

## II

*(Acts whose publication is not obligatory)*

## COUNCIL

## COUNCIL DECISION

of 22 December 1987

adopting the annual report on the economic situation in the Community and laying down economic policy guidelines for 1988

(87/609/EEC)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

HAS ADOPTED THIS DECISION:

Having regard to the Treaty establishing the European Economic Community,

*Article 1*

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 Community<sup>(1)</sup>, as amended by Decisions 75/787/EEC<sup>(2)</sup> and 79/136/EEC<sup>(3)</sup>, and in particular Article 4 thereof,

The Council hereby adopts the annual report on the economic situation and the policy guidelines to be followed by the Community which are contained in Part I of the Report attached to this Decision and which lay down the economic policy guidelines to be followed by the Member States, contained in Part II of the said Report.

*Article 2*

Having regard to the proposal from the Commission,

This Decision is addressed to the Member States.

Having regard to the opinion of the European Parliament<sup>(4)</sup>,

Done at Brussels, 22 December 1987.

Having regard to the opinion of the Economic and Social Committee<sup>(5)</sup>,

*For the Council*

*The President*

N. WILHJELM

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

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

<sup>(3)</sup> OJ No L 35, 9. 2. 1979, p. 8.

<sup>(4)</sup> OJ No C 345, 21. 12. 1987.

<sup>(5)</sup> OJ No C 356, 31. 12. 1987.

**ANNUAL ECONOMIC REPORT**  
**1987/1988**

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## PREAMBLE

Since the Commission adopted the draft Annual Economic Report 1987/1988 on 14 October 1987, share prices have fallen substantially on the stock exchanges of the main industrial countries. Interest rates have dropped by varying degrees in the United States and in almost all Community countries. On very unstable markets the dollar has depreciated against the ECU and the Yen.

In the light of these events the economic forecasts included in the Report should obviously be revised. The size and nature of these revisions will strongly depend on when, and at what level, financial and exchange markets stabilize.

The basic analysis of the international environment and of the problem of slow growth and unemployment in the Community, given in the Annual Economic Report, remains valid.

A significant and durable reduction of the federal budget deficit in the United States is an essential element for the solution of the present problems of the world economy. The plan to reduce expenditure and raise revenues by a net amount of \$ 30,2 billion in fiscal 1988 and \$ 45,9 billion in fiscal 1989 is encouraging, but it is important that early Congressional approval is followed rapidly by its implementation.

The guidelines for economic policy for the Community included in the Annual Economic Report remain relevant. Their implementation has become even more urgent. Pursuing macroeconomic and structural policies designed to accelerate growth is in the first instance in the Community's own interest. At the same time this contributes to the correction of international imbalances. As stated by the Council at its meeting on 16 November 1987, the Member States of the Community are resolved to improve the supply and demand conditions necessary to further internally generated non-inflationary growth and to contribute to the reduction of external imbalances.

The Member States intend to cooperate actively with other countries in decisions to ensure a more stable development of world financial and foreign exchange markets. Credible macroeconomic policies have to be implemented on a multilateral scale so as to accelerate the adjustment of international payments imbalances.

Given the uncertainties in the world economy which could seriously affect the behaviour of investors and consumers, it is all the more necessary that the Community and its Member States be ready to adapt their economic policy to the necessities of the situation as it evolves.



## PART I

## THE COMMUNITY ECONOMY

## 1. MORE DYNAMIC GROWTH IS NECESSARY AND POSSIBLE

## Summary and economic policy conclusions

## 1.1. Economic situation in the Community and outlook for 1988

Since 1982, the Community economies have strengthened. The level and degree of convergence of inflation rates are unmatched since the 1960s. Rates of return of capital and the adaptability of markets have improved significantly and structural adjustment, which has often been painful, has reinforced productive potential. Until 1986 economic growth effectively strengthened to reach 2,6 % on average last year for the Community.

However, growth in 1987, only barely over 2 %, is lower than in 1986. Hopes for a further acceleration have not, therefore, been realized. At the end of 1986 and again in 1987, Community exports to third countries have fallen back in real terms, influenced by two factors. Firstly, the effective appreciation of European currencies has led to a deterioration in Community competitiveness, not only *vis-à-vis* the United States, but also with respect to other areas such as the newly industrialized countries. Secondly, traditional Community markets show practically no growth on average, with imports of OPEC countries falling very sharply. On the other hand, Community imports have remained buoyant. Accordingly, the external balance has cost the Community one point of growth both in 1986 and 1987. This represents a contribution of the Community to the international adjustment process which cannot be regarded as negligible. This deterioration in the external climate was offset in 1986 by the impetus given to domestic demand by the improvement in the terms of trade, but the effects of this improvement on real incomes and private consumption are petering out. An added factor is that many firms in export sectors have been led to revise their investment plans downwards. The fall in extra-Community trade as well as the uncertainty attached to exchange rates and interest rates has contributed greatly here.

In 1988, growth should remain a little above 2 %. This level of growth is just about sufficient to hold the unemployment rate at nearly 12 %, an intolerable level. Extra-Community trade will undoubtedly recover slightly. Its contribution to growth, however, is likely to remain negative, while that of domestic demand should decrease anew. A threat is now emerging. A number of countries — Spain, Italy, Portugal and the United Kingdom — have so far maintained growth

rates in excess of 3 %. They have thus made a large contribution to sustaining intra-Community trade and growth in the Community. In order to preserve balance on their external accounts, some of these countries run the risk of being forced to put a brake on their own growth if expansion in their partner countries remains mediocre. This would affect the whole Community. This danger would grow if the international environment were to deteriorate further.

## 1.2. Imbalances in the world economy

The world economy continues to be affected by two severe imbalances: *the structure of payments' balances between the industrialized countries and the indebtedness of developing countries*. In 1987, the current external deficit of the United States is still increasing to reach US \$ 150 billion (3,5 % of GDP). The Japanese surplus (around US \$ 85 billion or 3,8 % of GDP) remains very high. The Community surplus is undoubtedly falling, but the counterpart of this fall is to be found for 1987, essentially, in the improvement in the current balance of oil-exporting countries in particular as a result of the fall in their imports. The debt of developing countries has continued to increase (US \$ 1 200 billion 1987). Restructuring agreements and falling interest rates up to the end of 1987 have moderated its burden, but the recent rise in interest rates again works against these countries.

Positive elements are appearing. Real trade flows are contributing to re-establishing balance on trade accounts. International cooperation is established and is leading to policy adjustments in the right direction. The dollar exchange rate is more stable following the Louvre accord of February 1987. The thrust of this policy was confirmed at the June 1987 summit of industrialized nations in Venice and subsequently at the Group of Seven meeting of September 1987 in Washington. UNCTAD VII has shown that it is possible to arrive at a common view with the developing countries on the main problems affecting the world economy. Meetings of the World Bank and the IMF in September 1987 have made some progress, in particular on the subjects of the indebtedness of African countries and an increase in World Bank funding. Finally, the Uruguay Round of negotiations within GATT provides a basis for continuing efforts to halt and roll back protectionism.

However, there are still *appreciable dangers* ahead. In 1988, progress towards the restoration of international balance of payments equilibrium will remain slow. The continuation of a large measure of stability on foreign exchange markets remains necessary to allow time for the considerable exchange rate adjustments which have already occurred to produce their full positive effects. Central bank intervention and international management of interest rate differentials can still contribute here. In order to stabilize durable exchange rate expectations, however, it is above all necessary to progress more rapidly towards the restoration of international payments' equilibrium, otherwise the gap between interest rates in the United States on the one hand, and Europe and Japan on the other, runs the risks of needing to widen still further. Additional rises in interest rates in the United States could then prove necessary. The situation of developing countries, already affected by the weakening of world trade, would be correspondingly worsened.

In these circumstances, it is desirable for relative trends in domestic demand between the various industrialized countries to continue helping to reduce trade imbalances, while at the same time preserving a high level of world growth. The current prospects for 1988 are not encouraging. It is essential for the United States to continue reducing its budget deficit, but Japan must also make greater efforts to create conditions which are favourable to a more rapid growth in imports, by strengthening growth and further opening up its markets. The Community, in addition, by reinforcing its own growth, would help to support world trade, while at the same time playing its part in the absorption of international payments' imbalances.

### 1.3. The task ahead: growth, cohesion and the internal market

Given the present situation of the world economy, the Community will no longer benefit from an external impetus. Implementing the *cooperative growth strategy for more employment* now means: successfully accomplishing the switch from growth underpinned by external factors to growth based on internal forces, shortening the period of conjunctural weakening and thus escaping more rapidly from the trap of slow growth extending into the medium term into which the Community seems to have fallen. In this way, the Community will once again be able to reduce unemployment, derive full benefit from the completion of the large internal market and reinforce its economic and social cohesion. In order to exploit Community strengths to the full, increased cooperation and the pursuit of ambitious Community policies remain essential. It also remains necessary to reinforce the consensus with and between the social partners on the policies required by a more intensive dialogue on all aspects of the strategy at both Community and national level.

To strengthen the Community's *economic and social cohesion*, all the Member States must coordinate their efforts as provided for in Article 130 B of the EEC Treaty, as amended by the Single European Act. Three conditions must be fulfilled. Firstly, the task is to create in Europe a climate of buoyant growth; an adequate rate of growth in the most advanced countries is necessary for this. Secondly, for the less-advanced countries it is crucial to implement policies which improve the domestic conditions for their growth, notably the return on, and effectiveness of, their investment as well as the public finance position. This would create the sort of conditions needed to attract inflows of private capital. Thirdly, the Community should support the adjustment process through the structural funds, as well as through its financial instruments and the EIB. The Commission proposes to double the resources of the structural funds in real terms by 1992, and to increase their effectiveness.

The completion of the *internal market* up to 1992 creates an important new momentum. It is essential not to disappoint the expectations of those involved in economic activity in this enterprise. Rapid progress should be made towards the abolition of frontier controls and customs formalities, the removal of tax and other impediments to the free movements of goods and services, the harmonization of technical standards and the unification of public procurement. In this connection, the Commission has in 1987 made proposals for the approximation of indirect tax rates and the harmonization of their structure and for the unification of public procurement markets.

The reduction in costs which will result from the completion of the internal market, economies of scale, increased competition, and the broadening of the economic basis for research and development, will lead to an easing of the burden on public budgets, productivity gains, an improvement in competitiveness on external markets and a boost to intra-Community trade. The internal market will create fresh opportunities for investment by opening up new horizons for entrepreneurs. For these opportunities to be quickly and fully seized, the irreversible nature of the enterprise must be demonstrated by speeding up its completion. The completion of the large internal market should also derive benefit from an infrastructure network which matches it in scale. The completion of large-scale infrastructure projects of Community interest should contribute here.

The productivity gains made possible will not, however, result in additional jobs and a faster rise in living standards unless productive potential is fully exploited. Stronger growth will also make it easier for the social and regional dimension of the internal market to be taken into account.

#### 1.4. Economic policies

Firstly, it remains essential to pursue *structural policies* aimed at a greater adaptability of the markets. In this connection the recommendations for supply-side policies contained in the most recent Annual Economic Reports remain entirely valid. In particular, the loosening of the constraints on small and medium sized enterprises, improved competition, and the reduction in subsidies affecting the productive use of resources will permit a further reinforcement of the domestic determinants of growth. Also, the greater adaptability of the labour market, the reorganization and reduction of working time, neutral for the level of costs, and investment in vocational training should also boost employment-creation.

The completion of the internal market and the structural policies provide substantial stimuli, which will be able to exert their full effects if they form part of a dynamic *macroeconomic* process. Investment should increase at a significantly faster rate than GDP over the years to come in order to make up the shortfall of jobs. The outlook for demand, profitability and real interest rates are determining factors. In the absence of an external stimulus, the outlook for demand depends to a great extent on a satisfactory trend of private consumption and therefore on the trend of personal disposable income. However, to improve profitability and competitiveness further, real wage costs per head must remain moderate. Under these conditions, reductions in the tax burden on households and business should also contribute to greater momentum. Additional cost-effective public investment would also boost productive potential and at the same time provide welcome support for internal demand. In addition, a fall in real interest rates is desirable. To this end, it is important to avoid calling into question the credibility of the medium-term consolidation of public finances, that inflationary expectations stabilize at a low level, and that financial external imbalances are absorbed. Such falls would also take pressure off public budgets. If it is to be durable, an acceleration in growth must be compatible with the maintenance of an external position that is sustainable in the medium-term. When supply conditions are improved at the same time, some acceleration of growth is thus possible without jeopardizing the balance of payments objective and without the danger of a resurgence of inflation.

Despite the high level of real interest rates, *monetary policy* is currently creating sufficient room for financing growth. Even if account is taken of financial innovation in certain countries, monetary growth remains strong. The task now is to prevent the build up of an excessive accumulation of liquidity which would be inflationary. The more favourably that other determinants of inflation, in particular the trend of wage costs, develop, the smaller the risk will be.

Within the EMS, the management of interest-rate differentials has contributed better than in the past to the

stabilization of exchange rates. Swift liberalization of capital movements should continue to go hand in hand with efforts to strengthen the system. The outcome of the Economic and Finance Ministers Council at Nyborg constitutes an important step in this regard. In the interests of permanent stability of the system, however, it is vital that this cooperation should continue to be based on a broad consensus on the need for stability-oriented monetary policies.

The scope for monetary policy is now limited. *Budgetary policy* therefore has a greater role to play. First, the efforts to restructure public expenditure and receipts must be pursued with determination. From the point of view of the public deficits, each country in the Community taken individually is still subject to severe constraints. In some countries the level of public debt is still increasing at an excessive rate and major efforts are being made to put public finances in order. However, the impact of those efforts on deficits is weakened and delayed by low levels of growth and the resultant shortfall in tax revenue. In other countries, the budgetary situation is easier and the tax reductions planned for next year and beyond will provide a welcome boost to growth, the positive effects of which will also be felt in the medium-term. In some of these countries, the consequences on tax receipts of the slowdown in growth, combined with the tax cuts planned, are already leading to an increase in public deficits.

There is a grave risk in a situation in which growth remains poor: the countries whose budgetary situation is more difficult could be compelled to take additional measures to attain their objective of public finance consolidation. This would have adverse effects on their own growth and on that of their partners, whose room for manoeuvre would in turn be affected. This shows how important it is for national budgetary authorities to take account of the interdependence among economies of the Community in their policy choices. The accession of Spain and Portugal, which are currently giving substantial support to intra-Community trade, has made this interdependence even wider. It is likely to increase further with the completion of the internal market and the liberalization of capital movements.

In the event of a further slowdown in growth, a joint and well-timed effort will permit a positive use of the interdependence among Member States, as envisaged in the conclusions reached by the Economic and Financial Affairs Council at its meeting in July 1987. Such an effort will, of course, have to be consistent with the objectives and constraints which exist at national level. However, if each country can count on more rapid growth elsewhere in the Community, its own external and budgetary constraints will be reduced and it will be able to contribute to a non-inflationary strengthening of growth.

The Community is faced with a difficult international environment. Its performance must rely mainly on its own efforts. It has major strengths to draw on: the structural

adjustments in train, the improvement in profitability, the reduction of inflation, all create conditions favourable to stronger growth which will create jobs. The large internal market will give the economies of the Community additional momentum and accelerate technical progress. Its completion will have to be supplemented by effective Community policies which should also contribute to better economic and

social cohesion. Closer cooperation between the Member States will improve the effectiveness of economic policy. To reinforce consensus on the policies to be followed, a continuation of social dialogue remains essential. Exploiting the Community dimension will thus enable Europe to make its economies more dynamic and to contribute to stabilizing the international environment.

## 2. ECONOMIC DEVELOPMENTS AND OUTLOOK

### 2.1. World economy

The overvaluation of the *dollar* that gradually became apparent in the first half of the 1980s was sharply corrected in 1985, 1986 and in the first two months of 1987 (see Graph 1). The unsatisfactory progress in reducing the United States' current account deficit and the expectation of a further fall in the dollar temporarily fuelled a self-sustaining process of depreciation. The dollar thus lost some 40 % of its value against the ECU between March 1985 and February 1987. There was a return to more settled conditions on the exchanges only after the Louvre accord of February 1987 between the leading industrialized countries had underscored the need to keep exchange rates close to their prevailing levels, and only after this consensus was accompanied by massive central bank intervention. As a result, the real effective exchange rate of the dollar was stabilized at about the level recorded in 1981, a year marked by relatively small current-account imbalances.

The rise in *crude oil prices* was greater in 1987 than had been expected a year earlier. The average price for Community imports is expected to be in the region of US \$ 17 per barrel, compared with US \$ 13,7 in 1986. Unlike in 1986, oil price movements are no longer expected, therefore, to make any contribution to a lowering of inflation rates. A limited rise in the oil price is assumed for the coming year. However, oil prices are prey to major uncertainties stemming from the political tensions in the Gulf and from the precarious nature of the production quotas agreed by OPEC.

*Other commodity prices* may increase slightly in dollar terms in 1987 and 1988 (see Graph 2). As, at the same time, prices of manufactures will increase more rapidly, the terms of trade of the commodity-exporting developing countries are likely to show a further worsening.

The growth in *world trade* over the last 12 months has remained below the forecast made last autumn. In the first half of 1987, imports by non-Community countries actually

remained flat in volume terms. The expectation at the moment is that total world imports (including the Community) will grow by some 3,5 % in 1987, compared with close on 4,9 % in 1986 (see Table 3). The prospects for the Community are even gloomier. If world imports (excluding the Community) are weighted to take account of the structure of Community exports, this gives for the current year a figure of less than 1 % for the expansion in Community export markets (see Table 5). World trade is not expected to stage a recovery of sorts until 1988. Its sluggish expansion in 1987 is due essentially to the squeeze on imports in the OPEC countries and to a much slower rate of growth of imports in the United States.

In the *United States*, the federal budget deficit fell significantly in fiscal 1987, but mainly under the impact of a once-off increase in tax revenue as a result of the tax reform. This specific effect will, however, no longer be felt in 1988. Moreover, the balanced budget originally foreseen under the Gramm-Rudman legislation for 1991 has now been put back to 1993. The fall in the dollar and the resulting increase in import prices will push up inflation in 1987. At the same time, the first signs of the anticipated impact on merchandise trade of the fall in the dollar are being felt. For the first time since 1980, the external balance has contributed positively to the growth in real GDP. Nevertheless, with the negative effects of changes in import and export prices exceeding for the moment the gains which they imply in movements in export and import volumes, no contraction in the US trade deficit in nominal terms is to be expected this year (J-curve effect). The current account deficit should also widen further in 1987 and reach US \$ 154 billion (3,5 % of GNP). An improvement can be expected only in 1988. Investment should recover in 1988 after the fall in real terms this year. In total, GNP growth could accelerate slightly from 2,3 % in 1987 to 2,7 % in 1988.

In *Japan*, a country heavily dependent on exports, the strong appreciation of the yen last year led to a sharp decline in the GNP growth rate, from 4,5 % in 1985 to 2,4 % in 1986. For the current and coming years, growth could recover, since the development of domestic demand remains dynamic and the negative contribution of the foreign balance to growth is

fading. This process is underpinned by the fiscal package announced by the Japanese government, worth over 6 000 billion Yen, that was adopted in 1987. Investment will probably expand at a rate of more than 7 %, as a rise in public investment and investment in residential construction looks set to make up for the sluggish nature of productive investment. Despite the recovery in growth, the unemployment rate is expected to remain in 1987, as in 1988, at the historically very high level of around 3 %. The Japanese current account surplus in dollar terms should be of the same order of magnitude in 1987 as in 1986, around US \$ 85 000 million, while falling as a percentage of GNP to 3,8 % from 4,5 % in 1986.

Leaving aside the newly industrializing countries in Asia, the situation of the *developing countries* has scarcely improved in 1986/1987 owing to the slack rate of growth in the world economy and the depressed level of commodity prices (see Tables 7 and 8). The deterioration in the current-account balances of the developing countries as a whole in 1986 is attributable primarily to lower oil prices and reflects the fall in the oil revenues of oil-exporting countries. The non-oil-exporting countries' current balances were, however, clearly eased. Nevertheless, the private external contribution to the financing of these external deficits remains very small.

The situation of the non-oil developing countries continues to show large differences. While the countries of the Far East continue to record high GDP growth rates, those with middle incomes in Europe and Latin America have performed only modestly. The situation in sub-Saharan Africa, on the other hand, remains extremely disturbing, with falling living standards in certain areas.

## 2.2. The adjustment process and international cooperation

International cooperation has been directed towards reducing international imbalances and is leading to policy adjustments that are pointing in the right direction. In particular, the efforts to stabilize the dollar's exchange rate have proved fruitful, but further progress is still needed in eliminating the major imbalances. The two main problems, i.e. current-account imbalances between the leading industrialized countries and the debt burden of the developing countries, are still being acutely felt. Solving them will be a task of overriding importance in the years ahead.

The unprecedented scale of *current-account imbalances* is illustrated in Graph 3. As early as 1985, these imbalances had become untenable; for the world economy, this

heightened the risk of a 'hard landing'. In this context, the major industrialized countries arrived at a consensus on the desired adjustment in parities which found its expression in the Plaza agreement of September 1985. It was reflected on the foreign exchange markets by a persistent fall of the dollar. Following what, over such a short period, were large exchange-rate adjustments, commitments were made, within the framework of the Louvre accord, to stabilize the dollar's rate so as to enable trade flows to adapt to the new configuration of exchange rates, and thereby to initiate a return to more balanced current-account positions. This accord was confirmed at the Group of Seven meeting in September 1987 in Washington. Some progress in correcting external imbalances is evident, but the process also exhibits some worrying trends. It is true that the trade balances of Japan and the Community at constant 1985 prices are moving in the desired direction: implying respective falls of around US \$ 23 000 million and US \$ 36 000 million between 1986 and 1988 (see Table 6). These falls only, however, correspond to the improvement in the United States' balance of US \$ 36 000 million between these two years. An important counterpart is furnished by the developing countries, in particular oil exporters who have substantially reduced their imports. Thus, the adjustment process between the industrialized countries is only advancing very modestly.

It is difficult to tell whether the *dollar's present exchange rate* is capable of redressing the current-account balance in the medium term. Nevertheless, real exchange-rate movements since 1985 have, to a large extent, compensated for the dollar's tendency to become overvalued during the first half of the 1980s. As for the Japanese yen, its appreciation since 1985 has, in fact, more than offset its earlier real depreciation. It could, therefore, be concluded that the exchange rate modifications which have taken place since 1985 may be sufficient to lead to significant progress towards balance in international payments, to the extent to which they are accompanied by overall macroeconomic policy compatible with a faster adjustment process.

In the first half of 1987, central bank intervention contributed substantially to financing the United States current deficit and to stabilizing the dollar. In the medium term, however, this alone cannot achieve the lasting stabilization of exchange rates necessary for a smooth adjustment process. Such a stabilization is conceivable only if a positive interest rate differential is combined with weaker growth of internal demand in the United States than in Japan and Europe. The movements in *interest rate differentials* since the beginning of the year have already contributed to a stabilization in exchange rates. Thus, for example, between January and August 1987, the interest rate differential between the United States and Germany, on both long- and short-term nominal rates, has increased by around one percentage point, thus preventing a further fall in the dollar. The short-term forecasts assume that this differential does not narrow in 1988. In any event, while the necessary differentials are being maintained, the average level of

interest rates must be kept as low as is consistent with low inflation. This is because high United States interest rates not only harm investment but also lead to a worsening of the situation of the heavily indebted developing countries.

However, the key to stabilization of the dollar and to a sustained reduction in external imbalances lies in the establishment of an adequate domestic demand *growth differential* between Japan and Europe, on the one hand, and the United States, on the other. Experience has shown that the effects of a large exchange-rate adjustment work through more rapidly if growth in the surplus country speeds up, triggering a pick-up in exports that is of crucial importance when it comes to rectifying the external balance of the country running a deficit. In 1987, it would seem that considerable progress is in the process of being made on this front. While the growth in final domestic demand in the United States is around 1 % below that of its 19 main partner countries, Japan and the Community will register a positive growth differential with respect to their partners of around 1,6 % and 0,5 % respectively (see Table 4). At the Community level it should, however, be recognized that this development is to a greater extent due to the slowdown in world economic activity than to an acceleration in final domestic demand. What is more, according to the forecasts for 1988 these differentials, except in the Japanese case, will probably tend, if anything, to narrow instead of growing wider as would be desirable and necessary. Then again, the growth in domestic final demand in the United States in 1988 is expected to be only some 0,7 % lower than the average for its major trading partners. In relation to the Community, there will be probably no disparity in growth rates whatsoever. If these forecasts were to hold good, external trade would only make a limited contribution next year towards reducing current-account imbalances between the industrialized countries. This could damage the credibility of the adjustment process in the medium term. This would increase the risk of a further fall in the dollar and of escalating protectionist measures. It is essential, therefore, that economic policy should thwart such a development. At the same time, steps must be taken to ensure that the necessary disparities in growth are achieved at a high, but non-inflationary level of growth. Without this, it will not be possible to set about tackling the pressing problem of unemployment in Europe. Furthermore, a recession in the United States would have an adverse effect on those countries running an external deficit and on the heavily indebted developing countries.

This year, the *level of developing-countries debt* will climb once again, partly as a result of exchange-rate adjustments. Admittedly, the ratio of debt interest payments to exports has declined slightly. The debt burden was eased by reductions in interest rates up to 1986 and by debt-rescheduling agreements, in particular within the framework of the Paris Club. However, the recent rises in interest rates will again make the situation of the developing countries more difficult. The Seventh United Nations Conference on Trade and Development (UNCTAD VII), in July 1987 in Geneva, showed that it was possible to make a common analysis with

the developing countries on the main problems of the world economy. At the September 1987 annual meeting of the World Bank and IMF in Washington, some successes could be noted, particularly the negotiations underway to raise the capital of the World Bank. Broad consensus is appearing on the need to support the adjustment efforts of the low-income countries, whose debts are primarily with official creditors, by alleviating the burden of their debt and by stepping up the volume of capital flows made available at favourable rates. In the other indebted countries, in accordance with the objectives of growth and structural adjustment, it would be necessary to mobilize domestic resources and to tap a sufficient amount of external financing, in particular private capital.

Even so, the industrialized countries themselves must, while helping to strengthen growth worldwide, spurn protectionist measures and open up their markets in order to allow the developing countries to expand their exports, thereby making it easier for them to repay their borrowings. Rapid progress would, therefore, be welcome at the current round of negotiations within GATT (the Uruguay Round). At any event, the present problems at international level can be resolved only if current-account imbalances are corrected and the debt crisis defused; given the growing interdependence of economies, this will be possible only if *international cooperation and coordination* are stepped up. In this respect, the improved multilateral surveillance arrangements agreed upon back in 1985 at the Tokyo Summit and confirmed in June 1987 in Venice could prove to be a useful instrument in avoiding any incompatibilities in economic policy and, where appropriate, identifying any possible divergence in good time. It is also important that the Community speaks with one voice in the international meetings of the coming months. This applies not only to trade policy and the indebtedness problems of developing countries but also in the area of economic and monetary cooperation between the major industrialized blocs.

### 2.3. The economic outlook for the Community for 1987 and 1988

Economic growth in the Community estimated at 2,2 % this year is significantly lower than expected in the last Annual Economic Report. The expectation of faster growth has not, therefore, been realized. Comparison of last year's forecasts with the most recent estimates pinpoints where the two main causes of this development lie: exports, and investment in plant and machinery (see Table 9).

Although, for reasons to do with international adjustment (see above), external trade cannot, basically, be looked to as a source of faster growth in Europe, the contraction in exports to third countries has, even so, been more

pronounced than expected. On the one hand, lower crude oil prices have caused the OPEC countries to reduce imports significantly. On the other hand, the price competitiveness of European producers has deteriorated sharply in response to exchange-rate adjustments. Compared with 1985, the Community has had to contend with a rise of 20 % or so in its real effective exchange rate against its major trading partners (see Table 10). Moreover, a number of newly industrializing countries in the Pacific have benefited from an improvement in their international competitiveness as their currencies have fallen in line with the dollar. At the same time the Yen/ECU exchange rate has only risen some 9 % so that the Community's price competitiveness *vis-à-vis* Japan has only improved slightly. As highlighted by a business survey conducted in April/May 1987 on behalf of the Commission, the magnitude of exchange-rate adjustment took many firms by surprise, causing them to modify substantially their forecasts and plans (see Table 11). The survey's findings indicate that firms have, in particular, revised their profit forecasts sharply downwards. At the same time, the prospects for sales in the medium term have also become much gloomier. In view of this simultaneous weakening of the two key determinants of investment, it is not surprising that investment projects have been deferred. This explains why the 1987 expansion in investment in plant and machinery as recorded in national accounts fell way below last autumn's forecast.

Revisions to business investment plans already occurred in the second half of 1986. This revision is also showing up in the regular investment surveys conducted in the Community. Whereas, in March/April 1986, real investment growth of 10 % in industry was still in prospect for the current year, by October/November that year the figure had been scaled down to 5 %. This was the largest revision since 1981. The most recent forecasts indicate a rise of some 3,3 % in the volume of *gross fixed capital formation* in 1988, compared with 3,6 % this year, the slight recovery in construction investment not compensating for a weaker growth of investment in plant and machinery.

The trend of *private consumption* has also been slightly more disappointing than expected. In 1987, a further fall in import prices and the resulting marked increase in personal disposable income again boosted private consumption by around 3 %. Nevertheless, with some of the extra income being channelled into saving, the stimulus to growth is not sufficient to set off an appreciable dynamic growth. In 1988, because of a slacker rate of increase in real disposable income, private consumption is forecast to grow at a rate of only some 2,7 %.

Although supply-side conditions have improved, the transition from growth underpinned by exports to growth based mainly on domestic factors has not been sufficient to

foster progress towards the growth and employment objectives laid down in the Community strategy. The contribution of domestic final demand to GDP growth rose steadily between 1981 and 1986, from -0,5 to +3,5 percentage points, but this has not been enough to offset, to the extent necessary, the distinctly adverse effect of external trade during 1986 and 1987. Since the particularly benign impact of the terms of trade in 1986 is fading, the slowdown that occurred in 1987 could only have been prevented through even more flexible budgetary policy management. During those two years, only intra-Community exports have expanded appreciably, with trade between Spain and Portugal, on the one hand, and the other Community countries, on the other, being particularly buoyant (see Chapter 3.3).

No improvement seems likely for 1988. On the contrary, the growth in domestic final demand will probably decelerate further, to around 2,7 % as against 3,2 % in 1987 and 3,8 % in 1986. This situation is apparent at the same time within the Community, with large disparities in growth rates. Among the larger countries of the Community, in France and Germany for example, the growth of final domestic demand, with rates of increase of only 2,0 % and 2,3 % respectively in 1988, is likely to be below the Community average. On the other hand, expected growth rates of 3,3 % in Italy and the United Kingdom and nearly 5 % in Spain and Portugal are well above the Community average. Furthermore, in some countries growth is coming up against mounting external constraints (see Table 1). These constraints could be eased if the more prosperous Community economies notched up more buoyant growth. Failing that, the rise in Community GDP will probably be no higher in 1988 than in 1987. The external sector's contribution is expected to remain only slightly negative, as the rise in imports loses momentum and the growth of extra-Community exports picks up again.

The favourable *trend of prices* has continued and inflation is still on the wane in the majority of countries. The rise in consumer prices (just over 3 % in the Community) is actually below the average for the 1960s. This stabilization process got under way at the beginning of the 1980s under the impact of monetary policies directed towards stability, and has also received a fillip since 1986 from the decline in energy and import prices. Since nominal wages have adjusted rapidly to lower inflation and since the growth of real wages has remained moderate (see Table 14), the particularly favourable external influences have resulted in a positive trend in internal costs, laying the foundations for lasting stability. Although the inflation reduction process is running out of steam at the Community level, a further strengthening of *price convergence* on the lowest inflation rate is also expected (see Table 12). This arises from the fact that the slide in inflation is particularly pronounced in those countries where the inflation rate is still comparatively high.



There has been little further progress towards convergence of living standards in the Community, that is, *real convergence*. On the contrary, the disparities, measured in terms of *per capita* GDP, have tended, if anything, to widen since the first oil shock. This compares with the appreciable progress registered in the 1960s (see Table 13). At present, GDP per head in Portugal and Greece is around 45 %, in Ireland 35 %, and in Spain 25 %, below the Community average. Since 1985, Spain and Portugal have succeeded in somewhat reducing their divergence from the Community average through a higher level of economic growth. In total the improvement remains modest; nor is there any indication that the less-favoured regions will manage to close the gap separating them from the rest of the Community in 1988 quickly. It is, however, essential for economic and social cohesion in the Community that this catching-up process should begin (see Chapter 3.3).

#### 2.4. Employment and unemployment

The slowdown in growth described above implies that the Community has failed to come nearer to meeting one of its main objectives: the substantial reduction of *unemployment*. For 1987 and 1988, employment is indeed expected to increase by around 0,8 % and 0,6 % respectively, compared with 0,8 % in 1986; but this is still not enough to bring about any major fall in the unemployment rate, which will probably be close on 12 % for the Community as a whole during those two years (see Table 1). Nevertheless, the relationship that seems to be emerging in 1987 and 1988 between economic growth and the rise in employment confirms observations made over a number of years, namely that the job content of growth has increased (see the box 'Growth and employment').

In 1987 and 1988, total employment is set to rise at an above-average rate in Spain, Italy and the United Kingdom and at a below-average rate in Belgium, Denmark, Greece, Ireland and France (see Table 1). The growth in employment since 1985 has been neither sufficiently broad-based nor sufficiently strong to produce any substantial improvement on the labour market. Rising employment in the service sector is alone helping to compensate for the downward trend of employment in agriculture and manufacturing (see Table 15) and the economy is not expanding fast enough at the moment to reverse, or at least stem, the contraction in manufacturing employment. In sectors subject to painful restructuring within the world adjustment process, such as coal, steel and shipbuilding, employment has fallen sharply. Of around 3,2 million jobs lost in industry between 1982 and 1986, 100 000 have been in steel, nearly 150 000 in coalmining and 80 000 in shipyards. Further employment shedding in problem sectors are to be expected. This development will have particularly noticeable effects on unemployment, since employment in certain regions often depends crucially on these industrial sectors. For both 1987

and 1988, the manufacturing workforce is again expected to fall slightly. Spain and the Netherlands will probably be the only countries to register a significant rise in industrial employment in those two years. Overall, the growth of employment in the Community is accounted for by the service sector.

New or modified forms of working as well as labour market measures have contributed to the rise in employment. Working time per person employed has fallen in almost all Member States following a reduction and reorganization of weekly working hours and an extension in part-time working. Where the reorganization of working time is concerned, flexible systems (see Chapter 4.1.4) under which employees' working hours can be divorced from operating hours proliferated. The expansion in part-time working also makes for more flexible use of labour. In 1986, 13,5 % of wage and salary earners (EUR 9) were in part-time employment, compared with only 10,8 % in 1979. In Denmark, the Netherlands and the United Kingdom, just under one quarter of wage and salary earners were in part-time employment (see Table 16). The part-time labour force is mainly made up of women, and most of the jobs available are in the service sector. If the reduction in working time and the introduction of part-time working meet the wishes of those in employment, and if both can be reconciled with the needs of firms, more flexible organization of working hours and operating hours opens up numerous possibilities for job creation<sup>(1)</sup>. The proliferation of fixed-term employment contracts should have made it easier for those without jobs to find employment. For instance, the proportion of persons covered by a limited-duration contract rose from 5 % of the total number of persons employed in 1983 to 5,5 % in 1985 in the United Kingdom and from 2,3 % to 3,2 % in France. In the Federal Republic of Germany, an increase from 4,2 % to 6,8 % was recorded in a single year (from 1984 to 1985). Young people and part-time workers account for an above-average proportion of those covered by limited-duration contracts (see Table 17). This often stems from new laws or specific employment measures (see Chapter 4.1).

In 1986, for the first time since 1979, the rise in total employment brought to an end the upward movement in unemployment. Even so, the increase in the demand for labour barely exceeds the expansion of the labour force. Demographic pressure on the labour market is easing, but the participation rate, especially among women, will probably continue to rise. Consequently, the number of people out of work will remain high in 1988, at 16 million.

<sup>(1)</sup> An enquiry undertaken for the Commission shows that only 10 to 20 % of part-time workers would wish to increase their hours worked, while the proportion of full-time workers who would prefer to work less is around 30 % (see *European Economy*, No 27, 'Employment problems: views of businessmen and the workforce'). This enquiry also reveals that a more flexible management of working-time and of production would enable an increase in employment perhaps reaching 6 %.



