovery, as and when necessary.

The European Parliament for its part decided, at the end of 1982, to examine the conditions for recovery of the European economy. It has subsequently decided to conduct a debate on this early in 1984, preceded by a phase of consultations.

These various initiatives in effect concern the same central complex of economic problems. In responding to the mandate of the European Council, the annual economic report sets out the conclusions that the Commission draws regarding the lines of action that seem appropriate for the period ahead.

2. The nature and extent of the recovery in progress

The following sections set out an assessment of the extent of the recovery now taking place, and the risks surrounding the outlook, on the extent to which the problems of unemployment, inflation and the balance of payments are being corrected and, finally, on the extent to which the underlying performance of the European economy seems to be changing.

2.1. *A hesitant European recovery in a turbulent international setting*

The recession, for the Community as a whole, probably ended around the end of 1982. The recovery which is taking shape (graph 1) offers the possibility of a progressive improvement in the economic situation. However, interpretation of the movement in progress, which in any case differs among the Member States, should not be exaggeratedly optimistic. It remains slow and fragile in all respects, particularly because of a series of risks relating, as described in the report, to the international environment. In the Community the total volume of output (GDP) remained stable in the second quarter of 1983 after rising at an annual rate of around 2 % in the previous two quarters, but the level of industrial production in the third quarter of 1983 was still lower than in the third quarter of 1982; in the United States, by contrast, industrial production has grown strongly (graph 2). At all events, it is a characteristic of the present economic cycle that neither the recession nor the recovery phase has been particularly pronounced in Europe.

(1) The Commission's proposed annual economic report is submitted to the Community institutions in accordance with Article 4 of Council Decision 74/120/EEC of 18 February 1974 on the attainment of a high degree of convergence of economic policies of the Member States of the European Economic Community (OJ No L 63, 5. 3. 1974, p. 16), as amended by Decision 75/787/EEC (OJ No L 330, 24. 12. 1975, p. 52). The Council is required in the fourth quarter of each year – on a proposal from the Commission and after consulting Parliament and the Economic and Social Committee – to adopt an annual report on the economic situation in the Community and to set economic policy guidelines to be followed by each Member State.

As in previous years the Commission is preparing, as a separate background document, an annual economic review which contains a more detailed factual analysis of economic trends and the outlook for the year ahead. This second document is for the information of the Council, Parliament and the Economic and Social Committee.

(% increase at seasonally adjusted annual rates)

	1982		1983	
	(whole year)	(fourth quarter)	(first quarter)	(second quarter)
Gross domestic product:				
— European Communities	0,4	2,3	2,1	- 0,2 [1]
— United States	- 2,2	- 1,3	2,6	9,1
Industrial production:				
— European Communities	- 1,4	- 6,6	2,8	2,8
— United States	- 8,5	- 9,3	12,1	20,2

(1) Figures for individual quarters are often erratic, and the early results are subject to revision. In the second quarter of 1983 there was a strong rise of output in Germany, offset by drops in Italy and the United Kingdom. However, in the UK case, alternative official estimates indicate stability in this quarter.

In its composition, the recent growth in Europe has been essentially due to a pick-up in private consumption, stockbuilding and house-building. This has been helped by the decline in inflation directly, as well as indirectly, through lower nominal interest rates. It will be recalled that around the beginning of 1982 there were also signs of a modest recovery. But these were sharply reserved by a collapse in world export demand, whose proximate cause lay in international debt and monetary problems.

The experience of previous cycles suggests that, in a second phase, investment and exports should become the engines of the recovery process. For this to happen it is important that there should be a decline in interest rates – which would help not only the growth of private investment within Europe but also a steady recovery in world trade through an easing of debt service burdens.

The distribution of economic recovery has been uneven between Member States of the Community: the main growth is forecast in the United Kingdom and the Federal Republic of Germany. In some countries the recovery will be retarded for reasons of necessary policy adjustment.

Looking ahead, there is a range of indicators which supports the forecast of gradual recovery (graph 10). Surveys of opinion among consumers, industrialists and construction enterprises all show widespread improvements. The share price index has in most countries showed striking gains, and this is usually a leading indicator of business prospects.

Revised forecasts by the Commission now suggest that the year-on-year GDP growth rates for the Community as a whole will be 0,5 % for 1983 and 1,5 % for 1984. Among demand components, in 1984, exports are expected to grow by 3,4 %, investment by 2 %, private consumption by 0,5 % and public consumption by - 0,1 %, whereas stockbuilding is expected to contribute little to growth. While aggregate growth will be modest its structural composition should thus be broadly in line with policy objectives.

This slow European recovery contrasts with that of the United States. However, while not denying that a major stabilization effort has been made in the United States and that its economy possesses genuine advantages of size and flexibility, it should be stressed that the US recovery springs to a considerable extent from an imbalance between a budgetary policy with expansionary effects and a monetary policy whose overriding aim, even though it has recently been more accommodating, is to reinforce the slowdown of inflation. The consequences of such a policy in terms of interest rates, the exchange rate and the trade deficit can, in the short term – and so long as their international impact is not taken into account – be more easily borne by a powerful, homogeneous economy benefiting from the advantages conferred by the status of its currency. In the Community, the economic policies of the Member States are subject to narrow margins of manoeuvre which reflect more burdensome constraints, notably constraints emanating from abroad. This situation has two consequences. First, an economic policy analogous to that in the United States cannot be adopted in the Community. Second, the effectiveness of European policies is very largely determined by their degree of coordination.

As to the effects of the US recovery on Europe, there are simultaneous and partly offsetting influences through several channels – the stronger direct US demand for imports, but also a more complex set of interest-rate, exchange-rate and business confidence effects. To give a simple first perspective, total European exports of goods and services to the United States amounted in 1982 to around $ 50 billion, or 2 % of the Communities' GDP.

Every 5 % increase in these exports would amount to a direct demand impulse of 0,1 % of GDP. Taking into account further possible European export gains in third country markets as well as the United States, in part as a result of the appreciation of the dollar's exchange rate, the total boost for European exports could *ceteris paribus* be twice or three times as great. However, there are important factors reducing this expansionary impact. The yen has remained relatively weak, which means that European competitivity gains overall have been much more limited than the simple dollar-ECU comparison might suggest. In addition, high world interest rates dampen the capacity of the indebted third world countries to import, in particular, from the Community. Finally, financial conditions within Europe are less favourable than they might otherwise have been, as a result of US interest-rate conditions and of a larger dollar appreciation *vis-à-vis* the Community. Overall it is hard to say where these offsetting influences net out; it should not be easily presumed that the balance for Europe is positive.

The world trade environment has evidently been depressed over the past three years (with nil or negative growth in 1981 to 1983) as a direct or indirect result of the second oil shock to begin with, and then the large and unpredictable swings in world interest rates and exchange-rate conditions. An acceleration of world trade is expected for 1984 (growth could be 3,5 %, according to Commission forecasts). The Community may be expected to make some small gains in market share.

2.2. *Stabilizing the unemployment rate?*

While a complete analysis cannot yet be made and caution is therefore called for, it seems that the recovery in activity was accompanied at the beginning of 1983 by a slowdown in the growth of unemployment and even a degree of stabilization. It should not be forgotten in interpreting this development that the forecasts for 1984 show a further slight increase in unemployment. In any case, the level of unemployment remains excessive: total unemployment at the end of August stood at 11,7 million, compared with 10,6 million at the same time last year.

From March to June 1983, the seasonally adjusted average rate of unemployment in the Community remained stable at the peak level of 10,7 %, and the observation for July showed a slight fall to 10,6 %, making it the first month to record a fall since July 1979. This level remained unchanged in August. The pattern of a stabilization or slight fall in unemployment since the spring of this year was common to all of the four large Member States, although continuing rises are still evident in most of the other countries and unemployment growth rates over the past 12 months are still positive for all Community countries except France. By comparison, in the United States, the rapid cyclical recovery has already reduced the rate of unemployment quite substantially from a peak of 10,7 % at the end of 1982 to 9,5 % in July of this year.

Coming after three years of continuous sharp rises in unemployment the significance of these recent developments needs careful assessment.

The statistical definition of unemployment has been revised in several countries (raising the total in the Netherlands but reducing it in Belgium and the United Kingdom), but the time series have been corrected and so this does not affect materially the recent trend.

The principal questions are whether the very recent stabilization of unemployment is to be attributed to a strengthening of labour demand or a reduction in labour supply, and whether this will now be sustained.

Although a definite assessment of the recent development of labour supply and demand cannot yet be made, there is some evidence that labour demand has strengthened a little: the number of vacancies registered showed increases in the second quarter of this year in Germany, the United Kingdom, Belgium and the Netherlands, but not in France, where they fell. The modest output growth recorded in the last three quarters may at least have arrested what was previously a slightly declining trend in total employment.

The intensification of special labour-market measures concerning, especially, young people and early retirement for older people (see further below) has had an effect on both labour demand and supply. One result is probably that the labour force is now nearly static in size, whereas the population of working age (15 to 64) is growing by over 1 % in 1983. Some direct employment creation measures have also been taken in a number of countries (again see below). Overall it seems probable that changes on both the labour demand and supply sides lie behind the recent developments in unemployment.

Forecasts indicate that the growth in unemployment will resume and that there will be a slightly higher yearly-average rate in 1984 compared with 1983. Some types of labour-market measures may be reaching the limits of their expansion and therefore output growth would have to strengthen if a renewed rise in the unemployment trend were to be avoided. However, the evolution of participation rates and productivity trends and the possible reaction of the labour market to real wage adjustments is also a matter of considerable uncertainty. In addition, the process of reducing and reorganizing working time is probably accelerating and, given certain prerequisites (also referred to further below), this could help ease the unemployment rate. Not all of the unknowns are therefore on the pessimistic side of the central forecast.

2.3. *A gradual convergence on slower inflation*

Considerable, but far from complete, progress has been made in reducing inflation in the period since the second oil-price shock in 1979/80. In 1980 the Community average consumer price rise was similar to that of the United States, being in the region of 14 %. By August 1983 the 12-month rate of increase had declined to 8,2 % in the Community but to 2,6 % in the United States. In recent months there have been signs that in both the United States and the Community the deceleration in inflation may have progressively been tending to ease off.

(% consumer price increases)

	1980	1981	1982	12 months to August 1983
Belgium	6,6	7,6	8,7	7,9
Denmark	12,3	11,7	10,1	6,1
Germany	5,5	5,9	5,3	3,0
Greece	24,9	24,5	21,0	20,0
France	13,6	13,4	12,0	9,6
Ireland	18,2	20,4	17,2	10,0
Italy	21,2	19,5	16,4	13,6
Luxembourg	6,3	8,1	9,4	8,3
Netherlands	7,0	6,8	6,0	2,7
United Kingdom	18,0	11,9	8,6	4,5
Community (10)	14,3	12,8	10,9	8,2
United States	13,5	10,3	6,2	2,6

Breaking down the total seven percentage points deceleration of inflation (measured by the total expenditure deflator) within the Community from 1980 to 1983, slower import price rises accounted for 2,5 points, unit labour costs four points and indirect taxes 0,5 point. While slower unit labour cost increases thus helped on average to reduce the inflation rate substantially, there were notable differences as between countries in the extent of the real wage adjustment in response to the second oil shock. Taking 1981 and 1982 together some real wage cuts occurred in several countries: Belgium, Denmark, Germany, Ireland, Luxembourg and the Netherlands. However, in France, Italy, Greece and the United Kingdom real wages continued to grow.

As regards the problem of divergent inflation rates, the figures above for the four larger countries show some progress in that the deceleration has (in percentage points) been greater in the countries which had double-digit rates of inflation in 1980. By mid-1983 the reduction in inflation had been three points in Germany, four points in France, six points in Italy and 14 points in the United Kingdom. Indeed, by mid-1983, no Community country except Italy and Greece any longer had double-figure inflation. In 1982 Denmark, France and Ireland were in double figures and in 1981 this was also true of the United Kingdom.

With the cycles of world inflation at times strongly influenced by world commodity prices, it is to be noted that the low point in the weakening of commodity prices in 1981 and 1982 has now passed. For non-oil commodities there was a clear break in trend around the end of 1982 as world prices for agricultural and mineral commodities turned sharply up (18 % in dollar terms and 34 % in ECU terms in the first nine months of 1983). However, this upward movement has been halted in recent weeks. The impact on costs and prices within the Community is reduced for agricultural commodities covered by the common agricultural policy (CAP), but is immediately felt for such commodities as rubber or aluminium. For the time being the positive aspects of these price adjustments must be recognized: they improve the terms of trade of many heavily indebted developing countries and are a condition for expansion of capacity in a number of cases.

The average price for oil imported into the Community did drop in dollars, from $ 33,7 per barrel in the fourth quarter of 1982 to $ 29,4 in the second quarter of 1983, following the cut in OPEC's marker price to $ 29 on 14 March 1983. Spare production capacity in OPEC countries should ensure a period of approximate dollar price stability through to 1984. However, the price of oil in ECU has hardly dropped at all from its mid-1981 peak level, and with the further recent appreciation of the dollar the ECU price probably rose again in the third quarter of 1983.

As noted in the table above, the deceleration of inflation has, on average in Europe, been considerably slower than in the United States. A large part of this difference may be identified in the 40% appreciation of the dollar against the ECU in the three years from mid-1981 to mid-1983. To the extent that at least the more recent rises of the dollar are deemed to be 'overshooting', then world inflation has been temporarily redistributed to the disadvantage of Europe and other countries with depreciating currencies. It is hazardous to quantify by how much there would have been a relatively better European price stabilization performance with less exchange-rate movement. However, if for example the ECU had depreciated by 15% less against the dollar, certain estimates suggest that the difference between the deceleration in inflation noted above from 1980 to mid-1983, as between the Community and the United States, might have been more than halved. At some stage in the future, when the dollar/ECU exchange rate reserves somewhat, it is likely that the current European stabilization effort will be more amply rewarded if it continues to be pursued with determination.

2.4. *Rapid balance-of-payments adjustments within Europe, but problems internationally*

Within the European Economic Community the pattern of balance-of-payments trends in the recent past has been a combination of several processes: the general adjustment to the second oil shock, correction in some cases of large, twin deficits in the budget as well as the balance-of-payments current account (e.g. Denmark, Ireland and Belgium), and correction in some cases of problems due to the marked desynchronization of business cycles (e.g. in France).

Overall, this complex adjustment process is proceeding reasonably well, both as regards the situation of the Community in the world, which is in moderate and declining deficit on current account, and as regards the situation of individual Member States. Several Community countries which have been in serious current-account deficit have, in recent months, been reporting much better trading results. In January of this year, Denmark and Belgium reported their first month of visible trading surplus for many years. For Ireland and France also a much improved foreign trade performance is emerging, whereas the results for Germany and the United Kingdom have recently weakened. In the deficit countries, the trade accounts have responded quite promptly to corrective measures including restraints on internal demand. Visible trade balances of course give only an incomplete picture, and rising debt services burdens in deficit countries require an improving trade account before the current account begins to improve. However, current-account deficits are also being reduced and Commission forecasts for 1984 suggest that in Belgium, Denmark and France their size as a share of GDP will be cut by two-thirds or more compared to 1982. For Ireland and Italy the reduction is even more marked, but for Greece an improving trend is not yet evident.

Major changes in the distribution of current-account balances at the world level are taking place:

Balance-of-payments current accounts (1)

(billions of US $)

	1980	1982	1983
European Communities	− 37	− 14	− 4
United States	0	− 11	− 30
Japan	− 11	+ 7	+ 18
OPEC	+ 111	− 4	− 22
Other developing countries	− 76	− 65	− 47

(1) The world balance, in theory equal to zero, differs from zero because of statistical discrepancies (non-recording of certain credits).

Compared to the extreme 1980 situation, by 1982 the industrialized and oil-exporting countries had, on the whole, completed the adjustment to the second oil-price shock. However, the indebted developing countries had delayed their adjustment and were also caught heavily exposed to the rise in world interest rates. By 1982 their current account position was still as unfavourable as in 1980. A rapid adjustment is now taking place; for example, Mexico reduced its imports by 60% over the past 12 months.

Among the industrialized countries there remain the problems of the worsening current account deficit of the United States and surplus of Japan.

For the Community a particular concern is that the US-Japanese disequilibria are not yet being met by plausible exchange-rate movements (a weaker dollar and stronger yen). Such movements would reduce protectionist pressures worldwide, and greatly ease problems of macro-economic policy in Europe. The Community's average competitiveness index improved by about a fifth from 1980 to 1982, whereas that of the United States deteriorated more than a quarter; however that of Japan changed much less.

Trade-weighted competitiveness index

(1970 to 1975 average = 100)

	1980	1982	1983 (estimated)
European Communities	124	100	100
United States	80	104	104
Japan	92	89	97

It is to be noted that these figures are significant for their evolution over time, rather than the relative levels of the index in a particular year, and the yen in particular is generally considered to be undervalued.

2.5. *Insufficient signs of structural improvement*

With cyclical trends gradually turning in more favourable directions, there remains the important question of whether the European economy is now on a course of more fundamental structural improvement. This notably concerns the problems of increasing the medium-run propensity to invest and employ, as well as performance in certain crucial branches of the economy such as energy and advanced technology industries, and services.

As long as both employment and investment are stagnant, as they are on average in the Community, the assessment must at best be cautious. Surveys of industrial investment intentions for the present year support this view. Between 1975 and 1982, the low points of the two major recent recessions, industrial output grew only by 1 % per year in the Community as a whole. Yet capacity utilization was reported by industrialists to be at the same level in both these years (76 %), which illustrates how little net addition there has been to the usable capital stock in industry and even hints at a possible reduction when capital productivity increases are taken into account.