As far as the regional distribution is concerned, unemployment is not only higher in the weaker than the more prosperous regions, but has additionally grown at a more rapid pace than the Community average. Thus, in 1985 for example, the unemployment rate was more than 20 % in the 25 weakest regions while it was 6,6 % in the more advanced regions (see Table 20). The most worrying factor is that, according to the projections, half the total growth (6,7 million from now to 1995) in the population of working age in the Community, is in the less favoured regions (see Table 21).

The various categories making up the labour force are being affected quite differently by high unemployment. The risk of unemployment is very pronounced among young people, women, the elderly and the unskilled. In the Community, over a third of the unemployed are young people, although the situation differs a great deal from one country to another. In 1986, 48 % in Italy and 43 % in Spain of the unemployed were under 25 while the corresponding figures for Germany and Denmark were only 22 % and 23 %, respectively. Nevertheless, in recent years, youth unemployment has fallen back little in the Community as a whole: in 1986, 36 % of the unemployed were under 25 as against 38 % in 1984; 22,7 % of the labour force under 25 (those in employment plus the unemployed) were out of work in 1986 against 23,5 % in 1984. This development can be put down to an easing of demographic pressures and to the wide variety of programmes to combat youth unemployment, including measures under the European Social Fund. Unemployment among women is also a specific labour market problem. It has risen steadily in recent years, to reach 13,2 % in 1986 (see Table 18). In April 1986, on the basis of the Community's labour force sample survey, it was particularly high in Spain (25,9 %), Ireland (20,2 %) and Belgium (16,8 %). Labour market problems are also the reason for a disturbing increase in the number of long-term unemployed. According to the definitions of the labour force sample survey, at the moment over half of those out of work have been without a job for more than a year, compared with 46 % in 1983 (see Table 19). This phenomenon is particularly pronounced in Belgium, Italy and Ireland, where the figure is over two thirds. In Spain and the Netherlands, the proportion of long-term unemployment easily exceeds 50 %. Given the sharp increase in long-term unemployment, it is of even more pressing importance that a solution should be found to the problems on the labour market.

## 2.5. The medium-term economic outlook for the Community

In the medium term, unemployment can only be reduced if growth accelerates and at the same time becomes more employment-creating. As already shown, a series of domestic economic conditions for stronger growth has improved. Positive external economic conditions cannot, however, be

counted on, because of the necessary international adjustment processes.

Although an attempt may be made, against the background of this situation, to quantify the medium-term economic outlook for the Community, the medium-term projections, unlike the short-term forecasts, can on no account be interpreted as a prognosis of probable economic developments. But with the help of plausible assumptions as to international developments, key economic reaction mechanisms and behaviour patterns, and as to the economic policy to be conducted, possible economic developments can be discerned. The medium-term projections prepared by Commission services since the start of the 1980s — in so far as it has so far been possible to observe their out turns — have presented the Community's growth and unemployment problems fairly realistically (see Table 22). However, this relative success does nothing to change the fact that each new projection throws up new uncertainties and that certain developments can be only imperfectly gauged by macroeconomic projections. This is not only true of the international environment, but also of developments in the internal economy. For example, macroeconomic projections take a long time to register — or have so far completely ignored — the gradual changes in economic relationships which stem from the efforts made in all the Member States to improve the adaptability of markets or to promote the completion of the internal market.

The present projection to 1991 assumes that the ECU will not appreciate by very much more against the dollar over the next few years, but the Yen will still have some margin for appreciation; the price of oil could gradually increase in the next few years but no new shock is assumed; the situation of the developing countries will remain difficult, but their imports could again increase appreciably in line with the upturn in world trade. Overall, on these assumptions, world trade (world import volume, excluding the Community) could gradually return to a growth rate of slightly under 5 % by 1990/1991 (see Table 23). With regard to economic policy in the Community, it has been assumed that the present stance of budgetary policy — including the tax cuts planned in major countries and a slightly more dynamic trend of public investment — would be maintained, that monetary policy would continue to be geared to stability but would leave sufficient margin for real growth and that increases in real wages would remain moderate, but accelerate slightly in comparison with the period 1981 to 1986.

On these assumptions, the average annual growth rate for the Community would be 2,5 % in the years 1987 to 1991 (see Table 24). The inflation rate would stabilize at its present level of a little over 3 %. The profitability of fixed capital would go on rising, but at a markedly slower rate than in the previous five-year period (see Graph 13). Corporate

investment would improve a little, but not sufficiently to create the desired number of jobs. The increase in employment achieved (0,7 % *per annum*) would certainly produce no more than a slight fall in the unemployment rate; in 1991 it would still be likely to be standing at over 10 %. The Community's current account surplus would gradually diminish which, given the needs of the international adjustment process, would be normal; the emergence of a large deficit as a result of growth being accelerated on employment grounds should, however, be avoided. However, this deterioration in the current account balance is chiefly attributable to the assumed rise in the oil price; if it were assumed that in 1989 the oil price stayed at 18 dollars and thereafter did not increase more sharply than the export prices of the industrialized countries, the Community would still have a comfortable current account surplus in 1991.

From the point of view of growth and employment, this projection is disappointing, and hardly seems to differ from the reference projection produced for the last Annual Economic Report, but, as has been indicated, it does not take sufficient account of the improvement in market adaptability and does not yet integrate the completion of the internal market. If we consider the annual progression of the principal variables, once the externally determined low growth of 1987 and 1988 is over, this year's reference projection shows a somewhat more dynamic growth trend than last year's projection (see Graph 14). Admittedly, the reduction of unemployment is still too small, but employment at the end of the projection period is marginally better, so that the unemployment rate then falls slightly more rapidly. Certainly, these are the first signs of a slight improvement in the outlook; they should not be overestimated, and on no account be interpreted as the probable course of the cycle. If the parameters are varied in the projections, it can be seen, however, that the slight improvement perceived is mainly connected with the assumed reduction in taxes and the slightly more sustained increase in public investment. These support demand and, in conjunction with a moderate development in wages, improve profitability. It remains the priority task of economic policy to strengthen and to accelerate these favourable developments.

*The depreciation of the dollar continued in 1986 and during the first two months of 1987. More settled conditions on the foreign exchange markets only came about as a result of the Louvre accord of February 1987. The hoped-for repercussions of the depreciation of the dollar have begun to be felt on real flows, but progress is still insufficient. To succeed in stabilizing the dollar, until credible progress has been achieved on the international adjustment front, requires not only a positive differential in interest rates but also an adequate negative growth gap between the United States on the one hand and Japan and Europe on the other. Although developments have been favourable in this respect in 1987, first indications for 1988 suggest that growth differentials will more probably shrink. If these forecasts were to come to pass, the credibility of the medium-term adjustment process could be compromised. This in its turn could only lead to a greater risk of a further fall in the dollar and a strengthening of protectionist measures. Substantial and credible progress in the absorption of the United States budget deficit and a greater opening up of the Japanese market would contribute substantially to averting the danger. Within the Community, the sharp ebb in extra-Community exports, and the consequent worsening of the investment climate, have quashed the hopes of an acceleration in growth which existed last Autumn. In addition, convergence in living standards in the Community is only progressing slowly. On the other hand, the convergence of price developments towards a lower level of inflation is continuing. The growth in employment noted since 1985 has enabled the rise in unemployment to be stemmed in 1986 for the first time since 1979. Reduction in working time, the extension of part-time working, moderation in real wages, new forms of working time reorganization, as well as other employment measures, have made growth more employment-creating for several years. Despite these favourable factors, the unemployment rate in the Community will scarcely fall in 1987/1988 since growth is slowing down. The increase in long-term unemployment is particularly worrying. In the medium term, a more favourable international economic environment cannot be counted on. Within the Community, there are some tentative signs of a slight improvement in growth and employment in the medium term. This stems essentially from the hypotheses of a reduction in taxation and an increase in public investment supporting demand which, in conjunction with a moderate development in real wages, increase profitability. At the beginning of the 1990s, nevertheless, the unemployment rate could still remain above 10 %.*

### 3. INTERNAL DETERMINANTS OF GROWTH AND THE INTERDEPENDENCE OF THE MEMBER STATES

Given the changed external situation, the Community's task is to strengthen its growth from its own forces. This is not only the best contribution it can make to restore international equilibria at a highest possible level of growth. High growth for the Community is above all necessary to achieve its

*internal objectives: the reduction of unemployment, the exploitation of all the advantages flowing from the realization of the large internal market and the strengthening of economic and social cohesion in the Community. Achieving each of these central internal objectives requires*

higher growth. Further, progress in achieving any one of the three will contribute significantly to achieving the other two.

Achieving internally-led growth means applying the cooperative growth strategy for more employment which was adopted by the Council for the Community in the 1985/1986 and 1986/1987 Annual Economic Reports. Stronger growth, in order to be durable and, finally, self-sustaining, must preserve achievements gained from the internal and external economic stability, strengthening them where necessary. It must be supported by improved profitability and adaptability of markets. In this respect, the recommendations on supply policies in the annual reports of previous years remain valid.

### 3.1. The internal market and the adjustment of economic structures as the engines of growth

The completion of an area without internal frontiers creates important stimuli for both the supply and demand sides in the Community. Removing fiscal and administrative barriers, mutual recognition of technical standards and the opening of markets will have both an immediate as well as a progressive impact. For the *private sector*, the following supply-side effects can be expected:

- (i) First, *direct cost savings* achieved in trade within the Community, if frontier formalities, additional inspections and certificates disappear;
- (ii) The easier and less costly it becomes to offer products marketed in one member country in other countries as well, the greater is the incentive to expand production capacities and to produce for the large internal market; the resultant *economies of scale* can be considerable; productivity rises while unit costs fall;
- (iii) Because transparency for public and private goods is greater, *competition* on the Community's internal market will intensify. Firms will have a greater incentive to increase their efficiency and to improve the quality of their products. In the medium term this can lead to a more efficient economic structure in the Community;
- (iv) The large internal market finally also creates substantially better conditions for a greater European *research and development effort* since it opens up the whole Community as an outlet for the institutes and enterprises involved, benefitting the technological competitiveness of the Community.

The completion of the internal market can also, however, have positive effects on private demand:

- (i) If competition is wider, lower unit costs lead to *lower product prices*. As a result, competitiveness is improved. This not only strengthens internal trade but also enables demand outside the Community to be better exploited;
- (ii) The *greater variety of products available* in the large internal market meets the needs of enterprises and consumers and is also likely to trigger additional demand.

Completion of the market will also produce many cost savings in the *public sector*: expenditure on the supervision of national regulations will fall, and procurement opportunities will improve, if public contracts are awarded within the Community under conditions of free competition. This also increases the budgetary margin available for growth-promotion measures on both the supply and the demand side.

The Commission has initiated a number of studies to estimate the quantitative effects of completing the internal market in some sectors. The overall effect is likely to be significant even though it is difficult to quantify exactly because of the large number of factors involved. The overall effect will also depend on the circumstances in which the internal market is completed:

- Considerable *additional investment* would enable the full exploitation of the opportunities created by completion of the large internal market. The earlier that firms realize that the Community has embarked on an irreversible process, the more quickly this investment will be forthcoming. Additional investment creates additional demand and increases the momentum of growth. On the other hand, improved market expectations of growth are also necessary, so that more is actually invested. The execution of *major projects of European interest* is also relevant to the completion of the internal market, since they help to establish modern and transnational transport and telecommunications networks and so to counteract the fragmentation of national infrastructure. In a suitable environment such projects can largely be financed on the private capital market.
- In the Member States it is also necessary to *increase the adaptability of the markets* in goods, services, capital and labour and to encourage entrepreneurial initiative (see Chapter 4.1); this improves supply-side conditions, allows firms to react more quickly to the new conditions of the internal market, and accelerates the exploitation of its advantages. The associated structural changes can create social and regional problems. In order not to call into question fundamental rights in the fields of social security, of social protection and of working conditions, an issue raised by the Council of Ministers in its

resolution of 22 December 1986, appropriate regard must be given to the *social dimension* and the process of structural adjustment must be accompanied by a wide social dialogue. The strengthening of economic and social cohesion in the Community (see Chapters 3.3 and 4.3) would also facilitate regional adjustment. Lastly, the social and regional problems associated with structural adjustment can be overcome only in an *environment of stronger economic growth*. Defensive behaviour of governments and social partners will then be easier to avoid.

An important contribution of the internal market is to increase productivity, but, for higher productivity to create both greater prosperity and more employment, growth has to be high enough. Admittedly, the completion of the internal market will provide a strong boost for growth, but this can only become fully effective if it goes hand-in-hand with a more dynamic macroeconomic process.

### 3.2. The macroeconomic process

Macroeconomic policy must also help to free the Community from the trap of low growth in which present policies and behaviour patterns would place it, even if there are perhaps signs of a slight improvement for the end of the decade (see Chapter 2.5). It must aim to promote self-sustaining growth which is higher and creates more jobs, without jeopardizing internal and external stability; in this way faster growth can be maintained in the medium term.

A dynamic equilibrium must therefore be established in the Community between *investment and private consumption*. From 1960 to 1973, private investment in the Community increased slightly more rapidly than private consumption, while the proportion of private investment in GDP increased; from 1973 to 1985 there was a complete change in the situation, with investment growth actually falling more sharply than the growth of GDP, the rate of which more than halved (see Table 25). If this investment gap, which has grown up over more than a decade, is to be closed and today's lack of jobs alleviated, if, in the future, capacity bottlenecks are to be avoided, and if structural change and the modernization of production facilities are to accelerate, private investment in the Community in the next few years will have to grow substantially more quickly than GDP. Since each unit of output now on average requires more capital than before, this means that the need for capital expenditure to expand production and employment is today considerably greater than in the 1960s (see Table 25). It will therefore be necessary for the share of *private investment* in GDP in the Community to rise appreciably in the next few years.

This can only be achieved if two essential determinants of private investment, i.e. expectations of demand and

profitability, improve *simultaneously*. However, since the Community cannot for the foreseeable future count on any great external boost to demand, the necessary stimulus must emanate from internal final demand in the Community, i.e. from *private consumption* and from higher *investment*. Private consumption would therefore have to grow at roughly the same rate as GDP over the next few years, requiring appropriate increases in private disposable income.

However, if investment is to grow strongly, its profitability must rise further for some years (see below); real wage increases in the Community must therefore continue to remain moderate. Moderate increases with stronger growth in employment still allow an appropriate rise in private incomes, provided that *budgetary policy also assumes an active role in this process*, by contributing to an improvement of conditions on the supply side and to the adequate growth of demand by reducing taxation on private households and firms and by more *public investment* in worthwhile or profitable projects. To avoid pressure for higher real interest rates which would be unfavourable to private investment, such a budgetary policy should not call into question the improvement of public finance in the medium-term.

A number of member countries have given themselves scope for a more active budgetary policy role by means of the consolidation efforts of the past (see Chapter 5.3). These countries have already cut taxes or are planning to do so. The positive effects of these measures for the medium term can already be perceived (see Chapter 2.5), but, should economic growth fall short of expectations for any length of time, these plans may be endangered, since the slackening of growth goes hand-in-hand with revenue losses for the public budgets and still higher crisis-induced expenditure, which reduces the budgetary room for manoeuvre accordingly. The prerequisite for a credible and realistic policy of medium-term budgetary consolidation therefore seems to be a flexible approach to planned tax cuts, both as regards their scale and timing. The growth-promotion effect is greatest and the danger of unsustainable external imbalances is most limited if those member countries which can conduct an active budgetary policy coordinate their action. Stronger growth in the Community would improve the budgetary situation of the other member countries. These, while adhering to their consolidation priorities, could then also contribute to the improvement of growth prospects in the Community (see Chapter 3.3).

*Public investment* has suffered severely as a result of the consolidation drive of the Member States. Its share in GDP has fallen by roughly one third since the beginning of the 1970s. An acceleration in profitable public investment would not only expand the productive potential in the Community more quickly but at the same time would also have a direct

effect on demand. The execution of major *infrastructure projects* of Community interest (see Chapter 3.1) can also contribute to the attainment of this objective.

However, it is not only important to improve demand prospects: *profitability* must also improve. In this respect, considerable progress has been achieved in recent years. Higher capacity utilization, the fall in the prices of important raw materials and in particular the fact that, for several years, real wage increases have not kept pace with productivity gains, have already markedly improved the profitability of physical capital. Nevertheless, it is still not back to the level of the 1960s, when profitability was sufficient to permit self-sustaining growth with low unemployment. Nor has profitability yet risen by much in 1987. Given the great need for private investment, and until a self-sustaining process of dynamic growth has become a reality, wage trends must therefore continue to contribute to improving the preconditions for investment. In this respect the reduction of the tax burden on wage and salary earners should facilitate moderation in real wage increases per head.

A wages trend which does not increase the pressure on costs and the continuation of a stability-oriented monetary policy make it easier to stabilize inflation at its present low level or to bring it down even further in a number of member countries. This enables inflationary expectations to be adjusted downwards, creating a sound basis for a further *fall in long-term interest rates*. Higher profitability and an increased self-financing capacity of firms would, in addition, reduce tensions between supply and demand for long-term capital. This too will have a favourable effect on investment activity, because financing costs fall and because the relationship between the expected return on physical capital and interest rates on the financial market is shifting more and more clearly in favour of productive investment. Most importantly, however, falling long-term interest rates will also take considerable pressure off public budgets: in some Member States the public debt already equals, if not exceeds, annual gross national product (see box on interest rates).

Such an increase in growth, underpinned by domestic demand, would also help to eliminate international current account imbalances while maintaining global growth at the highest possible level. This would strengthen confidence in the stability of international economic and monetary relations and would also remove impediments to additional investment. In order to avoid disturbances it is, however, important to preserve satisfactorily the *external equilibrium of the Community* in the medium term. The Community's competitiveness must therefore be maintained and strengthened. A further improvement in profitability and more adaptable markets will also help to satisfy more internal demand by means of internal production in those circumstances; it is thus possible to maintain external equilibrium in the medium term even if growth accelerates.

### 3.3. Interdependence between the Member States

In 1987 almost 60 % of the visible import and export trade of the Member States will be conducted with the other Member States (compared with less than 40 % in 1958, see Tables 26 and 27). The intra-Community imports or exports of all the Member States represent around 13 % of the Community GDP. These *trade ties* have recently become even closer with the change in the external trade flows of Spain and Portugal as a result of their accession to the Community. Thus, in Spain, the share of the Community in total imports has risen from below 38 % (1985) to over 52 % (1987); in Portugal, the corresponding rise was from under 46 % to over 69 %. For visible exports the Community share rose in Spain from over 53 % to over 69 % and in Portugal from less than 63 % to 70 %. The completion of the internal market will increase this interdependence even further. In addition the increasing liberalization of capital movements combined with the maintenance of stable exchange rates, particularly within the framework of the EMS, creates an even closer *interdependence between the money and capital markets of the Member States*.

Because of the ever-closer economic ties, the flows of goods and finance react more rapidly, and this increasingly reduces the autonomy of individual Member States in the conduct of their economic policy. The close economic ties, however, also provide new opportunities for joint action and increase the Community's potential for growth, *provided that economic policy measures are more closely coordinated*. The stabilization achieved within the framework of the EMS shows that, if monetary policies are coordinated, interdependence can be used to the advantage of all Member States. Further progress along this road can, and must, be made (see Chapter 5.2).

However, it is now important to make use of this interdependence to strengthen growth by also improving the coordination of budgetary policies. This can ease both the external and the budgetary constraints on the Member States. In a situation in which there are no appreciable external stimuli, the result is a substantial increase in the Member States' scope for action. Because of the great significance of intra-Community trade the Member States can expect faster growth to have *less serious consequences on their current account balances* if it is part of a coordinated approach than if they act in isolation (according to OECD calculations, these consequences would be reduced by between one half and two thirds). This is particularly important for the member countries whose room for manoeuvre in economic policy is limited because of concern for their external equilibrium; at present this is especially true of Denmark and France, but also of Italy, Portugal and Spain, where continuation of the present vigorous growth is endangered by the threat of external imbalance. Of course, the acceleration in domestic demand which such an effort brings about would lead to some deterioration in the external accounts of Community countries with the rest of the world.

The Community would thus contribute to the re-establishment of equilibrium in international payments. However, in order that this effort results in a durable acceleration in growth, it is necessary that it relies on a simultaneous improvement in supply conditions and does not call into question either a sustainable medium-term external position or price stability achievements. In a coordinated approach the budgetary constraints on tax cuts or additional public investment are also eased as a result of the close trade ties. Each Member State enjoying stronger growth makes an appreciable contribution to the growth of the other Member States; the increase in economic growth and the *accompanying additional tax revenue are substantially higher* than if initiatives are taken in isolation. It is thus easier to reconcile budgetary policy measures and medium-term budgetary consolidation. Stronger growth in the partner countries also helps to improve the situation of the member countries which still have serious budgetary problems (see Table 29) and after a time enables them to contribute to the common process of accelerating growth.

In the medium-term, a coordinated and differentiated approach for budgetary policies makes it possible to improve the convergence of the public finance situation in the member countries of the Community. Given the increasingly close *monetary interdependence* within the EMS, this convergence is of special importance. Without it, the member countries whose budgetary situation is relatively unfavourable could be compelled to accept higher interest rates in order to prevent outflows of capital and the resultant pressure on their currency.

The higher interest rates would oblige these countries to make additional adjustment efforts, which would be detrimental to the growth process in the Community as a whole.

Close concertation of economic policies at national and Community level also facilitates *efforts to accelerate the catching-up process in the least-favoured countries and regions* (Greece, Spain, Ireland and Portugal). Such a process occurred up to the 1970s, notably in Spain, Greece and Portugal, which were able to increase their real *per capita* GDP distinctly more quickly than the other member countries (see Table 30 and Chapter 2.3). In Spain and Portugal, this situation was favoured by above-average investment ratios, with the efficiency of investment high in all four countries. The catching-up process was made substantially easier because it took place against a background of high economic growth, which enabled those countries to preserve their external equilibrium.

In the second half of the 1970s, the efficiency of investment in these countries fell to the average level of the other Member States (and even far below in the case of Spain). It was only by increasing their investment substantially that Ireland and

Portugal were able to continue to close the gap in terms of *per capita* GDP, but at the price of serious external deficits.

In the 1980s, Greece and Ireland in particular were unable to gain more ground in terms of *per capita* incomes because their efficiency of investment was below the Community average and the investment ratio had fallen. However, Spain's efficiency of investment recovered to approximately the average level of the other *member countries* as a result of a vigorous internal adjustment effort: not only equalling them in terms of growth of per capita income, but even now drawing slightly ahead, while still succeeding in preserving external equilibrium.

To revive the catching-up process in the current changed circumstances requires coordinated efforts by all Member States, as laid down in Article 130 B introduced into the Treaty of Rome by the Single European Act. For this purpose, growth must accelerate in the Community as a whole, in order to assist the adjustment process and to prevent the least-favoured countries and regions being forced into restrictive policies as a result of domestic or external imbalances which are no longer sustainable. This is only possible if the economically strong member countries make a sufficient contribution to growth. However, it is also crucially important for the least-favoured countries and regions to improve their internal growth conditions further, i.e. as regards the profitability and efficiency of investment. This increases capital formation, makes it easier to preserve their external equilibrium despite higher growth, and creates the conditions necessary for increased capital imports. In addition, this policy must receive stronger support from the Community institutions, structural funds, the European Investment Bank and the other existing financing instruments, as stated in the communication from the Commission (COM(87) 100) to the Council. If, in this way, a lasting and self-sustaining catching-up process can be launched in these countries, not only will economic and social cohesion in the Community be strengthened, but, in addition, the countries and regions which start to catch up as a result of more dynamic growth will also make a considerable contribution to growth in the Community.

### 3.4. The prerequisites for success

The efforts of the last few years have substantially increased the profitability of investment and the adaptability of markets in the Community, thus favouring higher and more employment-creating growth, while preserving internal and external equilibria. However, in the last two years, growth has slowed down, primarily because of external factors; as a result, the economy of the Community has come scarcely any nearer attaining one of its main objectives, a substantial and lasting reduction in unemployment. Since the Community cannot expect very favourable external influences in the foreseeable future, it must rely on its own strengths even more than in the past.

In this new environment, application of the Community strategy therefore means making better use of the advantages of the Community dimension: completing the internal market, accelerating the macroeconomic process to achieve stable, higher economic growth and to profit from the interdependence between the Member States. This requires closer *cooperation* between Member States in the fields of monetary and budgetary policy and the development of *Community policies* (see Chapters 4 and 5). The Community must also contribute to the strengthening of *international cooperation*, in order to work in concert with the other large economic areas to reduce international imbalances and ensure more stable exchange rates, as well as to avert the threat of protectionism (see Chapter 2.2).

Strengthening social dialogue at national and Community levels remains decisive for widening the consensus on the changes of attitude and the economic policy measures necessary for the success of the Community strategy (see, for example, the 1986/1987 Annual Economic Report, Chapter 4.6). At the Community level, important progress has been made, notably two joint opinions of the social partners: one on the fundamental options of the Community strategy (6 November 1986), the other on training and motivation, as well as informing and consulting the workforce when introducing new technologies in the enterprise (6 March 1987, see also Chapter 4.2). Encouraged by this success, the Commission will pursue its efforts, to develop at European level dialogue with and between the social partners on all the themes of the Community strategy. This also conforms to Article 118 B of the Treaty amended in 1987 by the Single European Act. However, the will to cooperate shown by the social partners at Community level should also be better utilized at national level.

The objectives which the Community has, thus, set itself in its cooperative strategy for growth and employment are still relevant and realizable, though with a certain delay, despite the deterioration in the external environment.

*In the coming years the Community, while preserving achievements on the price stability front, must increase its economic growth, not only in order to contribute to the process of international adjustment while maintaining the highest possible level of world growth, but above all, in order to attain its own objectives: reducing unemployment, making full use of all the advantages of the large internal market, and strengthening its economic and social cohesion. Since it cannot expect strong external stimuli, it must rely more on its own strengths. The completion of the internal market will stimulate growth considerably while making Community output more profitable and making it possible to satisfy additional demand within the Community and on export markets. However, in order to make full use of the potential of the internal market for growth and employment, macroeconomic policy must also contribute to higher, self-sustaining growth, without thereby endangering internal and external stability. In this connection it is important for the growth of private investment to rise well above the growth of GDP. In addition to the moderate rise in real wages, tax cuts and higher profitable public investment will contribute to improving both supply-side conditions and demand expectations. However, such fiscal policy measures should not call into question the improvement of public finance in the medium term. The continuation of a stability-orientated monetary policy will furthermore help to bring long-term interest rates down again, favouring investment and above all easing pressure on the public budgets. In addition, closer coordination of budgetary policies between the Member States reduces external and budgetary constraints which considerably restrict the room for manoeuvre of certain Member States. Such coordination has to be consistent with the objectives and constraints which exist at national level. Lastly, coordinated effort by all the Member States and the Community are necessary to relaunch the dynamic process of catching up by the least-favoured countries and regions. In the new circumstances, application of the cooperative strategy means making greater use of the Community dimension, which requires closer cooperation between the Member States, the development of Community policies and a wide-ranging social dialogue at national and Community level.*

#### 4. COMMUNITY AND NATIONAL STRUCTURAL POLICIES

##### 4.1. Improving market adaptability

4.1.1. At the European level, the *completion of the internal market* by 1992 stands at the centre of efforts to *improve market mechanisms*. This was reconfirmed by the European Council of Brussels of 29/30 June 1987, with the observation that it was important to complete the internal

market according to the lines laid out in the Commission's White Paper <sup>(1)</sup> of June 1985. The Council requested the

<sup>(1)</sup> Cf. 'Completing the internal market', White Paper of the Commission at the request of the Council, document of the Commission of the European Communities, Luxembourg, 1985.



responsible Councils of Ministers for this purpose to make full use of the improved decision-making process introduced by the Single European Act. Under the new provisions of the Treaty (in particular Article 100 A) introduced by the Single European Act, it will be possible in future for some two-thirds of the proposals contained in the White Paper to be adopted by a qualified majority of the Council in cooperation with the European Parliament; only fiscal provisions, those relating to the free movement of persons, and those relating to the rights and interests of employed persons are excluded from these new rules. The Commission described the progress made in work on the numerous individual proposals in its reports on the implementation of the White Paper in May 1986 and 1987 (COM(86) 300; COM(87) 203). The Commission has also addressed another important area for the removal of frontier controls with its proposals of early August 1987 (COM(87) 320–328) for the approximation of rates and harmonization of structures of indirect taxes.

4.1.2. Beyond the completion of the internal market, the *general objective of improving market adaptability* remains valid for economic policy in the Community. In the Annual Economic Report 1985/1986 <sup>(1)</sup>, the Commission pointed out that action with the aim of improving the adaptability of markets, and not only the labour market, should be strengthened. It also stressed that the objective behind efforts to increase flexibility is not to destroy achievements made on the social front but to create jobs and therefore that, as far as at all possible, economic efficiency should be reconciled with the preservation and strengthening of fundamental social progress. In the Annual Economic Report 1986/1987 <sup>(2)</sup>, the Commission presented a number of measures to improve market flexibility, partly from the viewpoint of internal market policy.

Also worthy of mention are the Community measures in the approximation of legislation on consumer protection which, in substance, aim to *improve adaptability of markets in goods and services by increasing market transparency*. In this connection, it is appropriate first to cite the 1979 Directive on the indication of the price of foodstuffs and of the indication of the unit price where quantities presented in standardized packaging are concerned. Similar proposals for other consumer goods have been before the Council since 1983. Information on the characteristics of the products has also been improved and harmonized in the Community. Here the provisions on the labelling of foodstuffs or on the presentation and marketing of dangerous substances should be mentioned. For these product groups, the consumer is informed of the composition or the particular characteristics of the products offered by the same means throughout the European internal market. A harmonization of the rules

describing other product categories, e.g. on the basis of the proposal on dangerous preparations, would further increase market transparency in the Community.

4.1.3. A series of measures to improve market adaptability, through deregulation and liberalizing market access, concern *small and medium-sized enterprises* (SMEs). The evidence shows that, within the enterprise sector, such firms contribute most to new employment creation, essentially in the high-technology sectors. To encourage further the development of small and medium-sized enterprises, two types of action have been taken. The first aims to increase market flexibility and encourage the adaptability of firms. It includes measures to reduce the burden on business arising from Community regulations such as the simplification of fiscal and company law applicable to small firms proposed by the Commission. Several Member States are also endeavouring to facilitate the creation of new firms by policies in this area. The second type of measure aims to improve the flow of information to firms about European Community and national policies to promote trade and to foster cooperation among enterprises across national borders. These measures are envisaged in the Action Programme for Small and Medium-sized Enterprises approved in November 1986 by the Council.

4.1.4. *Adaptability of the labour market* continues to be a major concern in the implementation of government employment policies and collective bargaining. In its communication on the internal and external adaptation of firms in relation to employment <sup>(1)</sup>, the Commission has, *inter alia*, given an overview of recent developments in Member States both at legislative and, where possible, collective bargaining level.

This survey shows that governments and social partners tend to focus on a qualitative adjustment of the labour force. To succeed in the introduction and spread of new technologies it has become increasingly important for the enterprises to have a functional and versatile workforce capable of adjusting quickly to the new technological advances in world markets. In this context, qualification and training programmes have been agreed upon at a bi- or trilateral level.

It is also increasingly recognized that motivation and adaptability of personnel will be significantly enhanced when employees are involved and associated by way of information and consultation in relation to management decisions, especially those with employment implications. On these questions broad agreement has been arrived at between the social partners in the framework of the social dialogue at the Community level (Chapter 3.4).

Negotiations on adaptation of working time and flexibility in the duration of use of productive capacity continue. Thus, for example, in the metal-working industries in Denmark

<sup>(1)</sup> See Annual Economic Report 1985/86, in *European Economy*, No. 26, November 1985, Brussels, pp. 10 and 42 *et seq.*

<sup>(2)</sup> See Annual Economic Report 1986/87, in *European Economy*, No 30, November 1986, Brussels, pp. 63 *et seq.*

<sup>(1)</sup> COM(87) 229.



and the Federal Republic of Germany, long-term contractual agreements have been signed providing for a flexible reduction of working hours with wage compensation, arriving at 37 hours per week by 1990 and 1989, respectively. In France, a new law on the adaptation of working time and night work for women in industry was adopted in June 1987 increasing the possibility of a flexible modulation of working time arrangements. In Belgium, an interprofessional agreement in the National Labour Council on new working time arrangements in enterprises, with the exception of the distributive sector, was concluded in April 1986. It was confirmed by a law in July 1987.

A series of measures aims, in particular, at fighting high unemployment as well as accompanying social measures to structural adaptation in regions or industrial sectors (coal, steel, shipyards) where the need for adjustment is particularly great and important for the labour market. The object of these measures is very often to improve qualifications or for professional retraining of the persons concerned. The Community contributes here through its social funds and social expenditure from the ECSC budget. Another important aspect is aid for employment creation, more particularly in those areas where steel, coal and shipyards are concentrated. In this area, too, the Community contributes through the regional fund and its financial instruments.

In some countries the number of so-called 'atypical' employment contracts, notably with regard to part-time work, fixed-term employment and agency work, has increased considerably in recent years, in particular with regard to new recruitment. This has often happened under the impact of changed laws and administrative provisions.

Some progress has also been made towards a more flexible adaptation of labour costs to changed market situations. Measures on profit sharing are envisaged or have been introduced in Belgium, Denmark and the United Kingdom; and in Germany and France the capital-sharing schemes already in existence have been extended.

Measures aimed at better adaptability at the level of firms have been complemented by specific *employment policies* of Member States. The emphasis has been placed in particular on measures facilitating the re-employment of the *long-term unemployed* <sup>(1)</sup>. Continuing their efforts in the area of training and professional qualifications, several Member States are trying to improve the recruitment possibilities of the long-term unemployed, through supplementary motivation programmes and assistance in job search as well as by specific financial incentives (for example the temporary waiving of social contributions in Belgium, France and Ireland, assistance for recruitment in the Netherlands, temporary contribution to wages in the United Kingdom). In other respects, the majority of Member States have created possibilities for temporary employment, in particular

targeted at the young embarking on their professional life, in the public service or in non-profit-making voluntary organizations. These direct employment measures now cover a considerable number of wage earners (see box on growth and employment).

Finally, several governments are endeavouring to improve the climate for personal initiatives by the unemployed. Those without work who become self-employed or wish to start up their own firm can not only count on State assistance in the form of advice and training, but can also receive public aid enabling financial risks to be reduced (often in place of, and sometimes in association with, unemployment insurance assistance).

#### 4.2. Competitiveness, research and development, industry and services

For more than a decade, a series of indicators have shown that many branches of European industry have problems in holding their own against their competitors in the major developed economies. For example, in the period 1979 to 1985, *the share of Community exports of industrial products* (excluding intra-Community trade) in the exports of OECD countries declined by around 1,4 percentage points and, since 1963, by about twice as much. In the period 1979 to 1985, the United States increased its market share by 0,7 of a point while Japan actually increased its share by over five points (see Table 31). If it is true that the loss of market share, now and in the next few years, is perfectly in line with the essential adjustment of trade balances at world level, it is nevertheless worrying that the fall in Community shares is concentrated on industrial sectors in which demand is particularly dynamic (e.g. electrical and electronic products, data processing, and office machinery: a loss of 2,5 points from 1979 to 1985). In these sectors, the United States increased its market share by 1,2 points and Japan by over seven points. By contrast, the Community has gained market shares predominantly in the sectors where the expansion of demand is weak (e.g. a gain of 1,9 points for iron and steel, textiles, and building materials).

A more detailed breakdown at industry branch level (see Table 32) shows that, since 1979, the Community has increased market shares primarily in the areas of wood processing, food production and processing, textiles, clothing and paper. The United States has also lost market shares in most industrial sectors, but has made gains in important sectors such as office machinery and the electrical industry. All branches of Japanese industry except the food industry gained market shares from 1979 to 1985.

With regard to the evolution of market shares, it is interesting that losses within the Community for European industry in the years 1979 to 1985 were only about half as great as the losses on third country markets (see Graph 14) and that,

<sup>(1)</sup> For a more detailed description see the Memorandum on the fight against long-term unemployment (COM(87) 231).

since 1963, these shares have remained virtually unchanged. Internal trade has thus clearly had a stabilizing effect for the evolution of market shares in industrial products. Through its beneficial effects on competitiveness, the completion of the internal market should, moreover, provide appreciable additional support here.

An unfavourable structural development is also evident in the case of *investment activity* (see Table 33). In the years 1979 to 1982, investment declined markedly in the sectors in which demand was growing strongly but, with the general recovery in investment activity since 1983, the increase in investment in these sectors, at least up to 1985, has been above average. This indicates some catching up in relation to third country competitors. It probably also contributed to the virtual halting of the decline of employment from 1982 to 1985 in sectors of production in which demand was heavy (see Table 34).

This development in market shares, investment activity and employment should be considered alongside the evolution in the pattern of industrialized countries' exchange rates, in particular the dollar's rise during the first half of the 1980s and its depreciation since May 1985. However, these changes in exchange rates are unlikely to have been decisive by themselves for the evolution of different components of market shares. For example, the loss in the Community's market share for goods in the heavy and medium demand sectors occurred during the period of the ECU's depreciation between 1981 and 1984 (see Table 31). The only increase was in the area of goods for which demand is weak. For the United States, the dollar's appreciation over the period 1981 to 1984 had virtually no effect in the heavy demand sectors, but its effects are discernible for products in the medium and weak demand sectors. This indicates that the influence of technological and organizational factors is crucial, precisely in the sectors where the growth of demand is dynamic.

With regard to the order of magnitude of developments since 1985, the ECU has appreciated by some 50 % against the dollar if the average level for 1987 is compared with that for 1985. In the same period, the nominal effective exchange rate of the currencies of the Twelve (weighted average against the currencies of nine major trading partners) has risen by 20 %. Since, for the Community as a whole, relative unit labour costs in national currency compared with major industrialized partners have hardly changed, competitiveness bears the full brunt of the appreciation of the effective exchange rate: the Community's *cost competitiveness* has thus deteriorated by some 20 % as a result of the ECU's appreciation. This is another argument in favour of a moderate development in costs in the Community, and particularly labour costs. However, given the scale of the changes which have occurred, it will hardly be possible to

compensate in this way only for the deterioration in cost competitiveness.

It is all the more important to make the improvement of *competitiveness in terms of production and product technology* a priority. The losses of third-country market share in important industrial sectors between 1979 and 1985, irrespective of the exchange rate movements, should give food for thought (Tables 31 and 32: electrical goods -10,5 points; motor vehicles -11,4 points; office machinery -6,3 points). In comparison, Japanese export successes in the areas of electronics and motor vehicle construction show the importance of using advanced technologies in traditional industries. In this context it is noteworthy, however, that important branches of European industry (textiles, machine tools and also the car industry) have improved their position thanks to a rationalization in output as well as by innovation in products and production methods.

In order to improve technological competitiveness, the Community has made considerable efforts to promote *industrial innovation* by concentrating and strengthening *research and development programmes* in order to close the technological gap. The fact that cooperation between European enterprises in the field of research is still insufficient has without doubt been a disadvantage for Europe until now; as a result, research efforts in the Community have been unnecessarily fragmented, even though research capacity and financial resources for research purposes are in total comparable with those of the United States. Indeed, total research and development expenditure at the Community level (research managed by the Community, Eureka, ESA, etc.) represents between 5 and 6 % of total public funding of research in the Community. With regard to the Community budget alone, expenditure on cooperation in research amounts to only some 2,8 % of the total. A new era will be opened with the 1987 to 1991 framework programme for research adopted in July 1987. In the field of modern technologies mention should be made of the programmes Esprit (information technology), RACE (communication technology) and Brite (introduction of advanced technologies to traditional areas of production), Euram (advanced materials), and the biotechnology programmes.

Community research programmes are only one important link in an overall industrial strategy which covers the domestic and international aspects of technology. Thus, research programmes aim at creating the necessary base for proposals in the field of international standards as well as to encourage industrial cooperation downstream from research. At the same time, cooperation between various European firms on research is also giving rise to increased cooperation in other fields.

In order to ensure that research has a tangible impact on competitiveness and that it is circulated in scientific and industrial circles, the Commission has just launched a

Community programme for education and training in new technologies (Comett) which provides for various procedures on collaboration at the European level between educational establishments and firms.

The more competitive that Community industry becomes in terms of costs and technology, the more room will be created for expansion of employment, most notably in *services*. There are important interactions between industry and services, and a vigorously growing services sector in harness with a highly productive industrial sector represents the best prospect for employment growth in the Community. The Commission has recently published a Green Paper on the future economic and regulatory framework for telecommunications in Europe which considers the measures necessary to create a true internal market for the advanced communications services.

#### 4.3. Measures for improved economic and social cohesion

In accordance with Article 130 A of the Single European Act, the Community should develop and pursue its action leading to the strengthening of economic and social cohesion in order to promote its overall harmonious development. The Community has, in particular, fixed as an objective a reduction in the gap between the various regions and the backwardness of the least-favoured regions. Through the use of its structural funds, of its financial instruments and of the EIB's activities, the Community also has an important role to play in support of the Member States themselves in leading and coordinating their policies with a view to attaining the objectives of Article 130 A (cf. Chapter 3.3).

With regard to the *structural funds*, the Commission set out from February policy guidelines for their future organization with five objectives (COM(87) 100). Two of these relate to regional policy: achieving growth and adaptation in regional economies showing structural backwardness, and restructuring declining industrial regions. Three of the objectives are more non-regional: combating long-term unemployment, the integration into employment of young people and speeding up the adjustment of agricultural production structures. The Commission has also proposed that the budget funds committed via the structural funds to the achievement of these five objectives should be doubled in real terms by 1992, concentrating their application as a priority, in conjunction with the financial instruments, on the least-favoured regions. On the basis of these guidelines, it presented a proposal for a Council Regulation on 30 July 1987 (COM(87) 376).

Alongside the expansion of the structural funds, the Commission will place special emphasis on the *development of new financing instruments*. The object of these efforts is to

encourage private capital flows, in particular by developing new Community instruments enabling the market to offer new forms of financing combining Community and private capital. The resources raised in this way would primarily serve to finance projects of special interest for the Community.

The quantitative effects of the proposed measures could be considerable. With the strengthening of structural fund action and the parallel development of loan instruments, the proportion of these resources at the end of the 1980s, in certain less-favoured countries such as Greece, Ireland and Portugal, would stand at a little over 4 % of GDP (now slightly over 2 %). For the desired effect on growth to occur, it is crucial for the additional financial margin created to be used to expand investment activity.

In its reports 'The Single Act: A new frontier for Europe' (COM(87) 100) and 'The financing of the Community budget' (COM(84) 101), the Commission has set out guidelines for future budgetary policy. In its view, the extensive tasks which fall to the Community as a result of the Single European Act, especially the reform of the structural funds, require an increase in *its budgetary room for manoeuvre*. On the *expenditure side*, the following elements are especially important for the future development of structural policy in the Community: the growth of the European Agricultural Guidance and Guarantee Fund (EAGGF) Guarantee section should remain limited in the framework of budgetary discipline; its share in the total budget falling from over 60 % currently to slightly over 50 % in 1992. This slowdown of Guarantee section expenditure will permit a doubling in real terms of committed expenditure for the structural funds by 1992. Moreover, expenditure on research on the basis of proposals for the 1987/1991 framework programme should rise to 3 % of the budget against 2,5 % at present. On the *income side*, greater budgetary security would be achieved by the setting of an upper limit of 1,4 % of the Community's GNP for own resources; the Commission has suggested a complementary financial element which would take into account the financial capacity of the Member States. At the same time, greater financial discipline should also contribute to improved financial management.

*The completion of the internal market will enable resources to be better allocated and thus contribute to faster growth, at the same time as stimulating investment. The irreversible nature of the project must, however, be rapidly apparent to economic agents so that they can prepare themselves for change and intervene on the basis of an accurate picture of future developments. This necessitates respect for the timetable fixed in the White Paper and that delays in its application should be made up for as rapidly as possible. The economic restructuring necessary should be facilitated by an increased adaptability of markets, especially in the labour market by intensified vocational training. A series of indicators shows that the structural adjustments in the Community are too slow by comparison with other*

*industrialized countries; this essentially concerns the Community's industrial competitiveness in the high-technology sectors. This is why it is particularly important that the Community's aim of increasing its technological competitiveness is also rapidly realized within the framework of the European research and development policy, partly by utilizing the capacities of small and medium-sized enterprises. The reinforcing of the Community's structural funds, their concentration on a*

*limited number of objectives, as well as the development of financial instruments would enable the Community in the Commission's view to contribute more efficiently to achieving the aim of greater economic and social cohesion alongside the efforts undertaken by the Member States themselves. In this context, the Commission lays importance on its proposals on financing the Community budget and strengthening budget discipline being adopted as soon as possible.*

## 5. MACROECONOMIC POLICY STANCES AND PROBLEMS

The Community is faced with a difficult international environment and must rely on its own resources. It has, nevertheless, major strengths: inflation rates lower and more convergent than for almost 25 years, a relatively comfortable external position overall, a marked improvement in the financial situation and profitability of firms, and structural changes which, although painful, were necessary. These strengths constitute a solid basis from which to implement a monetary and fiscal policy mix aimed at strengthening non-inflationary growth.

### 5.1. Monetary developments and policy

The rate of money supply growth has declined from the early 1980s: from an average of over 14 % during the 1970s, it is now around 10 %. This slowing in monetary expansion has backed up the disinflation process. The rate of inflation as measured by the GDP deflator has been reduced from more than 13 % in 1980 to about 4 % in 1987 (EUR 12). At the same time, the rise in *per capita* wage costs has slowed down appreciably (from more than 14 % in 1980 to about 5,5 % in 1987), thus making a major contribution to stabilization. Consequently, the restrictive effects of policies of monetary stability have been largely attenuated. Thus there has been a gradual acceleration in the real money supply, i.e. nominal money supply adjusted for inflation, an indicator of the liquidity available to finance real growth. The rate of increase is now about 5 %, significantly above that of output.

The convergence of monetary policies has continued to improve appreciably, in particular within the EMS, evidenced by the convergence of targets for money and credit expansion adopted in the different member countries: the growth target range for central bank money in Germany was brought down from 4 to 7 % in 1981 to 3 to 6 % in 1987; the target for M2 in France was brought down from 9 % in 1983 to a range of 4 to 6 % in 1987. In Italy a target of 7 % was

adopted in 1987 for the expansion of lending to the private sector. This is well below the rates recorded in the early 1980s, which were over 13 %. Although the targets have sometimes appeared too ambitious in certain countries, actual monetary growth has indeed converged to a considerable extent.

The deceleration in monetary growth is now less marked. Most recent recorded outturns show rates of, as appropriate, money or credit expansion higher than the upper target limits adopted for 1987 (see Table 36). The liquidity ratio has increased in most Community countries. To date, these developments have not endangered the downward convergence of inflation rates.

The assessment of monetary policy stances on the basis of indicators of liquidity does involve some uncertainty: rapid financial innovation, structural adjustment on money and capital markets and greater freedom of capital movements can be accompanied by major changes in the relationship between monetary expansion and other variables, particularly GDP. It does seem, however, that the stance of monetary policies to date has been consistent with the requirements of the cooperative strategy; however, greater vigilance now seems necessary to prevent excess liquidity from building up in the Community, with the potential for sooner or later refuelling inflation.

Over the past twelve months, domestic monetary policies in Europe have been strongly influenced by events on the foreign exchange markets. The appreciation of the European currencies against the dollar obviously made it easier to bring inflation down but, at the same time, the monetary authorities had to keep their own currencies from appreciating too quickly, to prevent too great a loss of competitiveness and to limit the resulting damaging medium-term structural effects. Until the end of 1986, the

depreciation of the dollar was accompanied by a reduction in nominal interest rates in the United States and Europe, and by a narrowing of interest-rate differentials between the two regions (see Graph 16).

Since February 1987, exchange rates have stabilized. Following the Louvre Agreement, flexible interest-rate adjustments — leading in particular in 1987 to a wider differential between United States and German rates — and substantial intervention on foreign exchange markets have led to credible stabilization of short-term foreign exchange expectations despite persistent international balance-of-payments disequilibria.

In the framework of the EMS exchange rate mechanism, the authorities in most countries have given more consideration to economic developments in their partner countries when conducting monetary policies. Short-term interest rates have been more frequently used to supplement intra-marginal intervention to stabilize bilateral parities between currencies participating in the EMS exchange mechanism. For example, since the end of 1986, German short-term rates declined by nearly one point up to the summer of 1987 while French short-term rates declined only moderately. Central banks are now tending to take better account of external requirements when pursuing their domestic monetary targets, at least as long as the aim of domestic stabilization is not compromised.

Despite the decline in short-term interest rates up to mid-1987 and in inflation rates, long-term interest rates remain relatively high and in recent months have increased in certain countries. In September 1987 in the EMS countries they were a little above those in October 1986, while average short-term rates in the same countries had on the whole declined. Moreover, the gap between the long-term interest rate and the present rate of inflation is still very wide. The rapid decline in inflation over the past few years has not yet been fully absorbed in all countries into expected inflation rates, so that the expected gap over a longer period between the nominal interest rate and the inflation rate, a determining factor in investment, is probably smaller than the gap measured on the basis of current observation. Nevertheless, despite a major rise in the return on fixed capital, further rises in long-term interest rates could act as a disincentive to productive investment, as well as considerably hampering efforts to restore healthy public finances in countries with a high level of public debt (see box).

A decline in long-term rates appears desirable. However, the recent development of both long-term and short-term rates confirms that the monetary authorities are limited in their ability to influence long-term rates. Further declines in short-term rates, which would be accompanied by excessive expansion of liquidity, could even lead to higher long-term rates if they again raised inflationary expectations. Alongside domestic factors, long-term rates also reflect tensions on international capital markets. The monetary authorities, for

their part, can contribute to a decline in long-term rates by convincing economic operators, through their policy, that they are pursuing the objective of monetary stability in the medium-term, thus durably stabilizing inflationary expectations at a low level. This means that it is still important in the countries concerned to set and to pursue quantitative targets for monetary growth and credit expansion. Moreover, possible tensions in the EMS as the liberalization of capital movements gathers momentum will be more easily and rapidly dealt with as the monetary authorities are firmly and durably committed to a policy geared towards stability. In particular, more flexible adjustments of short-term rates might become necessary, but they should not, in such conditions, have major repercussions on long-term rates and bank base rates.

## 5.2. The liberalization of capital movements and the strengthening of the EMS

The aim of free capital movement is part of a wider approach aimed at the completion of the internal market while maintaining the economic and monetary cohesion of the Community. Substantial progress has been made over the past year towards freeing capital movements in the Community.

On 17 November 1986, the Council adopted a new Directive extending compulsory liberalization in the Community to three further categories of capital movements<sup>(1)</sup>. The Directive took effect on 1 March 1987, although Spain and Portugal have a longer period in which to comply (to the end of 1990 and to the end of 1992, respectively).

Liberalization measures taken in several Member States — Denmark, France, Italy and Spain — already go beyond the strict obligations imposed by the current Directive or the Act of Accession. Capital movements are entirely free in Germany, the Netherlands and the United Kingdom, and, subject to the application of the tow-tier exchange market, in Belgium and Luxembourg. Apart from the new members, only two Member States — Greece and Ireland — maintain restrictions, by virtue of the safeguard clause in Article 108 (3) of the Treaty, on certain capital movements that are normally free.

These developments encourage the Commission to pursue to completion the initiative launched in May 1986 towards the complete liberalization of capital movements in the Community by 1992. A new proposal for a Directive to this end, also taking account of the specific situation in certain Member States and providing the possibility for dealing with grave disturbances on the money markets when necessary, will shortly be presented to the Council.

<sup>(1)</sup> Long-term commercial credits, acquisition of securities not traded on a stock exchange, and the admission of securities on the capital markets.

This Commission proposal will be accompanied by two other proposals, permitting recourse to balance-of-payments support facilities to back up a programme of capital liberalization.

Lifting exchange controls is a necessary but not sufficient condition for the introduction of an integrated financial system. Such a system also implies effective freedom of movement for financial services within the framework of sufficiently harmonized rules to guarantee the protection of savings, ensure fair competition between financial intermediaries and avoid the risk of excessively strong distortions in the channelling of capital flows. The adoption and implementation of the proposals in the White Paper on completing the internal market, although not a prior condition for liberalizing capital movements, should make it possible, as far as careful supervision is concerned, to establish such a framework, adjusted to the new international financial environment. In the Commission's view, it is also important on the tax side to approximate company tax arrangements and to establish closer cooperation between the relevant authorities to combat tax evasion.

The removal of all exchange controls between Community currencies, and the further integration of money and capital markets, are major steps towards monetary unification, but they do mean extra constraints on the conduct of the monetary policies of the Member States, which must not be allowed to affect the stability of exchange rates, another necessary condition for the completion and viability of the internal market.

It is thus indispensable to continue along the road of cooperation and convergence in economic and monetary policies, and to reinforce the mechanisms involved in the management and functioning of the EMS. On 12 January 1987, the Community's Ministers for Finance asked the Monetary Committee and the Committee of Governors to examine the practical means of achieving this. The two Committees, which benefited in their work from Commission proposals, have produced a number of proposals for improving the monitoring of economic and financial developments within the Community. The Committee of Governors has also agreed on a number of operational changes to the EMS. All these proposals were unanimously endorsed by the Ministers for Economic and Financial Affairs at an informal Council meeting held at Nyborg on 12 September 1987.

In order to improve the coherence and the compatibility of various economic policy measures implemented by the Member States and the results thereof, the medium-term monitoring procedure has been strengthened. This exercise is based on a set of macroeconomic indicators defined for the

special needs of managing the EMS, but complementary in their use with those adopted at international level.

The greater mobility of capital requires rapid reaction to tensions in the System. While it will still be based on a broad consensus as to the stance of monetary policy, cooperation will now focus more on the problems of the short-term management of exchange rates, and in particular the more flexible use of authorized fluctuation margins, the coordinated management of interest rate differentials and the improvement of practices and conditions for intervention at, or within, the margins.

Here, too, a reinforced monitoring procedure has been established to improve the early detection of tensions which may occur within the System and to agree on how to deal with them.

This pragmatic approach is accompanied by some appropriate changes in the mechanisms of the EMS: in the case of very short-term financing these are an extension of its maximum duration from two-and-a-half to three-and-a-half months, the doubling of the amount eligible for automatic renewal and the changing of the '*de facto*' acceptance limit on official ECU from 50 % to 100 %. Lastly, it has been agreed that there will be a presumption that very short-term financing will be available, on certain conditions, for intra-marginal interventions.

### 5.3. Budgetary developments and policies

The general government deficit for the Community as a whole is continuing on the declining trend that began in 1982: it is expected to stand at 4,5 % of GDP in 1987 compared with 4,8 % in 1986 and around 5,5 % in 1982. However, the reduction for 1987 is smaller than envisaged in the last Annual Economic Report (1986/87), mainly because of the effect of the unexpected slowdown of growth in 1987 on tax and social contributions and on certain expenditure items. Moreover, the ratio of public debt to GDP is continuing to increase on average in the Community, although rather more slowly than in the early 1980s (see Table 38). The total burden of taxation (direct and indirect taxes and social security contributions), after tending to rise in the 1960s and 1970s, has remained at practically the same level since the early 1980s. It has nevertheless fallen in several Member States. In other respects, current expenditure is expected to continue increasing on average in the Community at a moderate rate, while its share in GDP declines significantly, and the share of public investment remains practically constant.

In the framework of the Community cooperative strategy, budgetary choices should contribute to reinforcing productive potential while achieving or maintaining a trend of public debt that is sustainable in the medium term. Medium-term action for this purpose should be based on a gradual reduction in the tax burden and a special effort in the area of profitable public investment (see Chapter 3.2). Such measures improve supply side conditions as well as strengthening demand. Budgetary policy is increasingly important at present, both because of the international mix of economic policies required to reduce balance-of-payments disequilibria and because of the limitations on the role of monetary policy in actively supporting growth (see Chapter 5.1). It is a question of continuing to create conditions favourable to faster growth which is durable; it cannot simply be a matter of generating higher domestic absorption in the short-term, with a consequent rapid reduction in the current surplus, and no lasting effects on employment.

In many countries, budgetary stances emerging for 1988 are already in line with the cooperative strategy. For example, tax reductions are expected in Germany, France, the United Kingdom, Spain as well as in Belgium and in the Netherlands. Public investment is also beginning to recover in countries such as Germany, France and Denmark. In other countries, however, tight budget policies have meant a further substantial decline in the share of public investment in GDP (see Table 40).

At national level, there are two main macroeconomic constraints on the conduct of public finance policies: the budget constraint in the strict sense and the external constraint. The importance of these constraints varies appreciably from one country to another.

Simply from the point of view of public deficits and public debt, *present positions* vary widely. However, emerging *stances* are increasingly convergent. In outline, two groups of countries can be distinguished. *In the first group*, the general government deficit is over 5 % of GDP and in some cases close to 10 %. The ratio of public debt to GDP is already very high, and still expanding rapidly at a rate of between 3 % and 8 % a year. This ratio is particularly high in *Belgium, Ireland and Italy*, where it is close to or even beyond 100 % of GDP. It is lower in *Greece and Portugal* (60 to 70 %), but the budget deficit is still close to 10 % of GDP, and in both countries the need for greater recourse to non-monetary financing of the deficit, so as to complete the disinflation process, might further accelerate the expansion of the public debt, which makes it all the more necessary and urgent to restore a basically healthy public finance situation. In *Spain and the Netherlands*, the level of both the public deficit and the public debt represent significant constraints but less so than in the other countries of the group. The seven countries of this first group, to differing degrees, are making considerable efforts to restore a healthy budgetary situation,

which should be reflected in an improvement in budget balances excluding interest from 1985 to 1988 equivalent to two to four percentage points of GDP. At present, however, these efforts are particularly painful because of low growth and fairly high real interest rates.

*In the second group of countries*, Denmark, Germany, France, the United Kingdom and Luxembourg, the budgetary situation is easier; the ratio of public debt to GDP is increasing at a much slower rate, or even declining, from a level already lower than elsewhere. In 1987, the general government budget balance as a percentage of GDP is between -2,8 % (France) and +1,9 % (Denmark) and +2,8 % (Luxembourg). Some of these countries, especially *France and Germany*, are using their scope for manoeuvre to support domestic growth in 1987 and 1988.

Their budgetary balances are in addition affected by the slowdown of growth, as in the case of *Denmark*, as receipts are depressed and 'crisis' expenditure increases. This has already led in 1987 to an increase in the general government deficit in Germany. In Denmark, despite restrictive fiscal measures aimed at redressing the external imbalance, the budgetary surplus will decline in 1987 and 1988. In *France*, on the government's plans, the general government deficit will decline between 1986 and 1988 (from 3,0 % to 2,3 % of GDP). To the extent that none of these countries can any longer rely on a faster expansion in its partners, it only has, in isolation, very limited extra margins of manoeuvre, where these exist at all. In the *United Kingdom*, growth is currently above the underlying trend of 3 % experienced since 1981 while inflation has accelerated moderately, partly as a result of higher oil prices. In 1987 growth has been assisted by stronger supply side performance and by the fall in the effective exchange rate of the pound sterling. Wage growth is strongly supporting private consumption. However, given productivity performance, the rate of profitability remains close to its 1986 level. In these circumstances the government has continued reducing the budget deficit, which looks set to undershoot the level forecast in the budget for the third year in succession.

The differences in budgetary trends between these two groups of countries carry serious risks. They complicate the task of the authorities to free the Community more quickly from the slow growth which seems to entrap it in the medium term. First, in the countries where public debt is rising too quickly, even more restrictive efforts to improve public finances may need to be made, in order to compensate for the

effects on tax receipts of growth lacking impetus from net exports. This prejudices these countries' growth and has negative repercussions on that of their partners, whose room for manoeuvre is affected in turn. The convergence process and that of improving public finance is thus markedly slowed, which also complicates the task of the monetary authorities, especially in the EMS, and slows the convergent fall in real interest rates. Consequently, some countries with currently above Community-average growth, particularly Spain, Italy and Portugal risk being forced (or have already been forced) to give a more restrictive orientation to their policies in order to safeguard their external accounts. This harms intra-Community trade, which is currently an important factor in economic development in the immediate term. These countries would thus be unable to draw all the benefits from the internal adjustment efforts which they have already made, and should pursue. They would thus no longer contribute, as at present, to sustaining demand in the Community.

There is a risk that these unfavourable trends could become more acute in the case of a further weakening of world trade or an additional decline of the dollar, which would instigate a *new slowdown of growth in the Community*. In such circumstances, as has already been envisaged in the conclusions of the July 1987 Economic and Financial Council, it will be a question of being ready to use positively the interdependence which exists between Community economies, within the framework of a joint effort (cf. Chapter 3.3). Such an effort would contribute to the realization of the internal objectives of the Community and to the correction of the international payments imbalances at a satisfactory level of world growth.

If such an effort is to have lasting favourable effects, it must respect the main macroeconomic equilibria in each of the Member States, in particular the achievement or maintenance of budget and external deficit positions sustainable in the medium term. The type and timing of possible measures should also take account of the economic situation of each country.

Some of the countries whose budgetary situation is easier, and which together account for close to 70 % of the Community's GDP, could currently — from the budgetary aspect — actively support growth.

If this support were an element of a cooperative solution, this would allow offsets against the budgetary or external balance effects. Action taken in isolation by one or other of these countries would run the risk of unsustainable external or

budgetary imbalances rapidly arising, without lasting effects on growth. Account should also be taken of the inherent inflationary risk from such measures. These measures should, therefore, be part of an economic policy mix oriented strongly and consistently to price stability.

If one takes account of particular economic circumstances, the contribution of each of these countries to a cooperative solution in the event of growth weakening further would be fairly differentiated. For example, in *Denmark and France*, the external situation makes it necessary to varying degrees to maintain a negative growth differential with their main trade partners while further reinforcing productive potential. In *Denmark*, the persistence of a very high current external deficit is still a constraining factor in the conduct of economic policy. In *France*, tax reductions already planned for 1988 should now be contributing to reinforcing domestic growth within limits compatible with the external constraint. However, these countries could remain prepared to review the stance of their budgetary policies in the framework of international cooperation to reinforce their domestic growth as soon as their efforts to improve the competitiveness of their economies and the policies implemented by their Community partners lead to favourable effects on their external accounts. In *Germany*, tax reductions planned for 1988 will indeed, as is desirable, contribute to the required change-over to domestic sources of growth. They involve some deterioration in the budget deficit, already affected by slower growth. For the moment, supplementary fiscal measures appear difficult if Germany acts alone. However, in view of the improvement in productive potential already achieved, this country could take full advantage of joint action by the Community partners, which would gradually widen the margin for manoeuvre and might make it possible to speed up the programme of tax reductions planned for the years after 1988. In the *United Kingdom*, there is a greater risk of inflation. More moderate growth of nominal wages would reduce this and also improve the economy's competitiveness, thus creating more favourable conditions for investment and employment. The objective of stabilizing the sterling exchange rate announced by the authorities after the Louvre accord could also help to contain inflation. This country could, however, contribute usefully to a greater dynamism in the Community if it can continue to sustain its still relatively high real growth rate while preserving monetary stability.

The other countries, whose budgetary situation remains fragile, should rely essentially on the benefits arising to them from faster growth in their partner countries, in order to attain their objectives of budgetary improvement at a higher level of growth. In this other group of countries, situations also differ considerably. In *Belgium and the Netherlands*, growth is still low. Both countries have an external surplus, and both economies have particularly close relations with their Community partners. They thus benefit to the full from



a more dynamic Community context. These two countries could use the margin made available by stronger growth in their Community partners to reinforce the domestic components of demand, while maintaining their aims for the gradual reduction of the budget deficit, or to accelerate the budgetary consolidation process. In *Spain, Italy and Portugal*, growth is likely to remain higher than average for the Community, although slightly lower than in 1987, and the three countries are making a major contribution to the relatively sustained expansion of intra-Community trade. A higher growth rate in the Community partners would help these three countries to maintain or even increase their present rate of growth while preserving a sustainable external position and reducing their budget deficits as planned, or perhaps even slightly more rapidly. Lastly, in *Greece and Ireland*, the process of budgetary consolidation is accompanied by very slow growth. Greece is, in addition, still facing an excessive external deficit. In both countries, the priority task is to restore a healthy public finance position.

Even if such a cooperative solution may appear difficult to implement, its consideration may be appropriate at the present time in view particularly of the uncertainties weighing on the world economy. If growth were to slow down further, action varied to suit each country's circumstances, and well timed, could lead to an average budget deficit for the Community somewhat higher than in present forecasts (4,5 % of GDP in 1988). In a situation where markets are considerably more adaptable, and productive capital considerably more profitable, the yield of such action in terms of growth, an acceleration of investment and thus tax revenue can be expected to be much higher than it would have been in the late 1970s or early 1980s. The returns on such a budgetary stimulus would be all the greater, the larger the number of countries participating, so that the initial boost would be more rapidly covered in each country by extra tax revenue. The durable reinforcement of growth in the Community that might result would contribute to the main domestic objective, i. e. a reduction of unemployment, and at the same time would facilitate solving the problem of international balance of payments disequilibria.

The country chapters in the second part of this Report, which underpin its economic policy recommendations, allow the constraints which each country faces in isolation to the gauged. Whether these concern the level of the external balance or what is necessary to restore healthy public finances, to implement tax reductions or to raise public

investment, constraints are tightened as a consequence of the slowdown in growth. This only confirms the necessity of fully taking into account the Community dimension of national economic policy choices.

*The deceleration in monetary growth continues but at a less pronounced pace than previously. The even more pronounced deceleration of prices and costs creates a satisfactory margin for real growth. A certain vigilance is, however, now necessary to avoid a build-up in the economy of excess liquidity. Following the Louvre accord the dollar's exchange rate has been more stable. Within the EMS, more flexible management of money market rates has contributed more effectively than in the past to stabilizing bilateral parities. The pursuit of monetary policies oriented in a credible and durable manner towards stability are contributing to further falls in long-term interest rates, which remain high despite the fall in short-term rates and in inflation. Within the EMS, such policies would enable an easier surmounting of the tensions which could arise from the already accelerated liberalization of capital movements. The progress made in September 1987 at the Economic and Financial Council's meeting at Nyborg should also contribute to this. With monetary policy no longer being able to support growth actively without certain risks, and the need for an improvement in the international economic policy mix, the role of budgetary policy becomes more prominent. On average for the Community, the budget deficit is still declining somewhat. The budget outlook for 1988 is that this is consistent with the direction of the cooperative strategy and will contribute to improving supply-side conditions while giving some support to demand. If carried out as part of an economic policy durably aimed at preserving price stability, faster reductions in taxes and additional public investment, compatible with a public debt position sustainable into the medium term, would contribute to further reinforcing the determinants of growth. The implementation of budgetary policies enabling growth to be better supported, however, is often confronted at the national level with external or budgetary equilibrium constraints. These constraints could be eased in the framework of common and well-timed effort which would take account of the existing interdependence between the Member States. In the case of a new slowdown in growth, some of the Community countries with an easier budgetary situation could join in such an effort to varying degrees, while the other countries took advantage of such faster growth in their partners to realize their aims of consolidating their public finances, if appropriate, at a higher level of growth. Such an effort would allow a faster convergence of budgetary positions and reduce the risk of some countries being forced to slow their own growth rates because of tighter budgetary and/or external constraints, which would have negative repercussions on their partners.*

### Growth and employment

In the years 1986/1983 the annual growth rate of real gross domestic product in the Community was only half as great as in the period 1973/1960, but that of employment almost doubled. In the 1991/1986 medium-term projections this — in labour market terms — favourable relationship between growth and employment is expected to continue (see Table 1).

TABLE 1  
Growth and employment in the Community

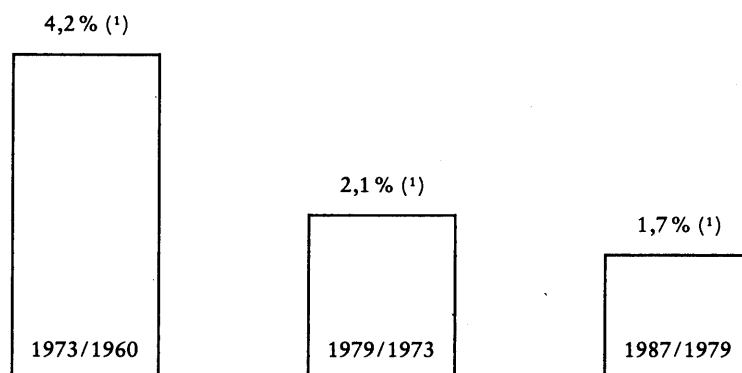
	Average annual change (%)				
	1973/1960	1979/1973	1983/1979	1986/1983	1991/1986 <sup>(1)</sup>
Real GDP	4,8	2,4	0,8	2,4	2,6
Employment	0,3	0,1	-0,6	0,5	0,6

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

Source: Commission services.

This means that in the Community, the growth threshold, above which an increase in employment is to be expected, is now substantially lower than it was in the 1960s. According to estimates by the services of the Commission, in the 1960s this threshold was reached when real GDP grew by 4,2%, in the period 1979/1973 when it grew by 2,1%, and in the period 1987/1979 when it grew by 1,7%.

GRAPH  
Employment thresholds



<sup>(1)</sup> Employment increases when this annual increase in real GDP is exceeded.

Source: Estimates by the services of the Commission.

The greater job content of growth in recent years is not a new phenomenon, but continues a trend which has been apparent since the first oil crisis in 1973. There is, however, reason to believe that this trend has become somewhat stronger in the 1980s and that the factors causing it differ.

The following factors in particular should be considered as helping to increase the job content of growth:

- (a) The reduction of average working time per person employed, which means that the input of labour can be shared between more people. A fall in average working time per person employed can be achieved by reducing weekly working time and lengthening annual holidays for full-time workers, and for an increasing proportion of part-time workers.

- (b) The structural shift towards the service sector. According to the three-sector theory, as the prosperity of an economy increases, a growing proportion of the national income is spent on services. Since the service sector is generally more labour-intensive than goods production, this increases the employment-creating effect of growth as a whole.
- (c) The slowdown of the substitution by the factor capital for the factor labour. In other words, the increase in the national product is produced with a relatively larger input of labour and a relatively smaller input of capital. The increase in capital intensity is declining. The slower substitution of capital for labour curbs the rise in the average productivity of labour in the economy as a whole. Growth becomes more employment-creating.

These three factors are not independent of one another, but they all overlap. It is therefore not possible to measure the influence of each of the factors accurately. Nor do the said three factors entirely explain the greater job content of growth.

Taking the long-term average, *working time per person employed* fell by just under 1 % a year in the four large industrialized countries of the Community (EUR 4) (see Table 2). In the 1960s and 1970s reductions of working time permitted no more than slight increases in employment (0,1 % and 0,2 % a year, respectively); in the period 1985/1980 they still weakened the decline in employment. Unlike the 1960s and 1970s, when the shorter working week time and longer holidays were clearly to the fore, in recent years it is the spread of part-time working in the Community which has substantially contributed to the greater effect on employment of growth. Table 3 shows the extent to which the growth of employment in recent years is attributable to *increasing part-time work*. In the period 1985/1983 it was based exclusively on the increase in part-time jobs; the number of full-time workers actually fell slightly. The figures show clearly that the effect on employment of shorter working time (per person employed) depends not only on the size of the average reduction, but also, and more importantly, on whether the reduction of average working time is due to the increase in part-time work or to the reduction of the working time of full-time workers.

Even if the increase in part-time jobs is concentrated on the service sector (the proportion of part-time workers in total employment has risen from 16,1 % in 1983 to 17,3 % in 1985), a slight increase in this proportion can also be seen in industry (from 5,1 % in 1983 to 5,7 % in 1985). Male part-time working is also increasing slightly (3,4 % of all male workers in 1985 compared with 2,8 % in 1983), although part-time work is still predominantly a female preserve (28,7 % of all female workers in 1985 compared with 24,4 % in 1983).

As a provisional result it must still be remembered that the spread of part-time work goes a long way towards explaining the higher job content of growth. To the extent that part-time work is desired by those concerned and does not represent a form of involuntary underemployment, there is nothing to be said against this trend, especially if part-time work is covered by collective agreements and does not carry with it greater disadvantages in terms of social security cover or promotion opportunities. However, the fact remains that part-time workers are frequently recruited from the 'latent reserve' (e.g. housewives) and therefore do not reproduce a corresponding fall in the number of the registered unemployed.