Total investment has continued to slide down as a share of GDP, probably reaching 18,6 % in 1983, compared to 21,1 % in 1980 and also in the 1975 recession year. Investment has become increasingly concentrated in market service sectors, but employment growth in this branch, while positive, has still been much slower than in the United States (1,5 % per year in the Community compared to 3 % in the United States for the period 1973 to 1981).

In the energy sector there has been considerable progress. Energy demand has fallen sharply and this is estimated to reflect a sharp responsiveness to price (with an average negative long-term elasticity in the Community of 0,45) and a lower positive elasticity with respect to output growth than previously thought (0,65 rather than around unity) [1].

These economic adjustments can be illustrated by the reductions in final consumption of oil per unit of GDP over the period 1973 to 1981 as follows:

— Belgium/Luxembourg: −34 %,
— Denmark: −34 %,
— Germany: −30 %,
— France: −30 %,
— Italy: −24 %,
— Netherlands: −36 %,
— United Kingdom: −26 %,
— Community (10): − 29 %.

This shows a strong adjustment in all countries. However, the cost of imported energy, at first in dollars, and then through the dollar's appreciation, has continued to rise, or only just stabilized for European countries. This may be seen in the net import bill of Member States in energy products:

	ECU (billions)								Community (10) (% of GDP)
	Belgium/ Luxembourg	Denmark	Germany	France	Italy	Netherlands	United Kingdom	Community	
1978	3	2	12	11	8	1	4	40	2,5
1980	5	3	25	22	16	2	1	76	3,8
1982	8	3	31	28	24	2	−7	91	3,8

As regards the major industrial technologies, the evidence continues to show a lagging performance in Europe. Recent studies by the Commission show the Community's traditionally very strong position in the equipment goods sector to have been deteriorating. The Community's export/import ratio in this sector declined from 3,4 in 1963 to 2,5 in 1973 and to below two in 1981. While Japan gained strongly (its ratio rose from 2,2 in 1963 to 9,7 in 1981), the United States appears to have arrested its declining performance (the US ratio fell from 3,9 in 1963 to 1,3 in 1973, but was still at that level in 1981). Germany, the Community's principal producer, has been worst affected [2].

(1) For a detailed analysis see 'Energy and the economy: a study of the main economic relationships in the countries of the European Community (European Economy No 16 of July 1983)'.

(2) For a detailed analysis see 'Community foreign trade: the equipment goods industry under threat (European Economy No 16 of July 1983)'.

There have been some examples of striking increases in average labour productivity performance, notably in the United Kingdom, Belgium and Denmark. However, this has so far more reflected cuts in employment levels in sectors or enterprises, which used to be overmanned, rather than growth in high-productivity enterprises. Elsewhere productivity growth has slowed down substantially:

Annual average growth of manufacturing productivity per employee

	Belgium	Denmark	Germany	France	Italy	Netherlands	United Kingdom	Community
1960 to 1980	5,3	4,5	4,2	4,7	4,6	5,3	2,4	4,0
1980 to 1982	3,8	4,4	1,0	1,5	0,6	2,7	4,7	2,2

As regards the adaptability of real labour costs and labour income shares and their positive impact on investment and employment growth in the enterprise sector, there are difficulties of measurement and interpretation. However, it seems, as reported below, that there has been some relative improvement in Europe in the period following the second oil shock compared with the first one: real wages seem to have been less rigid and there has been some recovery in profits, although not in all countries, and overall the change would not yet seem to be decisive in relation to the more positive environment for enterprise in the United States and Japan.

In summary, the European economy has set in train a series of important economic adjustments and is progressively managing to face up to serious external constraints. Thus, one should not under-estimate the results which have already been achieved, notably on inflation. These results demonstrate both a collective recognition of the changes to be made and a capacity to implement the necessary policies. Similarly, the energy crisis has shown that the Community is capable of adapting to sudden upheavals in prices and supplies. But a return to lasting growth requires the continued pursuit of the adjustment effort already undertaken. It is on this effort that will ultimately depend the Community's capacity to achieve a lasting solution to the problem of unemployment. The results already achieved and the conditions which must still be fulfilled show that it is both indispensable and possible for the Community economy to follow through its structural adjustment effort and to assure a progressive increase in its trend rate of growth. It would, at all events, be a mistake to under-estimate either the size of the task to be performed or the capacity which the Community has recently shown for committing itself to such action and for reacting to the developments bearing on it. Moreover, the time-scale for the realization of this task underlines the need to continue to pursue an active employment policy for the more immediate alleviation of unemployment, which, at its present high levels, imposes major economic and budgetary costs as well as social ones.

3. Policy to strengthen the recovery: recent initiatives and the scope for further action

The stabilization policies followed in 1982/83 in the Community are now giving rise, as has been shown above, to a number of encouraging results: inflation is slowing down; external imbalances are being rectified; the stabilization of public finances is, at least in several Member States, proceeding favourably. The beginning of a recovery is becoming apparent and an acceleration in growth in 1984 can reasonably be expected. The situation and prospects with regard to unemployment, however, remain a major source of anxiety. Moreover, the positive results on the stabilization front, and similarly the economic outlook for 1984, are highly fragile: this fragility stems both from factors external to the Community and from the need, in terms of domestic considerations, to consolidate the results already achieved. The often difficult policies pursued up to now are necessary conditions for economic stabilization in the Community, but it would be a mistake to think that, because of a start-up of activity, which is so far purely cyclical, the efforts which have been made amount to sufficient conditions for a lasting recovery in the Community. The section which follows has precisely the aim of drawing out the economic policy actions (in the macro-economic and financial fields; structural measures, notably in the area of unemployment) and developments (notably wage developments) required to bring together the conditions sufficient for a progressive but durable recovery in the Community. This analysis hinges on four main questions:

- key problems of macro-economic and financial strategy, and more particularly of monetary expansion, interest rates and budget deficits,

- questions linked to the implementation of a whole series of structural, sectoral or micro-economically oriented measures which determine the real performance of economies, as opposed to their price performance, and have a very direct influence on employment,

— measures aimed directly against unemployment,

— the specific role of the Community at the level of its share of responsibilities in an important number of economic policy fields.

3.1. *The marco-economic and financial policy assessment*

The principal characteristic of the marco-economic and financial policies pursued in the Community in the recent past has been one of increased convergence. Certainly this has not yet been sufficiently evident in all the key economic indicators – even though very substantial progress has already been achieved on inflation. But going beyond the realized outturn, there is now a broadly common approach both to very short-term questions and to the more fundamental adjustments to be made. In this respect it is particularly indicative that the present balance of monetary and budgetary policies – indeed narrowly determined by the international monetary environment – is the object of a rather widespread identity of view about the main medium-term objectives. Thus the Community Member States are in general seeking to redirect the economy towards stronger growth of the private sector and a more satisfactory investment performance as well as a lasting consolidation of the reduction in inflation.

It has recently been very difficult to reconcile short-term monetary developments with the pursuit of medium-term objectives. World interest rates have remained high. This has retarded the recovery of productive activity in the Community – for which the widespread reduction or containment of budget deficits has been intended to make room. Disequilibria – often very marked – in public-sector deficits or public debts, as well as a concern to brook no further delay in the stabilization of public finances, have led the Member States of the Community to make an effort to limit or reduce budget deficits before or, at the latest, at the onset of the recovery.

Thus, for the Community as a whole, budget deficits have been held broadly constant as a share of GDP during the prolonged recession (5,2 % in 1981 and 1982, 5,4 % in 1983). This has entailed restrictive public expenditure and taxation measures because of the rising interest-rate burden (+ 0,8 % of GDP from 1981 to 1983 in the Community as a whole, and over twice this amount for Belgium, Denmark, Ireland and Italy). In addition, the recession has automatically raised certain expenditures and reduced tax receipts, perhaps by about 1,5 % of GDP over the two years 1981 and 1982, compared with what a modest trend rate of growth would have given. This has also been offset by restrictive policy measures. Overall, therefore, budgetary policy has been severe. For 1984 it is estimated that the total Community deficit will decline to 4,7 % of GDP. This forecast reflects a growing consensus that there should be no further delay in correcting the trend of budget deficits. One index of the size of the budgetary adjustment at present under way is seen in comparing the evolution of the Community's average budget deficit as a share of GDP before and after deducting interest payments:

	1981	1982	1983	1984
Before deducting interest	− 5,2	− 5,2	− 5,4	− 4,7
After deducting interest	− 2,2	− 1,9	− 1,6	− 0,6

Thus, merely to offset the rising interest-rate burden and keep the total budget deficit roughly stable, it was necessary to make significant tax increases or cuts in other public expenditures.

In the Community as a whole, money supply is expanding at present at an annual rate of 10 %, whereas nominal GDP is probably expanding at a rate of 7 %. Monetary policy is thus on average allowing for economic expansion in spite of international interest-rate constraints.

Some substantial reductions in nominal interest rates in the Community have been made. From the beginning of 1982 to September 1983, average short-term interest rates in the Community fell from 14,3 to 10,5 %, and in Germany they fell from 10,3 to 5,9 %. Over the same period bond rates fell by about 2,5 percentage points in the Community on average, and by 1,5 % in Germany. There have been some important successes registered in some other Community countries, such as Denmark, Ireland and Belgium, where stricter public finance and incomes policies appear to have changed expectations to the point of permitting large interest-rate reductions. The most striking case has been Denmark, where government long-term bond yields fell by seven percentage points over the past 12 months.

Short-term interest rates

	Belgium	Denmark	Germany	France	Ireland	Italy	Netherlands	United Kingdom	Community	United States
January 1982	16,0	15,3	10,3	15,0	18,5	20,5	10,2	14,5	14,3	13,4
September 1982	13,0	16,3	8,1	14,0	15,2	18,6	7,9	10,6	12,0	7,6
September 1983	9,3	11,9	5,9	12,6	12,8	17,5	6,3	9,8	10,5	9,1

In general Community Member States have managed a progressive reduction of interest rates compared with the more volatile US movements.

However, the real rate of interest remains high. The real government bond yield stands at present at 5,5 % in Germany and 6,5 % in the United Kingdom [1]. During July and August, when United States rates were hardening again, distinct efforts were made in Europe to minimize the impact on European rates. Nonetheless the bond yield in Germany, which is little susceptible to short-run policy management, rose a full percentage point compared to the lowest level experienced this year.

Several countries (notably Germany, France and Italy) have maintained and expanded selective interest-rate subsidies in favour of productive investments and specific sectors and regions, in part so as to give further protection against international interest-rate conditions.

A result of the broad European preference for a different budget-monetary policy in proportion to that of the United States has been the tendency for the ECU exchange rate to decline against the dollar. In the past year, European monetary authorities have at times intervened in exchange markets to moderate these exchange-rate movements, and in August 1983 there was some concerted intervention involving the US, Japanese and some European central banks. While the Community would have preferred to see a greater convergence of financial policies internationally, the ECU depreciation against the dollar has, in the circumstances, provided some extra opportunities for European enterprises in the US and world markets. However, as already pointed out, this is mitigated by other factors, including a low-exchange rate for the yen.

Considering how monetary and budget deficit policies should best be adapted to the priority of consolidating the recovery in 1984, the broad assessment may be as follows:

— Monetary policy remains constrained by the international monetary environment as well as domestic factors in many countries. Some decoupling from US interest rates can be managed but there are limits to this at present. If changes in the market environment permits, more progress should be made in reducing European rates. This depends in part in confidence earned in domestic economic policies in Europe. There is hardly scope for faster monetary expansion where inflation has not been brought under control. In countries which have achieved a good record of price stability, some temporary upward deviations of money supply above the target range may be justified while real interest rates are high and inflation and activity levels are low. Money supply targeting has also to be alert to the emergence of unexpected changes in the velocity of circulation. However, in such cases, it has to remain clear that policy will steer the growth of the monetary aggregates back on to the targeted path promptly enough to avoid the recrudescence of inflationary expectations.

— The reduction of budget deficits is, in many countries, an indispensable step along the path of a durable recovery. Further progress in this area is still necessary, all the more because it would contribute directly to a reduction in interest rates. The implementation of this guideline must, nonetheless, take into account the global economic context and especially the effects it might have on supply and demand. Thus countries which have already achieved major progress in their adjustment (slowdown of inflation, bringing the external account back into balance) and record modest budget deficits should avoid too precipitate a reduction of those deficits. At all events, if activity showed further signs of weakness, it would be appropriate to allow the automatic stabilizers to operate. Just as it is indispensable for the policy of reducing public deficits to be presented in a convincing way, it should also be possible to follow this policy without adhering too rigidly to pre-established targets but rather taking account of its possible destabilizing effects on short-term developments. Progress achieved in reducing deficits should, in any event, increasingly leave room for a reduction in tax pressure.

(1) The deflator used is the rise in the consumer price index over the past 12 months.

3.2. *Policies to strengthen productive potential and improve resource allocation in the public and private sectors*

Three broad domains of action will be discussed:

- the restructuring of public expenditure and taxation, with priority for improving productive potential,
- the role of the social partners in improving competitivity and stimulating the recovery process,
- re-examination of regulatory functions of government with a view to stimulating the economy.

Restructuring public expenditure and taxation (1)

Efforts to achieve better control of total public expenditure have been widespread. However, given both the continued weakness of the labour market, and hence a rising cost of unemployment compensation and programmes to create jobs and to reduce the labour supply, and a continuing increase in the nominal cost of debt-service, these efforts were still not able to prevent its share of GDP from rising. The share rose from 49 % in 1981 to an estimated 51 % in 1983 for the Community as a whole. Over the two-year period only Germany succeeded in stabilizing this ratio; in the United Kingdom the increase was quite small. In other countries the increases ranged from 2 to 4,5 % of GDP.

On the whole, public consumption's share of GDP has been stabilized at about 19,5 % of GDP in the Community as a whole. The compression of entitlement or benefit levels for current transfer payments was often significant, but in many countries it did not prevent further increases in their share of GDP, notably from 22,5 % of GDP in 1981 to 23,5 % in 1983. Measures to limit current transfers often included, for example, reductions in some social and family benefits, a tightening of eligibility criteria for unemployment benefits (and in some cases reductions in the levels of such benefits), and various techniques for increasing user charges for health services. Announcements recently made in Member States for 1984 budgets indicate further efforts, often of exceptional severity, to bring the trend of current transfer payments under control (Germany, Italy, France, Belgium, the Netherlands and Denmark).

As regards public investment, some countries, notably France and Greece, have made very large absolute increases in the level of their public investment expenditures. Several other countries have been introducing a positive discrimination in favour of investment expenditure in roughly maintaining their level in real terms alongside a severe curtailment of many programmes of current public expenditure (Germany and Italy). This policy thrust comes after a number of years in which public investment appears to have been more squeezed than current expenditures.

For the promotion of private investment, a number of fiscal initiatives are being implemented (2). Indeed this category of action is receiving probably a stronger priority than public investment, notably in the United Kingdom. Here two broad types of action may be recognized: fiscal provisions to induce physical investment by enterprises, and fiscal provisions to strengthen the flow of savings into risk capital.

In the former category, depreciation allowances have been notably improved in France, and this is envisaged in Germany in 1984. The United Kingdom has introduced a large number of fiscal provisions to help the enterprise sector, some targeted on selected sectors such as oil exploration and new small firms, some easing corporate taxes more generally. Italy has improved the VAT treatment of investment, while the Netherlands has eased taxation on the self-financing of enterprises out of profits.

To aid the risk capital market, France and Belgium have extended or introduced fiscal advantages for personal investment in shares as has the United Kingdom for investment in smaller companies; in Italy a law has been passed to permit and encourage the establishment of investment funds; Germany and the United Kingdom have improved the fiscal provision for employees to take up shares in their enterprises (3). Germany and other countries are examining how to improve the supply of venture capital.

(1) See also the Commission communication to the Council of 1 July 1983 on fiscal policy in the Member States in 1984 and a related report of 6 July 1983 on budget discipline and economic convergence and restructuring public expenditure in favour of productive potential.

(2) 'Business investment and the tax and financial environment (European Economy No 16 of July 1983)' and the Commission communication to the Council of 18 April 1983 on tax and financial measures in favour of investment (also in 'European Economy No 16').

(3) Through increasing the amounts of share capital participations subject to tax advantages and, in the German case, benefiting from subsidies.

A general policy objective has been to reduce subsidies to uneconomic sectors and the financing of the operating losses of State enterprises. A particular aim has been to couple this with the reduction of excess capacity and with restructuring measures in the sectors and regions concerned. Remaining subsidies need to be subject to better control of their economic justification, that they lead towards the competitiveness of recipient enterprises and are in any case compatible with EEC competition law. In terms of aggregate expenditures, although the statistics are often incomplete or difficult to interpret, it is certainly not yet evident that the trend of these expenditures has on the whole been mastered. There remains a strong concentration of subsidies in contracting industries (steel, ships, textiles, coal, railways) compared to the financial effort in favour of innovation and advanced technology industry. In the United Kingdom there are major examples of reduced subsidies or losses of State enterprises (automobiles, railways, air transport) and individual examples in other countries. In Italy the losses of the State-enterprise sector remain of considerable macro-economic proportions. In Germany the recent 'Subventionsbericht' reported still slightly increasing federal subsidies, with a DM 29 billion total expected for 1984. Other countries would do well to publish equally systematic information on their subsidies.

A reduction of the tax burden, or at least putting a stop to its rise, is recognized as a major aspect of improving the European economy's performance and competitivity. The combination of cyclical influences and the priority given to containing deficits resulted in fact in further increases in the GDP share of tax and social security contributions taken together (46,6 % in 1983, after 44,7 % in 1981 and, 10 years earlier for the Community as a whole, 38 %). Germany held the aggregate unchanged from 1981 to 1983. In the United Kingdom it broadly stabilized between 1981/82 and 1982/83, but in all other countries the tax burden grew, in some cases very substantially (France, Italy, Greece and Luxembourg).

Broad changes in tax structure have been pursued in Germany, as in the United Kingdom in recent years, aimed at improving incentives and private investment. As regards France, major changes in 1981 and 1982 in the tax structure have been guided by the objectives of fiscal equity, with the result of moving the income-equalizing effect of the tax system closer to the European average.

Social security costs are conspicously high as an addition to labour costs in Europe compared with other industrialized countries. All countries have been attempting to limit these costs. However, no country was able to reduce the average rates of social security contributions in the past year, although in the United Kingdom the additional labour cost imposed in the form of a surcharge on firms has been reduced. Several countries were faced with rising social security expenditure (especially unemployment benefits) and deficits, and were obliged to raise total contributions (France, Luxembourg and the Netherlands). Such action to reduce deficits is helpful *vis-à-vis* interest rates, but from the point of view of the future of the enterprise sector and employment, and even if part of the problem is linked with the level of activity, the correction should be made less by increasing contributions than by curtailing expenditure. Heavier contributions still appear to be the predominant remedy.

As regards further action on the restructuring of public expenditure and taxation:

— while recent policy initiatives have often been important, the effort will have to be sustained, or even in some cases intensified, if past trends in the structural growth of public expenditure and taxation are to be adequately corrected,

— there is still a tendency in several countries to curb budget deficits more by further increases in the tax burden than by economizing on expenditure, and this needs to be halted or reversed,

— improvements in the tax and financial environment of firms should be made in order to induce a greater flow of resources into investment and a larger supply of risk capital. In its communication of April 1983 (1), the Commission concluded that there was a need to avoid increasing, and even to reduce, the tax burden on firms; to strengthen and adapt investment incentives; to encourage risk taking by adjusting certain tax arrangements; to improve the channelling of savings, especially the savings of wage and salary earners, into risk capital. A number of measures along these lines has recently been adopted or is proposed in the Member States. It is important for this effort to be maintained and adapted, along the lines proposed by the Commission and as a function of the specific situation in each member country. In this way, firms should be enabled to respond better to the requirements of modernizing productive structures.

(1) Tax and fiscal measures in favour of investment of 28 April 1983 (COM(83) 218 final).

The development of wages

In many Community countries there have been strong efforts to reduce wage cost increases in order to improve international competitiveness and reduce inflation. The form of this action has been quite varied according to institutional and other aspects of national situations. Examples include action focused on indexation practices (Belgium, Italy, Denmark, the Netherlands and Luxembourg), on the important role of public sector contracts (Germany, the Netherlands and the United Kingdom), or on broader incomes policy concepts (France). Overall, considerably stricter nominal and real wage-cost disciplines are being observed in Community countries. In nominal terms the average increase in compensation of employees per head in the Community is estimated to have declined to 7,2 % in 1983, compared with a peak of 13 % in 1980.

Cyclical recession usually causes an adverse development in labour productivity, but on this occasion the effort to improve productivity performance has outweighed the cyclical influence. Thus unit labour cost increases in the Community have on average declined to an estimated 5,5 % in 1983, compared with the peak of 11,5 % in 1980. However this is still above the 3 % increases estimated for 1983 for both the United States and Japan. The real product wage (unit labour costs deflated by the GDP deflator) fell by about 1 % in 1982 and is expected to do so too in 1983. This indicates some redistribution of income in favour of enterprise profits, a pattern common to almost all Community countries.

For the period ahead there is still much to be done to adapt costs and income shares in a manner that will support a long-term economic recovery:

— The development of nominal pay must continue, in certain Community countries in particular, to contribute to the slowdown in inflation, thus also creating increasing room for real economic growth. The 'real' degree of restrictiveness of financial policy, which is fixed in nominal terms, depends in large measure on the beaviour of trade unions and enterprises with regard to pay.

— While it is difficult to prescribe normative evolutions for real pay for a wide range of country situations, a plausible yardstick is that there should be little or no expectation of real pay increases, at the level of the macro-economic aggregate, until the economic recovery has well advanced into a phase of strong investment and employment creation. In some cases negative real-wage adjustments are still necessary. Income growth needs to be channelled as a priority into capital accumulation and capacity expansion for a period of some years. The relatively low profitability of the European enterprise sector remains a fundamental problem inhibiting the recovery process.

— As regards the negotiation of pay at the enterprise level, two objectives are of widespread relevance. Firstly, increased flexibility in pay differentials as between skills or branches is often needed to create more employment opportunities and to clear the labour market more effectively, even in countries where aggregate pay has evolved reasonably. Secondly, pay negotiations should be adapted far more directly to helping the individual enterprise to invest and expand. Europe would probably benefit from a higher share of remuneration being related to enterprise profits and performance, a practice which is far more developed in Japan. Schemes for participation of employees in the capital wealth of the enterprise are on a modest scale. Imaginative schemes are called for to adapt pay to the overwhelming need in the years ahead for high investment financed by risk capital. While the main initiative must lie with the social partners, governments can, as already indicated, encourage the process with regulatory and fiscal provisions.

Re-examination of regulatory functions of government

It is increasingly recognized that many regulatory activities and mechanisms do not properly achieve their desired goals, or do so at very high costs – both in terms of administration and disincentives to innovation and to the legally imposed efficiency of resource allocation; thus they may have in effect a depressing impact on the potential rate of growth. Recent actions to reduce the economic costs of (broadly defined) regulation are extremely disparate in nature, and no doubt leave large further scope for reform. Such examples include the easing of rent regulations in Germany, of the conditions of labour recruitment in Italy, of working time regulations in Belgium, the introduction of lightly regulated enterprise zones in Belgium and the United Kingdom, and the privatization of some State enterprises, and in the Netherlands a wide-ranging programme of action to streamline regulations that impede economic activity.

There is typically a very wide range of restrictive arrangements affecting service branches and the professions as well as industry and labour markets.

Competition policy in its traditional sense is usually quite limited in scope by comparison with what needs to be done. Many service branches, which are sometimes self-regulated or locally regulated, are good candidates for review – for example restrictions on opening hours of shops. Many financial services and professional activities are needlessly compartmentalized and sheltered from competition, imposing higher costs on the economy – or, directly, a higher cost of living. Monopolistic arrangements in various branches of industry may have lost their *raison d'être*, for example, for reasons of technological change. While not calling into question basic standards or some recent well-founded regulatory legislation, there are nevertheless labour laws, often introduced at times of full employment and of a smaller income-redistributive role of the State, which need to be re-examined for conformity with present economic and social priorities.

In conclusion, for the period ahead, there is much more to be done in Member States to remove unnecessary market rigidities. The objective must be to devise a continuing stream of regulatory reforms pushing in the direction of higher productivity and less inflated prices.

3.3. *Direct labour market actions to ease the unemployment problem*

Major training programmes have been further developed, for instance in Germany, France, Ireland, the Netherlands and the United Kingdom and the Council has adopted a resolution on vocational training. There is an efficient large consensus on the usefulness of these types of measures. They constitute a means of combating that part of unemployment which is structural. Technological progress is such that training needs constant adaptation if mismatch on the labour market between skills and vacancies is to be avoided. Direct aids to employment creation, either through a reduction in employers' social welfare contributions, or employment subsidies to the public sector, have also been introduced or expanded (particularly in Belgium, Denmark, Germany, Greece, France and the United Kingdom). In Germany, for example, 56 000 people are now concerned in the programme of employment subsidies, while 130 000 jobs are to be created in the United Kingdom for the long-term unemployed. In both cases, the additional financial burden is expected to be limited since planned expenditure is partly offset to the unemployment benefit payments saved.

On the other hand, early retirement schemes (such as those which have been introduced in Belgium, the Netherlands and France) are representing a growing financial burden on social security budgets. In addition, some doubts exist as to how much further these measures can be expanded. Depending on activity rates, a progressive reduction of the average retirement age may lead to a reduced ratio of employed to retired population, especially in a few years' time (1986) when the demographic growth of the population of the age bracket 15 to 64 stops, whereas the older population will be growing fast.

Programmes of local initiatives are receiving increasing attention, for instance in France and the United Kingdom, in order to encourage self-employment creation both in the service and in the industry sectors. Such developments needs help, for example as regards skills and guidance over organizational, fiscal and regulatory matters. If such support can be given at the time the initiatives are established, this will additionally help stem the growth of the black economy.

The Commission is preparing a communication to the Council on this subject. The potential employment capacity in very small-scale enterprises appears to be very considerable – depending upon diverse legal forms: self-employment, companies with individual ownership, cooperative enterprises and non-profit-making companies and voluntary organizations. Such initiatives may exploit local skills in craft and engineering sectors (local natural resources); they may also, for example, take over viable parts of failed enterprises.

The reduction and re-organization of working time has become an important element in debate and action on the very high rate of unemployment.

In several Member States, negotiations have been engaged or concluded with a view to using shorter working hours as an instrument of employment policy. In France, following official measures decided to reduce the average working week from 40 to 39 hours in 1981/82, the initiative has been passed on for decentralized negotiation.

In Belgium and the Netherlands, collective agreements have, as proposed by government, in many cases linked the reduction of annual working time to increases in employment, together with measures of pay restraint. In Italy, specific working hours reductions are envisaged in new collective agreements. In some cases an increased flexibility in working time in service sectors has been negotiated alongside a lengthening of opening hours and increase in employment (e.g. in the Belgian bank sector).

For such measures to have a durable positive impact on total employment, strict conditions have to be assured to prevent increases in the costs of enterprises. Experience is in fact showing both favourable and unfavourable examples. Among the positive examples, the combination of more flexible and shorter individual working hours with longer opening hours for service branches, more shift-work in industry, and more part-time jobs can all contribute positively to the economic recovery and to the reduction of unemployment. Many more detailed and often decentralized initiatives are emerging, such as the job-splitting schemes in the United Kingdom. The French 'ninth plan' too is intended to encourage the development of 'new formulae' for part-time jobs. They will be integrated into the negotiation on reduction of working time.

In response to the Commission's memorandum of 1982 on the reduction and reorganization of working time, the European Parliament adopted a resolution on 28 April 1983 recommending, in the short term, a significant reduction in working time, taking account of national circumstances and the circumstances of individual sectors and firms, and implemented in a way that avoids cost increases.

The social partners in the Economic and Social Committee adopted in July 1983 an opinion which concluded that the reduction and reorganization of working time could help to mitigate the unemployment problem, if conditions similar to those outlined in the Commission's memorandum were met.

In September 1983, the Commission proposed a recommendation to the Council on the reduction and reorganization of working time aiming:

(a) to bring about a reduction in individual working time, combined with its reorganization, sufficiently substantial to support the positive development of employment, under conditions which safeguard competitivity as well as basic social rights; and

(b) to limit systematic paid overtime more strictly and to increase the extent to which necessary overtime is compensated by time off in lieu of additional payments.

In conclusion, for the years ahead, active policies must be pursued which aim at reducing unemployment and its social and economic cost. While it takes time to change the macro-economic environment in the desired directions, many immediate initiatives have to be vigorously pursued. In particular, the Commission is advocating that the following domains of labour-market policy be given priority:

— training and retraining schemes, especially for young people (1),

— job creation initiatives, also with priority for young people (1),

— increased emphasis on the stimulation of local initiatives for small-scale employment creation,

— initiatives to increase employment through the reduction and reorganization of working time, while respecting the necessity of avoiding increases in unit costs of production.

3.4. *Actions by the European Economic Community to strengthen the recovery*

The European Economic Community's own policy responsibilities are substantial in its management of policies for trade, the internal market and competition. Moreover its role is tending to develop in the macro-economic field and in the field of improving competitivity, notably industrial competitivity, and more generally of strengthening the economic structure in liaison with the development of its financial instruments. The present report gives an overview of recent developments and initiatives following, notably, the conclusions of the European Council held in Stuttgart in June 1983.

Macro-economic and monetary policy

The European monetary system (EMS) fulfils several functions in the present economic situation, all tending ultimately to ensure stable economic growth. Firstly, it ensures exchange-rate coordination for most of the European continent and protects participating countries against the pronounced exchange-rate instability prevalent in the industrialized world as a whole. It thus ensures a certain homogeneity and cohesion for the economic entity formed by the Community. It thence contributes to consolidating the advantages afforded by the possibility of exploiting, notably in the industrial field, a large, integrated market. Further, the EMS is a strong instrument for monetary policy coordination and, beyond that, serves as framework for discipline and for experience in the better common practice of coordinating economic policies. Finally, the EMS, by requiring a common assessment of the external monetary constraints, provides the Community with an organized base for its contribution to work on improving the international monetary system.

(1) In April 1983, the Commission addressed to the Council a proposed resolution on the promotion of employment for young people. This is currently under discussion.

In the past year there was one realignment of parities in the EMS, on 21 March 1983. This realignment was notable for two reasons. It was a realignment involving finely judged changes for most of the central rates. It was accompanied by important domestic policy adjustments, in particular in France, so strengthening the future stability of the system.

The use of the ECU in private markets also grew markedly in the past year, and this should contribute in time to a more balanced international financial system.

The world economic recovery is almost certainly being hindered by slowly increasing protectionism. An important aggravating factor at present lies in the configuration of exchange rates and widening current account imbalances on the part of the United States and Japan. More stable and cooperative solutions to these problems are strongly desired by the Community.

Structural and micro-economic policy

The dimensions of the internal market in Europe represent an enormous under-exploited potential for making the economic environment propitious to growth, efficiency and low inflation (taking a broad view of this domain to include non-tariff barriers and the potential for more active competition and industrial policy). The extension of the internal market, which should provide enterprises with guaranteed access to a market of continental size, could constitute an element of dynamism as powerful as that which the achievement of the customs union represented for the Community during the first 10 years of its existence. The time has come to recognize the fundamental inter-dependence between this complex of micro-economic topics and the macro-economic prospects for the economic recovery of the Community in the medium-term. The links between Community actions, or potential actions, are widely and deeply connected with national policies. The two – national and Community – sets of actions have to move powerfully together in mutually supporting directions. Whole branches and sectors of the economy are at present blocked in their potential for higher productivity growth and for lower costs and prices by a combination of national restrictions and resistance to the efficient use of Community powers. Almost all trade in manufactured goods is severely impeded by multiple non-tariff barriers, including failure to agree on common technical standards, restricted public procurement and frontier delays and costs. Fast growing, and potentially even faster growing, branches of the service sector – such as civil aviation, road transport, insurance and financial services – are the subject of very serious regulatory restrictions throughout the Community, and negotiations on Commission proposals have been extremely slow-moving in this field, and the conclusions of the European Council in Copenhagen should be implemented more rapidly. The capital markets of the Community are also badly fragmented: the Commission has proposed a new attack on these problems, with a view to assuring a free flow of Europe's large capacity for savings into the effective restructuring of the Community economy (1).

As regards several of the technologically advanced growth industries – such as information technology, biotechnology, aerospace and alternative energy sources – there is in the view of the Commission a vast potential for more effective European collaboration. There are several different types of organization of the European effort which have shown themselves to be successful, of which the Community's Esprit programme is a new example, and should stimulate a much larger strategic push for a reversal of Europe's industrial technological weaknesses (2).

Regarding the Community budget, the Commission has, in its recent communications, recommended increasing the share of spending devoted to action to right the economy and to improve the employment situation: it has therefore proposed a doubling in real terms, over a five-year period, of the resources devoted to industrial, regional and energy objectives and to research and development.

The Community's borrowing and lending activities have also been developed and adapted to the need for an improvement in investment performance. Lending operations amounted to 5,3 billion ECU in 1982 and will probably show a significant increase in 1983, apart from the four billion ECU balance-of-payments loan to France. The higher priority given to the financing of investment in the productive sector is illustrated by the fact that loans in this area have more than doubled from 1981 to 1982 – particular attention having been paid to small and medium-sized enterprises. The continuing development of these activities has been secured in 1983 by the extension and renewal of the new Community instrument

(1) See the Commission communication to the Council of 20 April 1983 on financial integration.

(2) For further detail, see the Commission note on 'l'amélioration de la competitivité internationale des entreprises européennes', and many convergent ideas also presented in memoranda of the French Government ('Une nouvelle étape pour l'Europe: un espace commun de l'industrie et de la recherche'), of the United Kingdom Government (The development of the Community: other policies), and of the German Government (Reconsideration of policies and the development of new actions (excluding agriculture)), all of September 1983.

(NCI), under which the Commission has been empowered to borrow a further three billion ECU, with subsequent authorization of a first tranche for an amount of 1 500 million ECU. In addition, the Commission has made in June 1983 a proposal for a Community financing of innovation in small and medium-sized enterprises. In the Commission's view, a determined Community action, with the main objective of encouraging the private financial sector in the Member States to become more active in favour of innovative investment in small and medium-sized enterprises, will open up a substantial growth potential and lead to the creation of additional future oriented jobs.

In conclusion, the following further action by the Community is called for the period ahead:

— Reinforcement of the European monetary system is feasible as an aid to economic recovery, and a most important next step could be extension of its membership to the whole Community. Strengthening of the European monetary mechanisms should help give economic policy in Europe a greater margin of manoeuvre in relation to the international monetary environment. Development of the private and official uses of the ECU, and a revision of the capacity of its lending mechanisms, are among the possibilities of action.

— Better international cooperation could certainly help strengthen the recovery, and the Community must increasingly organize a collective position in order to influence events as effectively as possible. Concretely, the Community's interest is that the major industrialized countries should correct, or avoid creating, large distortions and external shock impulses in their financial policies. In the present situation, action in the United States to reduce future budget deficits is important to European policy management aimed at sustaining the recovery. The Community should also encourage work towards an international monetary regime that is less unstable in its exchange-rate behaviour, and whose adequacy in terms of the supply of reserve assets is assured. The Community urges that the expansion of IMF financial resources is quickly ratified by the United States. The industrialized world must give strong support to efforts to strike the right balance between adjustment and financing in the heavily indebted developing countries.