*The structural shift towards the service sector* is continuing. Since 1960 a steadily increasing proportion of total employment and gross domestic product has been attributable to the service sector (see Table 4). In recent years this trend has grown even stronger. Until 1973 the real gross value added to the service sector grew in proportion to the growth of the economy as a whole; since then it has been growing more than proportionately. The high effect of growth on employment in the service sector has increased in the last few years (see Table 4). An annual average increase in real gross value added in the service sector of just under 3 % in both 1984 and 1985 was accompanied by an increase in employment of approximately 2 % in each of those years. In the period 1979/1973, a 3,2 % annual average increase in real gross value added in the service sector was associated with a 1,7 % annual average increase in employment. Much of the increased effect on employment probably stems from the greater use of part-time workers.

The long-term trend in the Community towards higher capital intensity and the relative substitution of labour has slowed down in the Community since the first oil crisis in 1973. This can be measured by the contribution of the *factor substitution of capital for labour* to the increase in the productivity of labour per man-hour (see Table 5). Over the period 1973/1960 in the private sector (i.e. total economy excluding agriculture, housing and the public sector) it averaged 1,8 % a year compared with only 1,3 % for the period 1986/1979 (for EUR 4). The decline was particularly striking in Germany and Italy. Moderate real wage increases in the member countries and the plentiful supply on the labour market were probably contributory factors. The pressure to rationalize has eased. The number of profitable jobs has increased. This stimulated the increase in employment in labour-intensive areas (such as the service sector). A continuing tendency for factor substitution to slow down can probably be expected from the moves which have now started to dissociate company hours from individuals' working time. It is important in the future to conserve these effects, which give growth a greater job content, and also to extend them. At the same time, the declining growth rates for labour productivity per man-hour and for capital productivity (see Table 5) indicate that the efficiency of the economic process has declined. Economic growth today requires a relatively greater input of the two factors, labour and capital, than it did before. For strong and employment-creating growth, a more than proportionate increase in investment is therefore also necessary.

*State employment measures* have admittedly somewhat strengthened the trend to employment-creation in recent years. In 1985 and 1986, well over one million workers were employed in such programmes in the Community, but this employment effect was partly offset by the significantly slower rise in the number of public service employees (increase averaging 1,0 % a year over the period 1985/1979, compared with 2,3 % for 1979/1973). In most member countries the tendency is how to make only slight increases in the present number of persons employed in such programmes, mainly because of budgetary constraints. So, although such specific measures of labour market policy can be expected to have a stabilizing effect on employment, they cannot be expected to increase the job content of growth any further.

*Summary:* The threshold above which the growth of the economy as a whole leads to an increase in employment has fallen from real national product growth of over 4 % a year in the period before 1973 to under 2 % in the 1980s. This increased effect on employment can be explained by reductions in average working time per person employed, with part-time work becoming increasingly important, and by the slower factor substitution of capital for labour which curbs the rise in labour productivity per man-hour. In addition, there is the more than proportionate expansion of the service sector which is particularly employment intensive. These effects cannot be added together easily, since they are interrelated, but probably account for most of the increased job content of growth.

TABLE 2

Total labour input, average working time per person employed, and total employment  
(annual average percentage change)

	1970/1960	1980/1970	1985/1980	1983/1980	1985/1983
Federal Republic of Germany:					
— Total labour input	-0,8	-1,2	-1,2	-1,6	-0,4
— Working time	-1,0	-1,1	-0,5	0,3	-0,8
— Total employment	0,2	-0,1	-0,6	-1,3	0,4
France:					
— Total labour input	0	-0,4	-2,0	-3,1	-1,3
— Working time	-0,6	-0,9	-1,6	-2,1	-0,7
— Total employment	0,6	0,5	-0,4	-1,0	-0,6
Italy:					
— Total labour input	-1,1	-0,7	0	-0,2	0,3
— Working time	-0,6	-1,2	-0,6	-0,5	-0,8
— Total employment	-0,5	0,5	0,6	0,3	1,1

	1970/1960	1980/1970	1985/1980	1983/1980	1985/1983
United Kingdom:					
— Total labour input	-0,9	-0,7	-1,1	-3,1	2,2
— Working time	-1,1	-0,9	-0,5	-1,0	0,4
— Total employment	0,2	0,2	-0,7	2,1	1,7
EUR 4:					
— Total labour input	-0,7	-0,8	-1,1	-1,8	0,2
— Working time	-0,8	-1,0	-0,8	-0,9	-0,5
— Total employment	0,1	0,2	-0,3	-0,8	0,7

Source: Eurostat, OECD Employment Outlook 1987.

TABLE 3

Percentage change in employment, 1983 to 1985 (%)

	B	DK	D	GR	F	IRL	I	L	NL	UK	EUR 10
Total	0,8	5,6	0,8	1,3	-1,2	-4,3	0,9	0,6	3,3	3,3	1,1

Contribution <sup>(1)</sup> to the change in total employment:

Full-time workers	0	4,0	0,4	1,4	-2,5	-4,2	0,2	0	1,1	0,9	-0,1
Part-time workers	0,8	1,6	0,4	-0,1	1,3	-0,1	0,7	0,6	2,2	2,4	1,2

<sup>(1)</sup> With regards to the breakdown into full- and part-time workers, undertaken in accordance with the results of the Labour Market Sample Survey, it should be borne in mind that this survey is carried out in only one week of the year — in the spring — and therefore may not be fully representative of the annual average.

Source: Eurostat, Labour Market Sample Survey, 1983, 1985.

TABLE 4

Employment and growth in the economy as a whole and in the service sector in the Community (EUR 12)

	1968/ 1960	1973/ 1968	1979/ 1973	1985/ 1979	1983	1984	1985
Total employment (% p.a.)	0,1	0,5	0,1	-0,3	-0,5	-0,1	0,6
Real gross domestic product (% p.a.)	4,6	4,9	2,4	1,2	1,4	2,3	2,4
Employment in the service sector (% p.a.)	1,7	1,9	1,7	1,5	1,2	1,9	2,2
Real gross value added in the service sector (% p.a.)	4,5	5,0	3,2	2,1	2,0	2,8	2,9
	1960	1968	1973	1979	1983	1984	1985
Employment in the service sector as a proportion of total employment (%)	39,1	44,2	47,3	51,8	55,7	56,8	57,6
Gross value added in the service sector as a proportion of gross domestic product (%)	48,1	52,7	53,5	57,2	59,2	59,4	59,5

Source: Eurostat.

TABLE 5:  
Contribution of factor substitution to the productivity trend in the private sector <sup>(1)</sup>;  
annual growth rates (%)

	D	F	I	UK	EUR 4	USA <sup>(2)</sup>	Japan <sup>(2)</sup>
Labour productivity per man-hour <sup>(3)</sup>							
1973/1960	4,3	5,1	6,5	3,1	4,5	1,8	9,6
1979/1973	3,8	3,4	2,2	2,7	3,1	0,1	3,0
1986/1979	2,5	2,4	1,4	2,7	2,3	0,3	3,8
Capital productivity							
1973/1960	-2,1	0,2	0,5	-1,7	-0,9	-0,3	-0,5
1979/1973	-1,3	-1,2	-0,7	-1,8	-1,3	-0,8	-1,5
1986/1979	-2,0	-2,0	-1,2	-1,5	-1,7	-0,5	-3,0
Total factor productivity							
1973/1960	1,9	3,4	4,7	1,7	2,7	1,2	5,8
1979/1973	1,9	1,8	1,3	1,4	1,7	-0,1	1,4
1986/1979	0,8	0,8	0,6	1,5	1,0	0,1	1,3
Contribution of the substitution of capital for labour to the increase in labour productivity per man-hour							
1973/1960	2,4	1,7	1,7	1,4	1,8	0,5	3,5
1979/1973	1,9	1,6	0,9	1,3	1,4	0,2	1,6
1986/1979	1,6	1,5	0,8	1,2	1,3	0,2	2,5

<sup>(1)</sup> Private sector: total economy excluding agriculture, housing and the public sector.

<sup>(2)</sup> Data available only up to 1985.

<sup>(3)</sup> Because of the definition of sectors and of working time (hours worked per week) the values given here are not fully comparable with the data in Table 2.

*Definitions:*

— *Labour productivity*: real gross value added per man hour.

— *Capital productivity*: real gross value added per unit at constant prices.

— *Total factor productivity*: weighted average value of labour and capital productivity. The weights correspond to the shares of factor remuneration in gross value added.

— *Contribution of the substitution of capital for labour to the increase in labour productivity per man hour*: the difference between the growth rates of labour productivity per man hour and of total factor productivity (see *European Economy*, No 20, June 1984).

Source: Estimates by services of the Commission.

*Long term interest rates*

There are two main reasons why lower long-term interest rates would make it easier to implement the cooperative strategy. Firstly, lower interest rates would help to boost investment. However, perhaps more importantly, they would take substantial pressure off public budgets, heavily burdened by debt servicing costs. This would create more room for manoeuvre for faster budgetary consolidation or a boosting of growth.

The decision to *invest* depends very heavily on the *differential* between the expected profitability of the investment and the *financing cost* or the *yield from a financial placement*. This differential must be increased to stimulate more dynamic investment. *Profitability* has already risen substantially in recent years. However, as an indication, the average profitability of productive capital in the Community is not yet back to its average level in the 1960s (see Graph 12). Further improvements must and can still be made, but a fall in long-term *interest rates* would also have a favourable influence on investment. According to econometric analyses of Commission services, a lasting fall of 0,8 of a percentage point in long-term interest rates, based on the stabilization of inflationary expectations at a low level would increase the annual volume of private investment by a little over 2 % in four years; the annual growth of private investment would accelerate by an additional 0,4 to 0,5 %.

The other important element in the assessment of long-term interest rates is their impact on *public deficits* and hence on the management of budgetary policy. A fall in interest rates first has an immediate effect on the cost of new debt. Also, as the old debt is refunded, the fall in interest rates, provided that it is lasting, takes the equivalent amount of pressure off public budgets. Although the immediate effect may often be ignored, except for the countries with a very high budget deficit, the longer term effect will be appreciable in all the countries. According to Commission estimates, the assumed fall of 0,8 of a percentage point in long-term interest rates could have an effect on the budget deficit averaging between 0,5% and 0,6% of the Community's GDP, after the entire debt has matured and has been refunded at a lower rate. A cautious evaluation puts the reduction attainable over four years at 0,4 of a percentage point of GDP. As a result of this reduction in the interest burden, budgetary policy could gradually be given more flexibility.

This reduction would be of particular benefit to the countries with the highest level of public debt. It would contribute to an above average degree to reducing the rising tendency of the public debt, which these countries can at present curb only by creating larger and larger surpluses on their budgets excluding debt interest. It would thus contribute to the desirable closer convergence of public debt, positions which in its turn would be bound to have favourable repercussions on the downward convergence of interest rates themselves.

The assessment which can be made of the level of nominal interest rates is closely bound up with their differential with the inflation rate, i.e. the 'real interest rate'. Inflationary expectations are crucial in this respect, but since they cannot be directly observed, the 'real interest rate' measured by the differential between the nominal rate and the current inflation rate is often used as an initial approximation. However, this measurement creates very special problems when there is sharp and rapid variation in the inflation rate. In this case the current inflation rate and the anticipated inflation rate probably differ widely, with the economic agents' expectations proving false. The choice of the inflation indicator is also difficult. As a general rule, the different indicators of inflation (GDP or private consumption deflators, nominal unit wage costs) move in parallel. However, when major changes occur in relative prices, e.g. as in 1986, following the improvement in the terms of trade resulting from the depreciation of the dollar and the fall in oil prices, major differences may appear in the movement of these various indicators. All these factors must be taken into account when assessing the level of real interest rates and the room which exists for them to fall in the future.

As a historical comparison, the present differential between the nominal long-term interest rate and the inflation rate is wide, at around 5% (see Graph). This is, of course, distinctly wider than in the 1970s, when it was close to zero, or even negative, but then it was the expression of monetary instability and of high and rapidly fluctuating inflation rates rather than a reflection of the relative scarcity of capital. In many countries interest rates then lost the role which they ought to have in channelling scarce resources from saving into the most profitable allocations. This has probably led to waste of capital and has made the productive process even more capital-intensive. However, the differential is also now slightly wider than in the 1960s, a period which from the point of view of monetary stability is more comparable with the present period. The high level of real interest rates is also a sign of inadequate saving relative to the financing needs of the various economic agents.

Since the beginning of the 1980s, stability-oriented monetary policies have enabled interest rates to ensure balance on the capital markets more effectively. Their relatively high level can be explained by several factors; if these factors move favourably one can hope for a lasting fall in real interest rates without the achievement of stability being called into question.

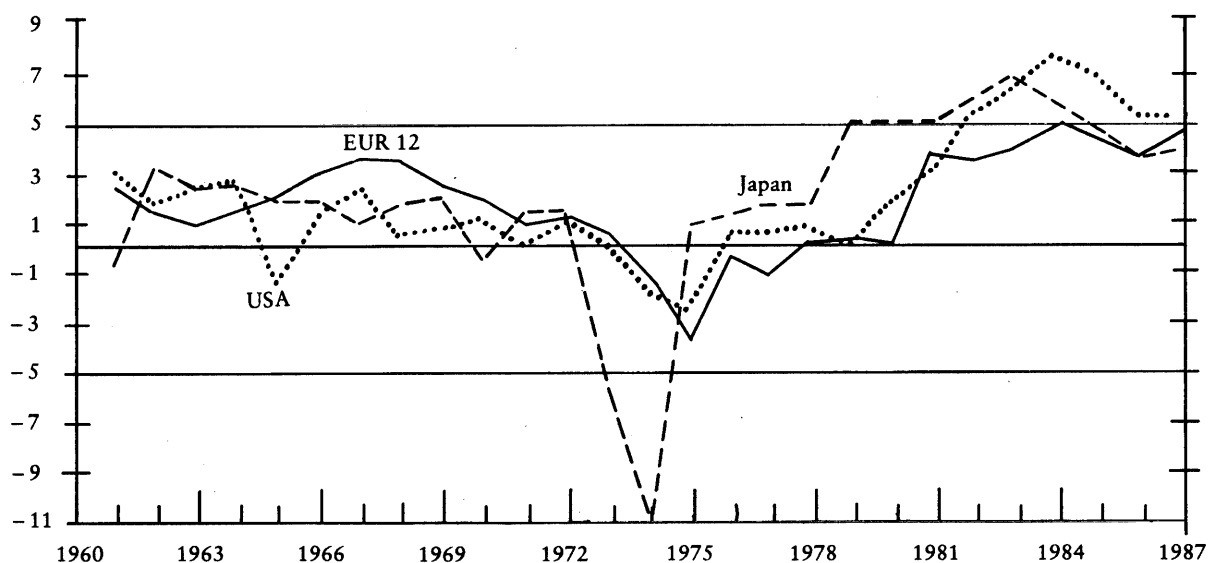
First, *at international level*, the absorption of domestic and external saving represented by the United States' budget and external deficits and the debt situation of the developing countries places a heavy burden on international capital markets. To the extent that these imbalances are corrected, scope would be created for interest rates to fall on international markets. To the extent that these imbalances are corrected, scope would be created for interest rates to fall on international markets, and consequently on the European capital markets.

Secondly, within the *Community*, the return to stability is a relatively recent phenomenon and the disinflation process is not yet complete in all countries. If monetary policies remain lastingly and credibly geared to stability and if, year for year, inflation rates remain low, inflationary expectations should still be able to fall, and this would have a favourable effect on interest rates. A progressive improvement in the *balance between domestic saving and investment* should also contribute to a relative fall in real interest rates. Such an improvement is possible if, within the framework of the cooperative strategy, the faster rise of investment can be based on rising profitability accompanied by a progressive increase in the margins for self-financing, and thus with a simultaneous increase in domestic saving. The pursuit of policies which permit, where necessary, a progressive consolidation of public finances and which improve the convergence of public debt positions should also contribute to reduce tension on the capital markets and would also facilitate the task of monetary policy in external and internal stabilization. The reduction of interest rates in the Community which would thus be possible would contribute to establishing at a lower level the differential between European and United States interest rates necessary to stabilize the dollar.

#### LONG-TERM INTEREST RATES

(annual average)

Differential between nominal rates and variations in the price of GDP



1. GDP prices have been chosen as representing underlying domestic inflation. Their evolution is on a long-term average roughly identical with the evolution of the prices of private consumption (average for the years 1970 to 1985: prices of GDP: + 10,1 % *per annum*; prices of private consumption: + 10,0 % *per annum* on average for EUR 12). However, in some years, wide differentials exist when the terms of trade change substantially (e.g. 1974: prices of GDP, 13,0 %; prices of private consumption, 14,6 %; 1986: prices of GDP, 5,6 %; prices of private consumption, 3,7 %; on averages, EUR 12).
2. The nominal interest rate corresponds to the weighted average of representative nominal long-term interest rates on the capital markets of the Community countries (weighting: GDP prices and PPA 1985).



## PART II

## THE ECONOMIES OF THE MEMBER STATES

## BELGIUM

In *Belgium*, energetic budgetary adjustment undertaken during 1987 marked the real growth rate of domestic demand, which slowed to 1,6 %; as the real contribution of the external balance was again negative, the GDP growth rate fell to 1,3 %. Against this somewhat slack background, fixed investment by firms nevertheless remained very sustained, increasing by almost 8 % in volume for the second year running, while public investment declined by 10 %. Private consumption increased by only 1,5 % in real terms, owing to a slowdown in real disposable income. The volume of imports increased faster than that of exports, but the terms of trade continued to improve and the balance of payments on current account showed an appreciable surplus (2,3 % of GDP). The consumer price rise was kept to 1,8 % on annual average. Unemployment diminished slightly, despite the contractionary effect of budgetary measures on employment.

Real personal disposable incomes could grow slightly faster in 1988; as a result, and assuming a further reduction in the savings ratio, private consumption will be able to expand at the same rate as in 1987. Private investment will continue to grow, stimulated by wider profit margins and given the still moderate trend of real wages. The contribution of the external balance to growth should become positive, since cost competitiveness is again improving. In these circumstances, the current account surplus should be maintained at around 2,5 % of GDP. The real GDP growth rate could be close to 2 %, while the unemployment rate should fall slightly. While remaining moderate, inflation could accelerate slightly, partly because of a turnaround in the trend of import prices.

It is still an absolute priority objective to restore healthy public finances. Further efforts in this direction are imperative for several reasons: the size of the gross debt, which reached the equivalent of 125 % of GDP in 1987 (the corresponding figure for the Community as a whole being 61 %), with external debt alone equivalent to 20 % of GDP; the burden of interest payments, which will approach 11 % of GDP (the corresponding figure for the Community as a whole being 5 %); and the fact that the reciprocal multiplier effects between the debt and interest payments have still not been brought under control.

After an appreciable reduction (about 3 % of GDP) in the central government borrowing requirement in 1987, mainly thanks to major public expenditure cuts, the Government intends to bring the budget balance down to 7,4 % in 1988 so as to achieve the programmed objective of 7 % of GDP

in 1989. This will involve a new series of expenditure cuts, especially on social transfers and operating expenditure, and the creation of new budget revenue, partly from the privatization of certain public sector activities.

At the same time, the Government has announced an ambitious programme of tax reform, spread over the period 1989 to 1993, including a reduction in the number and level of personal income tax rates, the effects of which would be partially offset by the discontinuation of a series of tax allowances in favour of enterprises and households. The programme has not yet been presented to Parliament.

To attenuate the effects on the labour market of public finance austerity and moderate economic growth, the Government's programme for 1988 also includes a set of direct specific measures in favour of employment, including opportunities for reduced social security costs in certain sectors, and facilities for young and long-term jobseekers. Job creation in the private sector is still being helped along by a steady decline in real unit labour costs. On the basis of wage agreements for 1987 and 1988, the increase in real wages should be below productivity gains.

Moreover, improvements in the operation of labour markets have made it possible to improve the flexibility of supply conditions. New laws introducing more flexible provisions on Sunday work, night work and working hours, came into force in July. Under these laws, new arrangements for work can be introduced by collective agreement negotiated at sectoral or firm level. This increased flexibility, along with the moderation of internal costs, creates favourable conditions for the development of exports and investment.

The policy introduced in 1982 to restore profitability and healthy finances in the business sector has already improved business investment, particularly in 1986/1987.

Monetary policy should continue to preserve the stability of the exchange rate of the Belgian franc within the European Monetary System, while using the margin for manoeuvre available to encourage a decline in interest rates and thus lighten the burden of servicing the public debt. The realignment of January 1987 involved revaluing the Belgian franc by 2 % against the ECU, after the 1 % revaluing of the

preceding realignment in April 1986. This policy has been made easier by the fact that the current balance of payments is showing a considerable surplus, and inflation performance is good. Progress towards reducing the budget deficit is likely to loosen the constraint imposed by changes in capital movements on interest rates. Along with a balance of payments surplus on current account, this development should also enable the authorities to reduce the external debt that has accumulated since 1979.

The success of the recovery plan for the Belgian economy depends on the interaction of a number of factors. A low inflation rate must help to bring down interest rates, stimulate investment and reduce the burden of interest on public debt. Wage moderation should safeguard

competitiveness and maintain profitability at a satisfactory level. If these conditions are met, growth might revive and make it easier to achieve the twofold aim pursued by the Belgian authorities: reduction of the budget deficit and reduction in the burden of compulsory levies — an objective that fits in with the strategy recommended by the Community, and which is expected to have favourable effects on employment. If it is to be a success in practice, the authorities must keep control of public expenditure and the Belgian economy must also be able to take advantage of sufficiently dynamic intra-Community trade. The implementation of the tax reduction programme could then be confined to using the 'budgetary dividend' generated by an improvement in the conditions of growth in the Community.

## Belgium: Main economic aggregates 1983 to 1988

(Annual percentage changes)

	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(2)</sup>	1988 <sup>(2)</sup>
Gross domestic product	6,0	7,2	6,7	6,9	3,4	4,0
{ value	-0,3	1,6	1,5	2,3	1,3	1,8
{ volume	6,3	5,5	5,1	4,4	2,1	2,2
{ deflator	7,3	6,5	4,8	1,3	1,8	2,5
Private consumption deflator	-3,6	4,4	3,8	6,6	7,0	4,9
Gross fixed capital formation volume	-7,6	-8,8	-13,1	-7,2	-11,0	0,2
{ private	-4,3	2,2	1,2	4,8	5,0	4,4
{ public	-5,5	-4,8	-0,4	1,6	1,6	3,1
{ total	-2,3	13,9	3,5	9,1	9,2	6,0
of which: construction equipment	-2,5	1,7	1,3	3,4	1,6	1,7
Domestic demand at constant prices	-3,8	-0,1	-1,0	-0,3	-1,0	-0,6
Gap with respect to other Community countries <sup>(3)</sup>	6,0	5,8	4,4	2,5	3,7	3,0
Compensation of employees per head	-0,3	0,3	-0,7	-1,8	1,6	0,8
{ nominal	-1,3	-0,6	-0,4	1,2	1,9	0,5
{ real A <sup>(4)</sup>	0,9	1,7	0,6	1,3	1,2	1,6
{ B <sup>(4)</sup>	-1,2	-1,4	-1,2	-3,1	0,4	-0,8
Productivity <sup>(5)</sup>	-2,2	-1,3	1,1	4,5	3,8	-0,6
Real unit labour costs	-1,1	0,0	0,8	1,0	0,1	0,2
Competitiveness <sup>(6)</sup>	14,4	14,5	13,7	12,6	12,4	12,1
Employment	-0,6	-0,4	0,4	2,4	2,3	2,3
Registered unemployed as % of the civilian labour force <sup>(7)</sup>	11,8	12,0	10,6	7,9	7,6	7,4
Current balance as % of GDP	7,0	6,1	6,7	10,7	8,0	6,0
Long-term interest rate	-11,3	-9,4	-8,4	-8,7	-6,6	-6,1
Money supply <sup>(8)</sup>	105,1	111,0	117,9	120,3	125,3	128,4
Net lending or borrowing requirement of general government as % of GDP <sup>(9)</sup>	9,4	9,9	10,6	11,1	10,9	11,0
Public debt as % of GDP						
Public debt interest as % of GDP						

<sup>(1)</sup> Estimates of the Commission services, September 1987.<sup>(2)</sup> Forecasts of the Commission services, September 1987, on the basis of present policies.<sup>(3)</sup> Differences in percentage points.<sup>(4)</sup> A: GDP deflator; B: private consumption deflator.<sup>(5)</sup> Gross value added per occupied person in the whole economy.<sup>(6)</sup> Effective exchange rate (*vis-à-vis* 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive figure = loss of competitiveness.<sup>(7)</sup> Eurostat definition.<sup>(8)</sup> End of year.<sup>(9)</sup> This 'borrowing requirement' is substantially different from the concept of 'the net balance to be financed' to which national budgetary policy refers and which includes loans, advances and equities and certain other exchequer operations.

## DENMARK

In *Denmark*, after five years with growth in excess of the Community average, the gross domestic product is estimated to have shown a small decline in real terms in 1987. While exports of goods and services had already stagnated in 1986, the growth of activity had been sustained by an exceptionally rapid expansion of domestic demand (5,7 % increase on average over 1985). Towards the end of the year, however, key domestic demand components turned distinctly downwards in response both to the deterioration of export prospects and the resulting worsening of the investment climate and to the sharp tightening of fiscal policy undertaken in several steps in the course of the year, and of measures aimed at increasing the saving ratio of private households. Private consumption, thus, declined by some 5 % (actual rate) from the third to the fourth quarter of 1986 and is, even with some rise in the course of 1987, likely to show a small decline on average for 1987 over 1986. Dwelling construction is estimated to have contracted by some 10 % and business investment is also likely to have dropped. Although public investment rose somewhat over the 1986 level, total gross fixed asset formation, therefore, is estimated to have declined by some 6,5 %. With, furthermore, a fall in the level of inventory formation, total domestic demand may have declined by almost 2 % in real terms. Imports fell even faster than domestic demand and, since exports remained rather unchanged, the contribution to growth from net exports was positive although not enough to prevent a small contraction of domestic activity. The number of persons employed nevertheless probably rose marginally but less than the fairly rapid increase in the labour force. The rate of unemployment, therefore, after having been on a declining trend since 1983, rose somewhat from 1986 to 1987.

Import prices are estimated to have fallen by some 3,5 % in national currency terms but domestic unit labour costs have risen substantially faster than in 1986 (in part as a result of a shortening of the working time) and consumer prices are expected to have shown a rise of 4 % against some 3,5 % in 1986.

Despite this acceleration of inflation, nominal incomes showed a marked deceleration and the rate of increase of tax receipts — exceptionally high in 1986 as a result of major tax rises — slowed down considerably. Government expenditure, on the other hand, accelerated as a result of wage and salary improvements for civil servants and a rise in transfers to households. The general government budget surplus, therefore, may have declined from 3,3 % of GDP in 1986 to some 1,9 % in 1987. The balance of trade in goods and services, which had been slightly negative in 1986, again turned positive in 1987 and, as the net interest payments to abroad remained practically unchanged, the current external deficit was reduced from 5,1 % of GDP in 1986 to 2,9 % in 1987.

Activity is expected to recover somewhat in the course of 1988 mainly in response to a continued improvement of the external balance in volume terms. The growth of export markets is unlikely to accelerate much and competitiveness may deteriorate further. On the other hand, given the weakness of the domestic market, producers may to some extent shift supply to external markets and exports may, therefore, nevertheless rise faster than in 1987. Real domestic demand is forecast to continue its decline, although at a somewhat slower rate, and this will be reflected in a further drop in the volume of imports. On average for the year, gross domestic product may show a rise below 1 % and the rate of unemployment is likely to increase over the level of 1987. Domestic cost increases will slow down but a rise in import prices will push up costs and the rate of increase of consumer prices is, therefore, unlikely to drop. Given the expected deterioration of the terms of trade (reflecting both a rise in import prices and a fall in export prices of agricultural products) the trade balance in current prices is not improving fully in line with the change in the volume balance. Moreover, the balance on invisibles may deteriorate as a result of a fall in net transfers from the Community. The current external deficit is, nevertheless, likely to fall from 2,9 % of GDP in 1987 to some 2,2 % in 1988.

Assuming unchanged policies, implying, notably, the continued implementation of the general guidelines for the development of central and local government expenditure and unchanged rules of taxation, the financial situation of general government should change little in 1988. The slow growth of private sector demand will exert a dampening effect on receipts from indirect taxes but direct taxes are expected to rise fast as a result of the widening of the tax base following the tax reform (notably the lowering of the scope for deducting interest payments). Interest payments on the public debt are expected to fall somewhat and the general government budget surplus may, therefore, remain broadly unchanged or perhaps even increase a little over the level of 1,9 % reached in 1987. The need to strengthen even further the external account remains imperative and warrants a considerable surplus on the general government budget as long as the saving of the private sector remains insufficient. The financial deficit of the private sector, which rose from 2,7 % of GDP in 1985 to 8,6 % in 1986, fell somewhat in 1987 but is, in fact, forecast to remain as high as 3,9 % of GDP in 1988. A more lasting improvement of the financial balance of the private sector will require further measures to enhance household savings and will also warrant a continued prudent stance of monetary policy.

The deterioration of the private sector's financial balance in 1986 (reflecting both a decline in the savings rate and a strong upturn in dwelling construction and business investment) in fact prompted a sharp rise in nominal long-term interest rates — from some 9 % in March 1986 to more than 12 % in September 1987. Short-term interest rates, apart from a brief

rise in January 1987 in the period immediately preceding the EMS alignment, have not increased fully in line with long-term rates, implying a rise in the steepness of the yield curve. The difference between Danish and German short-term interest rates, nevertheless, has widened very considerably since the beginning of 1986. This decoupling of Danish interest rates from the general lowering of rates within the EMS was instrumental in maintaining the relatively strong position of the Krone within the band of fluctuation and, thus, in dampening the rate of increase in consumer prices in the face of an acceleration of domestic cost increases. The tightening of domestic monetary conditions, in fact, to a large extent took place as an 'endogenous' adjustment to these cost increases rather than as a deliberate change in the policy stance. Any progress made by reducing the deficit in the current balance of payments would be helpful in reducing long-term interest rates and in stimulating private investment.

Growth was exceptionally vigorous during the years 1984 to 1986, notably as a result of a strong boom in private investment fostered by improved profitability and benefiting from favourable export prospects. However, the widening of

the gap between the expansion of internal demand in Denmark and in other Community and Scandinavian competitiveness, increased the current balance of payments deficit to an unsustainable level. In view of this situation, and of the high level of external debt and related interest payments, the relaxation of the external constraint should remain the primary objective of government policy. To this end the contribution of fiscal and monetary policies is essential, but wage restraint will be equally important, so as to ensure a return to a dynamic growth process which was successfully achieved in the recent past. A strengthening of foreign demand could help to reduce the external constraint. Increased growth in intra-Community trade sustained by appropriate macroeconomic policies in the Member States would be helpful in this respect.

With a view to strengthening the competitiveness of Danish enterprises, the Danish Government has started tripartite discussions with the social partners on moderation of growth of costs and incomes. Important subjects for these discussions are proposals to reduce the burden to enterprises of employment-related contributions and proposals to promote savings for pension purposes.

## Denmark: Main economic aggregates

(Annual percentage changes)

	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(2)</sup>	1988 <sup>(2)</sup>
Gross domestic product	10,4	9,4	9,7	8,4	4,4	5,1
{ value	2,5	3,5	4,2	3,4	-0,2	0,9
{ volume	7,6	5,7	5,3	4,9	4,6	4,1
{ deflator	6,8	6,5	4,9	3,6	4,1	4,0
Private consumption deflator	5,0	12,0	11,5	19,9	-7,6	-3,8
Gross fixed capital formation volume	-14,8	0,1	14,7	-5,3	1,9	2,1
{ private	1,9	10,5	11,9	16,8	-6,6	-3,2
{ public	1,9	7,3	8,6	19,4	-7,1	-4,3
{ total	1,8	14,5	15,9	13,9	-6,1	-1,9
of which: construction equipment	1,4	4,1	5,7	5,7	-1,9	-0,7
Domestic demand at constant prices	-0,2	2,1	3,2	1,9	-4,7	-3,1
Gap with respect to other Community countries <sup>(3)</sup>	8,2	5,4	4,6	5,1	7,2	5,2
Compensation of employees per head	0,5	-0,4	-0,6	0,2	2,5	1,1
{ nominal	1,4	-1,1	-0,2	1,4	3,0	1,2
{ real A <sup>(4)</sup>	1,8	1,8	0,8	1,2	-0,8	1,2
{ B <sup>(4)</sup>	-1,3	-2,1	-1,4	-1,0	3,3	-0,2
Productivity <sup>(5)</sup>	0,9	-3,6	1,1	7,4	9,1	0,2
Real unit labour costs	0,3	1,5	2,9	2,0	0,8	-0,1
Competitiveness <sup>(6)</sup>	10,1	9,9	8,7	7,6	7,7	8,6
Employment	-2,6	-3,4	-4,7	-5,1	-2,9	-2,2
Registered unemployed as % of the civilian labour force <sup>(7)</sup>	14,4	14,0	11,6	10,5	11,9	11,0
Current balance as % of GDP	25,5	17,0	15,8	8,0	4,3	4,4
Long-term interest rate	-7,2	-4,1	-2,1	3,3	1,9	1,7
Money supply <sup>(8)</sup>	62,6	67,6	65,8	61,7	59,1	53,3
Net lending or borrowing requirement of general government as % of GDP	8,1	9,7	9,9	8,8	8,2	7,8
Public debt as % of GDP						
Public debt interest as % of GDP						

<sup>(1)</sup> Estimates of *Danmarks Statistik*, April 1987.<sup>(2)</sup> Forecasts of the Commission services, September 1987, on the basis of present policies.<sup>(3)</sup> Differences in percentage points.<sup>(4)</sup> A: GDP deflator; B: private consumption deflator.<sup>(5)</sup> Gross value added per occupied person in the whole economy.<sup>(6)</sup> Effective exchange rate (*vis-à-vis* 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive figure = loss of competitiveness.<sup>(7)</sup> Eurostat definition.<sup>(8)</sup> End of year.

## FEDERAL REPUBLIC OF GERMANY

Economic prospects for the *Federal Republic of Germany* are currently viewed relatively cautiously. In the second half of 1986, the strong appreciation of the German mark, principally against the United States dollar, was reflected in a decline in exports in real terms and an increase in imports, particularly of finished goods. Although domestic demand remained buoyant, the influence of the external sector tended increasingly to blunt the overall economic performance.

In 1987 this dampening influence of the external side has again strongly marked the development of the economy. Following a further rise of some 10% in the German mark's value against the United States dollar and with economic activity suffering exceptionally from harsh winter weather, aggregate production contracted in the first quarter. Admittedly, the factors holding back exports weakened as the year progressed, and exports started to recover markedly from the second quarter on; on average for the year they may, nevertheless, in volume terms remain below their 1986 level. Domestic demand went on growing at a distinctly more rapid rate than aggregate production, even though it fell far short of the high 1986 growth rate — not least because of some deceleration in private consumption. The unfavourable trend of exports also dampened investment in equipment, although some revival appeared to take place at the end of the year. However, investment was channelled primarily into rationalization schemes. Investment in building and construction showed no growth, not just due to bad weather but also since the trendwise decline in residential construction has not yet slowed down. Since demand was increasingly met by imports, which enjoyed a competitive price edge, and since exports stagnated, the growth of GDP amounted to around 1,5% in 1987. Under those circumstances employment showed only little increase. The resulting annual average increase of around 0,5% was not sufficient to bring unemployment down below the average level for 1986. As in the previous year, the real balance on goods and services deteriorated significantly, to only slightly over half its 1985 level. Nevertheless, mainly because of a further major improvement in the terms of trade, the current account surplus fell by only around half a percentage point, to 3,7% of GDP.

The expansion in domestic demand is expected to show only a modest slowdown from 1987 to 1988. The increase in real gross private wage and salary income may slow down to just below 4%. However, the tax cuts planned for early 1988, will boost the rate of increase in disposable incomes. Despite some acceleration of consumer prices (to just below 2%) real disposable income of households may, therefore, show a rise of around 2%. With slightly faster growth in export markets and assuming only a small rise in the real effective exchange rate of the German mark, exports are expected to grow moderately, while imports might increase at much the same rate as in 1987. As a result, GDP may expand very close to

2% in 1988. The overall price increase in the economy, around 2%, would be broadly in line with domestic cost increases. The reduction in the current account surplus will be similar in scale to that of 1987, but it might still be above the 3%-of-GDP mark in 1988.