— A quantum step in progress in opening up the Community's internal market and in the stimulation of its advanced industrial capacity is now required as a contribution to medium-term economic recovery. If such progress is realized, the productive sector will have new opportunities to develop trade and industrial production.

— The Community budget should progressively be directed towards giving more active support to the achievement of industrial, regional and energy objectives as well as research and development objectives. Finally, the exploitation of the credit of the Community, through the development of its borrowing and lending activities, should contribute directly to the priority objective of strengthening investment in the Community.

4. Summary and conclusions: for consolidating a European recovery

1. The European Council has requested the Commission's assessment of the extent of the economic recovery, and what further measures could be taken to strengthen it.

2. Some cyclical recovery in Europe is apparent. But it is patchy and on the whole weak and potentially vulnerable to any new adverse shocks from the international economy. The increase in unemployment may have tailed off, but even if the level does stabilize it remains very high. Some of the major prerequisites for a stronger recovery – monetary and financial stabilization – have been largely assured in several countries, and progress is being made elsewhere. There is increasing evidence that there is now a Community-wide effort to bring trends in public finance and wage costs under control.

3. But the transformation of the adjustment process into a next dynamic phase of recovery is not yet evident on a wide or deep scale. This may emerge automatically in some degree. However, in the Commission's judgment, the risks of relapse into continued quasi-stagnation are too great to let policies stand on the status quo.

Because of the risks, mainly of external origin, to which the recovery is still subject, the Community should make it its first priority, alongside the national or related internal actions described in this report, to participate in every way in action to stabilize the international environment, whether such action concerns contributions to finding a lasting and balanced solution to the problem of indebtedness, or the improvement of the international monetary system.

Internally, a further impetus, as outlined below, is needed if the European economy is to regain the desired course – one of significant growth, of high levels of employment and competitivity, and low or declining inflation rates.

4. The Commission is of the view that the further development of policy to strengthen the prospects for a durable and profound European economic recovery should be in the following directions:

(i) use of room for manoeuvre to reduce interest rates further as and when international and domestic conditions allow;

(ii) reduction of structural budget deficits and then their stabilization at a low level to facilitate a renewed growth of private investment, without, however, excluding recourse to the automatic stabilizing properties of the budget, where its basic financial condition is sound;

(iii) a restructuring of public expenditure and taxation, notably to:
- give priority to expenditure, particularly infrastructure expenditure, that helps expand productive potential,
- stop and even reverse the growth of the tax burden,
- further improve the fiscal environment for the enterprise sector;

(iv) review of regulatory activities of government with a view to reducing inefficiencies and rigidities that depress productive potential;

(v) a sustained effort to reduce unemployment through direct measures such as:
- training and retraining schemes, especially for young people,
- job creation initiatives, especially through stimulating local and small-scale employment units,
- the reduction and reorganization of working time respecting the need to avoid cost increases;

(vi) development of incomes in line with the conditions for economic recovery, in particular:
- in many countries, further nominal deceleration in pay, which will reduce inflation and help financial policies have a more expansionary real effect,
- real wage evolutions that allow for a major improvement of enterprise profitability to support an investment recovery, and growth in employment,
- greater flexibility in pay, through collective negotiations, to help clear the labour market more effectively, and an expansion of practices which relate pay to enterprise performance and boost employee participation in the financing of investment;

(vii) strong support at the Community level for this concerted direction of national policies, notably through action under three headings:
- reinforcement of the Community's monetary mechanisms and determined action of the Community in pursuing improvements in the international monetary system and the environment for world trade,
- building up Europe's potential in new growth sectors of advanced technology such as information technology, telecommunications and biotechnology, through complementary national and Community action,
- large steps in fully opening up the Community's internal market, in which the remaining plethora of restrictions is barring the way to a new potential dynamic growth.

5. The European countries have little hope, if they act in a disorganized way, of transforming achievements in stabilization into a dynamic recovery process. Only a quantum step forward in a concerted national and Community action, which could be much helped by better wider national cooperation also, can achieve a strong recovery.

6. With a number of internal and external factors now clearly working in favour of economic recovery, a rapid mobilization of all the means of action presented above could confirm the movement.

7. If a sufficient critical mass of consistent policy initiatives is built up within countries and the Community as a whole, the fundamental climate of economic expectations in Europe could be changed in favour of growth in investment and employment and in favour of competitive European enterprise.

8. The objective should be to make 1984 the pivotal year in confirming this fundamental change in the European economy's development. A 'straw-fire' of unsustainable growth should not be the objective. What is required is the maximum positive growth consistent with progress in reducing fundamental structural problems that have been accumulating over a least a decade, if not two.

ANNEX

LABOUR MARKET POLICY MEASURES IN 1982/83 (1)

Belgium

Early pension granted on proof of replacement workers taken on; temporary reduction in social security contributions for employers recruiting their first employee; financial aid to small and medium-sized firms taking on registered unemployed; raising of school-leaving age; possibility of reduction in working hours associated with taking-on of additional workers.

Denmark

Government aid to firms or local authorities taking on young unemployed people.

Germany

Temporary aid to firms taking on unemployed people; programmes of training and retraining for young and adult unemployed people.

Greece

Financial aid to creating jobs for young people; reorganization of apprenticeship system; reduction of working-time to 40 hours a week.

France

Job-training contracts (financial aid to employers who guarantee a training and a certain length of employment); help towards the reduction of working-time if this takes place without loss of output and with the number of workers maintained or increased.

Ireland

Training programmes for young people; setting-up of an investment body for direct job-creation.

Italy

Setting-up of a investment fund for employment; agreement among the two sides of industry and the government *inter alia* on the wage escalator (scala mobile) and on a reduction in working-time by 40 hours a year by mid-1985.

Luxembourg

Aid for employing long-term unemployed people; ban on overtime.

Netherlands

Periods of job training for unemployed young people; subsidies to employers offering apprenticeships; agreement between the two sides of industry on the possibility of a reduction in working-time.

United Kingdom

Job-training programme for young people involving 12 months training for all those leaving school at 16; community programme creating part-time community-service jobs; job-splitting scheme to encourage part-time work.

(1) This list is illustrative, not exhaustive.

TABLE 1

The European Community economy, main economic aggregates, 1961 to 1984

	GDP nominal increase	GDP volume growth	GDP price increase	Consumer price increase	Compensation per employee	Current account of balance of payments	General government net lending or borrowing	Money supply growth	Unemployment rate
	% (4)	% (4)	% (4)	% (4)	% (4)	% GDP	% GDP	% (4) (5)	%
1961 to 1970	9,1	4,7	4,3	3,8	8,9	0,4	-0,4	10,4	2,1
1971 to 1980	13,0	2,9	9,8	9,7	13,3	-0,1	-2,8	13,8	4,2
1981	8,7	-0,4	9,1	10,1	12,1	-0,6	-5,2	10,8	7,8
1982	9,5	0,4	9,1	8,7	9,6	-0,6	-5,2	10,7	9,5
1983 (last report) (1)	(7,5)	1,1	(7,0)	(6,6)	(7,4)	-0,4	-4,9	10,0	10,3
1983 (this report) (2)	6,9	0,5	6,3	6,3	7,2	-0,2	-5,4	10,1	10,4
1984 (3)	6,6	1,5	4,9	5,6	6,0	0,0	-4,7	7,8	10,9

(1) Of October 1982. Figures in brackets from the last annual report are revised as a result of change in statistical weighting methods.
(2) Estimates of the Commission services (October 1983).
(3) Forecast of the Commission services (October 1983) on the basis of present or anticipated policies.
(4) Community averages calculated with current GDP weights at purchasing power parities.
(5) End of period (annual growth rates).

TABLE 2

Forecast evolution of gross domestic product in 1983 and 1984

(% change)

	1983				1984		
	Nominal GDP (last report)	Nominal GDP	GDP output volume	GDP price deflator	Nominal GDP	GDP output volume	GDP price deflator
Belgium	7,9	6,2	-0,9	7,1	7,0	0,6	6,3
Denmark	8,6	9,8	2,2	7,4	6,5	1,2	5,2
Germany	4,7	3,8	0,7	3,1	5,1	2,1	3,0
Greece	23,0	19,5	-0,2	19,7	19,7	1,5	17,9
France	10,8	9,5	-0,3	9,8	7,7	0,4	7,3
Ireland	15,5	11,2	0,5	10,6	10,1	1,8	8,2
Italy	16,9	14,1	-0,8	15,1	12,0	1,5	10,4
Luxembourg	8,8	5,6	-2,4	8,2	6,3	-1,0	7,4
Netherlands	3,3	1,9	0,3	1,6	2,4	0,0	2,4
United Kingdom	8,2	7,9	2,8	4,9	7,2	2,2	4,8
Community	(7,5)	6,9	0,5	6,3	6,6	1,5	5,1

Source: Commission services.

TABLE 3

Indicators of macro-economic disequilibria and constraints in 1983

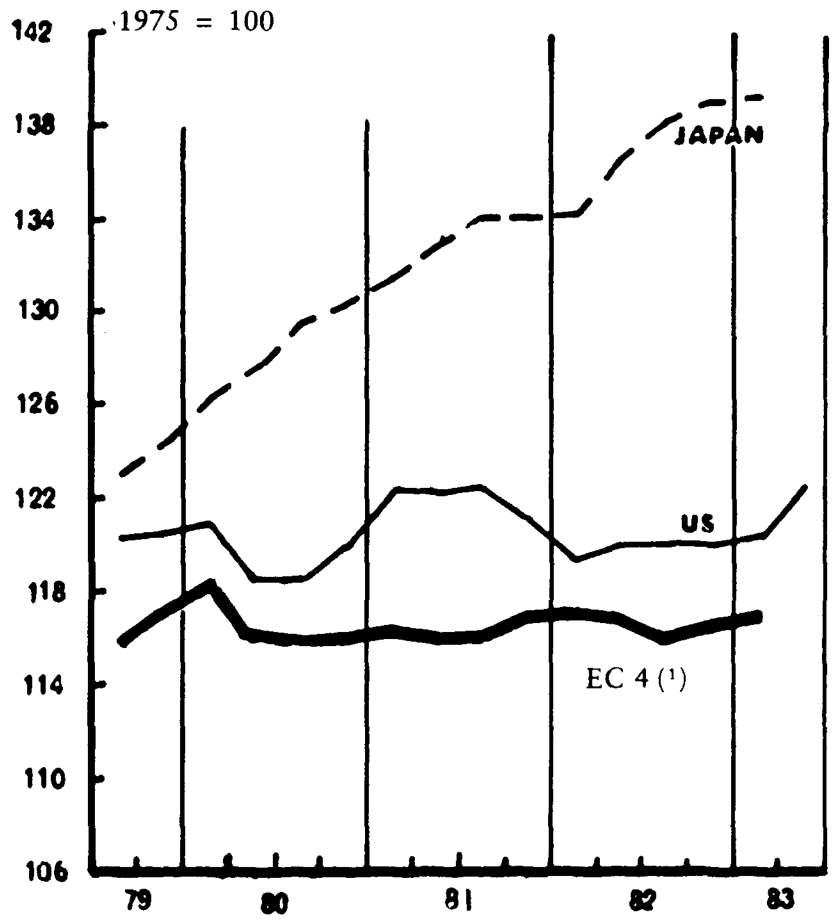
Member State	Unemployment rate	Private consumption deflator (% change)	Balance-of-payments current account (% of GDP)	Real rate of interest long-term ([1])	Public finance: Budget balance (% of GDP)	Public finance: Budget balance less interest payments	Public debt (% of GDP 1982) ([2])
Belgium	14,4	7,8	−2,4	3,6	−12,2	−2,9	(97,8)
Denmark	10,7	6,6	−2,2	7,8	− 8,8	−3,9	25,8
Germany	8,6	3,0	0,9	5,5	− 3,3	−0,7	38,3
Greece	7,8	20,5	−5,0	−0,6	− 6,3	:	:
France	8,9	9,0	−1,8	4,1	− 3,1	−1,4	(16,8)
Ireland	14,6	11,0	−2,6	3,5	−13,4	−3,3	102,5
Italy	9,0	15,0	−0,4	2,3	−11,9	−3,5	70,3
Luxembourg	1,8	8,4	:	:	− 2,9	−4,8	:
Netherlands	15,6	2,8	3,3	6,5	− 6,7	−3,4	(54,0)
United Kingdom	11,7	5,7	0,2	6,7	− 2,2	+0,9	54,7
Community	10,4	6,3	−0,2	3,6	− 5,4	1,6	(43,4)

([1]) Government bond yield in July 1983 adjusted by consumer price inflation over the preceeding 12 months.
([3]) Central government debt for Denmark, Greece, France, Ireland, Luxembourg and the Netherlands; general government debt for Germany; 'settore statale' for Italy; public sector for Belgium and the United Kingdom.

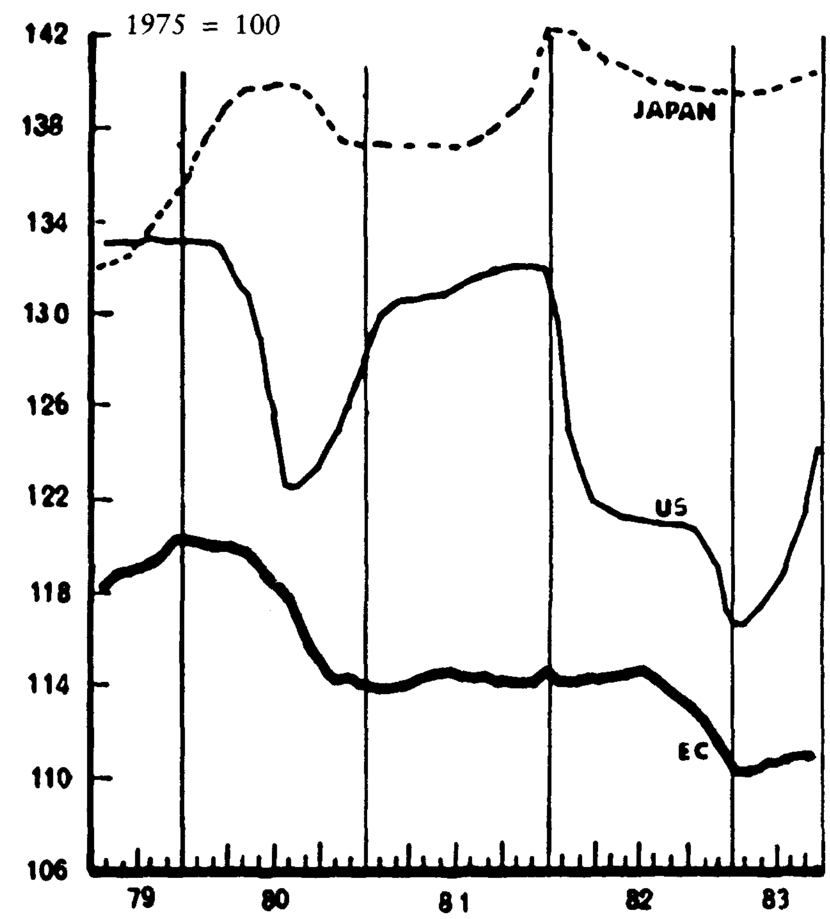
GRAPHS 1 to 8

Comparative evolution of the Community, United States and Japanese economies, 1979 to 1983

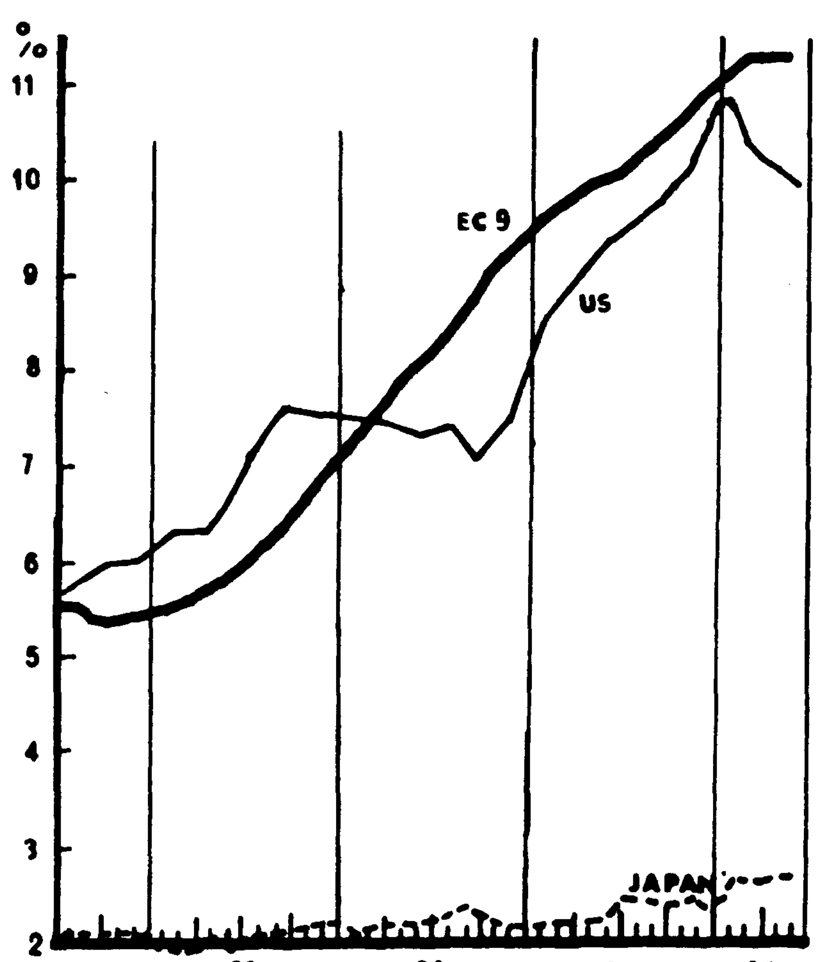
1. *Gross domestic product* (seasonally adjusted)