Employment during the year will probably rise to a similar extent as in 1987, but a further contraction is expected in employment in manufacturing. With a probable increase in total employment of around 70 000, unemployment is likely to edge up again.

The high level and rising trend of unemployment are still extremely worrisome features. Wage bargainers and economic policymakers are together facing the challenge of making full use of the opportunities for scaling down unemployment. Wage settlements concluded earlier this year suggest that the wage costs *per capita* in 1987 will increase by some 3,5%. The only reason why the resulting increase in unit wage costs did not so far damage business profits was the significant improvement in the terms of trade. A moderate rise in real wages therefore remains necessary if the propensity to invest is to be maintained despite the loss of competitiveness resulting from appreciation. However, the wage settlement recently reached in the metal industry contains some positive elements: working time will be progressively reduced by a total of one and a half hours, with agreed annual wage increases translating into a rise of around 4% in hourly wage costs. This settlement in the metal industry is the first in which wage bargainers have reached an agreement spanning three years. This will allow firms to make plans on a safer basis much in line with the government's policy with respect to the macroeconomic framework. Given the importance of this branch of industry, which accounts for some 50% of employment in manufacturing, the pattern has been set for wage costs in the economy as a whole in the medium term, and this will be an important factor influencing monetary and financial policy.

In view of the prospective small decline in real unit-labour costs, the overall profit situation of enterprises in general remains healthy. The net rate of return (measured as the net operating surplus in proportion to the net capital stock) has increased from the trough of 1981 and should next year be back to the level of the early 1970s. As firms can count on steady — although still rather moderate — growth in demand, investment conditions are in general not unfavourable.

Although the Federal Republic of Germany is already making a major contribution towards eliminating international payments imbalances, with the growth in domestic demand

probably exceeding the growth of GDP by over 2,5% in real terms between 1986 and 1988, the current account surplus, as a result of the terms of trade improvement, is being reined back only gradually.

Budgetary policy is still directed towards reducing the proportion of scarce resources taken up by the state by imposing tight restrictions on the rise in expenditure. Even so, a pronounced change in the stance took place in 1986. Up to 1985, the main purpose of the restrictions on expenditure was to trim budget deficits and to stem the rise in public debt as a percentage of GNP. Since 1986, however, the headroom available has been used to ease the burden of taxation. Following the reduction in direct taxation in 1986 (equivalent to 0,6% of GDP), a somewhat larger step will be taken in 1988 (0,6 to 0,7% of GDP), with the tax cuts originally planned being augmented in the wake of the Louvre accord of February 1987 by bringing forward DM 5 billion of the tax reform scheduled for 1990. The remaining parts of the reform will result in tax cuts equivalent to somewhat less than 1% of GDP from 1990 onwards. In addition, budgetary policy served to underpin growth last year and has continued to do so this year, especially as public investment in goods and materials has risen at a much faster rate than GNP. Alongside this, the automatic stabilizers have been able to produce their full effects this year since, by and large, the Government has not attempted to make up for revenue shortfalls due to the degree of capacity utilization with corresponding cuts in expenditure. As a result, the total public authority deficit in 1987 is expected to widen again significantly for the first time since 1981.

The abovementioned tax cuts, amounting to DM 13 to 14 billion (0,6 to 0,7% of GDP), will be the main feature of budgetary policy in 1988. These cuts will not only stimulate demand, but also serve to improve incentives to effort on the part of employees and firms. In view of the fairly modest growth prospects, a further expansion in the deficits cannot, therefore, be avoided. The Central Government (combined Federal Government and Länder) deficit will probably reach 2,7% of GDP in 1988, corresponding to a rise of 0,3 points over 1986, while the total public authority cash deficit (central and local government, and the special Federal funds) might even rise to some 3% in 1988. Since the growth in expenditure has, in any case, already been adjusted to the more unfavourable trend in revenue, a temporary widening of the deficits under the impact of tax cuts provides no justification for any weakening of confidence in the soundness of budgetary policy. However, through dismantling subsidies and deciding on how the tax reform is to be financed, care must be taken to ensure that the expansionary forces in the economy are given full rein. An energetic dismantling of subsidies should, in particular, prevent the preservation of production structures for which there will be no future whatsoever in the longer term.

Since the beginning of 1986, the Central Bank money stock has been expanding at an average annual rate of over 7%, while the nominal national product has been rising by no more than around 5%. As a result of falling interest rates, the faster pace of monetary expansion was, at the outset, attributable principally to growth in highly liquid forms of money but then, from about the middle of last year, the money supply aggregates expanded on a broader front. Low interest rates, together with falling prices, significantly eroded the opportunity costs of holding money, while the money supply was characterized by strong growth in credit institutions' claims on non-residents.

However, monetary policy still shows some conflict between domestic and external objectives; under such circumstances, there is a danger that the measures which are inherently necessary to curtail monetary growth will be impeded by further undesirable upward pressure on the DM. Developments since May 1987 have, however, clearly shown the limitations the Bundesbank faces in influencing long-term interest rates. Since May, the capital market has not followed the targets established by the Bundesbank. On the contrary, there was a rise of more than 0,5 points in the current yield on public loans, less in response to changes in investors' inflationary expectations than to movements in exchange rates and international interest rates. From a monetary policy viewpoint, a slowdown in monetary expansion would be welcome in order to start next year with a lower rate of growth. If the external environment were to prove more stable than in 1986/1987, there would probably be a good prospect of this happening.

The attempts to make markets more adaptable have continued. In recent months, the main objective in many cases has been to facilitate market access for new firms set up by the self-employed and by enterprises, to improve their access to new equity capital and to remove as many as possible of the numerous obstacles they encounter. Against this, scant progress has been made hitherto in dismantling subsidies. The latter were, in fact, increased substantially, especially in 1986, partly as a result of the German mark's appreciation but also under mounting political pressure from interest groups. In the context of the financing of the tax reform it has subsequently been decided to reduce the tax exemptions by an amount of broadly DM 8 billion. By taking further modest steps towards reducing weekly working time and by expanding the scope for flexible working arrangements, the two sides of industry have helped improve employment opportunities; at the same time, the Federal Labour Office stepped up efforts to provide vocational and further training.

All in all, the outlook for economic development in the Federal Republic in 1988 does not appear fully satisfactory — notably since no further reduction in



unemployment is to be expected. Judging from past experience, a recovery in the trend of exports, as seen from mid-1987, will with a certain lag lead to a general upturn in the domestic growth leading ultimately to a further reduction of the external surplus. However, should economic growth

significantly loose momentum, it would be desirable to reconsider the stance of budgetary policy not only with a view to prevent a further deterioration of the labour market but also to avoid a slowdown of the process of renewing productive capacity.

## Federal Republic of Germany: Main economic aggregates, 1983 to 1988

(Annual percentage changes)

	1983	1984	1985	1986	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
Gross domestic product						
{ value	4,8	4,8	4,3	5,7	3,3	3,7
{ volume	1,5	2,8	2,1	2,6	1,4	1,9
{ deflator	3,3	2,0	2,2	3,1	1,9	1,8
Private consumption deflator	3,2	2,5	2,1	-0,5	0,6	1,8
Gross fixed capital formation (volume)						
{ private	5,1	1,2	-0,1	2,5	1,2	1,6
{ public	-8,6	-2,1	0,8	7,3	2,9	0,7
{ total	3,2	0,8	-0,1	3,1	1,4	1,4
of which: construction	1,7	1,6	-5,6	2,4	-0,4	0,8
equipment	5,6	-0,5	9,4	4,1	3,8	2,3
Domestic demand at constant prices	2,3	2,0	1,0	3,7	2,5	2,3
Gap with respect to other Community countries <sup>(2)</sup>	1,6	-0,1	-0,9	-0,1	-0,4	-0,1
Compensation of employees per head						
{ nominal	3,9	3,5	3,1	3,9	3,3	2,9
{ real A <sup>(3)</sup>	0,6	1,4	0,9	0,8	1,4	1,1
{ B <sup>(3)</sup>	0,7	1,0	1,0	4,4	2,6	1,1
Productivity <sup>(4)</sup>	3,0	2,8	1,8	1,8	0,8	1,6
Real unit labour costs <sup>(5)</sup>	-2,4	-1,3	-0,9	-1,0	0,6	-0,5
Profitability <sup>(6)</sup>	11,5	2,1	5,2	5,0	-3,2	-2,2
<i>idem</i> (1970 = 100)	85,4	87,2	91,7	96,3	93,2	91,2
Competitiveness <sup>(7)</sup>	-0,9	-4,3	-2,6	10,0	5,7	-0,0
Employment	-1,5	0,1	0,7	1,0	0,6	0,3
Registered unemployed as % of the civilian labour force <sup>(8)</sup>	8,4	8,4	8,5	8,1	8,1	8,2
Current balance as % of GDP	0,7	1,3	2,4	4,1	3,7	3,2
Long-term interest rate	7,9	7,8	6,9	5,9	5,7	5,7
Money supply <sup>(9)</sup>	7,0	4,6	4,5	7,8	6,9	5,9
Net lending or borrowing of general government as % of GDP	-2,5	-1,9	-1,1	-1,2	-1,6	-2,0
Total public authority cash deficit as % of GDP <sup>(10)</sup>	-3,3	-2,6	-2,1	-2,2	-2,6	-2,9
Public debt as % of GDP	40,9	41,8	42,5	42,6	43,8	45,2
Public debt interest as % of GDP	3,0	3,0	3,0	3,0	2,9	2,9

<sup>(1)</sup> Forecasts of the Commission services, April/May 1987, on the basis of present policies.<sup>(2)</sup> Differences in percentage points.<sup>(3)</sup> Deflated by: A = GDP deflator; B = private consumption deflator.<sup>(4)</sup> Gross value added per occupied person in the whole economy.<sup>(5)</sup> Ratio of real wages per head to productivity.<sup>(6)</sup> Net operating surplus relative to net capital stock at current replacement cost.<sup>(7)</sup> Effective exchange rate (*vis-à-vis* 19 industrial countries) on the basis of unit labour costs for the whole economy; positive figure = loss of competitiveness.<sup>(8)</sup> Eurostat definition.<sup>(9)</sup> Central Bank Money Stock; Q4 over Q4.<sup>(10)</sup> Territorial Authorities and special Federal funds; financial statistics concept.

## GREECE

In *Greece*, the year 1987 has seen further progress towards stabilization, even though it has not been possible for all the targets initially set to be complied with. The deficit on current account narrowed further as domestic demand and GDP contracted; the public sector deficit as a proportion of GDP fell again and the monetary aggregates expanded less than in 1986. Inflation showed a downward trend, while unemployment remained unchanged, the fall in total employment being offset by a similar decline in the labour force. In 1988, activity will tend to return to positive growth. Both consumption in volume and the savings ratio of households are likely to steady and investment will continue to rise, leading to a real growth of demand and output. Prices should rise at a slower rate after having been affected by exceptional factors in 1987, but the public sector deficit will only narrow if additional measures are taken, while no appreciable improvement is likely in the current account of the balance of payments.

The end of 1987 is the official date for the completion of the stabilization plan. Adopted at the end of 1985, this plan was designed to achieve a rapid improvement in the balance of payments through a deliberate cutback of domestic demand, in order to stabilize the level of the external debt from 1988 onwards. The plan was supported by the Community authorities which granted a balance of payments loan for the purpose. The objectives involved reducing the rate of inflation to 10 % by the end of 1987, cutting the public sector net borrowing requirement by 8 % of GDP over two years, and limiting domestic credit expansion to 17 % in 1986 and 11 % in 1987.

Wage policy, the key instrument for restraining domestic demand, was based on a system of degressive indexation focused on a targeted inflation rate and excluding the effect from import prices. In addition, very moderate growth was authorized for farm incomes. The strict incomes policy produced a 10 % reduction in real wages and a 7 % reduction in real personal disposable income in the period 1986/1987.

However, as a result of initial doubts by private economic agents about the durability of the plan and because of speculative behaviour, private consumption contracted only slightly, entailing a sharp drop in the personal savings ratio, helped especially by the very high degree of liquidity in the personal sector. The public sector net borrowing requirement was reduced from 17,6 % of GDP in 1985 to 13,7 % in 1986, partly as a result of an increase in the taxation of oil products which offset the fall in oil prices. In 1987, a further reduction to 12 % of GDP is likely, but this level is higher than the objective set in the context of the programme.

This development, together with a volume of sales of treasury bills and medium-term paper that fell short of

expectations, caused the domestic credit expansion target to be exceeded even though bank lending to the private sector was generally within the rates envisaged. Consumer price inflation, after fluctuating around 20 % for a number of years but rising to 25 % at the end of 1985, was cut to 17 % in 1986. The rate is expected to fall by approaching three percentage points on a year-end basis in 1987 despite the inflationary effect caused by the introduction of VAT.

The curtailment of domestic demand and the lower oil bill were very beneficial to the balance of payments on current account, which showed a deficit of 9,8 % of GDP in 1985, 4,3 % in 1986 and 3,1 % in 1987. The current account deficit in 1986, at US \$ 1,7 billion, is formally in line with the target set in connection with the Community loan, but the deficit for 1987, while lower than in 1986, is likely to be somewhat higher than the target.

Substantial progress has been made in reforming the financial system. Preferential interest rates for certain categories of operator have been abolished. The general level of interest rates, which previously had been lower than the rate of inflation, has been raised and commercial banks have been granted a degree of freedom in fixing their lending rates. The strict administrative rules and regulations governing the administration of credit have been made more flexible and efforts have been made to place treasury bills and medium-term paper with private non-banks. Continuation of these efforts, together with the creation of an efficient non-bank financial market, should facilitate the implementation of monetary policy and contribute to the modernization of the financial system, which is essential for the development of the country.

For a number of years, the public sector in Greece has been expanding rapidly, with a significant increase in the public debt. Getting the current deficits in the central government budget under control is clearly a priority, but the deficit of the social security system raises the greatest problem. The rapid deterioration in this field is a result of the policy, pursued since the beginning of the 1980s, of substantially increasing pensions and extending social security benefits to people who had not previously paid contributions. The drive to cut back the public deficit, already initiated by the authorities, will need to continue for a number of years in order for the public debt to be stabilized as a proportion of GDP.

From a structural angle, the basic problem of the Greek economy is the continued decline since 1980 of productive investment, brought about by the unfavourable climate for industrial activity associated with a wide-ranging regulation of markets. Since the end of 1985, the Government has been

working on phasing out price controls; combined with the very moderate growth of wage costs and a consistent exchange rate policy, this has helped to produce a significant improvement in the financial position of enterprises. This is expected to lead to a significant upturn in productive investment, although initially companies have given priority to improving the structure of their balance sheets.

The country's productive capacity has been considerably weakened as a result, so that continued efforts need to be made in 1988 to contain the pressure of domestic demand and thereby avoid a deterioration in the balance of payments. However, in view of the scale of the adjustment of real wage incomes in the past two years, wage policy can no longer be the main instrument for managing demand. Wage negotiations should take account of a rate of inflation that is consistent with the macroeconomic objectives pursued, while the degressive structure of wage rises will gradually have to be abandoned, as this has produced a levelling of incomes that is not conducive to productivity growth. Overall, this policy might be consistent with a slight increase in real wages in the course of the year.

In these circumstances, reducing the public sector deficit will have to be the prime instrument of demand management. It will be difficult to apply, especially since the social security deficit is tending to increase, while income policy will not

contribute to the moderation of the public sector wage bill to the same extent as in the previous two years and certain exceptional receipts will no longer accrue. Some essential changes in legislation should be made rapidly: in particular, reorganizing the pensions system, widening the tax base through fuller taxation of certain categories of tax payer, and containing the wage and salary bill in the public service through a ban on new recruitment and restriction of wage and salary increases below the average in the economy. Alongside the dismantling of export subsidies, which began in 1987, agricultural subsidies, which again rose significantly in 1987, will need to be cut. Rationalization of the management of public enterprises and agencies should help to reduce both the budget transfers to them and their own deficits.

In view of the medium-term public finance objectives, and in order to stabilize the external debt in 1988, budgetary policy for the coming year should aim at making up the slippage from target recorded in 1987 and also at achieving substantial additional progress in reducing the public sector net borrowing requirement as a percentage of GDP. An active monetary policy seeking a further deceleration in domestic credit expansion should accompany this restrictive stance. In these circumstances, domestic demand would decline further, the inflation rate would fall below 10 % by the end of 1988, and the deficit on current account of the balance of payments should narrow to about 2 % of GDP.

## Greece: Main economic aggregates 1983 to 1988

(Annual percentage changes)

	1983	1984	1985	1986	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
Gross domestic product	20,3	23,0	19,6	20,6	15,8	12,2
{ value						
{ volume	0,3	2,6	2,1	1,3	-0,8	0,5
{ deflator	19,9	19,9	17,1	19,0	16,7	11,6
Private consumption deflator	18,6	18,0	18,4	22,1	16,0	12,0
Gross fixed capital formation volume	:	:	:	:	:	:
{ private						
{ public	:	:	:	:	:	:
{ total	-1,9	-4,7	3,4	-4,8	-2,0	3,7
of which: construction	3,9	-7,7	2,6	-3,4	-5,5	3,7
equipment	-8,2	-0,9	4,4	-6,5	2,2	3,8
Domestic demand at constant prices	-0,7	0,8	4,9	-0,3	-0,6	0,3
Gap with respect to other Community countries <sup>(2)</sup>	-0,4	-2,5	3,0	-4,5	-3,4	-2,2
Compensation of employees per head	21,8	22,6	20,4	13,7	12,5	12,0
{ nominal						
{ real A <sup>(3)</sup>	1,5	2,3	2,8	-4,5	-3,6	0,4
B <sup>(3)</sup>	2,7	3,9	1,7	-6,9	-3,0	0,0
Productivity <sup>(4)</sup>	-0,1	2,9	1,0	0,3	0,1	0,2
Real unit labour costs	1,6	-0,6	1,9	-4,7	-3,7	0,2
Competitiveness <sup>(5)</sup>	-3,4	1,4	-2,1	-13,6	-2,9	-3,5
Employment	-1,0	-0,2	1,1	0,3	0,1	0,2
Registered unemployed as % of the civilian labour force <sup>(6)</sup>	7,9	8,1	7,8	7,4	7,4	7,5
Current balance as % of GDP	-4,7	-4,1	-8,2	-5,4	-4,2	-4,1
Long-term interest rate	18,2	18,5	15,6	15,8	17,3	16,0
Money supply <sup>(7)</sup>	20,3	29,4	26,7	18,5	17,3	11,7
Net lending or borrowing requirement of general government as % of GDP	-8,9	-10,1	-13,6	-10,7	-10,6	-9,8
Public debt as % of GDP	44,3	53,2	62,6	64,3	65,4	67,2
Public debt interest as % of GDP	3,4	4,6	5,4	5,9	6,5	6,9

<sup>(1)</sup> Forecasts of the Commission services, September 1987.<sup>(2)</sup> Differences in percentage points.<sup>(3)</sup> A: GDP deflator; B: private consumption deflator.<sup>(4)</sup> Gross value added per occupied person in the whole economy.<sup>(5)</sup> Effective exchange rate (*vis-à-vis* 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive figure = loss of competitiveness.<sup>(6)</sup> Eurostat definition.<sup>(7)</sup> End of year.

## SPAIN

In 1987 Spain will again see higher economic growth than the other member countries, with domestic demand expanding a good deal more rapidly than in the rest of the Community. Real gross domestic product will increase by over 4%. Private consumption has been stimulated not only by real wage increases in the private sector but also by the sharp increase in non-agricultural employment. The very strong expansion of fixed investment continued, reflecting the continuing favourable trend of company profits, positive sales prospects and the need for modernization of productive equipment in the face of increasingly strong competition from abroad following the country's accession to the Community. Export performance, which was poor in 1986, improved gradually during the year thanks to strong demand from the other Community countries. Import growth remained very rapid and the exceptional buoyancy of domestic demand was therefore only partially reflected in the gross domestic product. Similarly, the trade deficit widened rapidly and the fall in the current account surplus was only slowed down by the rapid growth of receipts from tourism. Very good employment growth allowed the unemployment rate to fall below 21%, but its decline continues to be hampered by the sharp growth in the labour force. The fall in inflation continued, helped by the evolution of food prices, so that the official objective will probably be achieved (5%, on a twelve-month basis, for the consumer price index by the end of 1987).

The main tendencies observed in 1987 should continue in 1988, by and large; real GDP should grow by approximately 3,75%. Domestic demand is likely to remain buoyant but may slow down a little, with this movement apparent in both consumption and investment. In particular, following the surge in productive investment in 1986/1987, the renewed fall of enterprises' financing capacity may well exert a moderating influence. Exports, moreover, are likely to slow down slightly, notwithstanding some improvement in markets.

The current account surplus will probably go on shrinking and show a moderate deficit (0,5% of GDP) as a result of the buoyancy of imports, which is attributable mainly to the continuing wide difference between the growth of domestic demand in Spain and elsewhere in the Community. Employment growth, while slower, will still be significant at a rate of 1,7%, whereas the unemployment rate is expected to decline only slightly because of the strong growth of the labour force. The disinflation process is likely to continue despite a somewhat faster increase in import prices.

The Governments' economic policy, which has been broadly unchanged since 1983, remains consistent with the guidelines of the cooperative growth strategy for more employment. Its main focus is the elimination of the macroeconomic disequilibria — of which unemployment is clearly the most worrying — and the modernization of the

structures of production, the need for which has grown as Spain is rapidly opening up its economy to the outside world. In the medium term, this policy seeks to achieve average real economic growth of 3,5 to 4% per year, underpinned mainly by buoyant investment and exports, a reduction of the order of half a percentage point of GDP per year in the general government borrowing requirement, and convergence of the rate of inflation towards the Community average. The gap between *per capita* incomes in Spain and the most prosperous countries in the Community could thus go on narrowing.

Major progress was already made in 1986 and 1987 in implementing the growth strategy for more employment, the most positive aspect clearly being the upturn in productive investment. With profit margins being rebuilt and the economic environment improving, businesses have demonstrated their willingness to modernize production equipment and take up the challenge of Community membership, arising not only in the form of the dismantling of barriers as provided for in the Accession Treaty but also in that of the completion of the internal market by 1992. The strong growth in employment was likewise a positive result and confirmation of cyclical buoyancy and renewed business confidence: non-agricultural employment is likely to increase by 3,3% in 1987 and 2,4% in 1988, although much of this will be in the form of part-time or temporary work contracts. With the activity rate and the female labour force participation rate relatively low, the positive employment trend has prompted many 'discouraged workers' to enter the labour market. As a result, the labour force is growing a good deal more rapidly than the population of working age. In the circumstances, employment will need to rise strongly over many years if the level of unemployment is to come down significantly.

Following the breakdown of the social dialogue in early 1987, the Government, in an effort to secure greater industrial peace and rule out the risk of wages getting out of control in the years ahead, took the initiative in the summer of proposing the conclusion of a new social pact for the remaining period of the current Parliament (1988 to 1990). Although conclusion of such a pact has come up against difficulties, consultations as wide-ranging as possible should be held, not only on the evolution of wages and salaries and working conditions, but also on the economic and social strategy for the medium term.

The drive to reduce the general government borrowing requirement should help to cut it from 5,7% of GDP in 1986 to 5,0% in 1987 and 4,9% in 1988. On the revenue side, maintenance of the main direct tax rates and scales in 1987 and greater efficiency in collection will probably produce a significant measure of fiscal drag. On the expenditure side, targets have been widely missed in 1987 despite the

moderation in subsidies to public enterprises. There will therefore have to be effective control of expenditure in 1988 if the general government borrowing requirement is to be reduced and any room created for lower direct taxes and social security contributions. Monetary policy had to deal with some strains in the first half of 1987 as the growth of monetary aggregates was in excess of previously set objectives. This overshooting was due to various factors: strong loan demand from the private sector, higher than expected economic growth, shifts in the portfolio mix towards more liquid assets and, more recently, an upsurge in monetary financing by the public sector as well as an increase in the external counterpart. Following a sharp increase in the spring, the level of short-term interest rates declined a little after the summer, but this still leaves them relatively high. What is more, long-term interest rates have been affected by this movement even though inflationary expectations remain favourable. This means that putting interest rates back on a downward path requires an appropriate mix of budget management and monetary policy geared to disinflation.

For employment to go on improving, there is a need for strong and indeed faster economic growth, with the emphasis on productive investment and exports. Economic policy must give priority to the moderation of wage costs, not only

because of the scale of the imbalances on the labour market but also in order to reduce inflation and improve the competitiveness of the economy. Excessive wage increases would in particular lead to an unduly sharp upsurge in private consumption, sucking in even more imports.

In a medium-term context, the current account balance may well become an increasingly severe constraint: even on an optimistic view of the modernization of the capital stock, domestic supply will for years to come remain insufficient to counteract the combined effects of an increase in the rate of import penetration caused by the buoyancy of the economy and a growth rate of intra-Community trade that is lower than would result from general application of the cooperative strategy for more employment. Imports must therefore be expected to grow more rapidly than exports and the trade deficit to continue to widen. Even if the trend of the balance on invisible transactions is likely to provide partial compensation, the authorities must take care to ensure that the deterioration in net borrowing of the nation does not place an excessive burden on enterprises. The general government deficit must therefore be reduced to a level well below 5% of GDP in 1988 so as to free extra financial resources for strong growth in productive investments.

## Spain: Main economic aggregates 1983 to 1988

(Annual percentage changes)

	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(2)</sup>	1988 <sup>(2)</sup>
Gross domestic product	13,6	13,0	10,9	15,1	10,0	7,9
{ value	1,8	1,9	2,1	3,5	4,1	3,7
{ volume	11,6	10,9	8,6	11,2	5,7	4,1
{ deflator	12,4	10,9	8,3	8,9	5,4	4,2
Private consumption deflator	-2,1	-7,2	0,8	14,1	12,5	9,4
Gross fixed capital formation volume	-5,2	8,5	20,7	2,1	12,5	7,2
{ private	-2,5	-5,1	3,9	11,9	12,5	9,0
{ public	-2,0	-5,4	2,0	6,9	9,4	6,9
{ total	-3,5	-4,6	7,1	20,2	17,0	12,0
of which: construction equipment	0,3	0,0	2,3	6,5	6,2	4,8
Domestic demand at constant prices	-1,2	-2,3	0,5	3,0	3,4	2,5
Gap with respect to other Community countries <sup>(3)</sup>	16,0	10,1	9,9	8,7	6,5	5,3
compensation of employees per head	3,9	-0,7	1,2	-2,3	0,8	1,1
{ nominal	3,2	-0,7	1,4	-0,1	1,0	1,0
{ real A <sup>(4)</sup>	2,8	3,9	3,3	1,5	1,7	1,9
{ B <sup>(4)</sup>	1,0	-4,4	-2,1	-3,7	-0,9	-0,8
Productivity <sup>(5)</sup>	-12,1	0,6	0,2	3,2	0,9	-0,1
Real unit labour costs	-1,0	-2,0	-1,2	2,0	2,4	1,7
Competitiveness <sup>(6)</sup>	18,7	20,7	22,0	21,6	20,8	20,5
Employment	-1,5	1,3	1,7	2,0	0,6	-0,4
Registered unemployed as % of the civilian labour force <sup>(7)</sup>	16,9	16,5	13,4	11,4	12,7	12,3
Current balance as % of GDP	16,0	13,3	12,9	12,2	12,0	10,0
Long-term interest rate						
Money supply <sup>(8)</sup>						
Net lending or borrowing requirement of general government as % of GDP	-4,8	-5,5	-6,7	-5,7	-5,0	-4,9
Public debt as % of GDP	34,5	41,2	46,5	47,3	49,2	51,6
Public debt interest as % of GDP	1,3	2,0	3,4	3,9	3,7	3,7

<sup>(1)</sup> Estimates of the Commission services, September 1987.<sup>(2)</sup> Forecasts of the Commission services, September 1987.<sup>(3)</sup> Differences in percentage points.<sup>(4)</sup> A: GDP deflator; B: private consumption deflator.<sup>(5)</sup> Gross value added per occupied person in the whole economy.<sup>(6)</sup> Effective exchange rate (*vis-à-vis* 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive figure = loss of competitiveness.<sup>(7)</sup> Eurostat definition.<sup>(8)</sup> End of year.



## FRANCE

Given that the international economic environment is turning out less favourable in 1987 than was expected in the autumn of 1986, it has been more difficult to achieve the objectives for growth and employment set by the Government that took office following the elections of March 1986. The growth of gross domestic product, estimated at 1,2% in real terms for 1987 as a whole, was entirely based on the expansion of domestic demand, the external balance making a negative contribution. Despite some downward revision of investment intentions due to the deterioration of the international environment, productive investment was the most dynamic component of demand, expanding considerably in distributive trades and private industry, although it contracted in the large national corporations and in agriculture. As investment by households rose by some 2% in real terms and as general government investment was also up, gross fixed capital formation as a whole rose only slightly less than the 3% recorded last year. Private consumption, on the other hand, lost momentum, mainly because of the slower increase in wage incomes. Thus, the rate of growth of real domestic demand slowed down markedly, from 3,5% in 1986 to 2,2% in 1987.

The rise in consumer prices remained fairly moderate: the annual average rate was virtually unchanged from 1986. The downward pull of import prices was almost imperceptible, but the rise of domestic costs began to slow down.

Assuming no notable change in the real exchange rate, but allowing for a slightly higher expansion of export markets than in 1987, shipments abroad in 1988 should give the French economy a stronger boost. Domestic demand, on the other hand, may only strengthen slightly. The improvement in rates of return will underpin investment in plant and machinery, while residential buildings might continue to increase moderately. On the other hand, even though disinflation is likely to progress in 1988, private consumption will hardly expand by more than 1,7% in real terms since household's incomes, especially overall wage incomes, are rising only modestly.

In view of the fairly high rate of penetration on the French market, imports are likely to progress in parallel with exports. The external balance is unlikely to make much positive contribution to the growth of GDP in real terms, which might stand at about 1,5 to 2%, a rate that does not hold out hope for a reduction in unemployment. Despite the rising trend of prices for oil and other raw materials, the terms of trade may improve somewhat. The balance of payments on current account (national accounts definition) will probably be in equilibrium after a slight deficit in 1987.

The problem of unemployment is still the major concern of the French authorities. Since the middle of 1986, a series of

special measures have been successfully applied, in particular to combat unemployment among young people and long-term unemployment; they include the organization of sandwich courses and exemption from costs for firms recruiting new workers. The system of benefits for long-term jobseekers has been improved through elimination of the hiatus between exhaustion of entitlement to unemployment insurance benefits and eligibility for State benefits.

The macroeconomic conditions for an appreciable increase in employment continue to be fragile, however, since the expansion of activity is still being hampered by the external constraint and is subject to the achievement of greater flexibility in the French economy.

The slowdown in domestic costs deriving from wage restraint and, to a lesser extent, the realignment of January 1987 led to gains in European market shares that partially offset losses on markets outside the Community. It is important to maintain the trend towards real wage moderation in 1988, so that French exports can continue to benefit from an improvement in price competitiveness, and so that the rate of penetration on the French market, in particular for consumer goods, can at least be stabilized.

On the supply side, the authorities have continued their efforts to stimulate the adaptability of the economy. In 1986, their efforts mainly concerned the labour market, e.g. by adaptation of working time arrangements and conditions of dismissal; in 1987, the authorities concentrated on liberalizing capital movements and foreign exchange, and on improving the flexibility of the money market, as well as removing the last remaining price controls. All the measures should contribute to greater adaptability to the changing conditions of demand, and should improve competitiveness. They should be an incentive to more intense investment activity.

The authorities have earmarked about three quarters of the revenue originally expected from privatization for the reimbursement of the public debt; the remaining quarter is to be used as endowment of capital to public-sector enterprises. Receipts in excess of the forecasts, some 20 billion francs, will be distributed on an analogous basis as between debt reimbursement and supply of capital to public enterprises. In this way the financial rehabilitation and the reduction of the level of debt of these enterprises will be brought to an end.

Monetary policy should also contribute to the expansion of productive investment through the reduction in nominal and real interest rates. From 1 January 1987, credit controls were discontinued and replaced by the use of interest rates as the main regulatory factor. Exchange controls were relaxed in several stages. By harmonizing the maturities Treasury bills with those of commercial paper issued by firms (*billets de*

*trésorerie*) and negotiable deposit certificates issued by banks, the authorities have decompartmentalized the market in these securities, thus making it more active. Henceforth, firms' borrowing costs will be determined by conditions on the money market rather than by commercial banks' base rates.

This package of measures can influence the behaviour of the monetary aggregates and establish a more direct link with the interest rates applied on international markets. Thus, following increased demand for certificates of deposit, the growth of M3 has tended in 1987 (figures at end July 1987) to increase faster than the upper limit on the monetary authorities' target range, while M1 and M2 developed more slowly than expected. After a sudden spurt immediately prior to the realignment of 12 January 1987, interest rates subsequently gradually declined.

For 1988, the monetary authorities could choose rates of expansion for the monetary aggregates close to the rate of increase in nominal national income. The favourable development of the inflation rate, which is tending to align itself on that of other Community countries such as Germany and the Netherlands, and the consequent decline in inflationary expectations, could contribute to a sharper decline in both short-term and long-term interest rates. The extent of the decline should be determined in particular by the drain on financial markets exercised by the Treasury: if, as expected, that drain is limited, conditions conducive to a fairly steady reduction in real interest rates would be created.

Control of public finances is vital not only from this point of view but also to contain domestic demand within limits compatible with external equilibrium. The Government's aim is to balance, by 1989, the central government budget net of interest payments, i.e. to achieve a deficit equivalent to about 2% of gross domestic product; budgetary policy intentions for 1988 are consistent with this line. As the Government has also committed itself to reducing the tax burden on firms and households (including the reduction of VAT on certain products) in 1988 by about 30 billion francs (some 0,5% of GDP), the increase in public expenditure will have to be limited to about 2% in cash terms. Savings will be made mainly on operating expenditure and subsidies to public sector firms. The net central government borrowing requirement might thus not exceed FF 115 billion. Moreover, the equilibrium of social security accounts might require further efforts to complement the measures taken in May 1987: an increase in social security contributions and a plan to streamline expenditure on health. As wage moderation and widespread unemployment place a damper on revenue while the rise in benefits continues, further pressure is put on the financial situation of the social security funds.

The stance of the public finances as a whole seems consistent with the requirements of the present situation and outlook. However, if present forecasts for the world economy turned out to be less favourable than currently envisaged, there would be grounds, within the framework of international cooperation, for remaining prepared to reconsider the stance of budgetary policy.