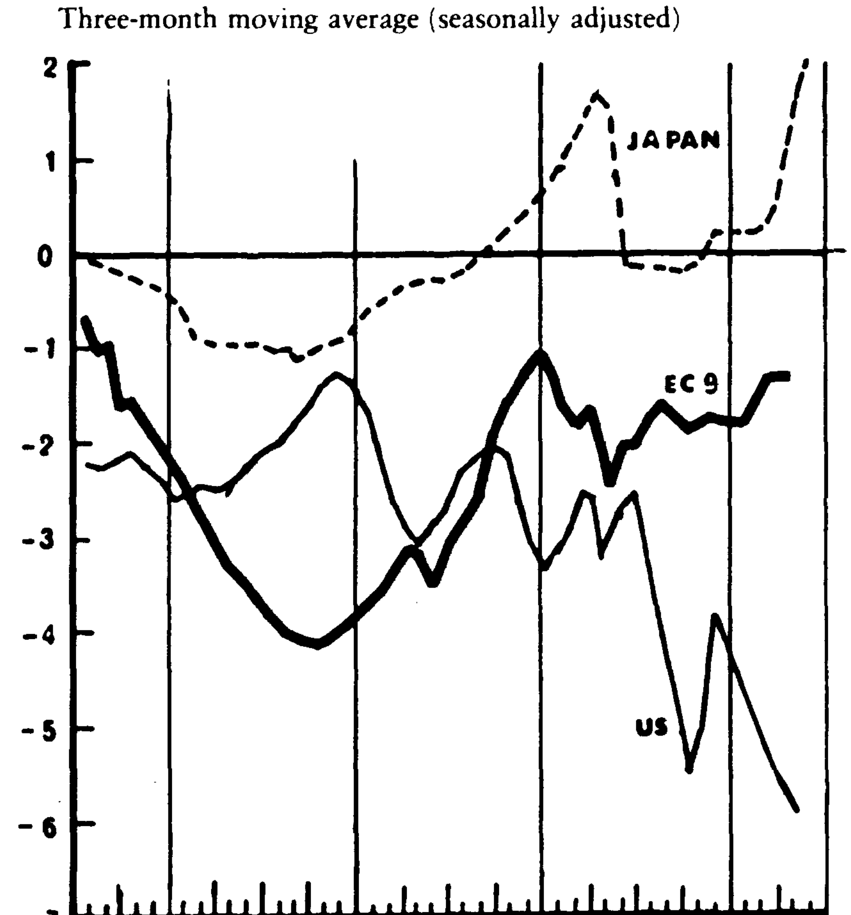
2. *Industrial production*
Three-month moving average (seasonally adjusted)



3. *Unemployment rate*

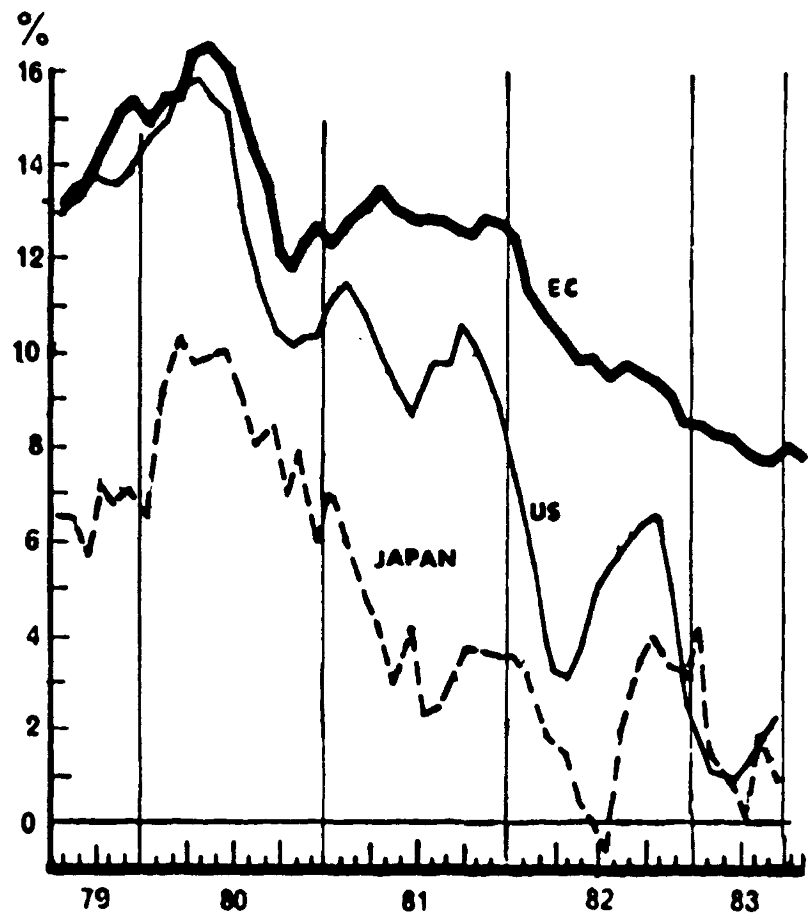


4. *Trade balance*
(fob/cif, billion ECU)
Three-month moving average (seasonally adjusted)

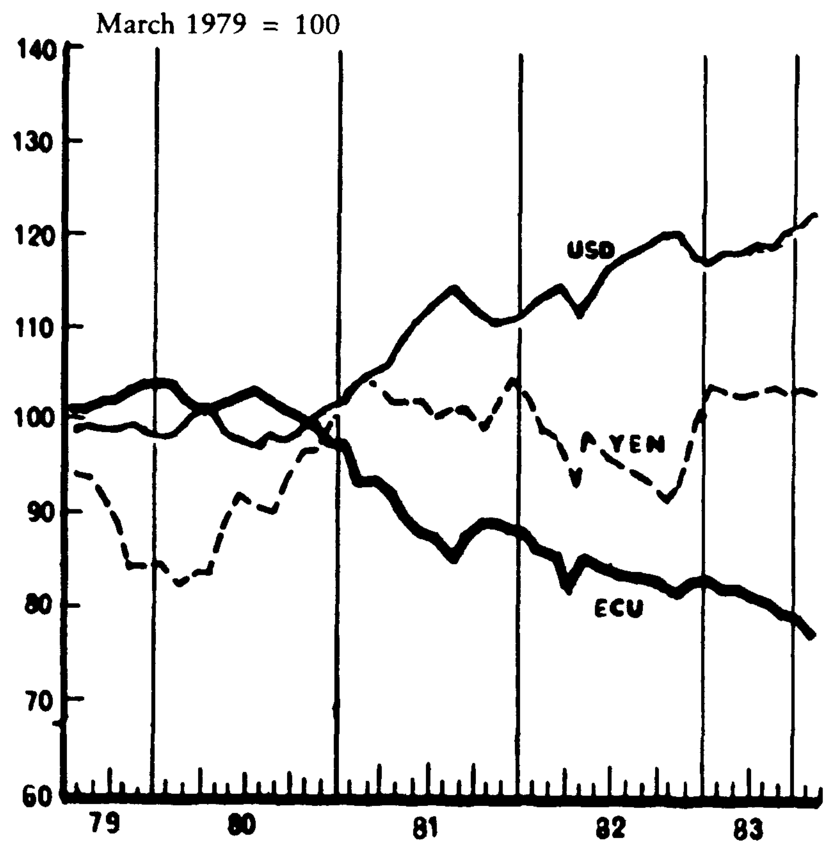


(1) Germany, France, Italy and the United Kingdom.

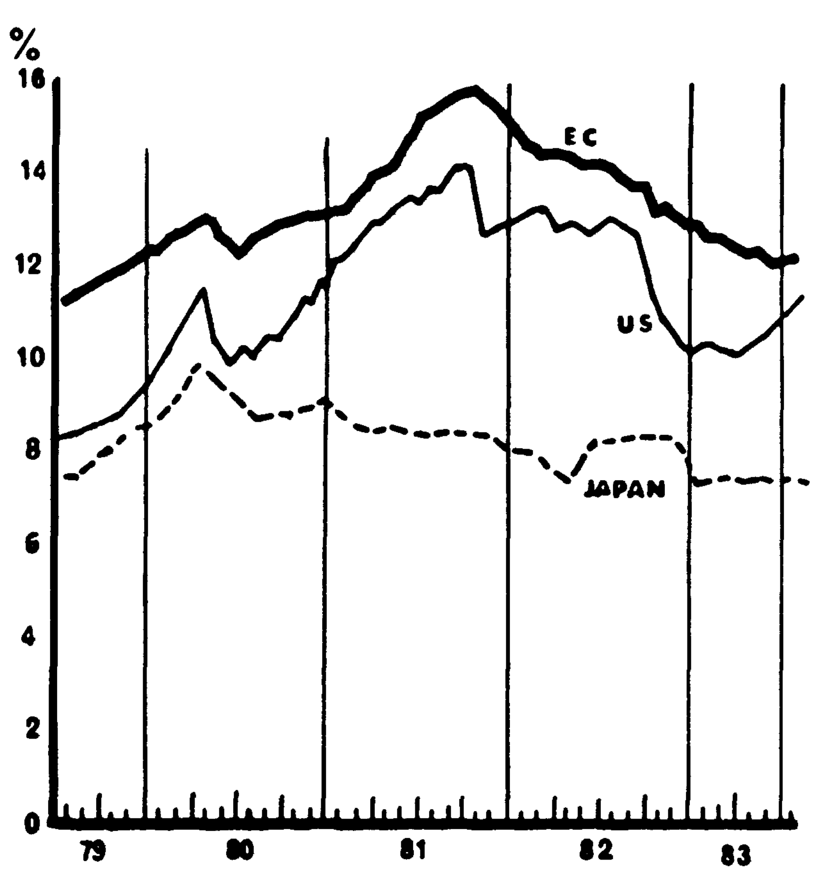
5. *Consumer prices*
Six-month change (seasonally adjusted) annual rates



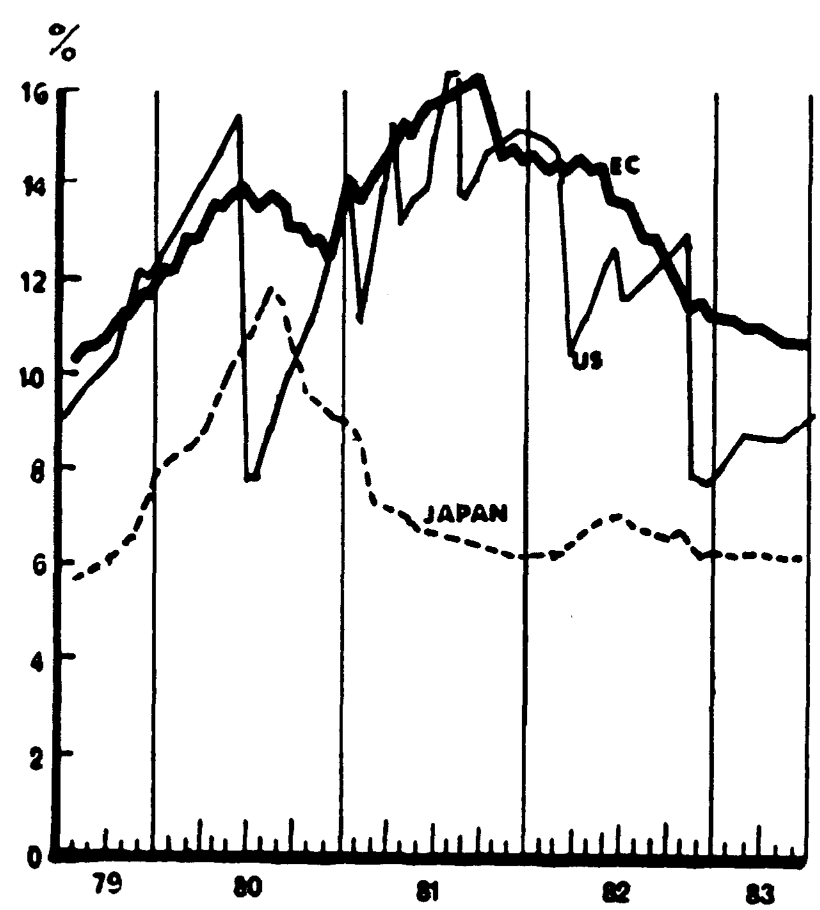
6. *Exchange rates*
Index of SDR per currency unit



7. *Long-term interest rates*

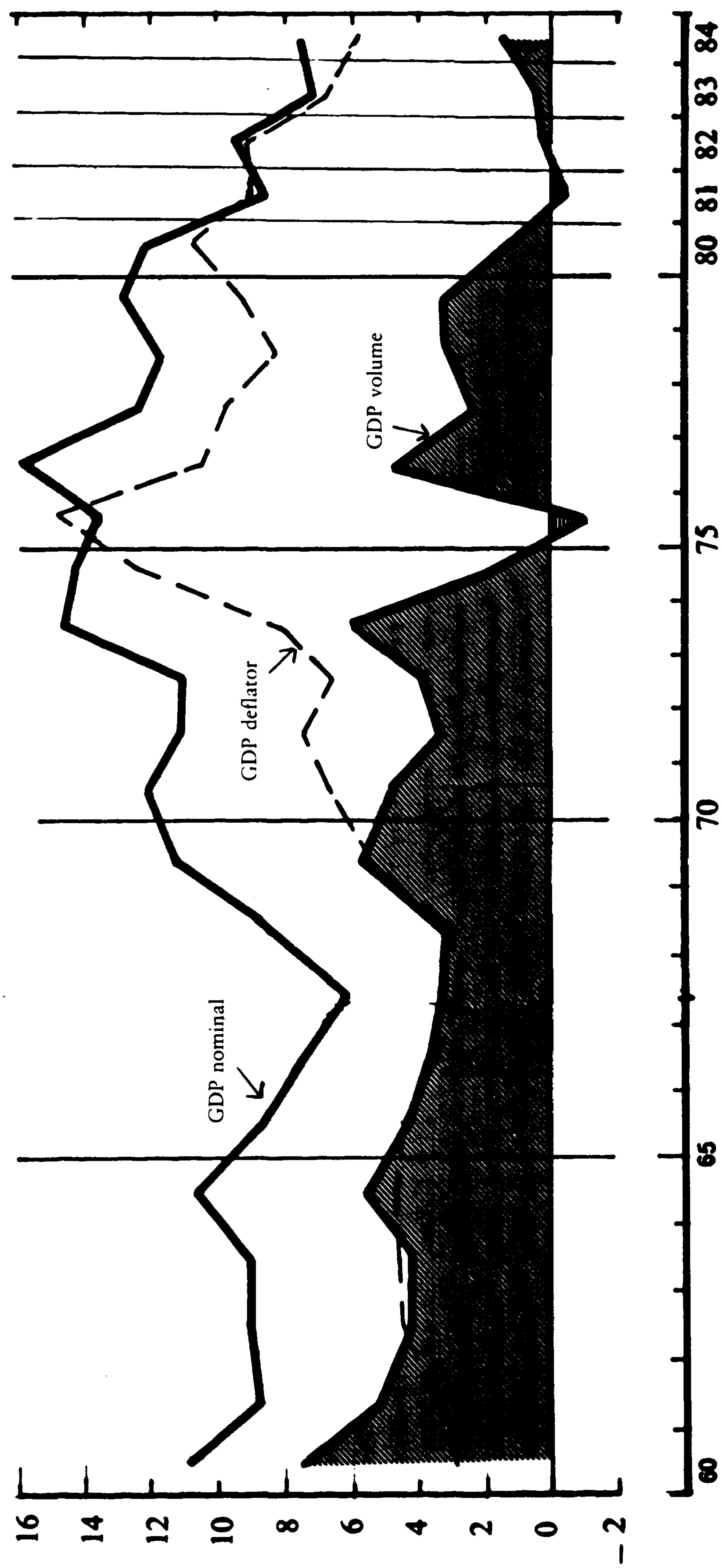


8. *Short-term interest rates*



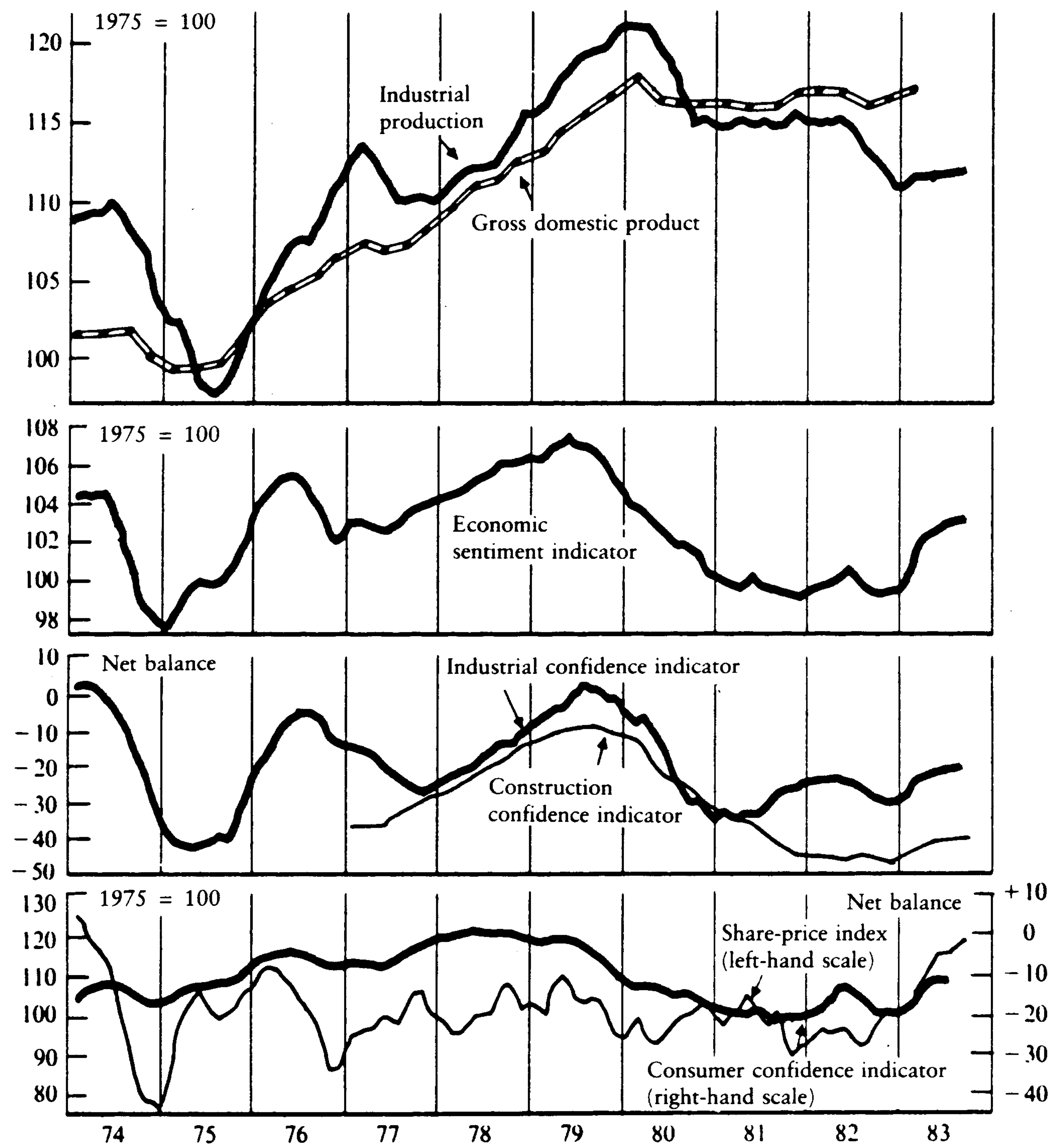
GRAPH 9

Gross domestic product of the Community, nominal, deflator and volume (% increase)



GRAPH 10

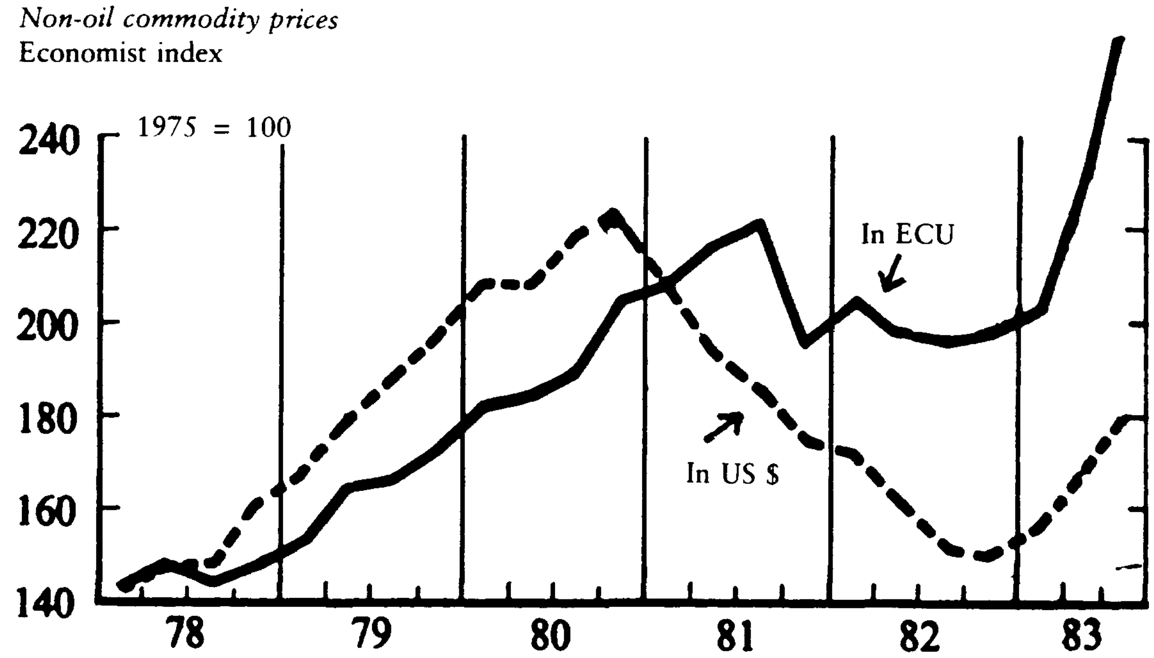
Indicators of output and economic sentiment – Community



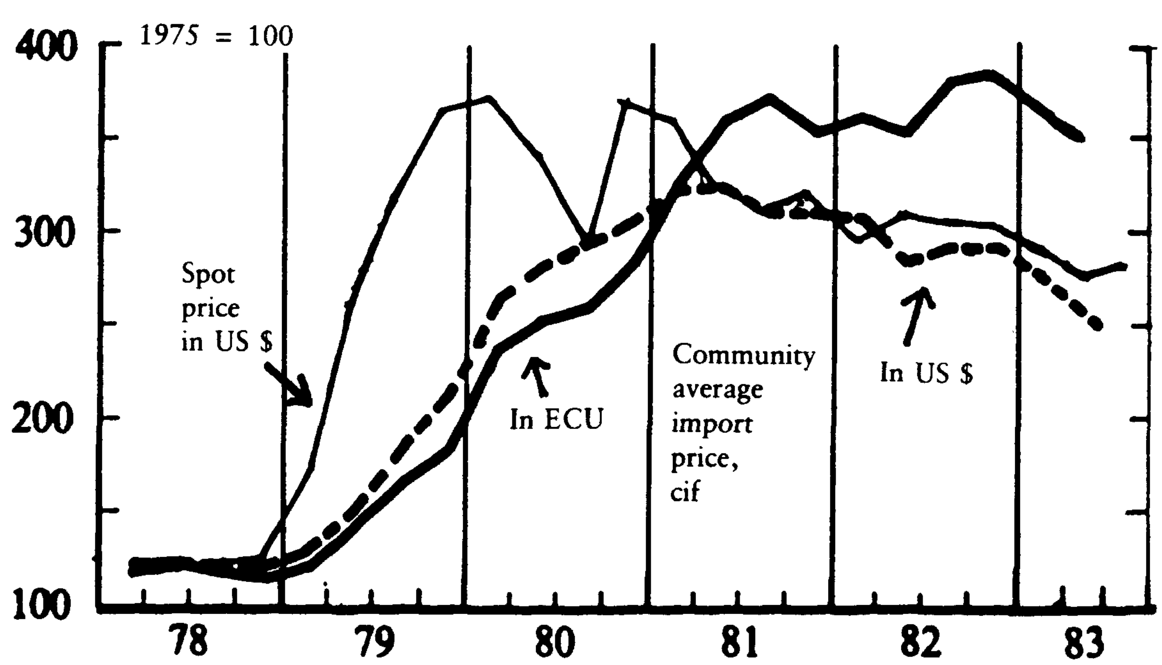
GRAPH 11

Commodity prices

Non-oil commodity prices
Economist index



Oil prices



PART II

THE ECONOMIES OF THE MEMBER STATES

In *Belgium,* the economy made further progress towards restoring external balance by improving competitive capacity. However, economic activity was weak for the third consecutive year and this led to a further increase in unemployment. Gross domestic product for 1983 contracted by almost 1 % in real terms.

It is expected that 1984 will see a slight expansion, mainly due to increased exports, since domestic demand will, on balance, probably remain stable. Private consumption is expected to contract somewhat as a result of the squeeze on households' disposable income, while business investment should gradually show more vigour. The balance of payments on current account will show a smaller deficit than in 1983; the deficit of 1,5 % of GDP will be mainly attributable to the levels of official transfers and interest payments on public debt, denominated in foreign currency since, for the first time since 1975, a small surplus is expected on the balance of trade. Unemployment is likely to be up again on the previous year, affecting on average 15,3 % of the civilian labour force in 1984. The agreements concluded since the end of 1982, at sector or individual firm level, which provide for shorter working hours and extra recruitment in the context of wage restraint, may help to curb the growth of unemployment.

Since the currency realignment of March 1983, the Banque nationale has managed to reconstitute its foreign currency reserves and clear its debtor position in the European monetary system, while reducing the discount rate from 14 to 9 %. If monetary policy could be geared to a steady reduction in interest rates, this would make a major contribution to the recovery of investment; however, the distance still to cover in achieving external equilibrium and the sizeable borrowing requirement of the public sector would appear to make the implementation of such a policy far from easy.

Incomes restraint must be maintained to safeguard the competitiveness of the economy and the development of productive investment in 1984, but the reduction of the budget deficit is now the keystone for economic improvement and for a return to conditions conducive to sustained growth. Against a background of weak growth, with adverse effects on tax revenue, the reduction of the central government deficit to 7 % of gross domestic product – the target for 1985 set in the 1982 government agreements – will certainly not be easy in spite of major savings in expenditure in the past two years.

Even the slight reduction in net borrowing in relation to 1983 planned in the draft budget for 1984, which actually implies somewhat slower progress towards the 1985 objective, will be difficult to achieve in view of the weakness of activity in 1984. However, the cost of servicing the public debt and the burden of taxation have reached a stage where even tighter management of expenditure is absolutely essential. Also the limit imposed on the central government deficit (11,3 % of GDP in 1984, compared with a deficit of 12,7 % of GDP in 1983) cannot in any circumstances be exceeded as it has been in previous years. If necessary supplementary measures will have to be taken to keep the deficit within this limit during the budget year.

Restoring the budget to a sound footing by means of a reduction of the structural deficit is an essential condition for more satisfactory development of economic activity and employment, but, basically, it will be determined in the medium term by in-depth restructuring of the economy which in turn depends on a substantial increase in productive investment. The tax measures adopted in 1982 will help here, but a policy of restraint for both direct and indirect wage costs is equally important, if not more so. The results obtained so far confirm, subject to the above remarks, that the policies pursued are producing results and that a return to growth in production and employment, in the years to come, can be expected.

TABLE 4

Belgium: main economic aggregates, 1961 to 1984

	GDP value growth	GDP volume growth	GDP price deflator	Rise in consumer prices	Compensation per employee	Current account of balance of payments	General government balance	Money supply growth, M2 (³)	Unemployed in labour force
	%	%	%	% (²)	% (²)	% GDP	% GDP	%	%
1961 to 1970	8,5	4,8	3,5	3,2	7,8	0,2	- 1,3	8,6	2,2
1971 to 1980	10,4	3,2	7,0	7,0	11,9	0,4	- 4,6	10,3	5,8
1981	4,0	-1,1	5,2	8,8	7,4	-4,2	-12,6	6,6	10,7
1982	8,1	1,0	7,0	7,4	8,0	-3,6	-11,9	5,7	12,6
1983 (¹)	6,2	-0,9	7,1	7,8	6,0	-2,4	-12,2	5,0	14,4
1984 (¹)	7,0	0,6	6,3	6,5	7,7	-1,5	-11,1	6,7	15,3

(¹) Preliminary estimate of the Commission services on the basis of present or anticipated policies.
(²) % change over previous period, annual rate.
(³) End of year.

In *Denmark,* economic growth slowed down from 3,4 % in 1982 to some 2,2 % in 1983, and the inflation rate came down from about 9,8 to 6,6 %, partly as a consequence of the restrictive stance of fiscal and incomes policy since the end of 1982. Following the sharp deterioration in 1982, the deficit on the current balance of payments improved considerably as a result of the policies pursued and a favourable shift in the terms of trade. Although the public finance situation worsened between 1982 and 1983, there was some improvement during 1983 as social transfer payments and public sector pay increased at a slower rate, and the cost of servicing public sector debt increased less rapidly. Thus the net central government borrowing requirement was limited to 12 % of GDP, slightly below the corresponding guideline adopted by the Council last year. Although lower inflation helped to increase the room for manoeuvre with regard to economic policy, the employment situation did not improve. The slow increase in economic activity inhibited the demand for labour from the private sector and consequently the reallocation of resources envisaged as between the public and the private sector.

The outlook for 1984 points to rather slow growth accompanied by a moderate increase in nominal wages and prices. Real domestic demand is likely to level off, reflecting a stagnation of private consumption, a fall in public consumption and a moderate pick up in private investment. Despite growing net interest payments abroad, the current balance of payments should improve, particularly since domestic substitution of imported energy becomes more and more important.

The economic policy pursued during 1983 and envisaged for 1984 aims primarily at reinforcing the competitive parts of the economy and at improving resource allocation, and thus the overall performance in the longer term, even though there will be some dampening effects on economic activity in the short run.

The government plans to reduce the net central government borrowing requirement in 1984 to 11 % of GDP. In view of this, a number of measures were adopted by Parliament aiming to slow down the increase in various compulsory and non-compulsory expenditure, to increase the application of user contributions and to raise certain public service charges. The planned reduction of the budget deficit is fully in accordance with a strategy designed to achieve better economic convergence within the Community. The cost of servicing the growing public sector debt represents a major constraint, so that it is unavoidable, if the central government net borrowing requirement is to be reduced, to cut other public expenditure, although this should not lead to a reduction of items needed to develop productive activities. A substantially lower government deficit will no doubt have a favourable effect on inflationary expectations and on interest rates and thus become a major incentive for enterprises to invest and accelerate the necessary structural change in the economy.

The biennial wage settlements agreed in the spring of 1983 conform to the government guideline of a 4 % nominal increase in 1983 and 1984 and imply a rise in unit labour costs below the Community average. The application of this guideline should allow for sufficient flexibility in the labour market to promote a better allocation of resources. This should help to avoid bottlenecks in parts of the labour market and, together with the implementation of various training schemes, facilitate the redeployment of the labour force.

The government's structural policy, incorporated in its overall strategy, is mainly embodied in the investment programme launched in the autumn of 1982 and the programme for growth and modernization announced by the government in October 1983. These programmes aim at coordinating private and public activities in such areas as education and research, technological innovation, infrastructure and communications. As investment in energy will be falling in 1984, more room will be available for capital formation in advanced technology with the aim of reinforcing the competitiveness of the economy.

Furthermore, the government intends to facilitate the flow of risk capital to enterprises and change tax legislation in order to promote investment and growth in the private sector of the economy. Finally, initiatives have been taken to make the public sector more efficient by means of *inter alia* increased flexibility of budget procedures and decision making.

TABLE 5

Denmark: main economic aggregates, 1961 to 1984

	GDP value growth	GDP volume growth	GDP price deflator	Rise in consumer prices	Compensation per employee	Current account of balance of payments	General government balance	Money supply growth, M2H (3)	Unemployed in labour force
	%	%	%	% (2)	% (2)	% GDP	% GDP	%	%
1961 to 1970	11,2	4,9	6,0	5,2	10,5	−2,2	0,7	10,2	1,1
1971 to 1980	12,2	2,3	9,7	10,2	11,1	−2,9	0,0	11,3	3,8
1981	10,9	0,1	10,8	11,8	10,2	−3,1	−7,0	9,6	8,3
1982	13,6	3,4	9,9	9,8	11,0	−4,2	−9,1	11,7	9,7
1983 (1)	9,8	2,2	7,4	6,6	7,5	−2,2	−8,8	12,5	10,7
1984 (1)	6,5	1,2	5,2	5,4	5,5	−1,3	−7,8	7,5	11,8

(1) Preliminary estimate of the Commission services on the basis of present or anticipated policies.
(2) % change over previous period, annual rate.
(3) End of year. Until 1979, M2.

The *Federal Republic of Germany* experienced a distinct upturn in economic activity in the first half of 1983 but, because of the low level from which the recovery started, the year-on-year increase in GDP is expected to be only modest (0,75 %). Whilst exports remained sluggish, reflecting both their country and commodity composition, domestic private demand expanded at a fairly strong rate. Consumers' expenditure, which had been falling steadily since the end of 1980, picked up as a result of the slowdown in inflation, combined with a fall in the savings ratio, whilst wage settlements remained modest. Capital formation also recovered, following government measures taken in 1982, and the beginning of a revival of business confidence. Inflation decelerated to about 3 % and the rise in unemployment virtually ceased in the autumn.

Prospects for 1984 point to a continuation of the recovery mainly led by domestic demand. Some slowdown through the year however cannot be excluded. The direct effects of government incentives to invest weaken, in addition, other factors determining investment such as capacity utilization, and interest rates are not expected to become favourable in comparison with earlier periods of recovery. The current moderate pace of wage settlements, admittedly, is helping to improve the depressed level of corporate profitability but is not providing direct short-term support to the level of demand in the economy. The continued modest rise in consumer spending expected for 1984 implies a further fall in the savings ratio. The balance of current account is projected to stay in surplus (0,75 % of GDP) and inflation to remain at around 3 %. Overall, GDP is expected to rise by 2 % in 1984.

With regard to budgetary policy in 1984 and beyond, the authorities have announced their firm intentions to reduce both the share of public expenditure in GDP and the structural deficit. This is reflected in the decision to limit, with regard to 1984, the growth of expenditure of the Federation to 2 % and the net borrowing of the

Federation to DM 37 340 million, slightly below the projected outturn for 1983 (taking account of lower Bundesbank profits to be transferred to the Federation). At the level of general government, net borrowing could well fall from DM 54 000 million (3,4 % of GDP) in 1983 to about DM 37 000 million in 1984 (2,1 %).