## France: Main economic aggregates 1983 to 1988

(Annual percentage changes)

	1983	1984	1985	1986	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
Gross domestic product	10,5	8,9	7,5	6,9	4,5	4,6
{ value	0,7	1,4	1,7	2,1	1,2	1,9
{ volume	9,7	7,5	5,7	4,8	3,3	2,6
{ deflator	9,7	7,5	5,7	2,5	3,1	2,6
Private consumption deflator	9,7	7,5	5,7	2,5	3,1	2,6
Gross fixed capital formation volume	-3,6	-2,4	0,2	2,1	2,3	2,8
{ private	-3,6	-1,6	6,2	7,6	1,4	2,0
{ public	-3,6	-2,3	1,1	3,0	2,2	2,7
{ total	-2,9	-3,4	0,2	1,4	1,8	2,3
of which: construction	-4,1	-1,4	1,8	4,3	2,5	3,0
equipment	-0,4	0,6	2,2	3,5	2,2	2,0
Domestic demand at constant prices	-0,4	0,6	2,2	3,5	2,2	2,0
Gap with respect to other Community countries <sup>(2)</sup>	-1,7	-1,6	-0,3	0,0	-0,7	-0,5
Compensation of employees per head	10,1	8,6	6,7	4,0	3,0	3,5
{ nominal	0,4	1,0	0,9	-0,8	-0,3	0,9
{ real A <sup>(3)</sup>	0,4	1,0	0,9	1,5	-0,1	0,9
{ B <sup>(3)</sup>	1,3	2,5	2,0	1,7	1,4	1,9
Productivity <sup>(4)</sup>	-0,9	-1,5	-1,1	-2,5	-1,7	-1,0
Real unit labour costs	3,2	16,9	5,8	13,5	1,5	1,5
Rates of return <sup>(5)</sup>	52,2	61,0	64,6	73,3	74,4	75,5
idem (1970 = 100)	-2,9	-2,6	1,7	4,2	-0,5	-1,5
Competitiveness <sup>(6)</sup>	-0,6	-1,0	-0,3	0,3	-0,2	0,0
Employment	8,8	9,9	10,3	10,5	10,7	11,0
Registered unemployed as % of the civilian labour force <sup>(7)</sup>	-0,9	-0,1	0,0	0,6	0,0	0,0
Current balance as % of GDP <sup>(8)</sup>	14,4	13,4	10,9	8,4	9,0	8,5
Long-term interest rate	11,2	8,3	5,6	4,4	6,3	6,0
Money supply <sup>(9)</sup>	-3,2	-2,7	-2,9	-2,9	-2,8	-2,3
Net lending or borrowing requirement of general government as % of GDP	30,7	32,9	35,2	37,0	38,9	40,3
Public debt as % of GDP	2,6	2,8	2,8	2,8	2,8	2,7
Public debt interest as % of GDP						

<sup>(1)</sup> Forecasts of the Commission services.<sup>(2)</sup> Differences in percentage points.<sup>(3)</sup> A: GDP deflator; B: private consumption deflator.<sup>(4)</sup> Gross value added per occupied person in the whole economy.<sup>(5)</sup> Net operating surplus on the net capital stock of current replacement cost.<sup>(6)</sup> Effective exchange rate (*vis-à-vis* 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive figure = loss of competitiveness.<sup>(7)</sup> Eurostat definition.<sup>(8)</sup> On the basis of national accounts definitions. The corresponding figures on the basis of Bank of France definitions (current balance of payments) are as follows:

1981	1982	1983	1984	1985	1986	1987	1988
-0,8	-2,2	-0,9	-0,2	0	0,5	0,0	0,0

<sup>(9)</sup> End of year.

## IRELAND

In *Ireland*, economic recovery is proceeding in 1987 at a slow but steady pace. Despite the appreciable tightening of an already restrictive budgetary stance, real GDP should rise by over 2% this year after zero growth in 1986. Private consumption continues to expand moderately, but aggregate investment has developed unevenly. While reductions in domestic interest rates are supporting investment in plant and equipment, performance in the construction sector remains depressed by falling demand for private housing and reduced public sector activity. On the trade side, export volumes have risen sharply this year and a substantial trade surplus has emerged as imports have developed more slowly. Consumer price inflation is expected to average 3% in 1987, the lowest rate since the 1960's, helped by low import and wholesale prices and the lagged impact of the 1986 oil price reductions. The Irish pound's exchange rate against the currencies of major trading partners has remained stable throughout most of the year, while the significant easing in domestic interest rates is occurring in response to the determined budgetary policy and developments on international money markets. The unemployment rate, however, has continued to edge upwards in the absence of significant growth in total employment.

Economic growth should continue in 1988, albeit at a modest rate in the context of a further sharp budgetary contraction. The slow upward trend in private consumption may continue, while the improvement in business confidence inspired by further progress in reducing the budget deficit should help to stimulate private investment. Continued low price inflation and the likelihood of a sustained reduction in domestic interest rates will help maintain the present level of competitiveness of the export sector and, while import volumes should rise in phase with consumer demand, another healthy trade balance is probable. Growth in GDP is expected to be about 1,25% in real terms in 1988. This may be sufficient to entail some expansion of private sector employment outside of agriculture, which could help to contain the upward drift in the unemployment rate.

The public finances and unemployment are undoubtedly the major structural problems facing the economy. While recent demographic developments, including emigration trends, have offset the strong underlying growth in the labour supply, no significant reduction in unemployment can be expected without sustained growth in employment. This in turn will depend on a stronger performance by the economy in general. The re-establishment of a favourable environment for growth through further budgetary adjustment is thus an essential precondition for progress in reducing unemployment. In addition, to ensure that growth has a high employment content, more attention must be given to the supply side of the economy, where greater flexibility is desirable. Changes in the wage formation process in the early part of this decade have promoted a more flexible and cost-sensitive evolution of wages, but there are other areas of the labour market — working patterns, protective

legislation, administrative costs of employment — which could also be examined. Meanwhile, moderation in wages is essential to protect existing levels of employment. Training and marginal employment schemes remain an important short-term response to the difficulties in the labour market. In the context of vocational training, greater emphasis needs to be given to the development of management and marketing skills in order to support the parallel efforts being made to expand export-based industry and services.

Budgetary policy in 1987 has been characterized by a relatively large fiscal contraction. As a percentage of GDP, the Exchequer Borrowing Requirement is expected to fall by some 2% to under 10%. The Current Budget Deficit should fall by more than 1% of GDP. The adjustment in the public finances is being achieved through cutting or deferring capital expenditure, miscellaneous savings in the provision of services and a tight control on increases in the Exchequer wage bill. Indeed, wage moderation throughout the public sector is a key element of the budgetary strategy as a means to control State expenditure and encourage more moderate wage demands in other sectors of the economy. In this, as in many other areas, budgetary policy has been broadly successful in 1987 and has facilitated a sustained decline in real domestic interest rates, which began the year at over 10% at the short end.

Persistent imbalances in the public finances are imposing a serious constraint on economic growth through high interest rates, heavy taxation and the diversion of public funds into debt-servicing and away from more productive uses, and significant budgetary adjustments are required over a period of years. In October, the Government published its 'Programme for National Recovery' following negotiations with the social partners. The programme extends over a three-year period and reaffirms the Government's commitment to medium-term budgetary adjustment leading to a stabilization in the national debt/GNP ratio during the course of the programme. Stabilization of the public debt/GDP ratio, on the basis of feasible medium-term growth and interest rate assumptions, would require a reduction of the Exchequer Borrowing Requirement to about 5 to 6% of GDP. This implies further substantial real reductions in non-interest expenditure over the coming years.

In 1988, therefore, budgetary policy must continue to be restrictive; it would be appropriate to achieve another staged reduction in the Exchequer Borrowing Requirement of at least one and a half percentage points of GDP from the expected outturn for this year. This stance should be consistent with continued real GDP growth in 1988. This financial constraint precludes any reduction in the overall burden of taxation in 1988, although the budgetary authorities should be considering possible options to widen the tax base and rationalize the tax structure in future years. In deciding on possible cuts in public expenditure, it seems

appropriate to concentrate on those areas where savings are also possible in the medium term. An obvious area for consideration is the Exchequer wage bill. In view of the difficult employment conditions, wage moderation in the economy as a whole is a crucial factor in order to maintain competitiveness and to restore a healthy growth process

sustained by the development of investment and exports. It is essential that the moderation involved in the pay arrangements associated with the Programme for National Recovery should be realized. The expansion of social transfers should also be limited and greater emphasis placed on more effective matching of benefits with needs.

## Ireland: Main economic aggregates 1983 to 1988

(Annual percentage changes)

	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(2)</sup>	1988 <sup>(2)</sup>
Gross domestic product						
{ value	9,7	11,1	6,1	5,4	5,5	4,1
{ volume	-0,6	3,2	1,1	-0,3	2,5	1,3
{ deflator	10,3	7,7	5,0	5,7	2,9	2,7
Private consumption deflator	8,6	9,4	4,5	3,6	3,0	3,2
Gross fixed capital formation volume						
{ private	:	:	4,7	2,0	5,3	6,8
{ public	:	:	-5,2	-8,0	-8,0	-6,5
{ total	-9,0	-2,4	-4,4	-2,3	-0,7	1,0
of which: construction	-14,4	-3,9	-9,6	-5,3	-5,0	-4,1
equipment	-2,3	-0,9	0,9	0,3	3,0	5,0
Domestic demand at constant prices	-2,9	0,2	-1,3	0,8	0,0	0,2
Gap with respect to other Community countries <sup>(3)</sup>	-2,9	-1,7	-3,6	-2,9	-2,8	-2,3
Compensation of employees per head						
{ nominal	11,9	11,8	6,5	6,1	6,1	4,9
{ real A <sup>(4)</sup>	-1,4	3,8	1,4	0,4	3,1	2,1
{ B <sup>(4)</sup>	3,0	2,2	1,9	2,4	3,0	1,6
Productivity <sup>(5)</sup>	0,0	6,2	4,6	0,1	2,8	1,1
Real unit labour costs <sup>(6)</sup>	-0,2	-0,5	-2,3	0,3	0,3	0,9
Competitiveness <sup>(7)</sup>	2,4	-2,2	-0,2	7,4	-2,1	0,8
Employment	-1,9	-1,9	-2,2	-0,4	-0,3	0,2
Registered unemployed as % of the civilian labour force <sup>(8)</sup>	14,9	16,6	17,9	18,4	18,5	18,2
Current balance as % of GDP	-6,3	-5,5	-3,2	-1,8	-1,1	-0,3
Long-term interest rate	13,9	14,6	12,6	11,1	11,3	10,5
Money supply <sup>(9)</sup>	5,6	10,1	5,3	-1,0	9,3	6,4
Net lending or borrowing of general government as % of GDP	-11,8	-9,7	-11,4	-11,2	-10,0	-7,5
Public debt as % of GDP	107,4	113,3	117,9	133,2	136,0	138,0
Public debt interest as % of GDP	9,1	9,6	10,6	10,9	10,3	10,2

<sup>(1)</sup> Estimates of the Commission services, September 1987.<sup>(2)</sup> Forecasts of the Commission services, September 1987, on the basis of present policies.<sup>(3)</sup> Differences in percentage points.<sup>(4)</sup> Deflated by: A = GDP deflator; B = private consumption deflator.<sup>(5)</sup> Gross value added per occupied person in the whole economy.<sup>(6)</sup> Ratio of real wages per head to productivity.<sup>(7)</sup> Effective exchange rate (*vis-à-vis* 19 industrial countries) on the basis of unit labour costs for the whole economy; positive figure = loss of competitiveness.<sup>(8)</sup> Eurostat definition.<sup>(9)</sup> M3; end of year.

## ITALY

In *Italy*, a rapid expansion of domestic demand and imports has resulted in 1987 from the delayed effects of the reverse oil shock, from the wage increases agreed at the beginning of the year within the framework of the three-yearly collective negotiations and from some acceleration in the pace of public expenditure. The strength of demand has exerted downward pressure on the trade balance, leading the authorities, soon after the formation of the new government following the early elections on 15 June, to tighten monetary policy and take a series of tax measures, in order to restrain household consumption and avoid a rekindling of inflationary expectations.

For 1987 as a whole, domestic demand will rise by over 4 %, the real external balance will deteriorate three times as fast as in 1986 — due also to the weakening of exports — and the growth of GDP will be about 3 %. Despite a fairly favourable year for tourism, the surplus achieved last year on current account will to a large extent disappear. The revival in inflation recorded since July is likely to continue for a period following the increases in a range of indirect taxes. Although employment increased once again in the services sector, flat export markets and some worsening in business output prospects held back industrial recruitment, and the unemployment rate continued to rise.

In 1988, some slowing in household disposable income, together with the budgetary and credit measures, should lead to a slightly less rapid growth of domestic demand. However, an acceleration of exports, which are expected to benefit from stronger growth of international markets, should allow the negative contribution to growth from the real foreign balance to be reduced significantly. In total, real GDP should grow by nearly 3 %, only slightly less than in 1987. In these conditions, and assuming no change in the terms of trade, the balance of payments on current account should show only a fairly small deficit. The unemployment rate is unlikely to change much compared with 1987.

Some slowing in inflation during the course of 1988 seems likely because of the inclusion in the new collective agreements of a commitment that no wage increases will be granted beyond those already settled, taking into account also the restrictive nature of monetary policy. The extent of the slowdown in prices is still uncertain, however. The Government's target of 4,5 % inflation on average for 1988 presupposes some deceleration in prices during the year (by about one percentage point from January to December), but this does not appear absolutely guaranteed, given the trend in productivity and the development of the public finances, especially in regard to expenditure.

Indeed, budgetary policy still faces the structural problem inherent in the size of the deficit and the persistent upward trend in the public debt. On the basis of the revised national

accounts <sup>(1)</sup>, the debt/GDP ratio has now reached 90 %. The medium-term plan approved in June 1986 aimed at stabilizing this ratio by 1990, by eliminating the deficit net of interest, without changing the level of taxation, and by keeping debt servicing costs at about 6 % of GDP. This would lead to a reduction of almost half in the Treasury deficit as a percentage of GDP compared with the level reached in 1986, subject to real growth averaging about 3,5 % from now to 1990 and the inflation rate coming down to 3 % from 1988. However, the weaker-than-expected development of economic activity and the trend in real interest rates since the end of 1986 required an updating of these projections. The new macroeconomic framework foresees growth slightly above 3 % per year for the period 1988 to 1990, and a continued reduction in inflation. The objective of bringing the Treasury net borrowing requirement excluding interest payments into balance in 1990 is reaffirmed, which would still imply a small increase in the public debt/GDP ratio by the end of the decade.

This objective appears ambitious, especially in the light of public finance developments in 1987. Whereas the Treasury borrowing requirement should not have been more than Lit 102 000 000 million (10,5 % of GDP) in 1987, the outcome will be closer to Lit 110 000 000 million, due to the faster rate of expenditure caused by, among other factors, the implementation of the new wage agreements. In 1988, the government, in its revised draft budget agreed in November, intends to limit the borrowing requirement to Lit 103 500 000 million, which would reduce the deficit to 9,9 % of GDP, only a little below the initial objective for 1987, and still leave a margin of two and a half percentage points compared with the deficit aimed for in 1990 (about 7,5 % of GDP). The revised budget proposals link reductions in personal income tax (IRPEF) to the achievement of the targeted inflation rate and postpone the VAT increase. Additional revenues are foreseen, especially from increases in certain indirect taxes and through a speeding up in the collection of direct taxes. Nevertheless, substantial spending cuts, mainly to be concentrated on health expenditure, will be necessary to limit the public deficit in 1988. This represents an essential step towards achieving the budget balance targeted for 1990, which is crucial not only for the equilibrium of the public finances but also for the return to lasting monetary stability.

The increasingly restrictive stance of monetary policy in 1987 was made necessary by the brisk acceleration in private sector credit demand and by the overshooting of the budget target. The limits set for growth by the end of the year of the main credit aggregates (6 to 9 % for private sector credit and

<sup>(1)</sup> Revised national accounts published in 1987 raised GDP by 17,7 % in 1986, which automatically reduced the relative size, as a percentage of GDP, of a series of budget indicators (public debt, borrowing requirement, burden of taxation, etc.).

11% for total domestic credit on the basis of a Treasury deficit of Lit 100 000 billion) were exceeded during the first half of the year. The financial market situation continued to tighten during the third quarter, obliging the authorities to raise interest rates on several occasions. These precautionary moves must be seen against the background of the further measures introduced in May to liberalize capital movements, abolishing the compulsory interest-free deposit required on purchases of foreign securities. The Commission was thus able, early in August 1987, to abrogate the authorization granted to Italy under the safeguard clause of Article 108 (3) of the EEC Treaty. However, with capital outflows growing in scale during the summer, and since part of domestic credit seems to have been used for such operations, and also for other short-term transactions, the monetary authorities have recently reintroduced measures restricting bank credit. The potential risks attaching to domestic and external equilibrium make a moderating stance desirable for monetary policy in 1988. It would be advisable to retain indicative rates of expansion for the main aggregates compatible with nominal GDP growth close to 7,5%.

The reform of wage indexation and the wage rises foreseen in the next few years at branch level are liable to encourage a gradual slowdown in prices, providing there are no wage increases other than those already planned; but rapid disinflation seems unlikely without a strong expansion of investment, the only means of durably reducing external dependence and speeding up productivity gains. Business investment should become the key factor in keeping the growth of the Italian economy sufficiently rapid and healthy.

An economic policy stance based on monetary strictness and flexibility of wage adjustments is certainly behind the

favourable results recorded in recent years. With a view to the creation of a single market by 1992, it seems necessary to reinforce internal structures so that the opening of markets can contribute to raising the growth potential. From this point of view, healthier public finances and freedom of capital movements are two priority objectives. The opening of capital markets should enable financial institutions to diversify investment opportunities and to increase the fluidity of financial circuits. The authorities have a special role to play in reinforcing productive capacity; this presupposes an improvement in economic infrastructure, and also a reorganization of public services. In the same context, it would seem desirable to reconsider energy policy options, in view of Italy's strong dependence on imported energy, and of the risk which an increase in the oil bill would bring for the balance of payments.

The defence of the competitive capacity of the Italian economy is the key factor for continued healthy expansion and a reduction in unemployment. Although economic growth has been relatively more satisfactory in Italy over the past few years than in most of the other Community countries, it has been associated, except in 1986, with a considerable positive differential in the growth of domestic demand in relation to the rest of the Community, while the real exchange rate of the lira appreciated up to the beginning of 1987. Monetary and budgetary policies must together contribute to limiting both the rise in costs and the increase in domestic demand to an extent compatible with maintaining external equilibrium. The authorities would obviously have more margin for manoeuvre if joint action taken by the Member States managed to increase intra-Community trade.



## Italy: Main economic aggregates 1983 to 1988

(Annual percentage changes)

	1983	1984	1985	1986	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
Gross domestic product	15,9	14,1	11,8	11,0	8,7	7,6
{ value	0,5	3,5	2,7	2,7	3,0	2,8
{ volume	15,3	10,2	8,9	8,0	5,5	4,7
{ deflator	14,9	11,4	9,3	6,3	4,8	4,9
Private consumption deflator	14,9	11,4	9,3	6,3	4,8	4,9
Gross fixed capital formation volume	:	:	:	:	:	:
{ private	:	:	:	:	:	:
{ public	-1,6	4,4	3,3	1,2	3,5	2,8
{ total	0,8	0,6	-0,5	-0,7	1,0	2,1
of which: construction	-4,2	8,9	7,4	3,1	6,0	3,5
equipment	-0,4	4,4	3,1	3,2	4,5	3,3
Domestic demand at constant prices	-0,4	4,4	3,1	3,2	4,5	3,3
Gap with respect to other Community countries <sup>(2)</sup>	-1,8	3,0	1,1	-0,6	2,0	1,0
Compensation of employees per head	16,0	11,4	10,2	7,7	8,3	6,0
{ nominal	0,6	1,1	1,2	-0,3	2,8	1,3
{ real A <sup>(3)</sup>	1,0	—	0,8	1,4	3,5	1,1
{ B <sup>(3)</sup>	0,1	3,4	1,8	1,9	3,0	2,1
Productivity <sup>(4)</sup>	0,1	3,4	1,8	1,9	3,0	2,1
Real unit labour costs	1,0	-2,6	-0,5	-0,6	0,3	-1,1
Competitiveness <sup>(5)</sup>	11,9	2,0	3,1	10,5	7,2	2,9
Employment	0,5	0,8	1,4	0,8	0,3	0,2
Registered unemployed as % of the civilian labour force <sup>(6)</sup>	10,9	11,9	12,9	13,0	14,2	14,3
Current balance as % of GDP	0,4	-0,6	-0,7	0,8	0,2	0
Long-term interest rate	18,0	14,9	14,3	11,7	10,9	11,6
Money supply <sup>(7)</sup>	13,2	12,1	11,1	9,4	8,9	6,6
Net lending or borrowing requirement of general government as % of GDP	-11,0	-10,8	-12,3	-11,3	-10,4	-10,4
Public debt as % of GDP	72,1	77,7	84,6	88,6	93,6	97,9
Public debt interest as % of GDP	7,5	7,6	8,1	8,5	7,7	7,9

<sup>(1)</sup> Forecasts for the Commission services, September 1987, on the basis of present policies.<sup>(2)</sup> Differences in percentage points.<sup>(3)</sup> A: GDP deflator; B: private consumption deflator.<sup>(4)</sup> Gross value added per occupied person in the whole economy.<sup>(5)</sup> Effective exchange rate (*vis-à-vis* 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive figure = loss of competitiveness.<sup>(6)</sup> Eurostat definition.<sup>(7)</sup> End of year.

## LUXEMBOURG

In *Luxembourg*, economic growth weakened in 1987, and the rate of expansion of gross domestic product in real terms fell to 2%. Households' consumption was boosted by an appreciable increase in their disposable incomes, sustained among other things by tax reductions; but gross fixed capital formation in industry, which had expanded strongly in earlier years, was somewhat hesitant as demand weakened in the steel sector. Slack sales of steel products also led to a smaller rise in total exports. Imports also slowed down. The inflation rate remained moderate thanks to the decline in import prices; the rate of unemployment rose marginally.

In 1988, gross domestic product should grow by about 1,8% in real term. In view of the decline in sales of steel, the increase in total exports will be slow. Although the rise in *per capita* wages should be comparable with that of the previous year, the benefit to households of the tax reductions will be lower, and their disposable income will rise more slowly in real terms than in 1987. Private consumption is consequently expected to expand less rapidly. Corporate investment should continue on the slower trend that began in 1987, and residential constructions should stabilize. The private consumption deflator could speed up markedly as a result of higher import prices. Although the unemployment rate will be little affected by labour shedding in the steel industry, it is not likely to improve.

Economic policy in the Grand Duchy corresponds, from many points of view, to the main thrust of the cooperative growth strategy for more employment. Having served, in the first instance, to reconstitute the financial resources of central government investment funds, the budgetary margin is now being used to reinforce the competitive position of firms, in particular by reducing direct taxation on companies. The cumulative effect of measures of tax-relief on firms and households will reach almost 3,7% of GDP in 1988 without endangering budgetary equilibrium.

On the other hand, wage trends are disturbing, in view of the extreme openness of the Luxembourg economy and the need not only to improve companies' profitability but also to safeguard their competitive position. For the economy as a whole, *per capita* wages increased in real terms by 3,9% in 1987, and forecasts for 1988 point to a probable increase of about 2,0%, well in excess of the simultaneous increase in productivity (0,4% in 1987 and 1,2% in 1988). The accumulation of wage rises and social security charges could put a break on possibilities of economic development in the longer term.

The policy of diversification and of restructuring the productive apparatus has not only made the economy less dependent on the steel industry, but has also enabled the creation of new jobs. Moreover, specific measures such as early retirement schemes have helped to keep the number of unemployed at a very low level. The authorities have developed vocational training and guidance to absorb the persistent hard core of unemployment. Furthermore the authorities intend to set up the legal framework necessary to allow the flexibility of the labour market to be increased subject to the agreement of all the parties involved.

In 1988, general government net lending should be slightly higher than in 1987. The increase in public expenditure will not be able to offset the effects of the weakness of export demand, but the reduction in the direct taxation on businesses, granted under the 1987 and 1988 budgets, will be a further effective aid to the policy of diversifying the economic structure, and the reduction in personal taxation should stimulate consumption. Nevertheless, some caution is still called for in the management of expenditure since social policy measures (early retirement, pensions, public sector wages) are sure to reduce the available budgetary margin.

## Luxembourg: Main economic aggregates 1983 to 1988

(Annual percentage changes)

	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(2)</sup>	1988 <sup>(2)</sup>
Gross domestic product	11,2	12,1	5,5	6,7	4,6	4,0
{ value	3,2	5,5	2,9	2,5	2,0	1,8
{ volume	7,7	6,3	2,5	4,1	2,5	2,2
{ deflator	8,1	6,4	3,3	0,3	0,5	2,3
Private consumption deflator	8,1	6,4	3,3	0,3	0,5	2,3
Gross fixed capital formation volume	-8,0	-0,6	2,6	5,3	2,8	1,2
{ private	-9,0	-3,7	0,6	3,1	2,2	3,2
{ public	-8,3	-1,3	2,1	4,8	2,7	1,7
{ total	-8,6	-3,1	1,2	3,2	3,0	1,8
of which: construction	-7,5	2,5	4,0	7,9	2,0	1,5
equipment	0,5	1,7	0,8	3,7	3,3	2,1
Domestic demand at constant prices	0,5	1,7	0,8	3,7	3,3	2,1
Gap with respect to other Community countries <sup>(3)</sup>	:	:	:	:	:	:
Compensation of employees per head	6,9	7,0	4,1	4,0	4,4	4,2
{ nominal	-0,7	0,7	1,5	-0,2	1,8	1,9
{ real A <sup>(4)</sup>	-1,1	0,5	0,7	3,6	3,9	1,9
{ B <sup>(4)</sup>	3,9	4,6	1,6	0,4	0,4	1,2
Productivity <sup>(5)</sup>	3,9	4,6	1,6	0,4	0,4	1,2
Real unit labour costs	-4,5	-3,7	-0,1	-0,5	1,5	0,7
Employment	-0,4	0,6	1,4	2,4	1,0	0,4
Registered unemployed as % of the civilian labour force <sup>(6)</sup>	1,6	1,7	1,6	1,4	1,5	1,4
Current balance as % of GDP	38,5	38,9	41,9	40,4	38,7	37,8
Long-term interest rate	9,8	10,3	9,5	8,7	(8,2)	:
Money supply <sup>(7)</sup>	:	:	:	:	:	:
Net lending or borrowing requirement of general government as % of GDP	0,2	2,0	4,4	3,9	2,8	3,1
Public debt as % of GDP	14,6	14,6	14,4	14,7	14,7	14,8
Public debt interest as % of GDP	1,0	1,2	1,3	1,3	1,3	1,1

<sup>(1)</sup> Estimates of the Commission services, September 1987.<sup>(2)</sup> Forecasts of the Commission services, September 1987, on the basis of present policies.<sup>(3)</sup> Differences in percentage points.<sup>(4)</sup> A: GDP deflator; B: private consumption deflator.<sup>(5)</sup> Gross value added per occupied person in the whole economy.<sup>(6)</sup> Eurostat definition.<sup>(7)</sup> End of year.

## THE NETHERLANDS

In the Netherlands, the growth of GDP in volume terms slowed down in 1987 to a rate of some 1,7 % notably as a result of weaker domestic demand. As in 1986, private consumption, stimulated by a substantial increase in real personal disposable incomes, expanded by nearly 3 % in volume terms, but public consumption and investment contracted. After rising strongly for a number of years, business investment and especially purchases of plant and machinery fell off appreciably while public investment declined mainly because of the completion of the large water engineering projects. While export sales of natural gas were again down on the level of the previous year, manufactured exports were relatively buoyant in spite of the large appreciation of the guilder in 1986 and 1987. The positive export result was obtained by reducing profit margins.

The number of persons employed grew by 1,4 % in 1987 partly as a result of the expansion of part-time work and unemployment contracted. The trade surplus declined considerably and the balance on current transactions consequently fell from almost 3 % of GDP in 1986 to 1,9 % in 1987.

In 1988, the growth rate of gross domestic product, affected as in 1987 by a declining energy production, is again expected to slow down and should barely reach 1,2 % in real terms. Exports of goods should increase at nearly the same rate as in 1987, but the growth of domestic demand will probably weaken markedly. The increase in personal disposable incomes will hardly reach 1,2 % in real terms, in particular because of the slow rate of rise of wages. Even assuming a fall in the savings ratio by comparison with 1987, private consumption should rise only slowly. Unless there is an appreciable improvement in the external environment, the volume of business investment will barely increase in 1988 and public investment should stagnate. After declining in 1987, consumer prices might rise slightly, as the effects of lower natural gas and import prices gradually fade. Despite a slight deterioration in the terms of trade, the balance of payments surplus on current account should stabilize at the 1987 level. The number of persons employed is expected to increase by about 1 %, partly as a result of the implementation of programmes to promote employment and training, and the extension of part-time working; the unemployment rate should consequently fall to around 11 % of total labour force.

The economic policy stance adopted since the autumn of 1982, which has made possible an appreciable reduction in the public sector deficit, an increase in employment and a more flexibly operating labour market, has been confirmed by the new government which took office in July 1986. The government agreement stresses the need to reduce major imbalances — the budget deficit and the high level of unemployment — without increasing the fiscal burden, and if possible reducing it, and to maintain the purchasing power of

households on the whole. The authorities are aiming to cut the numbers unemployed by 200 000, bringing them down to 500 000 by 1990.

On the budgetary side, the government programme provides for a reduction in the central government deficit from 8 % of net national income in 1987 to 7 % in 1988, 6 % in 1989 and 5,25 % in 1990. In view of the commitment to stabilize the burden of taxes and parafiscal charges, the burden of adjustment will fall mainly on expenditure. Substantial savings will be achieved by freezing social transfer payments, making a substantial reduction in subsidies to the private sector and cutting the numbers employed in the civil service.

The achievement of these aims is based on fairly favourable assumptions for the international environment, a stabilization of the labour income share in GDP between 1986 and 1990 and an increase in employment, expressed in man-years, of over 3 % during the same period accompanied by a reduction in working hours and a spread of part-time work. Any economic outturn which is less favourable than forecast would require an additional effort in order to safeguard the adjustment desired by the authorities.

Since 1983, real progress has been made in the consolidation of public finances, making it possible to reduce the net general government deficit; however, the international environment and the loss of non-tax revenue in 1986 and 1987 imposed a halt on the advance towards the multiannual targets. In 1988, the main thrust of budgetary policy is unlikely to be very different from that applied at present, which is mainly geared to containing expenditure.

Higher than forecast growth in tax revenue led the authorities to reduce the level of taxation on personal income by Fl 1,35 billion for 1988. However, the possibility that expenditure will exceed budget targets has forced the government to impose further cuts in addition to those already planned in the government agreement. The final result is a slight easing of the budget target (the central government deficit will probably be 7,2 % of NNI in 1988 whereas the original target was 7 %, and the comparable deficit for 1987 is 7,6 %). The overshooting remains within acceptable limits, given the weak growth which does not favour efforts to restore healthy public finances. It does, however, imply that expenditure cuts must be somewhat intensified over coming years if multiannual objectives are to be achieved, in view of the steady rise in interest payment on the public debt until 1991.

Central bank management gives high priority to the stability of the parity of the guilder against the German mark. The interest rate differential required to support this aim might gradually narrow if expectations of price rises remain low. The propensity to invest should thus be stimulated. On the

home front, monetary authorities reached an agreement with the banks at the end of 1986 under which the latter will limit creation of liquidity to 11 to 12 % for two years. The targets for increasing the money supply set by the central bank seem appropriate to guarantee an adequate degree of liquidity for the economy, while helping to keep the rate of inflation down.

Budgetary policy, although restrictive, still involves spending considerable resources on suitable training of workers and job creation for younger and older jobseekers. In addition, the decentralization of wage negotiations is continuing, and this will make it possible to adapt wages more closely to sectoral increases in productivity and hence to continue the

overall moderation of real wage increases. The efforts to reduce the rigidity of the labour market operation also include a freeze on the minimum wage, which affects the range of primary incomes and which is important for the evolution of companies' wage costs because of its close link with the average wage. Insofar as the authorities have formally withdrawn from the wage determination process, the development of real labour costs will depend more on market forces and on the attitude of the two sides of industry. By lowering the tax burden on individuals the authorities contribute to the objective of wage moderation. As productivity gains are still low, real wage rises should remain very limited so as to encourage a process of investment-led growth, which started in 1985 and 1986, but which has since tended to weaken once more.

## Netherlands: Main economic aggregates 1983 to 1988

(Annual percentage changes)

	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(2)</sup>	1988 <sup>(2)</sup>
Gross domestic product	3,3	5,0	4,1	3,1	0,7	1,7
{ value	1,4	3,2	2,3	2,4	1,7	1,2
{ volume	1,9	1,8	1,8	0,7	-1,0	0,5
{ deflator	2,7	2,0	2,5	0,2	-0,8	1,0
Private consumption deflator	3,3	5,1	7,4	9,6	3,9	0,8
Gross fixed capital formation volume	-4,6	7,6	-7,7	-8,8	-1,1	0,0
{ private	2,1	5,5	5,1	7,2	3,3	0,7
{ public	-2,6	3,6	-3,1	4,9	2,6	0,5
{ total	10,0	8,2	16,9	9,9	4,1	0,9
of which: construction	1,5	1,7	2,5	3,9	2,3	1,0
equipment	0,4	-0,5	0,2	0,2	-0,3	-1,4
Domestic demand at constant prices	3,2	0,2	1,4	1,6	1,9	1,6
Gap with respect to other Community countries <sup>(3)</sup>	1,3	-1,5	-0,4	0,8	3,0	1,1
Compensation of employees per head	0,4	-1,7	-1,1	1,4	2,7	0,6
{ nominal	3,4	3,2	1,0	0,6	0,8	1,0
{ real A <sup>(4)</sup>	-2,0	-4,6	-1,3	0,2	2,1	0,1
{ B <sup>(4)</sup>	-2,8	-7,0	-2,6	5,8	2,7	-0,7
Productivity <sup>(5)</sup>	-1,9	-0,1	1,3	1,8	0,9	0,2
Real unit labour costs	14,0	14,3	13,1	12,1	11,4	11,0
Competitiveness <sup>(6)</sup>	3,1	4,2	4,3	2,8	1,9	1,8
Employment	8,8	8,6	7,3	6,4	6,3	6,4
Registered unemployed as % of the civilian labour force <sup>(7)</sup>	10,5	7,7	10,5	4,4	3,5	5,5
Current balance as % of GDP	-6,4	-6,3	-4,7	-4,7	-5,6	-5,9
Long-term interest rate	61,9	66,4	69,9	73,0	79,3	85,2
Money supply <sup>(8)</sup>	5,7	5,9	6,0	6,0	6,0	5,9
Net lending or borrowing requirement of general government as % of GDP						
Public debt as % of GDP						
Public debt interest as % of GDP						

<sup>(1)</sup> Estimates of the Commission services, September 1987.<sup>(2)</sup> Forecasts of the Commission services, September 1987, on the basis of present policies.<sup>(3)</sup> Differences in percentage points.<sup>(4)</sup> A = GDP deflator; B = private consumption deflator.<sup>(5)</sup> Gross value added per occupied person in the whole economy.<sup>(6)</sup> Effective exchange rate (*vis-à-vis* 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive figure = loss of competitiveness.<sup>(7)</sup> Eurostat definition.<sup>(8)</sup> End of year.

## PORTUGAL

The upturn in economic activity that started in 1985 has continued since, underpinned by the brisk recovery of domestic demand. However, following a marked increase in 1986 (+ 4,3 %), real GDP <sup>(1)</sup> is likely to increase slightly less in 1987 (3,75 %). This slowdown is due exclusively to the increased contractionary effect exerted by the external balance and the slower rate of stock building. Private consumption, by contrast, maintained its vigorous rise as part of a catching-up process, while investment growth accelerated appreciably, spurred in particular by the effects of the country's accession to the Community. The improvement in employment strengthened and the unemployment rate fell significantly (from 8,6 % in 1986 to 7,2 % in 1987). At the same time, inflation showed a clear slowdown even though it still diverged markedly from rates in the other member countries. The external surplus went down significantly following the recovery in 1985 and 1986.

Under the impact of an appreciable deceleration in domestic demand and despite good export performance, the growth in real GDP <sup>(1)</sup> should be close to 3 % in 1988. The improvement in employment is expected to be less strong leading to a significantly slower reduction of unemployment. In line with the authorities' objectives, major progress will again be made in bringing down inflation. The balance of payments on current account will probably deteriorate further and should, for the first time since 1984, close with a deficit (of the order of 1 % of GDP).

The differential between the growth rate of Portugal's domestic demand and that in the other member countries, while smaller than in previous years, will still be substantial in 1988. Admittedly, this is justified by the need to make further progress on reducing Portugal's structural deficiencies through a sustained recovery in the investment ratio, which is still a good deal lower than the level recorded until the beginning of the 1980s. However, in view of the uncertainties surrounding the external environment and because of the Portuguese economy's heavy dependence on oil imports and its increasing openness, such a trend carries risks for current payments. Application of the programme for the structural correction of the external deficit and unemployment (PCEDED), adopted in March and confirmed at the end of August when the new government announced its programme to Parliament, will allow the avoidance of these risks, all the more so as the envisaged policies are largely in line with the Community's cooperative strategy for growth and employment.

Marked progress has already been made towards improving the conditions of demand and supply. The policy of planned depreciation of the escudo and wage policy in particular have

been made to serve greater nominal convergence with the other member countries. Since July 1986 a permanent Council for social dialogue has been playing an active role in this field. Adjustment measures in the fields of taxation and the modernization of financial markets are supporting the investment drive. The Community for its part is continuing to make a significant contribution in order to promote greater real convergence and a reduction in the gap between Portugal's level of development and that in the other Member States. The relative share of the Community's structural Funds and financial instruments in Portugal's gross domestic products thus reached more than 2,8 % in 1986. Overall, however, the recent beginning of the process of convergence, both real and nominal, remains insufficient and fragile. This process must therefore be actively continued and indeed strengthened.

Budgetary policy has a particularly important role to play in this context. The reduction in the general government borrowing requirement achieved in 1985 was continued by the authorities in 1986 thanks in particular to taxes on oil products and the introduction of VAT. However, the trend of the central government's budget for 1987 reveals the need for an accompanying rigour in order to achieve the tax receipts projected in the budget, particularly as regards value added tax. The objective of a reduction in the medium term of the central government borrowing requirement, which was set for the first time in 1987 and involves cutting it from 8,8 % of GDP in 1987 to less than 5 % of GDP as from 1990/1991, will not be achieved without a continuous drive to contain operating expenditure, a reduction in transfer payments, notably to enterprises in the competitive sector, and a widening of the tax base. A rapid implementation of the tax reform would play a positive role in this context. In the absence of tangible results in this field, the policy of improvement of infrastructure and, more generally, the required contribution from budgetary policy to increasing the country's investment ratio, improving vocational training and making appropriate use of human capital will be placed in jeopardy. This would be particularly so if, failing a sufficient reduction in the public deficit in 1988, the external account deteriorated at an excessive pace, requiring a return to restrictive policies which, until the recent past, hampered the country's growth process and the scope for bringing down agricultural underemployment.

Achievement of the budgetary objective is essential if the task of monetary policy is to be eased both domestically, especially as regards the necessary moderation in growth of the monetary aggregates, and from the point of view of exchange-rate performance. Only on this condition will it be possible to continue reducing inflationary expectations and maintaining the downward movement of interest rates. Fresh progress on modernizing financial channels would also be helpful.

By influencing inflationary expectations and the evolution of production costs, continued pursuit of the active policy of social dialogue makes an essential contribution to the

<sup>(1)</sup> At 1985 prices. Calculated on the basis of the previous year's prices, growth would be 5,2 % in 1987 and 4,2 % in 1988.

balanced and sustained expansion that is necessary if the Portuguese economy is to succeed in becoming progressively integrated into the Community. In particular, there is a need for the consensus on the 6 % inflation rate aimed at for 1988 to be maintained and effectively taken into account in wage negotiations for next year.

The conclusion is that the various measures necessary for achieving the authorities' macroeconomic objectives must be implemented energetically. Only on this condition will it be possible to maintain satisfactory growth, both quantitative and qualitative, and to bring inflation down progressively to a rate close to the Community average.



## Portugal: Main economic aggregates 1983 to 1988

(Annual percentage changes)

	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(2)</sup>	1988 <sup>(2)</sup>
Gross domestic product	23,7	23,4	25,9	23,1	15,3	10,5
{ value	-0,3	-1,7	3,7	4,3	3,7	3,0
{ volume	24,1	25,6	21,3	18,0	11,2	7,3
{ deflator	25,5	29,3	19,3	12,1	9,3	6,5
Private consumption deflator <sup>(3)</sup>	:	:	:	:	:	:
Gross fixed capital formation volume	:	:	:	:	:	:
{ private	-7,5	-18,0	-1,8	9,9	14,6	10,5
{ public	-3,0	-13,5	-4,0	4,7	9,5	9,0
{ total	-13,1	-23,0	1,0	16,0	20,0	12,0
of which: construction equipment	-7,0	-7,0	0,6	8,5	8,3	5,0
Domestic demand at constant prices	-8,7	-8,4	-1,7	4,3	5,1	2,4
Gap with respect to other Community countries <sup>(4)</sup>	21,6	19,8	22,0	16,7	11,9	8,5
Compensation of employees per head	-2,0	-4,6	0,6	-1,1	0,6	1,1
{ nominal	-3,1	-7,4	2,2	4,1	2,4	1,9
{ real A <sup>(5)</sup>	1,4	-0,4	4,2	4,0	1,3	1,9
{ B <sup>(5)</sup>	-3,4	-4,2	-3,6	-4,9	-0,6	-0,8
Productivity <sup>(6)</sup>	-8,3	-4,9	-1,2	1,2	-0,2	-1,2
Real unit labour costs	-1,7	-1,3	-0,5	0,2	2,3	1,0
Competitiveness <sup>(7)</sup>	7,9	8,5	8,7	8,6	7,2	6,8
Employment	-7,2	-3,0	1,7	3,9	1,4	-1,0
Registered unemployed as % of the civilian labour force <sup>(8)</sup>	30,3	32,5	25,4	17,9	15,1	14,3
Current balance as % of GDP	16,3	24,7	29,1	25,7	17,0	13,0
Long-term interest rate	10,4	13,3	11,0	9,2	9,4	8,3
Money supply <sup>(9)</sup>	9,1	12,0	10,0	8,2	8,8	7,8
Net lending or borrowing requirement of general government as % of GDP	56,2	61,2	64,8	67,1	71,8	78,5
Public debt as % of GDP	6,4	7,1	7,8	9,3	8,1	7,2
Public debt interest as % of GDP						

<sup>(1)</sup> Estimates of the Commission services, September 1987.<sup>(2)</sup> Forecasts of the Commission services, September 1987.<sup>(3)</sup> Series different from the official retail price index.<sup>(4)</sup> Differences in percentage points.<sup>(5)</sup> A: GDP deflator; B: private consumption deflator.<sup>(6)</sup> Gross value added per occupied person in the whole economy.<sup>(7)</sup> Effective exchange rate (*vis-à-vis* 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive figure = loss of competitiveness.<sup>(8)</sup> Eurostat definition.<sup>(9)</sup> End of year.<sup>(10)</sup> A: Including loans, advances and equities; B: excluding loans, advances and equities.

## UNITED KINGDOM

In the *United Kingdom*, the expansion of economic activity, which has been under way without interruption since 1981, has gained strength since mid-1986, and the growth of real GDP in 1987 is expected to be about 3,5 %. Registered unemployment has shown a clear downward trend since the middle of 1986, and employment has begun to rise more rapidly again. Although the sharp fall in inflation last year has been partially reversed, the twelve-month rate of retail price inflation has risen only slightly during the course of 1987, remaining close to 4 %. The current account has weakened to a lesser extent than earlier seemed likely, despite a deterioration of over 3 % in the terms of trade during 1986 and 1987.

In 1987, growth has been assisted by stronger supply-side performance and also by the fall in the effective exchange rate, which increased the price competitiveness of the economy. Weak export market growth has thus been felt less in the United Kingdom than in countries with appreciating currencies. Exports picked up sharply in the latter part of 1986 and have remained at a high level throughout the current year, despite the 5 % appreciation of sterling in the months up to the June general election. In addition, subdued imports in the early part of 1987 suggest some import substitution and an improved supply response from the economy.

Private consumption, though no longer making the dominant contribution to growth, has continued to develop vigorously in 1987. Higher inflation and a steadying of the savings ratio after its fall last year have only partly offset the boost to consumption coming from rapid growth in nominal earnings and other personal incomes, and from the reduction in the basic rate of income tax to 27 % in the March Budget. Overall, business and consumer confidence has tended to strengthen and a pick-up has begun in business investment, particularly in manufacturing, after a period of sluggishness since 1985 which partly reflected changes in the corporation tax system. The upward pressure on sterling in the first half of the year enabled bank base rates to be reduced by a cumulative two percentage points, giving further support to domestic demand, although this movement was partly reversed in August as a result both of some temporary weakening of sterling and of strong credit demand.

In 1988, developments should remain positive, given a relatively encouraging world outlook. Another strong rise in private consumption is likely, particularly if, as expected, the inflation rate steadies and there is a further reduction in the basic rate of income tax. Growth in fixed investment should become more marked. Export volumes may, however, rise more slowly, implying some deterioration in the current balance. In total, real GDP is forecast to rise by about 2,5 %, somewhat slower than in 1987.

The expansion of activity has begun to have an increasingly large impact on the unemployment figures. Around one and a quarter million new jobs have been created since the trough in employment in 1983. Employment growth has strengthened in recent quarters particularly, with a strong increase in male employees at the start of 1987. Until recently, the composition of employment growth has been such as to reduce the impact of rising employment on the unemployment total, but the downward trend in unemployment has now been firmly established, and in large part appears attributable to the strong growth of the economy. The government's employment and training programmes also contributed to increased employment and reduced unemployment. In recent months they covered almost 400 000 persons, slightly more than a year earlier.

The unemployment rate is still about 10 % and the continued rapid rise in *per capita* earnings and unit labour costs is worrying. Towards the end of 1986 there was some moderation in the level of wage settlements but, because of a rise in overtime working, this did not show up in the underlying rate of increase in average earnings, which has continued almost unchanged at close to 7,5 % since 1983. Indeed, the size of pay settlements seems to have begun to increase again recently. Apart from a recession-induced decline at the beginning of the 1980's, real wages have risen strongly in the current decade, but, at the same time, there has been a significant recovery in profitability achieved through substantial productivity gains, particularly in manufacturing. The capital stock has been rising only slowly in recent years. With more firms reporting capacity constraints and unemployment still very high, an appreciable extension of productive investment is doubly necessary. In this regard, the recent clear signs of a pick-up in business investment are encouraging.

In 1986, as the oil price fell and the strong expansion of private consumption pulled in imports, there was a marked deterioration in the visible trade balance. Improved competitiveness temporarily helped to stabilize the position in the first half of 1987, but some further deterioration is now likely as imports pick up again on response to growth in final demand and as domestic production of oil gradually declines in the medium term. To limit the deterioration requires that the supply response of the economy be sustained and improved; this in turn depends on maintaining competitiveness through achieving changes in unit labour costs in line with those of the United Kingdom main competitors and keeping the exchange rate stable, and on a steady expansion of the productive capacity of the economy. On the invisibles account, the income stream from the growing stock of foreign assets has risen in value. While the strong growth in net factor income recorded in 1986 is unlikely to be sustained over the medium term, invisible

earnings should be sufficient to offset much of the deficit on visible trade this year and to make a substantial contribution in subsequent years to holding the current account deficit within limits which do not place a major constraint on growth.

Considerable progress has been made in achieving the budgetary objectives set within the framework of the Medium-Term Financial Strategy. The buoyancy of non-oil revenues and the acceleration of the privatization programme enabled the long-term objective of bringing the public sector borrowing requirement down to 1 % of GDP to be achieved ahead of schedule in the financial year 1986/1987. With borrowing at a low level, the policy emphasis has now switched to using the room created by strict control of expenditure to reduce the burden of taxation further when it is prudent to do so (with a cut in the basic rate of income tax to 25 % as one specific goal). In the current financial year, 1987/1988, the Government's latest forecast is for a PSBR of £ 1 billion (0,25 % of GDP), compared to the budget projection of £ 4 billion (1 % of GDP). This reflects both higher tax revenue, mainly as a result of faster than expected real economic growth, and lower spending. The PSBR therefore appears to be heading for a third successive year of significant undershooting of Budget plans.

In regard to monetary policy, only the narrow money measure M0 now has target status. The information content of the broader aggregates about the growth of nominal income has become blurred by the effects of deregulation and innovation in financial markets. Even so, the authorities have made it clear that the behaviour of liquidity is a key factor to be taken into account in assessing monetary conditions. The rapid growth in M3 this year, although partly explained by extensive Bank of England intervention to hold down the rise of sterling in the first half of the year, may suggest too rapid an expansion of personal sector credit, and needs to be kept under review. For many years, the objective of monetary policy has been to attain a balance between domestic monetary conditions and the exchange rate which will place a steady downward pressure on inflation. An increased emphasis does, however, appear to have been given to the exchange rate as an indicator of monetary conditions. The authorities accepted a significant downward adjustment in the exchange rate during 1986 following the fall in the oil price, and managed this relatively smoothly from the interest rate point of view. After the Louvre Agreement in February 1987 the Chancellor of the Exchequer stated that a period of stability for sterling and other exchange rates would be desirable, and, helped by a judicious mixture of intervention and interest rate changes, the sterling/DM cross rate has remained within a relatively narrow range.

The Government continues to press ahead with structural policies designed to promote the functioning and flexible operation of markets. In regard to the financial markets, a wide range of legislative and other controls has been abolished since 1979. At present, a key concern in this regard is how an adequate level of surveillance can be maintained consonant with deregulation. Other supply-side measures include reductions in the basic rate of income tax, tax incentives to promote profit-related pay, extensive employment and training measures, help for small firms which are seen as an important engine of growth, trade union reform, and a considerable expansion of the privatization programme.

In 1988 and subsequent years, a main task is to ensure that the improvement in labour market conditions now under way is sustained and strengthened. Bearing in mind that the growth in employment has been stronger in some regions than others and that pockets of high unemployment persist, the Commission's view is that a possible option might be for the authorities to consider using some of the scope available for tax cuts in the next financial year for targeted action in the high unemployment areas, perhaps through reductions in taxes affecting the cost of employment, in order to stimulate the creation of new jobs and to attract investment to these areas. A drive to improve the level and effectiveness of vocational training in these regions would also be a prudent step in view of worries about skill shortages in the economy. In this context, it would also be desirable to promote labour mobility by taking appropriate measures to make available sufficient reasonably priced accommodation, especially in the South East where activity is strongest; the shortage of such accommodation at present is a disincentive to mobility. The authorities have recently placed more emphasis on the need to rehabilitate decayed inner city areas, through a better coordination of existing public programmes and private sector initiative. This could be a suitable opportunity for some judiciously chosen increases in capital expenditure in these areas, particularly on infrastructural repairs.

While a better regional differentiation of real wages would be desirable, there is a more pressing need to moderate the level of wage increases generally in the economy if competitiveness is to be maintained and satisfactory employment growth sustained. The Government does not favour the use of an incomes policy as it would be inconsistent with its goals of freeing markets and encouraging greater wage differentiation. Tight control on public sector wage settlements is, however, an important means of influencing wage trends in the wider economy. An extended period of exchange rate stability, which would be reinforced by full entry of the United Kingdom into the European Monetary System, could also in due course exercise a moderating effect

on wages by influencing inflationary expectations. At the same time, renewed efforts to achieve comprehensive reforms in the structure of personal taxation and social security are desirable, in spite of the lukewarm reception

given to the recent green paper, not only in order to strengthen incentives and to reduce poverty and unemployment traps, but also to help in achieving wage moderation.

(Annual percentage changes)

	1983	1984	1985	1986	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
Gross domestic product <sup>(2)</sup> { value	8,9	6,4	9,9	6,5	7,4	7,6
volume	3,6	2,0	3,7	2,9	3,2	2,7
deflator	5,2	4,3	5,9	3,5	4,0	4,7
Private consumption deflator	5,0	4,7	5,2	3,6	3,0	3,9
Gross fixed capital formation volume { private	2,7	8,6	4,1	-0,5	4,7	3,8
public	36,6	11,9	-3,1	4,4	-2,5	3,7
total	5,2	8,2	3,1	0,3	3,8	3,9
of which: construction	7,3	7,9	-3,2	4,3	3,5	4,0
equipment	4,2	10,3	8,1	-4,0	4,2	3,7
Domestic demand at constant prices	4,5	2,7	2,9	3,8	3,2	3,3
Cap with respect to other Community countries <sup>(3)</sup>	4,2	1,0	0,8	0,0	0,6	1,2
Compensation of employees per head { nominal	9,1	5,1	7,3	7,2	6,8	6,6
real A <sup>(4)</sup>	3,7	0,8	1,3	3,6	2,7	1,8
B <sup>(4)</sup>	3,9	0,4	2,0	3,5	3,7	2,6
Productivity <sup>(5)</sup>	4,7	0,2	2,4	2,3	1,8	1,8
Real unit labour costs <sup>(6)</sup>	-1,0	0,6	-1,1	1,3	0,9	0,0
Profitability <sup>(7)</sup>	9,9	0,7	2,2	-1,4	-1,5	-1,8
<i>idem</i> (1970 = 100)	84,7	85,3	87,1	85,9	84,7	83,1
Competitiveness <sup>(8)</sup>	-7,6	-2,9	1,1	-5,3	-0,3	3,0
Employment	-0,8	1,7	1,5	0,6	1,4	0,9
Registered unemployed as % of the civilian labour force <sup>(9)</sup>	11,6	11,8	12,0	12,1	11,0	10,4
Current balance as % of GDP	1,0	0,4	0,8	-0,3	-0,5	-0,8
Long-term interest rate	10,8	10,7	10,6	9,8	9,3	9,5
Money supply <sup>(10)</sup>	10,3	9,8	13,1	18,9	21,7	11,9
Net lending or borrowing of general government as % of GDP	-3,6	-3,9	-2,9	-2,7	-2,0	-2,0
Public debt as % of GDP <sup>(11)</sup>	57,5	59,3	57,5	57,6	56,2	54,1
Public debt interest as % of GDP	4,7	4,9	5,0	4,5	4,3	4,1

(11) General government gross debt at market values.

## STATISTICAL ANNEX

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TABLE 1  
Summary of main macroeconomic aggregates by country (1960 to 1988)

## (a) Real GDP

(percentage change per annum)

	1973/1960	1980/1973	1981	1982	1983	1984	1985	1986 (1)	1987 (1)	1988 (1)
B	4,9	2,5	-1,5	1,9	-0,3	1,7	1,5	2,3	1,3	1,8
DK	4,3	1,6	-0,9	3,0	2,5	3,5	3,9	3,4	-0,2	0,9
D	4,4	2,2	0,2	-0,6	1,5	2,7	2,6	2,6	1,4	1,9
GR	7,7	3,4	-0,3	-0,2	0,4	2,8	2,1	1,3	-0,8	0,5
E	7,3	2,4	-0,2	1,2	1,8	1,9	2,2	3,5	4,1	3,7
F	5,6	2,8	0,5	1,8	0,7	1,5	1,1	2,0	1,2	1,9
IRL	4,4	4,4	3,4	1,4	-1,9	4,2	2,0	-0,3	2,5	1,3
I	5,3	2,8	1,1	0,2	0,5	3,5	2,7	2,7	3,0	2,8
L	4,1	1,5	-1,0	1,5	3,2	5,5	2,9	2,5	2,0	1,8
NL	4,8	2,4	-0,7	-1,4	1,4	2,4	1,7	2,4	1,7	1,2
P	6,9	3,3	0,5	3,2	-0,3	-1,6	3,3	4,3	3,7	3,0
UK	3,1	0,9	-1,2	1,0	3,8	2,2	3,7	2,9	3,2	2,7
EUR 12	4,8	2,3	0,0	0,6	1,5	2,4	2,5	2,6	2,2	2,3
USA	3,9	2,1	2,1	-2,5	3,4	6,6	2,9	2,9	2,3	2,7
Japan	9,6	3,7	3,9	2,8	3,2	5,0	4,5	2,4	2,9	3,5

## (b) Real final domestic demand including stocks

(percentage change per annum)

	1973/1960	1980/1973	1981	1982	1983	1984	1985	1986 (1)	1987 (1)	1988 (1)
B	4,8	2,6	-4,3	0,4	-2,5	1,8	1,2	3,4	1,6	1,7
DK	4,6	0,7	-4,1	3,5	1,4	4,1	5,4	5,7	-1,9	-0,7
D	4,5	2,3	-2,6	-2,0	2,3	1,9	1,5	3,7	2,5	2,3
GR	8,2	2,1	1,8	2,9	0,8	-0,4	5,3	-0,3	-0,6	0,3
E	7,8	2,2	-2,3	1,1	-0,1	-0,5	2,7	6,5	6,2	4,8
F	5,8	2,9	-0,3	3,7	-0,4	0,6	1,9	3,5	2,2	2,0
IRL	5,4	3,6	3,0	-2,9	-4,1	1,0	-0,4	0,8	0,0	0,2
I	5,5	2,5	-1,2	0,3	-0,5	4,5	3,2	3,2	4,5	3,3
L	3,9	2,1	0,7	0,4	0,5	1,7	0,8	3,8	3,3	2,1
NL	4,9	2,4	-4,6	-0,9	1,5	1,4	2,2	3,9	2,3	1,0
P	7,5	2,8	2,5	3,4	-7,4	-6,6	0,5	8,5	8,3	5,0
UK	3,2	0,4	-1,7	2,1	4,7	2,8	2,8	3,8	3,2	3,3
EUR 12	5,0	2,1	-1,7	0,9	1,0	1,9	2,4	3,8	3,2	2,7
USA	4,0	1,8	2,8	-1,5	5,1	8,6	3,4	3,9	1,7	2,0
Japan	9,9	2,7	2,1	2,8	1,8	3,8	3,6	4,0	3,9	4,1



## (c) Balance of current transactions with the rest of the world

(percentage of GDP)

	1973/1960	1980/1973	1981	1982	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
B	1,0	-1,4	-4,6	-3,3	-0,5	-0,4	0,5	2,4	2,3	2,3
DK	-1,9	-3,5	-3,0	-4,2	-2,6	-3,5	-4,6	-5,1	-2,9	-2,2
D	0,8	1,0	-0,5	0,5	0,6	1,1	2,2	4,1	3,7	3,2
GR	-2,9	-1,8	-0,7	-4,4	-5,1	-4,1	-8,3	-5,4	-4,2	-4,1
E	0,1	-1,9	-2,7	-2,5	-1,5	1,3	1,7	2,0	0,6	-0,4
F	0,3	-0,8	-1,4	-3,0	-1,7	-0,8	-0,8	0,6	-0,0	0,0
IRL	-2,3	-7,7	-14,7	-10,6	-7,0	-6,1	-3,8	-1,8	-1,1	-0,3
I	1,4	-0,5	-2,2	-1,6	0,3	-0,6	-0,9	0,8	0,2	0,0
L	7,0	20,7	23,0	35,2	38,5	38,9	42,4	40,4	38,7	37,8
NL	0,7	0,8	2,2	3,2	3,1	4,1	4,3	2,8	1,9	1,8
P	0,1	-6,1	-11,8	-12,7	-6,3	-1,9	3,0	3,9	1,4	-1,0
UK	-0,1	-0,9	2,3	1,2	0,7	-0,3	1,0	-0,3	-0,5	-0,8
EUR 12	0,4	-0,4	-1,0	-1,1	-0,2	0,1	0,6	1,5	1,1	0,8
USA	0,5	0,3	0,3	-0,0	-1,0	-2,4	-2,9	-3,3	-3,5	-3,1
Japan	0,5	0,1	0,5	0,7	1,8	2,8	3,7	4,5	3,8	3,3

## (d) Private consumption deflator

(percentage change per annum)

	1973/1960	1980/1973	1981	1982	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
B	3,7	7,8	8,0	7,3	7,5	6,2	4,8	1,3	1,8	2,5
DK	6,6	10,8	12,0	10,2	6,8	6,5	4,8	3,6	4,1	4,0
D	3,6	4,9	6,0	4,7	3,2	2,4	2,1	-0,5	0,6	1,8
GR	3,5	16,0	23,4	20,8	17,9	18,4	18,6	22,1	16,0	12,0
E	6,7	17,8	14,3	14,5	12,3	10,7	8,3	8,9	5,4	4,2
F	4,7	10,8	12,8	11,2	9,5	7,2	5,5	2,5	3,1	2,6
IRL	6,0	16,1	19,6	15,9	10,0	7,5	4,2	3,6	3,0	3,2
I	4,8	17,6	17,9	15,9	14,8	11,4	9,3	6,3	4,8	4,9
L	3,1	7,4	8,7	10,8	8,1	6,4	3,3	0,3	0,5	2,3
NL	5,0	7,2	6,3	5,3	2,7	2,5	2,6	0,1	-0,8	1,0
P	3,4	22,0	18,3	22,5	25,5	29,3	19,0	12,1	9,3	6,5
UK	4,8	15,7	11,4	8,7	5,0	4,8	5,2	3,6	3,0	3,9
EUR 12	4,6	12,3	12,0	10,4	8,5	7,0	5,9	3,7	3,2	3,4
USA	3,1	8,0	8,7	5,8	4,0	3,9	3,3	2,2	4,1	4,9
Japan	6,2	9,0	4,4	2,6	1,9	2,1	2,2	0,7	0,2	1,5

## (e) Total Employment

(percentage change per annum)

	1973/1960	1980/1973	1981	1982	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
B	0,6	0,1	-2,0	-1,3	-1,1	0,0	0,8	1,0	0,1	0,2
DK	1,1	0,4	-1,3	0,4	0,3	1,5	2,8	2,0	0,8	-0,1
D	0,2	-0,3	-0,7	-1,7	-1,5	0,1	0,7	1,0	0,6	0,3
GR	-0,5	0,8	4,9	-0,8	1,1	0,3	1,0	0,3	-1,0	0,3
E	0,8	-1,3	-3,0	-1,0	-0,8	-3,0	-1,0	2,0	2,4	1,7
F	0,7	0,3	-0,6	0,1	-0,4	-0,9	-0,3	0,3	-0,2	-0,0
IRL	0,1	1,2	-0,9	0,1	-2,2	-1,6	-2,8	-0,4	-0,3	0,2
I	-0,4	0,8	-0,0	0,6	0,5	0,8	1,4	0,6	0,6	0,8
L	1,1	0,6	0,3	-0,3	-0,3	0,6	1,4	2,4	1,0	0,4
NL	0,9	0,3	-1,5	-2,5	-1,9	-0,4	1,1	1,8	0,9	0,2
P	-0,5	0,3	1,2	-0,4	4,3	-1,5	0,3	0,2	2,3	1,0
UK	0,3	0,1	-3,9	-1,8	-1,2	2,0	1,3	0,6	1,4	0,9
EUR 12	0,3	0,1	-1,3	-0,8	-0,5	0,1	0,6	0,8	0,8	0,6
USA	1,9	2,0	0,9	-0,5	1,0	4,8	2,4	2,3	2,5	1,9
Japan	1,3	0,7	0,8	1,0	1,7	0,6	0,7	0,8	0,8	1,0

(f) Unemployment rate <sup>(2)</sup>

(percentage of the civilian labour force)

	1973/1960	1980/1973	1981	1982	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
B	2,4	6,8	11,1	13,0	14,3	14,4	13,6	12,6	12,4	12,1
DK	1,2	5,5	8,7	9,3	10,1	9,9	8,7	7,6	7,7	8,6
D	0,9	3,6	4,8	6,9	8,4	8,4	8,4	8,1	8,1	8,3
GR	:	:	4,2	5,8	7,8	8,1	7,8	7,4	7,4	7,5
E	:	:	14,4	16,2	17,7	20,6	21,9	21,5	20,7	20,3
F	1,1	4,7	7,7	8,7	8,9	10,0	10,5	11,1	11,3	11,7
IRL	5,1	8,1	10,2	12,3	14,9	16,6	17,9	18,4	18,5	18,2
I	5,7	5,9	8,1	9,7	11,0	12,0	12,9	13,0	14,2	14,3
L	0,1	0,4	1,0	1,3	1,6	1,8	1,7	1,4	1,5	1,4
NL	1,4	5,3	8,8	11,8	14,2	14,5	13,3	12,1	11,4	10,9
P	:	:	:	:	:	8,5	8,6	8,6	7,2	6,8
UK	2,2	4,5	9,1	10,6	11,6	11,8	12,0	12,1	11,0	10,4
EUR 12	:	:	:	:	:	11,7	12,1	11,9	11,8	11,7
EUR 9	2,2	5,1	7,7	9,3	10,4	10,9	11,1	:	:	:
USA	5,3	6,8	7,6	9,7	9,6	7,5	7,2	7,0	6,3	6,0
Japan	1,4	1,9	2,2	2,4	2,7	2,7	2,6	2,8	3,0	2,9

<sup>(1)</sup> Economic Forecasts, September 1987.<sup>(2)</sup> The figures presented here are based on the number of registered unemployed on a common Eurostat definition, except for Greece, Spain and Portugal where national survey results are presented.

Source: Eurostat and Commission services.

TABLE 2  
Summary of main economic aggregates for EUR 12 (1960 to 1988)

(Annual percentage changes)

	1973/ 1960	1981/ 1973	1982	1983	1984	1985	1986	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
Gross domestic product									
— nominal	10,2	14,4	11,2	10,1	9,1	8,7	8,4	6,2	5,9
— real	4,8	2,0	0,6	1,5	2,4	2,5	2,6	2,2	2,3
— deflator	5,1	12,2	10,6	8,5	6,5	6,1	5,6	3,9	3,5
Gross fixed capital formation <sup>(2)</sup>	5,5	-0,2	-1,8	0,2	1,6	2,3	3,4	3,6	3,3
— construction	:	-1,4	-2,4	0,4	1,2	-3,1	2,7	2,0	2,6
— equipment	:	1,7	-1,0	2,1	5,8	9,2	4,2	5,3	4,0
Share of nominal gross fixed capital formation in GDP									
— total	23,1	22,1	20,1	19,6	19,3	19,1	18,9	19,1	19,2
— public	3,8 <sup>(11)</sup>	3,3 <sup>(12)</sup>	3,0	2,9	2,8	2,8	2,7	2,7	2,8
Private consumption <sup>(2)</sup>	5,0	2,3	0,7	1,3	1,4	2,5	3,9	3,1	2,7
Domestic demand (incl. stocks)									
— in the Community	5,0	1,6	0,9	1,0	1,9	2,4	3,8	3,2	2,7
— gap with respect to other OECD countries	-0,5	-0,6	0,9	-1,8	-3,4	-1,1	0,1	0,5	0,0
Inflation (private consumption deflator)	4,6	12,2	10,4	8,5	7,0	5,9	3,7	3,2	3,4
Compensation per employee									
— nominal	10,0	14,8	11,1	9,9	7,4	6,8	6,0	5,4	4,7
— deflated by the price of private consumption	5,1	2,3	0,6	1,3	0,3	0,9	2,2	2,1	1,3
— deflated by GDP prices	4,6	2,4	0,4	1,3	0,8	0,7	0,4	1,5	1,2
Productivity <sup>(3)</sup>	4,5	2,1	1,5	2,0	2,3	1,8	1,8	1,4	1,7
Real unit labour costs <sup>(4)</sup>	100,3	104,0	102,9	102,2	100,7	99,6	98,2	98,3	97,8
Profitability <sup>(5)</sup>	108,2	72,8	63,5	66,4	72,7	77,7	82,1	80,9	81,1
Competitiveness <sup>(6)</sup>	101,3	108,9	99,2	93,6	86,6	85,8	95,3	101,6	101,8
Employment	0,3	-0,1	-0,8	-0,5	0,1	0,6	0,8	0,8	0,6
Unemployment rate (as % of the civilian labour force)	2,2 <sup>(7)</sup>	5,1 <sup>(7)</sup>	9,3 <sup>(7)</sup>	10,4 <sup>(7)</sup>	11,7 <sup>(7)</sup>	12,1 <sup>(7)</sup>	11,9	11,8	11,7
Current balance (as % of GDP)	0,4	-0,6	-1,1	-0,2	0,1	0,6	1,5	1,1	0,8
Net lending or borrowing of general government (as % of GDP)	-1,0 <sup>(8)</sup>	-4,1 <sup>(8)</sup>	-5,5	-5,3	-5,3	-5,2	-4,8	-4,5	-4,5
Public debt (as % of GDP)	37,5 <sup>(8)</sup>	43,4 <sup>(9)</sup>	48,2	51,5	54,8	57,4	59,0	61,4	63,6
Money supply <sup>(10)</sup>	11,4 <sup>(7)</sup>	13,7	11,3	11,2	9,5	8,5	10,2	10,2	8,6
Long-term interest rate <sup>(13)</sup>	7,1	10,7	12,6	10,7	10,4	9,6	7,9	7,8	7,7

<sup>(1)</sup> Economic Forecasts, September 1987.<sup>(2)</sup> At constant prices.<sup>(3)</sup> Real GDP per person employed in the whole economy.<sup>(4)</sup> Compensation per employee deflated by GDP prices divided by real GDP per person employed, index 1970 = 100.<sup>(5)</sup> Estimate for EUR 4: non-agricultural business. Index 1970 = 100. Net rate on net capital stock.<sup>(6)</sup> Relative unit labour costs in the Community vis-à-vis its nine main industrial partner countries, in a common currency, index 1970 = 100.<sup>(7)</sup> EUR 9 (EUR 12 excluding Greece, Spain and Portugal).<sup>(8)</sup> EUR 9 (EUR 12 excluding Greece, Ireland and Portugal), 1973 and 1981, respectively.<sup>(9)</sup> 1981 (EUR 12)<sup>(10)</sup> Annual average. Broad money supply M2 or M3 according to country.<sup>(11)</sup> EUR 9 (EUR 12 excluding Greece, Ireland and Portugal), 1970 to 1973.<sup>(12)</sup> EUR 9 (EUR 12 excluding Greece, Ireland and Portugal).<sup>(13)</sup> EUR 10 (EUR 12 excluding Spain and Portugal). Data from 1961, levels.

Source: Eurostat and Commission services.

TABLE 3  
World output, trade and prices

	1986 <sup>(1)</sup>	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
<b>Real gross national/domestic product</b>			
	<i>(% change on preceding year)</i>		
EUR 12	2,6	2,2	2,3
Other OECD	2,8	2,5	2,9
— USA	2,9	2,3	2,7
— Canada	3,2	3,2	2,9
— Japan	2,4	2,9	3,5
— Rest OECD	2,6	2,2	2,3
Total OECD	2,7	2,4	2,7

<b>Volume of world trade (goods)</b>			
	<i>(% change on preceding year)</i>		
EUR-definition <sup>(2)</sup>			
— excluding EUR	3,8	2,1	3,5
— including EUR	4,9	3,5	3,9
OECD-definition <sup>(3)</sup>			
— excluding EUR	4,2	3,1	3,9
— including EUR	4,3	3,4	4,0

<b>World export prices in US \$</b>			
	<i>(% change on preceding year)</i>		
Raw materials excluding fuels	5,1	4,1	4,8
Crude oil (fob)	-49,7	26,2	4,1
Manufactured products	19,2	11,4	5,9

<b>Balance on current account</b>			
	<i>(billions of US \$)</i>		
EUR 12	52,8	44,8	36,3
Other OECD	-87,8	-94,8	-89,9
— USA	-141,3	-154,3	-147,3
— Canada	-6,3	-4,0	-1,5
— Japan	85,8	84,9	79,0
— other OECD	-25,9	-21,5	-20,0
Total OECD	-35,0	-50,1	-53,6
OPEC countries	-33,0	-6,9	-2,4
Other developing countries <sup>(4)</sup>	-7,2	-8,6	-14,4
Other countries <sup>(5)</sup>	-2,5	-0,6	-0,3
Errors and omissions	-77,7	-66,2	-70,7

<sup>(1)</sup> *Economic Forecasts*, September 1987.

<sup>(2)</sup> Growth rate of world imports.

<sup>(3)</sup> Arithmetic average of respective growth rates of world imports and exports.

<sup>(4)</sup> Other developing countries include China, Yugoslavia and South Africa.

<sup>(5)</sup> Other countries exclude intra-COMECON trade.

Source: Commission services.

TABLE 4  
Contribution to real GDP growth

(in percentage points at 1980 prices <sup>(2)</sup>)

	1981	1982	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
<i>EUR 12</i>								
Domestic demand (excluding change in stocks)	-0,5	0,3	1,1	1,4	2,3	3,5	2,9	2,7
Change in stocks	-1,3	0,6	-0,1	0,5	0,0	0,2	0,3	0,1
Balance of trade in goods and services	1,7	-0,3	0,5	0,5	0,1	-1,2	-1,0	-0,4
GDP growth	0,0	0,6	1,5	2,4	2,5	2,6	2,2	2,3
Deviation of change in domestic demand from that in other OECD countries <sup>(3)</sup>	-3,5	0,9	-1,8	-3,4	-1,1	0,1	0,5	0,0
<i>USA</i>								
Domestic demand (excluding change in stocks)	1,9	0,0	4,7	6,9	5,1	4,1	1,3	2,3
Change in stocks <sup>(4)</sup>	0,9	-1,5	0,5	2,0	-1,5	0,3	0,7	-0,1
Balance of trade in goods and services	-0,8	-1,0	-1,8	-2,4	-0,7	-1,2	0,3	0,5
GDP growth	2,1	-2,5	3,4	6,6	2,9	3,1	2,3	2,7
Deviation of change in domestic demand from that in other OECD countries <sup>(3)</sup>	2,5	-1,2	3,2	5,4	0,3	0,3	-1,0	-0,7
<i>Japan</i>								
Domestic demand (excluding change in stocks)	2,2	2,8	2,1	3,2	3,4	4,1	4,4	4,0
Change in stocks	-0,1	-0,1	-0,4	0,5	0,1	0,6	0,1	0,1
Balance of trade in goods and services	1,7	0,1	1,4	1,3	1,0	-1,3	-0,8	-0,4
GDP growth	3,9	2,8	3,2	5,0	4,5	2,4	2,9	3,5
Deviation of change in domestic demand from that in other OECD countries <sup>(3)</sup>	1,4	3,6	-1,5	-1,6	0,6	0,2	1,6	1,7

<sup>(1)</sup> Economic Forecasts, September 1987.<sup>(2)</sup> Due to statistical discrepancies, the sum of the contributions is not always identical to total GDP growth.<sup>(3)</sup> Domestic demand (including stocks) growth differential from a weighted average of OECD partner countries. The weighting structure is the same as that used to calculate effective exchange rates.<sup>(4)</sup> Including statistical discrepancies.