This deliberate strategy of consolidation of the general government account at a time of only modest growth prospects is designed to bring about a larger absorption of economic resources by the private sector. However, should there be clear indications that activity is weakening again, a temporary deviation from the projected path of consolidation could be contemplated, allowing the automatic stabilizers to support demand. If, however, satisfactory progress in reducing the budget deficit can be achieved, notably as a result of favourable economic circumstances, it should be possible to lighten the tax burden somewhat as well as to pursue a more active investment policy. In any event a firm grip on subsidies and transfer payments should be maintained. Policies with regard to subsidies should pave the way for a more positive supply side policy, shifting resources towards encouraging new technologies rather than to supporting declining industries. An expansion of public sector investment could also contribute to the sustained growth of private investment and the process of structural adjustment.

The tight stance of budgetary policy voted for 1983 may have helped the Bundesbank to announce its intention to steer the growth of the central bank money stock (CBM) within the upper half of the target range, set at 4 to 7 % for the year to the fourth quarter of 1983. From the beginning of the year, however, CBM growth has been outside the target. As these developments were considered to be largely due to special factors (such as the effects of the transfer of Bundesbank profits to the Federation, speculative movements related to the March EMS realignment and unusually high maturity payments from savings contracts), the Bundesbank refrained from taking measures which would have had adverse effects at an early stage of the recovery. Only in September, when it became very unlikely that the growth path of CBM would return within the target range, did the Bundesbank react by raising the Lombard rate in line with money market rates, which had already increased in part in response to external developments.

Of great importance for the behaviour of fixed capital formation, in addition to interest rates, are developments in the labour market. Some progress has recently been made towards a better balance of relative factor incomes, but it is important that the relation between wage settlements (in real terms) and the rate of growth of productivity is such that returns on capital investment can be restored to satisfactory levels. In this respect it is important that more consideration is now being given to the role that participation by company employees in future profit earning could play in the process of wealth creation. On the other hand, at a time when the external and public sectors are not contributing to overall demand, the evolution of real wages should help improving the propensity to invest.

While appropriate wage settlements are fundamental in re-establishing a growth oriented economy, they cannot solve in the short term the large imbalances in the labour market that have built up over the years. Specific labour market measures remain therefore of great importance, in particular those which improve training, incentives and mobility. Reductions in working time are now also being widely considered in the Federal Republic. There is as yet no consensus, however, of the effects of such measures, nor about the conditions under which they would be beneficial for the long run performance of the economy. If any generalized implementation of shorter working time would appear to be inappropriate, individual schemes could be negotiated at the level of sector or company, to take account of particular circumstances, such as the structural problems of the sector concerned, the cost and profit situation and the age structure of the workforce.

TABLE 6

Germany: main economic aggregates, 1961 to 1984

	GDP value growth	GDP volume growth	GDP price deflator	Rise in consumer prices	Compensation per employee	Current account of balance of payments	General government balance	Money supply growth, M2 (3)	Unemployed in labour force
	%	%	%	% (2)	% (2)	% GDP	% GDP	%	%
1961 to 1970	8,4	4,7	3,5	2,9	8,6	0,7	0,5	10,4	0,8
1971 to 1980	8,2	2,9	5,2	5,2	8,6	0,6	-2,2	9,8	2,8
1981	4,2	0,2	4,0	5,6	5,3	-1,0	-3,9	5,0	4,7
1982	3,7	-1,0	4,8	5,3	4,4	0,5	-3,5	7,1	6,8
1983 (1)	3,8	0,7	3,1	3,0	3,8	0,9	-3,3	7,5	8,6
1984 (1)	5,1	2,1	3,0	3,2	3,5	0,9	-2,1	5,5	8,7

(1) Preliminary estimate of the Commission services on the basis of present or anticipated policies.
(2) % change over previous period, annual rate.
(3) End of year.

In *Greece,* where economic policy is geared to reconciling the requirements of external adjustment with those of a recovery of investment, the improvement aimed for on these two fronts is not yet clearly apparent. Weak private consumption has been offset by stronger demand from general government, especially public investment, but business investment has continued to be slack. Moreover, the real balance on goods and services has slightly deteriorated once again. Overall, the contradictory effects of these trends have resulted in a slight fall in activity in the first half of 1983, but some recovery is expected in the second half. As agricultural output fell sharply, gross domestic product for the year is unlikely to show any growth. The rate of consumer price rises has remained high at around 20 % through the year.

For some time to come, economic policy must continue to give priority to improving the real balance of trade and, consequently, to developing competitive production capacity. In spite of some improvement in the terms of trade, the balance of payments on current account is still heavily in deficit, and the burden of foreign debt is still growing rapidly. The recovery of business investment, on which prospects for restoration of external balance heavily depend, looks uncertain. Efforts which must be made in this regard imply that there will be no significant recovery in private consumption in 1984, and that public consumption should be kept in check. They should also be geared more forcefully to containing inflationary pressures so as to reduce as quickly as possible the factors making for instability, which distorts behaviour, and, in particular, produce a cautious attitude on the part of private investors. In 1984, growth could amount to about 1,5 % and inflation to an annual average of about 18 %, while the balance of payments on current account could once more show a large deficit, amounting to over 5 % of gross domestic product.

Even such limited achievements imply a strict policy on the incomes side as well as in budget management. Wages policy in particular must be aimed at a reduction in real unit costs, by an appropriate limitation on the effects of indexation while avoiding as far as possible a further squeeze on wage differentials.

This policy should restrain both incomes and transfers, and the ultimate aim should be appropriate limits on the growth of households' real disposable incomes, without any reinforcement of tax pressure other than that resulting from more energetic measures to combat evasion. While the provisions adopted should make for better balanced public finance, they will not be sufficient to reduce the public deficit to a level commensurate with growth and price targets: less than 6 % of gross domestic product in 1984 for the general government borrowing requirement, and less than 9 and 12 % of GDP respectively for the gross financing requirements of the central government budget and the public sector. Although these figures are only about half a percentage point below the expected outturn for 1983, they will still be difficult to achieve against a background of hesitant economic recovery. In particular, they imply a substantially slower rate of growth of real operating expenditure and an increase in public service charges large enough to lighten the real burden of subsidies to public sector firms.

The main reason why the public deficit must be reduced is that it is financed by highly inflationary means. Although liquidity is showing a growing tendency to settle spontaneously in savings deposits, disinflation in the economy will be all the more certain as the rate of monetary creation and the liquidity ratio in the broad sense decline. A smaller deficit would thus enable monetary policy to achieve its objective without imposing excessively strict limits on lending to firms. But disinflation also requires a firmer trend towards the stabilization of savings, and this can hardly be achieved without a gradual rise in real interest rates, which are still negative at present, in contrast to the general run of rates internationally. Some increase in real rates must now be encouraged, although cautiously, so as to avoid compromising the recovery of business investment, which is essential.

External monetary policy must be geared to helping the disinflation effort by keeping exchange rate depreciation in check as closely as possible.

TABLE 7

Greece: main economic aggregates, 1961 to 1984

	GDP value growth	GDP volume growth	GDP price deflator	Rise in consumer prices	Compensation per employee	Current account of balance of payments	General government balance	Money supply growth, M2 (3)	Unemployed in labour force
	%	%	%	% (2)	% (2)	% GDP	% GDP	%	%
1961 to 1970	11,0	7,6	3,1	2,5	9,8	-3,1	:	17,6	:
1971 to 1980	19,1	4,7	13,8	13,6	18,3	-2,7	:	23,8	:
1981	18,9	-0,7	19,7	24,4	27,1	-0,2 (4)	-10,1	34,3	4,1
1982	25,4	0,0	25,4	21,1	26,2	-3,8 (4)	- 6,4	29,1	5,7
1983 (1)	19,7	0,0	19,7	20,5	17,3	-5,0 (4)	- 6,3	22,6	7,4
1984 (1)	19,7	1,5	17,9	18,5	18,5	-5,5 (4)	- 6,3	20,2	7,9

(1) Preliminary estimate of the Commission services on the basis of present or anticipated policies.
(2) % change over previous period, annual rate.
(3) End of year.
(4) According to information from the Bank of Greece, compiled on the basis of statistics of payments, these figures would be as follows: 1981, 6,5 %; 1982, 5 %; 1983, 5,5 % (estimates); 1984, 5,5 % (forecast).

In *France,* the measures adopted following the currency realignment of 21 March 1983 (1) reinforced the firm stance of economic policy. They reinforced the incipient decline in consumption, followed, after some delay, by a halt of stockbuilding. Together with successive reductions in the exchange value of the franc, this produced an improvement in the trade balance, which shows a substantially lower deficit than in 1982. The rate of price inflation has also slowed down and could average under 9 % for 1983. However, with slightly recovering exports providing the only support, activity is losing momentum and employment is contracting at a higher rate.

In view of the growing debt burden, the complete restoration of external balance is still some distance away. The present stance of economic policy will have to be maintained in 1984, therefore pointing to only a weak recovery in activity during the year and a positive but very low annual rate of growth. Nevertheless, substantial progress should be made towards establishing economic balance. The rate of increase of prices through the year should fall to well below the figure for 1983 and the trade balance should move out of deficit towards the end of the year.

The extent of such progress, which implies an effective struggle against the structural causes of inflation, a further deceleration in costs and strict limitation of consumer demand, depends crucially on wage restraint. It depends particularly on maintaining the present wages policy, which is directed towards separating the growth of incomes from previous price increases, in order, rather, to relate it to future developments, that is to say, leaving open the possibility of some catching-up at the end of the period to the price increase eventually foreseen for the year. If this principle is applied, and if with virtually zero growth a pause takes place in the indexation for low wages, the growth of wages is likely to be strongly reduced compared with 1983.

(1) Followed by the granting of a Community loan of 4 000 million ECU to France.

Maintaining the restrictive stance of economic policy also means keeping the general government borrowing requirement to about 3 % of gross domestic product, an aim which should be achieved by the draft budget for 1984 adopted by the government on 21 September 1983. Bearing in mind the lower revenue buoyancy, the continuing expansion of the burden of interest payments and the numerous factors contributing to an increase in the volume of social expenditure, this target implies a determined squeeze on expenditure and a further reinforcement of compulsory levies. Central government expenditure will at best remain constant in real terms – actually declining under a number of headings – except for expenditure on priorities such as employment, training, research and support for productive investment. Public investment and aid will suffer from restrictions, but constraints will be especially tight on operating expenditure, limiting its rate of expansion to well below the average rate of price increases. The growth of social security benefits will also be strictly limited, in particular through the continued pursuit of efforts to curb the expansion of expenditure on health and by making no real improvement in cash benefits that are not linked to the trend of wages. Even so, the additional effort required to increase revenue to the desired level – especially the revenue of social security schemes – will be very great, representing over 1 % of GDP, approximately equally distributed between taxation and social security contributions.

This strict discipline is indispensable to ensure that the economy as a whole is financed in a manner consistent with the aims of disinflation and restored external equilibrium. It must be accompanied by measures to achieve monetary growth commensurate with the outlook for nominal gross domestic product. Moreover, strict quantitative controls on credit and fairly high real interest rates will need to be maintained both to stimulate stable savings and to contribute to restoring the balance-of-payments position.

The present restrictive phase of economic policy should lay the foundations for the gradual improvement in business investment required for the restoration of durable external equilibrium and sustained growth. The positive effects of currency depreciation and cost reductions on firms' operating accounts will be the best guarantee of such improvement. The financial markets seem capable of responding satisfactorily to the need of business for a stable flow of capital. Finally, budgetary austerity deliberately does not affect such policies which, apart from general and sectoral tax incentives, involve large financial assistance, in particular capital grants for newly nationalized undertakings. It is thus reasonable to expect the first signs of a business investment recovery in 1984, particularly in the investment of industrial undertakings in the competitive sector, which have been lagging further and further behind over the years and consequently contributing to recent external trade difficulties. This recovery must be consolidated without compromising the emerging trend towards improved profitability. In particular, decisions on the financing of social security schemes and the adjustment of working hours must take this point into account.

The emerging signs of recovery in investment and growth trends are not such as to provide much hope of a spontaneous reduction in the disequilibrium between labour supply and demand in the near future. There is still scope, however, for an eventual reduction in the longer term. In particular, a labour force with training and qualifications that corresponded better to employers' needs could more easily take up the potential supply of jobs. More flexibility in working hours could be introduced, providing that the adjustment neither increases costs nor adversely affects capital productivity.

Overall, 1984 should be a year of transition marked by important progress towards restoring the overall balance in the economy and paving the way for sustained growth.

TABLE 8

France: main economic aggregates, 1961 to 1984

	GDP value growth	GDP volume growth	GDP price deflator	Rise in consumer prices	Compensation per employee	Current account of balance of payments	General government balance	Money supply growth, M2 (3)	Unemployed in labour force
	%	%	%	% (2)	% (2)	% GDP	% GDP	%	%
1961 to 1970	10,2	5,6	4,4	4,3	9,4	0,2	0,4	12,7	0,9
1971 to 1980	13,4	3,6	9,5	9,5	13,8	-0,4	-0,1	14,8	3,8
1981	12,1	0,2	11,9	12,9	14,5	-1,4	-1,8	11,4	7,8
1982	14,8	1,8	12,8	10,9	14,5	-2,9	-2,7	10,8	8,7
1983 (1)	9,5	-0,3	9,8	9,0	9,7	-1,8	-3,1	8,8	8,9
1984 (1)	7,7	0,4	7,3	7,2	8,2	-1,2	-3,3	6,5	9,7

(1) Preliminary estimate of the Commission services on the basis of present or anticipated policies.
(2) % change over previous period, annual rate.
(3) End of year.

Economic activity in *Ireland* showed almost no growth in 1983, reflecting the unfavourable international conditions. There were, however, definite encouraging features. The rate of price inflation, although still high at around 11 %, moderated significantly from the 17,2 % recorded in 1982. A marked improvement took place in the deficit on the current balance of payments, which fell less than 3 % of GDP. The trend towards increasing budget deficits, particularly for current purposes, has been decisively arrested and Exchequer borrowing has been reduced by about 3 % of GDP in 1983. On the debit side, however, it must be remembered that the unemployment rate has continued to rise and at end year may well approach 16 %.

The outlook for 1984 points to a modest revival in economic growth. Foreign demand will be more buoyant but this is expected to be largely offset by the effects of the domestic deflationary forces, as there is little alternative to pursuing the current policy stance firmly over the medium term with a consequent lower level of consumption.

A number of factors are at the root of the present difficulties. Demographic changes are adding large numbers of young people to the labour force each year and, in the medium term, are putting increasing pressure on demand for basic social services. The long established policy of achieving growth and employment through the encouragement of export-based industry entails the need for considerable public expenditure, funded by borrowing, and the provision of essential infrastructure, both economic and social. The recession in international trade and, until recently, in the UK market in particular, has meant that a full return could not be realized from the substantial investment made. Moreover, after the two oil shocks, fiscal policy remained expansionary, promoting short-term income generation to the detriment of the country's productive capacity. Attempts to maintain and increase real earnings, despite adverse movements in the terms of trade, reduced the ability of many sectors in the economy to compete and pushed the current balance into deficit in spite of a continued strong export performance.

Corrective action, taken vigorously in hand, has concentrated largely on reducing the Exchequer borrowing requirement and the authorities have committed themselves to phase out deficit spending for current purposes by 1987. In pursuing this objective, however, it is important to maintain an appropriate balance between tax increasing and expenditure cutting measures given their respective economic costs. Recent budgets have stressed large increases in the level and scope of taxation, while the current low level of activity reduces tax buoyancy; this suggests that a new general increase in taxation would not be appropriate in 1984, but that attention should now be directed at achieving significant real cuts in expenditure. Pressure on scarce Exchequer resources is likely to continue, principally because of the continuing high level of interest charges on the accumulated national debt and increasing demand for social expenditure. Great efforts are therefore necessary to reduce both current and capital spending programmes. It would seem appropriate to reduce the Exchequer borrowing requirement in 1984 by 1 to 1,5 % of GDP by reference to the likely outturn for 1983 and on the basis of the current budgetary definitions.

It is of first importance that the authorities continue and intensify their efforts to achieve wage moderation. This is significant not only from the point of view of containing public expenditure, of which wages costs form a major part, but also from the point of view of protecting employment.

Monetary policy is designed to support the adjustment being pursued through fiscal policy, without itself imparting an independent and additional deflationary bias to macro-economic policy. Given a favourable external environment, continued success in curbing domestic inflation and in reducing the current external deficit might facilitate some further lowering in interest rates. At the same time, an important continuing concern is to finance as large a proportion as possible of the Exchequer deficit from domestic sources.

Efforts to ease the labour market problems more directly in 1984 should concentrate on improving the flexibility of the labour market and encouraging the ending of overtime working while giving special attention to youth unemployment.

TABLE 9

Ireland: main economic aggregates, 1961 to 1984

	GDP value growth	GDP volume growth	GDP price deflator	Rise in consumer prices	Compensation per employee	Current account of balance of payments	General government balance	Money supply growth, M2 (3)	Unemployed in labour force
	%	%	%	% (2)	% (2)	% GDP	% GDP	%	%
1961 to 1970	9,9	4,2	5,5	4,6	9,9	- 2,3	- 2,7	10,4	4,5
1971 to 1980	18,3	4,1	13,6	13,8	18,0	- 4,6	- 8,1	18,5	7,4
1981	19,0	1,1	17,7	19,5	18,5	-13,1	-15,8	17,4	10,2
1982	18,3	1,2	16,8	17,1	14,9	- 8,3	-16,2	12,9	11,7
1983 (1)	11,2	0,5	10,6	11,0	12,2	- 2,6	-13,4	14,4	14,6
1984 (1)	10,1	1,8	8,2	8,8	8,9	- 0,6	-11,8	14,4	16,6

(1) Preliminary estimate of the Commission services on the basis of present or anticipated policies.
(2) % change over previous period, annual rate.
(3) End of year.

In *Italy*, new tax provisions and public service changes introduced at the beginning of the year and the difficulty in reaching new national labour agreements have tended to keep domestic demand and activity weak, the only dynamic factor being the marked improvement in exports. This helped to restore external balance which should be more or less realized for the current account by the end of 1983. It has also slowed inflation down considerably, and the average monthly rate is expected to be less than 1 % in the second half of the year.

From now on, the various demand components should tend to expand and activity should strengthen. The expected recovery of consumption, which should continue into 1984, could have been strong enough to interrupt the current but as yet insufficiently marked trend towards restored balance, particularly while the adverse inflation differential, in relation to the other industrialized countries, is still eroding competitiveness. To control the recovery and ensure that it is lasting, anti-inflationary policy has therefore to be actively pursued by an optimum combination of the three instruments available: concerted incomes and prices restraint, holding down the public deficit and monetary rigour. If all the available scope of these instruments is fully exploited, growth of about 1,5 % can be expected in 1984, while payments on current account should remain more or less in balance and the year-on-year rate of consumer price inflation should come down to under 10 %.

Progress will depend firstly on whether incomes and prices policy can succeed in slowing down the wages and prices spiral as far as possible, along the lines of the tripartite agreement of 22 January 1983 on wages and working conditions. This means not only that the limits set for increases of wage rates for 1983 and 1984 must be rigorously observed (as, by and large, they have been until now), but also that deliberate measures to slow down the effects of indexation mechanisms must be taken as far as is feasible; for example by linking remunerations to planned rather than to observed inflation. The recent agreements between government and the professions to stabilize the prices of some essential goods and services should help to guide nominal trends in the desired direction.

However, the greatest effort will be required on the public finance front. Because of the automatic nature of increases in a large proportion of expenditure – notably social security expenditure and interest payments – and in view of the once-off nature of some of the tax provisions introduced to contain the deficit in 1983, the underlying deficit for 1984 once again showed a large rate of increase, whereas a declining deficit would be necessary to foster disinflation. A further effort, much more energetic than that made in 1983, has thus been agreed on to limit the deficit to an amount compatible with macro-economic objectives, i.e. about 10 % of gross domestic product for the general government borrowing requirement and less than 15 % of GDP for net Treasury borrowing, which also includes financing operations. The reduction of the deficit again had to be achieved partly through measures affecting revenue, both permanent measures, and, once more, temporary measures. But to keep the expansion of the tax burden within certain limits, it has been decided that this time a fair share of the effort would be borne by expenditure, involving major savings on government general services, expenditure on health and pensions.

The restrictive stance of monetary policy must be maintained in a new effort to lower the liquidity ratio, which once again rose in 1983. Therefore, the financing norms for the economy should be defined from 1984 onwards in terms not only of total domestic credit, as heretofore, but also of money supply growth. A further substantial increase of public issuing of government securities will be essential to achieve these aims. This implies that real interest rates must remain definitely positive, in line with the international trend.

Demand management as outlined here should create appropriate conditions to help the economy to face its structural problems. The most serious of these is clearly the steady increase in unemployment which bears witness to an inadequate control of costs, the chronic weakness of productive investment, and the growing proportion of investments in labour saving capacity. It is therefore essential to make cost control and employment policy compatible on a lasting basis: this means long-term wage restraint, which can be achieved if the opportunities provided by the agreement of 22 January 1983 are used to improve profitability and not simply to push ahead with disinflation. Special care will be required here to ensure that the benefits to be expected in the medium-term from limiting agreed increases are not compromised by wage drift or shortening of work time with adverse effects on unit labour costs and possible further steps.

In view of the need to restructure the system of production so as to improve competitiveness and employment trends, the gradual reduction of the public deficit is a priority. This reduction is necessary not only to avoid financial crowding out of private firms, but also, and especially, to impose a more efficient distribution of public expenditure and more generally to improve resource allocation. The effort should thus be concentrated on public expenditure by subjecting the management of departments of the social security system as well as public and semi-public enterprises to stricter efficiency criteria. In the medium term measures to reduce the deficit should avoid as far as possible a further increase in the burden of taxation and contributions unless parallel steps are taken towards a more equitable tax system.

TABLE 10

Italy: main economic aggregates, 1961 to 1984

	GDP value growth	GDP volume growth	GDP price deflator	Rise in consumer prices	Compensation per employee	Current account of balance of payments	General government balance	Money supply growth, M2 (3)	Unemployed in labour force
	%	%	%	% (2)	% (2)	% GDP	% GDP	%	%
1961 to 1970	10,5	5,7	4,5	3,8	10,7	1,8	- 2,3	13,3	5,2
1971 to 1980	18,3	3,1	14,7	14,6	18,4	-0,2	- 8,0	19,5	6,0
1981	17,4	-0,2	17,6	19,0	22,0	-2,3	-11,7	16,0	8,8
1982	17,1	-0,3	17,5	16,7	17,1	-1,6	-11,9	17,2	8,7
1983 (1)	14,1	-0,8	15,1	15,0	15,6	-0,4	-11,9	16,0	9,0
1984 (1)	12,0	1,5	10,4	11,5	12,4	-0,2	-10,0	11,0	9,4

(1) Preliminary estimate of the Commission services on the basis of present or anticipated policies.
(2) % change over previous period, annual rate.
(3) End of year.

In *Luxembourg,* economic activity in 1983 has been affected by the steel crisis and the slackness of domestic demand. Gross domestic product in real terms fell by 2,4 %. Despite wage restraint in the steel sector and the temporary suspension of wage indexation, prices have continued to rise fairly fast, not only because of the delayed effects of the devaluation, but also because of the increased rates of value added tax.

Economic activity will probably remain slack in 1984. On the export side, the outlook for Luxembourg's main industries is not very bright. Moreover, although the limitation of wage indexation in 1984 to a single adjustment will improve profitability in Luxembourg firms outside the steel sector and contribute to restructuring within the sector, it will also damp down private consumption.

The law of 1 July 1983 on restructuring the steel industry is intended to reduce production capacity in such a way as to avoid intolerable financial and social consequences in a country where steel is a major industry. The government's priority is to reconstitute a vigorous and internationally competitive economic structure. The strategy is based on wage restraint paralleling that in the competitor countries, but continued strict budget policy must also be given an important role. The net public sector borrowing requirement has again increased considerably in 1983 as a result of exceptional measures to aid the steel sector. The improvement in the central government borrowing requirement expected in 1984 (a reduction from 4,9 % of GDP in 1983 to about 1 % in 1984) due to increased revenue designed to offset extra expenditure on the steel sector, implies also a constant effort to hold expenditure down, and, if necessary, further compensatory measures should be taken.

TABLE 11

Luxembourg: main economic aggregates, 1961 to 1984

	GDP value growth	GDP volume growth	GDP price deflator	Rise in consumer prices	Compensation per employee	Current account of balance of payments	General government balance	Money supply growth, M2 (3)	Unemployed in labour force
	%	%	%	% (2)	% (2)	% GDP	% GDP	%	%
1961 to 1970	7,6	3,6	3,9	2,5	6,7	7,1	1,6	:	0,1
1971 to 1980	9,5	3,0	6,3	6,7	10,5	18,5	2,0	:	0,3
1981	6,5	-0,3	6,8	7,7	8,3	31,1	-2,3	:	1,0
1982	6,7	-1,1	7,9	10,0	6,9	38,8	-2,0	:	1,2
1983 (1)	5,6	-2,4	8,2	8,4	7,1	37,2	-2,9	:	1,8
1984 (1)	6,3	-1,0	7,4	7,7	5,9	36,3	-1,5	:	2,4

(1) Preliminary estimate of the Commission services on the basis of present or anticipated policies.
(2) % change over previous period, annual rate.
(3) End of year.

In the *Netherlands,* budgetary restrictions and wage restraint in the private sector contributed to a further reduction in domestic demand in 1983. On the other hand, the favourable trend of costs enabled Netherlands' exporters to take advantage of the slight improvement in world trade. Thus, after declining by a total of 2,9 % in 1981 and 1982, economic activity remained stable in 1983. Nevertheless, unemployment expanded considerably, mainly because of a large increase in the labour force. In 1980 the unemployment rate at 4,7 % was well below the Community average; by 1983, however, it averaged 15,6 % compared with a Community rate of 10,4 %. Nevertheless the inflation rate fell to about 2,8 % on average for 1983, and the balance-of-payments surplus on current account, which was already large in 1982, should amount to the equivalent of 3,3 % of gross domestic product this year.

The world economic recovery will improve the Netherlands' exports in 1984, but domestic demand, especially private consumption, is liable to decline once more. Real gross domestic product will not grow in relation to 1983 and the rate of unemployment will rise further to about 17,6 %. Inflation will remain fairly low, and in view of the slackness of domestic demand, the current balance-of-payments surplus will increase once again.

The choice of economic policy guidelines is not easy against this background. The growing surplus on the balance of payments on current account, the firmness of the guilder on exchange markets, the large surplus of savings in the private sector, the slackness of investment, the stability of prices, the high rate of unemployment and the low rate of capacity utilization all indicate that the economy could deal fairly smoothly with much more vigorous domestic demand. For example, while wage restraint – involving virtually no change in *per capita* remuneration in 1984 – is regarded as necessary to maintain competitive capacity and to improve the profitability of firms and the climate for investment, it may, if taken too far, exercise an excessively restrictive effect on final demand. On the other hand, there would no doubt be major objections to the use of budgetary policy in promoting recovery.

The scope for action on the public finance front is particularly narrow because the borrowing requirement has ballooned over the past few years. Indeed, it has doubled in three years, and the expansion is likely to gain momentum if new suitable measures are not taken. The situation is the more alarming as the pressure of taxation, social security contributions and public service charges, the greatest in the Community, is increasingly eroding both real disposable private income and business profitability. There is no alternative to pursuing a policy of budgetary austerity, especially as tax revenue is expanding only very slowly because of slack economic activity and low inflation, revenue from natural gas is tending to stabilize, and some items of expenditure, notably on unemployment, are still growing rapidly. The draft budget for 1984 once again includes a programme to reduce expenditure by over Fl 10 000 million, mainly on public service remuneration, social security and public health. The draft budget also provides for a reduction of Fl 2 000 million in the burden on enterprises and new revenue amounting to about Fl 3 000 million, with very little change in the total burden of taxation. The net borrowing requirement of central government and local authorities, on national definitions, should be reduced to 12,4 % of net national income in 1983 and to 12,1 % in 1984. This should make it easier to lower interest rates – which in real terms are still among the highest in the Community – and stimulate productive investment.

In the medium term, the strategy adopted is expected to promote growth by improving competitiveness, thus boosting exports, and by improving profitability, so promoting investment. It will not, however, prevent a further rise in unemployment in 1984. Special attention is thus called for to explore ways of reducing working hours and increasing labour mobility without increasing labour costs.

TABLE 12

The Netherlands: main economic aggregates, 1961 to 1984

	GDP value growth	GDP volume growth	GDP price deflator	Rise in consumer prices	Compensation per employee	Current account of balance of payments	General government balance	Money supply growth, M2 (3)	Unemployed in labour force
	%	%	%	% (2)	% (2)	% GDP	% GDP	%	%
1961 to 1970	10,6	5,2	5,2	4,1	10,6	0,0	-0,9	9,1	0,9
1971 to 1980	10,7	2,8	7,6	7,7	10,7	1,3	-1,4	10,8	3,4
1981	4,3	-1,2	5,6	6,2	3,3	2,2	-5,2	5,2	7,1
1982	4,0	-1,6	5,7	5,7	5,7	2,7	-6,9	7,6	12,7
1983 (1)	1,9	0,3	1,6	2,8	3,2	3,3	-6,7	5,5	15,6
1984 (1)	2,4	0,0	2,4	3,6	0,1	4,4	-7,1	6,0	17,6

(1) Preliminary estimate of the Commission services on the basis of present or anticipated policies.
(2) % change over previous period, annual rate.
(3) End of year.

In the *United Kingdom*, economic activity has expanded relatively quickly in 1983 (GDP growth 2,5 to 3%), faster than at any time since 1978, and at a rate significantly above the Community average. The principal reason for this has been the strength of private consumption, with consumers' propensity to save continuing to decline and consumer price inflation falling to between 5 and 6%. In addition, the long period of destocking, lasting from 1980 to 1982, has come to an end. However, the impact of these developments on domestic output has been limited by substantial growth of imports, while there has been no increase in export volumes. The underlying trend of unemployment is still upward, although at a slower rate than in recent years. Fiscal developments have largely been in line with official plans, but some monetary aggregates have been growing at rates outside the target range despite high real interest rates.

It is likely that growth will continue in 1984, but perhaps at a slightly slower rate than in the current year – about 2 to 2,5%. The expansion of private consumption is expected to slow down, and this will not be fully compensated by faster growth of investment and exports. Manufacturing output should increase somewhat faster than in 1983, but there is some risk of a further increase in unemployment. Wage settlements and price inflation are likely to remain close to current levels.

In the past few years, the UK economy has gone through a period of considerable structural adjustment, partly as a result of the development of North Sea oil and partly through policies designed principally to bring about a rapid reduction in inflation. As these adjustments coincided with a period of international recession, their effects on domestic demand, output and employment were even greater than might otherwise have been expected. Despite the recovery now under way, the level of GDP has only just returned to that already achieved in 1979, and a period of lasting growth would be necessary to reduce significantly the level of unemployment. The achievement of such growth will be helped by improvements obtained in industrial structure and productivity, and by the low levels of price inflation and wage settlements. Nevertheless, the outlook is still uncertain because of the unbalanced nature of the current recovery, at least during its early phase, depending predominantly on consumer demand. As the United Kingdom moved out of recession earlier than its major trading partners, and owing to the relative weakness of the international competitive position, there has been a substantial worsening of the balance of payments, the balance of trade in manufactured goods having moved into deficit. Capital goods investment has as yet shown little response to higher demand, a factor which may have adverse supply side effects at a later stage of the cycle.

Consolidation of the improvements achieved in labour market conditions will be essential to the achievement of more balanced growth. The very large productivity gains during the recession helped to compensate, in terms of international competitiveness, for some of the exchange-rate appreciation, but future gains are likely to be smaller. In order to encourage investment, a further redistribution of relative factor incomes is necessary, allowing higher rates of return on real assets. It is therefore important that there should be no acceleration of wage settlements, even if consumer price inflation increases slightly in 1984. Prospects for higher industrial output and employment in the longer term appear to be dependent upon a stronger competitive position obtained through wage moderation and, if indicated by market forces, some exchange-rate adjustment.

During the past few years, monetary conditions have improved considerably, as inflation, nominal interest rates and the growth rates of the monetary aggregates fell from very high levels. The strength of consumer spending in the past 18 months, however, has been accompanied by a sharp increase in lending to the personal sector and some acceleration of monetary growth. At the same time, the level of real interest rates has discouraged borrowing by enterprises despite the expansion of demand. Even though monetary growth has been exceeding the target range (7 to 11 % annual rate) set for 1983/84 in the medium-term financial strategy (MTFS) published in March 1983, the stance of policy as revealed by other indicators has remained cautious and the authorities should perhaps consider some reduction in interest rates in order to encourage borrowing for investment and stockbuilding purposes. For 1984/85, the March 1983 MTFS set out an illustrative range of 6 to 10 % for the growth of the monetary aggregates. This appears consistent with the financial outlook for that period, particularly given the planned level of public sector borrowing, and should allow for some further modest downward movement of interest rates.

The trends in public finance in the current financial year are such that the public sector borrowing requirement (PSBR) should be relatively close to the target indicated in the MTFS (£ 8 200 million or 2,75 % of GDP). Measures were announced in July to help keep public expenditure in line with plans, but it remains possible that the outturn for both expenditure and revenue will be a little above planned levels.

For 1984/85, the MTFS target for the PSBR, of £ 8 000 million or 2,5 % of GDP, represents a broadly unchanged fiscal stance, given the increase in revenue resulting from moderate growth of the economy. In view of the modest level of the targets in both the current and the next financial years, slightly higher levels of the PSBR could be tolerated.

In the longer term there may be scope for lowering the relative level of public spending and therefore also the tax burden. It would be desirable to improve the structure of expenditure in respect of its productive element. This depends partly on the overall level of expenditure and partly on the achievement of sufficient economic growth, so that the categories of expenditure determined by demand in the economy, such as unemployment and related benefits, can be reduced. Possibilities for cuts in other spending programmes appear more limited, in view of demographic factors (the increasing average age of the population) and the low level of public investment in recent years.

TABLE 13

United Kingdom: main economic aggregates, 1961 to 1984

	GDP value growth	GDP volume growth	GDP price deflator	Rise in consumer prices	Compensation per employee	Current account of balance of payments	General government balance	Money supply growth, M2 (3)	Unemployed in labour force
	%	%	%	% (2)	% (2)	% GDP	% GDP	%	%
1961 to 1970	7,2	2,8	4,2	4,0	7,1	0,0	-0,7	5,9	1,9
1971 to 1980	16,0	1,9	13,9	13,3	16,2	-0,7	-3,2	14,5	4,4
1981	9,9	-2,0	12,1	11,0	14,7	2,4	-2,9	14,6	9,6
1982	9,4	1,5	7,8	8,0	8,8	1,5	-2,1	9,3	11,1
1983 (1)	7,9	2,8	4,9	5,7	7,9	0,2	-2,2	10,6	11,7
1984 (1)	7,2	2,2	4,8	5,8	6,3	-0,2	-2,1	8,6	11,9

(1) Preliminary estimate of the Commission services on the basis of present or anticipated policies.
(2) % change over previous period, annual rate.
(3) Sterling M3.