Source: Commission services.

TABLE 5  
Merchandise imports and exports (volume)

(percentage change on the preceding year)

	Imports			Exports			Market growth <sup>(1)</sup>			Export Performance <sup>(3)</sup>		
	1986	1987 <sup>(2)</sup>	1988 <sup>(2)</sup>	1986	1987 <sup>(2)</sup>	1988 <sup>(2)</sup>	1986	1987 <sup>(2)</sup>	1988 <sup>(2)</sup>	1986	1987 <sup>(2)</sup>	1988 <sup>(2)</sup>
EUR 12 total	6,7	5,7	4,6	2,0	2,0	3,3	4,1	3,3	3,9	-2,0	-1,3	-0,6
— intra—EUR <sup>(4)</sup>	6,0	4,5	3,9	5,6	5,3	4,7	7,2	5,5	4,5	-1,5	-0,2	0,2
— extra—EUR <sup>(4)</sup>	7,4	7,5	5,7	-2,1	-1,9	1,5	0,5	0,7	3,1	-2,6	-2,6	-1,6
USA	13,9	2,5	2,6	7,7	11,8	11,1	2,7	3,0	4,4	4,9	8,6	6,4
Japan	10,1	6,2	5,2	-2,7	-4,9	0,6	3,8	2,6	3,4	-6,3	-7,3	-2,7
OPEC	-20,5	-17,0	-0,0	6,0	2,5	4,4						
Other developing countries	-0,9	4,3	4,9	6,0	4,6	4,4						
World	4,9	3,5	3,9	3,4	3,4	4,4						
World excluding EUR	3,8	2,1	3,5	4,2	4,1	5,0						

<sup>(1)</sup> Change in imports from third countries weighted by the regional export structure of the respective country or zone.<sup>(2)</sup> Economic Forecasts, September 1987.<sup>(3)</sup> Index for exports divided by an index for growth of markets.<sup>(4)</sup> Estimates of the Commission services.

Source: Commission services.

TABLE 6  
Real trade balances (1985 to 1988) <sup>(2)</sup>

	1985	1986 <sup>(1)</sup>	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>	change 1985/1986	change 1986/1988
(a) In billions US \$ at 1985 prices						
USA	-124,5	-155,1	-137,5	-119,1	-30,6	36,0
Japan	56,0	39,4	23,0	16,9	-16,6	-22,5
EUR 12	11,9	-17,3	-42,3	-52,8	-29,2	-35,5
Germany	28,1	21,7	16,1	14,6	-6,4	-7,1
Developing countries						
— OPEC	57,1	86,6	104,1	111,5	29,5	24,9
— other developing countries	-4,4	19,0	21,0	20,1	23,4	1,1
(b) As percentage of GDP at 1985 prices						
USA	-3,1	-3,8	-3,3	-2,7		
Japan	4,2	2,9	1,6	1,2		
EUR 12	0,5	-0,7	-1,6	1,9		
Germany	4,5	3,4	2,5	2,2		

<sup>(1)</sup> Economic Forecasts, September 1987.

<sup>(2)</sup> Balance of payments basis, fob-fob.

Source: Commission services.

TABLE 7  
Current account transactions of developing countries

(in billions of US \$)

	All developing countries <sup>(2)</sup>			Fuel exporters			Non-fuel exporters			Exporters of manufactures		
	1981	1985	1986	1981	1985	1986	1981	1985	1986	1981	1985	1986
Current account balance	-48,5	-23,8	-46,3	34,8	3,0	-37,1	-83,2	-26,8	-9,2	-15,2	-4,2	13,0
— Trade balance	37,1	45,4	7,2	120,4	67,4	15,2	-83,2	-22,0	-8,0	-25,2	-12,2	1,9
— Net services	-100,7	-90,6	-79,5	-68,8	-50,6	-40,0	-31,9	-40,0	-39,5	0,8	-2,6	-0,5
— Unrequited transfers	15,1	21,3	26,0	-16,8	-13,8	-12,3	31,9	35,1	38,3	9,1	10,6	11,5
Oil trade balance	216,8	118,4	63,8	278,1	155,2	87,4	-61,4	-36,8	-23,6	-25,3	-15,6	-10,0
Resource balance <sup>(1)</sup>	-30,7	20,0	-3,5	17,2	1,6	-39,2	-47,8	18,5	35,7	-5,2	4,0	21,2

<sup>(1)</sup> The resource balance is intended to show the availability of external resources to an economy. In the present context it has been calculated as the current account balance minus net investment income. A positive resource balance reflects an outflow of financial resources and vice-versa.

<sup>(2)</sup> Countries are grouped by predominant export. Fuel exporters and non-fuel exporters are subgroups of the total. Exporters of manufactures are those non-fuel exporters, whose exports of manufactures accounted in 1980 for over 50 % of their total exports.

Source: IMF World Economic Outlook 1987 and Commission services.

TABLE 8  
External financing and indebtedness of capital importing developing countries

(in billions of US \$)

	Capital importing countries <sup>(1)</sup>			Countries with recent debt-servicing problems			Subgroups <sup>(7)</sup> : Fifteen heavily indebted countries			Sub-Saharan Africa		
	1981	1985	1986	1981	1985	1986	1981	1985	1986	1981	1985	1986
(a) External financing												
Net external borrowing	129,5	44,2	41,5	86,3	13,7	14,4	65,2	5,7	9,1	9,2	4,0	5,7
— Long-term borrowing from official creditors	31,4	24,0	30,6	17,1	16,2	16,5	6,5	7,7	6,7	4,8	4,0	4,0
— Reserve-related liabilities	12,2	2,8	7,1	9,1	2,4	7,3	1,4	-0,5	2,2	2,4	1,8	0,4
— Other net external borrowing <sup>(6)</sup>	85,8	17,4	3,8	60,1	-4,9	-9,4	57,3	-1,5	0,2	2,0	-1,8	1,4
(b) External indebtedness												
Total debt <sup>(2)</sup>	708,0	954,1	1 036,3	462,0	585,9	621,6	332,3	416,5	433,5	48,6	65,1	74,1
Debt ratio <sup>(3)</sup>	30,4	39,8	41,5	37,6	48,6	50,3	32,8	46,2	60,3	44,6	65,7	67,8
Debt service ratio <sup>(4)</sup>	22,2	25,0	27,1	32,9	36,7	42,0	39,3	42,1	49,8	19,3	24,9	29,6
Interest service ratio <sup>(5)</sup>	12,3	14,2	13,3	18,6	23,8	23,2	22,8	29,6	30,0	9,1	11,1	11,3

<sup>(1)</sup> All developing countries except Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, United Arab Emirates.<sup>(2)</sup> For all developing countries (capital importing and capital exporting countries) total debt amounted to around US \$ 1 101 billion in 1986. The IMF forecasts for 1987 an increase to about US \$ 1 198 billion, of which 1 128 billion represents the total debt of capital importing countries.<sup>(3)</sup> External debt relative to GDP.<sup>(4)</sup> Debt service relative to exports of goods and services.<sup>(5)</sup> Interest service relative to exports of goods and services.<sup>(6)</sup> Residually calculated. The amounts shown reflect mainly net external borrowing from private creditors and short-term flows.<sup>(7)</sup> According to different commonly used classifications.

Source: IMF World Economic Outlook 1987 and Commission services.

TABLE 9  
Comparison of forecasts for 1987 (EUR 12): October 1986 — September 1987

(percentage change on the preceding year)

	October 1986 <sup>(1)</sup>	September 1987 <sup>(2)</sup>
Real GDP	2,8	2,2
Private consumption	3,5	3,1
Gross domestic fixed capital formation	5,1	3,6
— Construction	3,2	2,0
— Equipment	6,9	5,3
Exports of goods and services	3,7	1,9
Private consumption deflator	3,0	3,2
Employment	0,8	0,8
Current balance <sup>(3)</sup>	0,9	1,1
Unemployment rate <sup>(4)</sup>	11,7	11,8

<sup>(1)</sup> Economic Forecasts, October 1986.<sup>(2)</sup> Economic Forecasts, September 1987.<sup>(3)</sup> Percentage of GDP.<sup>(4)</sup> Percentage of the civilian labour force.

Source: Commission services.

TABLE 10  
Bilateral nominal, nominal and real effective exchange rates

(Index 1970 = 100 and percentage change on preceding year)

	Bilateral nominal exchange rate		Nominal effective exchange rate <sup>(1)</sup>		Relative unit labour costs in national currency <sup>(2)</sup>		Real effective exchange rate <sup>(3)</sup>	
	Level	Change	Index	Change	Index	Change	Index	Change
<b>EUR 12</b>	<b>ECU/US \$</b>							
average 1960—1969	1,059		101,9		98,5		100,3	
average 1970—1977	1,137		100,8		103,8		104,7	
1978	1,274	11,7	94,7	0,6	111,5	1,9	105,7	2,4
1979	1,371	7,6	100,9	6,5	114,4	2,5	115,4	9,3
1980	1,392	1,6	102,6	1,6	119,9	4,8	122,9	6,5
1981	1,116	-19,8	86,1	-16,1	122,4	2,1	105,3	-14,3
1982	0,980	-12,2	80,0	-7,0	123,9	1,2	99,2	-5,9
1983	0,890	-9,1	73,2	-8,5	127,8	3,2	93,6	-5,6
1984	0,789	-11,4	66,6	-9,1	130,1	1,8	86,6	-7,5
1985	0,763	-3,3	65,3	-1,8	131,4	1,0	85,8	-0,9
1986	0,984	29,0	72,4	10,8	131,7	0,2	95,3	11,1
1987 <sup>(4)</sup>	1,136	15,4	77,2	6,6	131,6	0,0	101,6	6,6
1988 <sup>(4)</sup>	1,180	3,9	78,2	1,3	130,2	-1,1	101,8	0,2
<b>USA</b>	<b>US \$/ECU</b>							
average 1960—1969	0,945		98,9		99,6		98,6	
average 1970—1977	0,879		89,7		88,4		79,3	
1978	0,785	-10,4	80,2	-9,2	79,7	1,4	63,9	-8,0
1979	0,730	-7,0	77,9	-2,8	82,0	2,9	63,9	-0,0
1980	0,718	-1,6	77,8	-0,2	82,4	0,5	64,1	0,4
1981	0,896	24,7	87,7	12,8	82,0	-0,4	72,0	12,3
1982	1,021	14,0	98,3	12,0	83,1	1,3	81,6	13,4
1983	1,123	10,1	103,9	5,7	82,3	-1,0	85,5	4,7
1984	1,267	12,8	112,0	7,8	82,2	-0,1	92,0	7,7
1985	1,310	3,4	116,5	4,0	82,8	0,7	96,5	4,8
1986	1,016	-22,5	95,0	-18,4	81,5	-1,6	77,5	-19,7
1987 <sup>(4)</sup>	0,881	-13,3	85,0	-10,5	81,3	-0,2	69,1	-10,8
1988 <sup>(4)</sup>	0,848	-3,7	82,1	-3,4	82,0	0,9	67,4	-2,5
<b>Japan</b>	<b>Yen/ECU</b>							
average 1960—1969	0,00262		98,1		101,3		99,3	
average 1970—1977	0,00291		111,3		113,5		127,5	
1978	0,00374	14,5	153,5	21,8	116,5	-3,6	178,8	17,4
1979	0,00333	-11,1	142,2	-7,4	109,0	-6,4	155,0	-13,3
1980	0,00317	-4,6	136,4	-4,0	100,6	-7,7	137,3	-11,4
1981	0,00408	28,4	155,0	13,6	95,1	-5,5	147,5	7,4
1982	0,00411	0,8	147,3	-5,0	89,7	-5,7	132,1	-10,5
1983	0,00473	15,2	163,3	10,9	87,2	-2,7	142,4	7,8
1984	0,00535	13,0	172,2	5,5	84,2	-3,5	145,0	1,8
1985	0,00554	3,6	177,4	3,0	80,9	-3,9	143,5	-1,0
1986	0,00606	9,4	228,5	28,8	80,7	0,2	184,4	28,5
1987 <sup>(4)</sup>	0,00601	-0,9	246,6	7,9	80,0	-0,9	197,3	7,0
1988 <sup>(4)</sup>	0,00612	1,9	256,9	4,2	79,8	-0,3	204,9	3,8

<sup>(1)</sup> The nominal effective exchange rate is the weighted average of the exchange rate of a currency with respect to the main nine (EUR 12) or 19 competing countries. The weight attributed to each currency reflects the importance of the respective country as a bilateral trading partner and as a competitor on third markets (double export weights).

<sup>(2)</sup> Index of unit labour costs in the country or zone in question in relation to the weighted average of unit labour costs in the main nine (EUR 12) or 19 competing countries in national currency. This indicates the relative competitiveness of the country or zone in question in the absence of any movements in exchange rates.

<sup>(3)</sup> The index of the real effective exchange rate is derived by multiplying the index of the nominal effective exchange rate by a similarly calculated index of the relative change in price or cost levels in national currencies, in the present case unit labour costs in the total economy. Such an index can also be used as an indicator of the competitiveness of a country, where an increase in the index (index of relative unit labour costs in a common currency) reflects a deterioration in cost competitiveness.

<sup>(4)</sup> *Economic Forecasts*, September 1987.

Source: Commission services.



TABLE 11  
Business survey results on the revision of plans and expectations in response to exchange rate changes  
(weighted balance) <sup>(1)</sup>

	B	D	GR	E	F	IRL	I	L	NL	UK
Domestic production	-23	-10	-15	-1	-18	-11	-6	-41	-25	+2
Number employed	-15	-13	:	-19	:	:	:	-42	-25	-8
Domestic investment (nominal)	-10	-8	-18	+23	-8	-11	+10	+4	-9	-2
Investment abroad (in national currency)	-8	-2	:	+2	-1	0	:	+3	-6	-3
Profits	-39	-35	-59	:	-37	-12	:	-51	-49	-32
Domestic selling prices	-14	-5	+55	0	-12	-10	0	-6	-42	+20
Export prices in national currency	-51	-19	+25	0	-28	-22	-2	-89	-68	+4
Medium-term sales expectations	-23	-15	:	:	:	-19	:	-34	-41	-5
<i>pro memoria:</i> exchange rate changes January 1986/ May 1987 against:										
— US \$	+34,9	+36,8	+11,5	+22,3	+25,6	+20,2	+29,1	+34,9	+36,8	+17,1
— weighted average of the currencies of 19 main trading partners	+7,5	+11,6	-10,8	-0,4	+1,1	-1,5	+4,7	+7,5	+8,4	-4,2

<sup>(1)</sup> The special survey was conducted in April/May 1987. The wording of the question was: 'The appreciation of the national currency has prompted us to revise plans/expectations for 1987 that we announced last autumn.' The offered response categories were: no change/no response, revised sharply upwards, revised somewhat upwards, revised sharply downwards, revised somewhat downwards. The balance has been calculated on the basis of responses for total industry, with sharp revisions being given a double weight.

The results for Portugal are not yet available.

Denmark did not take part in this special survey.

Source: European Community business survey.

TABLE 12  
Deflator of private consumption and convergence of price developments

	1969/1960	1977/1969	1981/1977	1982	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
B	3,2	7,4	5,6	7,3	7,5	6,2	4,8	1,3	1,8	2,5
DK	5,7	10,0	10,6	10,2	6,8	6,5	4,8	3,6	4,1	4,0
D	2,7	5,5	4,7	4,7	3,2	2,4	2,1	-0,5	0,6	1,8
GR	2,4	10,7	18,6	20,8	17,9	18,4	18,6	22,1	16,0	12,0
E	5,9	13,5	16,3	14,5	12,3	10,7	8,3	8,9	5,4	4,2
F	4,2	8,3	11,3	11,2	9,5	7,2	5,5	2,5	3,1	2,6
IRL	4,5	13,8	15,2	15,9	10,0	7,5	4,2	3,6	3,0	3,2
I	3,7	13,0	16,5	15,9	14,8	11,4	9,3	6,3	4,8	4,9
L	2,3	6,8	6,2	10,8	8,1	6,4	3,3	0,3	0,5	2,3
NL	4,1	8,0	5,5	5,3	2,7	2,5	2,6	0,2	-0,8	1,0
P	2,7	13,4	21,6	22,5	25,5	29,3	19,0	12,1	9,3	6,5
UK	3,7	12,6	12,6	8,7	5,0	4,8	5,2	3,6	3,0	3,9

Weighted average

EUR 12	3,7	9,9	11,3	10,4	8,5	7,0	5,9	3,7	3,2	3,4
EMS	3,6	8,7	9,9	9,8	8,3	6,4	5,1	2,4	2,5	2,9

Measures of dispersion related to average <sup>(2)</sup>

EUR 12	0,9	2,5	4,7	4,6	4,7	4,6	3,9	4,1	2,7	1,8
EMS	0,8	2,2	3,9	3,4	2,8	1,9	1,7	1,8	1,6	0,8

Measures of dispersion related to lowest <sup>(2)</sup>

EUR 12	1,4	4,7	7,4	7,7	7,6	7,0	5,2	5,8	5,0	3,2
EMS	1,5	3,6	4,8	5,5	5,1	3,8	2,5	2,7	2,9	1,7

<sup>(1)</sup> Economic Forecasts, September 1987.

<sup>(2)</sup> The dispersion index is an unweighted sum, disregarding signs, of each country's deviation from the respective reference value (e.g. weighted average or lowest rate).

Source: Eurostat and Commission services.

TABLE 13  
Real convergence — *per capita* GDP <sup>(2)</sup> and its divergence in the Community

	1960	1970	1975	1980	1985	1986 <sup>(1)</sup>	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
B	96,1	99,5	103,0	104,4	101,7	101,8	101,2	101,0
DK	119,8	116,7	111,3	109,5	116,7	117,8	115,1	113,6
D	118,2	113,6	109,6	114,2	116,0	116,2	115,6	115,4
GR	38,7	51,7	57,1	58,4	56,1	55,3	53,7	52,6
E	58,3	72,3	80,1	73,8	72,3	72,7	73,9	74,6
F	101,4	106,1	110,4	111,6	109,0	108,2	106,8	106,2
IRL	61,9	61,4	63,0	64,7	63,8	62,3	62,7	62,3
I	91,4	100,6	97,7	102,0	103,2	103,5	104,4	105,1
L	141,3	125,3	122,7	120,5	127,5	127,5	127,4	127,0
NL	120,0	117,3	116,3	112,4	107,3	106,7	105,9	104,4
P	38,2	47,4	50,3	54,3	52,6	53,2	53,8	54,1
UK	128,3	108,0	105,7	100,7	103,9	104,2	105,3	105,8
EUR 12	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0
Weighted standard deviation EUR 12	26,2	17,9	15,5	16,8	17,6	17,5	17,2	17,1
Ratio of four poorest to four richest countries	41,0	56,3	63,4	60,0	58,6	58,9	59,9	60,4

<sup>(1)</sup> *Economic Forecasts*, September 1987.

<sup>(2)</sup> GDP *per capita* at current prices and purchasing power standards as a percentage of the Community average.

Source: Commission services.

TABLE 14  
Nominal wages, real wages and real unit labour costs

(percentage change per annum)

	1973/ 1960	1980/ 1973	1981	1982	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
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(a) Nominal compensation per employee

B	8,9	11,6	6,5	8,2	6,0	5,8	4,4	2,5	3,7	3,0
DK	10,7	11,7	9,2	11,9	8,2	5,3	4,8	5,1	7,2	5,2
D	9,2	7,4	5,2	4,2	3,8	3,4	3,0	3,9	3,3	2,9
GR	10,2	21,1	21,5	27,8	21,3	21,2	21,7	13,7	12,5	12,0
E	14,5	21,8	15,7	13,8	14,5	11,8	9,9	8,7	6,5	5,3
F	9,9	14,7	14,3	13,7	10,6	8,1	5,8	4,0	3,0	3,5
IRL	11,3	19,5	18,1	14,4	11,6	11,8	7,5	6,1	6,1	4,9
I	11,6	20,2	22,6	16,2	16,0	11,4	10,2	7,7	8,3	6,0
L	7,4	11,0	8,5	6,9	6,8	7,2	4,1	4,0	4,4	4,2
NL	11,4	9,5	3,5	5,8	3,2	0,4	1,3	1,6	1,9	1,6
P	12,0	25,2	19,9	20,1	16,6	18,7	19,9	16,7	11,9	8,5
UK	8,3	17,5	13,2	9,3	9,1	5,1	7,3	7,2	6,8	6,6
EUR 12	10,0	15,1	13,0	11,1	9,9	7,4	6,8	6,0	5,4	4,7

<sup>(1)</sup> *Economic Forecasts*, September 1987.

	1973/ 1960	1980/ 1973	1981	1982	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
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## (b) Nominal compensation per employee deflated by the private consumption deflator

B	5,1	3,5	-1,4	0,9	-1,4	-0,4	-0,3	1,2	1,9	0,5
DK	3,8	0,8	-2,5	1,5	1,3	-1,1	0,0	1,5	2,9	1,2
D	5,4	2,4	-0,8	-0,5	0,6	1,0	0,9	4,4	2,6	1,1
GR	6,5	4,4	-1,6	5,8	2,9	2,4	2,6	-6,9	-3,0	0,0
E	7,3	3,4	1,2	-0,6	1,9	1,0	1,5	-0,2	1,0	1,1
F	5,1	3,5	1,3	2,3	1,0	0,8	0,4	1,4	-0,1	1,0
IRL	5,0	2,9	-1,2	-1,3	1,5	4,0	3,2	2,4	3,0	1,6
I	6,5	2,3	3,9	0,2	1,0	0,0	0,8	1,3	3,3	1,0
L	4,2	3,4	-0,2	-3,5	-1,2	0,7	0,7	3,6	3,9	1,9
NL	6,0	2,2	-2,7	0,5	0,4	-2,0	-1,3	1,4	2,7	0,6
P	8,3	2,7	1,3	-2,0	-7,1	-8,2	0,8	4,1	2,4	1,9
UK	3,3	1,6	1,6	0,6	3,9	0,4	2,0	3,5	3,6	2,6
EUR 12	5,1	2,5	0,9	0,6	1,3	0,3	0,9	2,2	2,1	1,3

(c) Real unit labour costs <sup>(2)</sup>

B	0,3	1,4	1,0	-2,0	-1,1	-1,2	-1,3	-3,1	0,4	-0,8
DK	0,2	0,5	-1,2	-1,3	-1,7	-2,3	-1,5	-1,1	3,4	0,0
D	0,5	0,0	0,3	-1,2	-2,5	-1,2	-1,1	-0,8	0,6	-0,5
GR	-2,5	1,9	6,5	1,7	2,5	-1,6	2,4	-5,4	-3,8	0,1
E	0,5	-0,2	0,4	-2,2	0,0	-4,0	-2,1	-3,7	-0,9	-0,8
F	0,0	1,0	1,2	-0,7	-0,1	-1,6	-1,4	-2,5	-1,6	-1,0
IRL	-0,4	1,2	-3,5	-2,4	0,0	-0,7	-2,4	0,3	0,3	1,0
I	0,2	0,3	2,2	0,3	0,6	-1,6	-0,1	-2,4	0,3	-0,7
L	-0,2	3,3	1,7	-5,0	-4,3	-3,9	-0,7	-0,3	0,9	0,6
NL	1,0	0,2	-2,7	-1,3	-2,0	-4,4	-1,6	0,2	2,1	0,1
P	0,3	1,4	4,0	-5,2	-1,5	-5,0	-4,8	-5,0	-0,7	-0,8
UK	0,2	0,0	-1,3	-1,3	-1,1	0,8	-1,0	1,2	0,8	-0,1
EUR 12	0,1	0,3	0,5	-1,0	-0,7	-1,5	-1,1	-1,4	0,1	-0,5

<sup>(1)</sup> Economic Forecasts, September 1987.<sup>(2)</sup> Compensation per employee deflated by the GDP deflator and divided by real GDP per person in total employment.

Source: Eurostat and Commission services.

TABLE 15  
Sectoral developments in employment (EUR 10)

	Percentage annual average rate of change						Percentage share of employment	
	1980/1970	1983/1980	1985/1983	1986 <sup>(1)</sup>	1987 <sup>(1)</sup> <sup>(2)</sup>	1988 <sup>(1)</sup> <sup>(2)</sup>	1970	1985
Employment in:								
— Agriculture	-3,2	-2,4	-2,4	—	—	—	11,2	7,0
— Industry	-0,8	-3,3	-1,4	-0,2	-0,5	-0,3	41,7	33,2
— Services	1,9	0,9	2,0	—	—	—	47,1	59,8
Total	0,3	-0,6	0,5	0,8	0,8	0,6	100	100

<sup>(1)</sup> EUR 12.<sup>(2)</sup> Economic Forecasts, September 1987.

Source: Eurostat and Commission services.

TABLE 16  
Percentage of employees working part-time of total employees

	B	DK	D	F	IRL	I	L	NL	UK	EUR 9
1975	4,1	22,3	10,1	6,5	4,7	4,0	4,8	8,8	17,9	10,2
1979	5,5	24,6	10,8	6,9	4,1	3,7	5,4	10,8	17,9	10,8
1983	8,3	25,6	12,0	8,9	5,8	3,5	6,2	20,9	19,4	12,3
1985	9,3	25,3	12,3	10,5	5,8	4,5	7,1	22,4	21,7	13,5

Source: Eurostat, 'Employment and Unemployment 1987' Table VI/2 and previous issues. Based on Community labour force sample survey.

TABLE 17  
Employment under fixed-term contracts

Fixed-term contracts	United Kingdom		France		Germany	
	1983	1985	1983	1985	1984	1985
Percentage share of:						
— Total salaried employment	5,0	5,5	2,3	3,2	4,2	6,8
— Men	3,8	4,0	2,0	3,1	4,2	7,0
— Women	7,0	7,4	2,7	3,3	4,1	6,4
— Part-time	11,5	13,2	2,1	4,1	7,6	8,9
— Full-time	2,5	2,4	2,3	2,8	3,6	6,4
— Young persons under 25 years	10,2	9,8	7,0	10,9	9,5	16,7
	1985/1983		1985/1983		1985/1984	
Percentage change:						
— Employment under fixed-term contracts	+ 11,2		+ 36,2		+ 64,0	
— Total salaried employment	+ 1,9		- 1,0		+ 0,8	

Source: Wissenschaftszentrum, Berlin on the basis of Community labour force sample surveys for France and the United Kingdom, and Microcensus (Statistisches Bundesamt) for Germany.

TABLE 18  
Structure of unemployment (EUR 12) <sup>(1)</sup>

Unemployment rate	(in %)		
	1984	1985	1986
Total	10,5	10,7	10,8
Men	9,3	9,4	9,3
Women	12,5	12,7	13,2
Under 25 years	23,5	22,9	22,7
Over 25 years	7,3	7,6	7,8

<sup>(1)</sup> Data are from the harmonized Community labour force sample survey. Accordingly, rates differ from those published for registered unemployment as a percentage of the civilian labour force.

Source: Eurostat, 'Employment and Unemployment 1987' Table IV/1, based on Community labour force sample surveys.

TABLE 19  
Long-term unemployment <sup>(1)</sup> as percentage of total unemployment

	1983	1984	1985
B	64,1	67,1	68,2
D	38,4	43,4	46,9
DK	32,2	30,9	32,0
GR	32,3	37,1	43,4
E	52,5	53,4	56,3
F	39,6	39,1	43,8
I	54,6	60,5	63,6
IRL	35,2	44,5	62,2 <sup>(3)</sup>
L	32,7	29,3	36,8
NL	46,9	n.a.	56,4
P	45,2	43,5	48,4
UK	44,8	45,5	48,7
EUR 12	46,3 <sup>(2)</sup>	48,3 <sup>(2)</sup>	52,1 <sup>(2)</sup>

<sup>(1)</sup> Unemployment of more than one year duration.

<sup>(2)</sup> Estimate.

<sup>(3)</sup> The change of format of the question in 1985 appears to have affected the response.

Source: COM(87) 231 final on the basis of Community labour force sample survey.

Spain: national survey.

Portugal: national definition of unemployment.

TABLE 20  
Evolution of unemployment rates by region (as a percentage of labour force)

	1976	1980	1985
EUR 11 <sup>(1)</sup>	4,6	6,2	11,7
25 weakest regions	8,0	11,7	21,1
25 strongest regions	2,4	3,0	6,6

<sup>(1)</sup> EUR 12 excluding Greece.

Source: COM(87) 230, Annex p. 134.

TABLE 21  
Evolution in labour force (1985 to 1995) <sup>(1)</sup>

	Increase 1985 to 1995 (in thousands)	Annual average growth rate
Total weaker countries and regions	3 442	1,0
— Spain	1 380	0,9
— Portugal	387	0,8
— Greece	338	0,8
— Ireland	291	1,9
— Mezzogiorno	1 046	1,3
Total strongest regions	3 256	0,3
EUR 12, total	6 698	0,5

<sup>(1)</sup> On the assumption of no net migration between regions.

Source: COM(87) 230, Annex p. 149.

TABLE 22  
Medium-term projections of Commission services and outturns — EUR 10

(percentage change per annum)

	Projection	Outturn
<i>European Economy No 9, July 1981 — 5th Programme</i>		
GDP in volume 1985/1980	1,9	1,2
Employment 1985/1980	-0,2	-0,5
Unemployment rate <sup>(1)</sup> 1985, percentage of civilian labour force	10,2	11,1
<i>European Economy No 14, November 1982</i>		
GDP in volume 1987/1980	1,6	1,4
Employment 1987/1980	-0,2	-0,2
Unemployment rate <sup>(1)</sup> 1987, percentage of civilian labour force	11,1	10,5
<i>European Economy No 18, November 1983</i>		
GDP in volume 1987/1982	1,9	1,9
Employment 1987/1982	-0,1	0,2
Unemployment rate <sup>(1)</sup> 1987, percentage of civilian labour force	10,4	10,5

<sup>(1)</sup> Rate obtained by aggregating the rate of Member States calculated according to their national definitions. Rates can therefore differ from harmonized rates published by Eurostat.

TABLE 23  
Main working hypotheses for the 1987 to 1991 reference projection of September 1987 — EUR 12  
(percentage annual average growth rates, unless otherwise stated)

	1970/ 1960	1980/ 1970	1985/ 1980	1986	1987	1988	1989	1990	1991	1991/ 1986
<i>Hypotheses concerning the international environment</i>										
Oil price (US \$/barrel) <sup>(1)</sup>	1,3	28,7	27,5	13,7	17,3	18,0	19,0	22,0	24,0	24,0
Exchange rate ECU/US \$	0,3	-3,0	12,8	-22,7	-13,3	-3,7	-1,0	-1,0	-1,0	-4,2
Exchange rate Yen/US \$	0,0	-4,5	0,9	-29,3	-12,6	-5,5	-3,0	-3,0	-3,0	-5,5
Imports of goods (1980 prices)										
— USA	8,4	4,5	6,5	13,9	2,5	2,6	3,5	4,0	4,5	3,4
— Japan	14,4	5,1	1,4	10,1	6,2	5,2	5,5	5,5	5,5	5,6
— Other OECD	7,6	4,1	4,5	6,0	2,0	3,1	3,5	4,0	4,5	3,4
— OPEC	4,5	15,4	-0,4	-20,5	-17,0	0,0	10,0	10,0	7,5	1,5
— Developing countries	6,2	4,9	2,0	-0,9	4,3	4,9	5,0	5,0	5,0	4,8
— Other countries	7,8	7,5	2,6	-2,0	4,5	3,0	4,0	4,0	4,0	3,9
World trade excluding EUR 12	7,8	5,7	3,2	3,8	2,1	3,5	4,5	4,8	4,8	3,9
<i>Economic policy hypotheses</i>										
Real public consumption	3,6	3,1	1,5	2,4	1,8	2,0	1,5	1,4	1,3	1,6
Real public investment	4,0 <sup>(2)</sup>	-0,2	-0,3	1,0	2,9	3,3	2,5	2,5	2,5	2,7
Annual average change in the share of public current receipts in GDP (in percentage points)	0,6	0,6	0,5	-0,2	-0,0	-0,2	-0,0	-0,2	-0,0	-0,1
Money supply (M2/M3)	10,2 <sup>(2)</sup>	14,8	10,4	10,2	10,2	8,6	8,0	8,0	8,0	8,6
Nominal long-term interest rates	6,7 <sup>(2)</sup>	9,9 <sup>(2)</sup>	11,5 <sup>(2)</sup>	9,2	9,1	9,1	9,0	8,8	8,6	8,9
Labour costs per head	9,2	14,3	9,6	6,0	5,4	4,7	4,7	5,0	5,1	5,0
Real labour costs per head (deflated by GDP prices)	4,6	3,2	1,0	0,4	1,4	1,2	1,4	1,7	1,8	1,5

<sup>(1)</sup> Level at end of period.

<sup>(2)</sup> EUR 10 (EUR 12 excluding Spain and Portugal).

Source: Eurostat and Commission services.

TABLE 24

1987 to 1991 reference projection of September 1987 — EUR 12 (percentage annual average growth rates, unless otherwise stated)

	1970/ 1960	1980/ 1970	1985/ 1980	1986	1987	1988	1989	1990	1991	1991/ 1986
Real GDP	4,8	3,0	1,2	2,6	2,2	2,3	2,3	2,6	2,8	2,5
Unemployment rate (% of labour force) <sup>(1)</sup>	2,0 <sup>(5)</sup>	6,1 <sup>(5)</sup>	12,1	11,9	11,8	11,7	11,4	11,1	10,6	10,6
Price of private consumption	3,8	10,6	8,7	3,7	3,2	3,4	3,3	3,4	3,4	3,3
Balance on current transactions (% GDP) <sup>(1)</sup>	0,5	-1,3	0,5	1,5	1,1	0,8	0,7	0,4	0,2	0,2
Real domestic demand	4,9	2,9	0,6	3,8	3,2	2,7	2,5	2,7	2,8	2,8
Real private consumption	4,9	3,4	1,0	3,9	3,1	2,7	2,6	2,7	2,8	2,8
Private investment	6,4 <sup>(2)</sup>	1,8	0,6	3,8	3,7	3,3	3,7	4,2	4,4	3,9
Real exports of goods and services	7,9	5,8	4,3	1,6	1,9	3,2	4,2	4,5	4,8	3,7
Real imports of goods and services	8,7	5,4	2,4	5,9	5,3	4,4	4,5	4,8	4,8	4,8
Total employment	0,2	0,2	-0,5	0,8	0,8	0,6	0,6	0,6	0,7	0,7
Productivity (GDP per person employed)	4,6	2,8	1,7	1,8	1,4	1,7	1,7	2,0	2,1	1,8
Real unit labour costs <sup>(3)</sup>	0,0	0,4	-0,7	-1,4	0,0	-0,5	-0,3	-0,2	-0,2	-0,3
Real long term interest rates	2,3	-0,9	3,0	3,6	5,2	5,6	5,7	5,6	5,4	5,5
Index of the profitability of capital <sup>(4)</sup> (1960 to 1969 = 100)	98,9	75,0	61,9	75,9	76,1	78,3	79,6	80,7	81,8	79,3
Public deficit (% of GDP)	-0,6	-2,8	-5,2	-4,8	-4,5	-4,5	-4,1	-3,9	-3,4	-4,1

<sup>(1)</sup> Level at end of period (in percentage points).<sup>(2)</sup> EUR 10 (EUR 12 excluding Spain and Portugal).<sup>(3)</sup> Calculated as the relationship between real labour costs per employee and GDP per person in employment.<sup>(4)</sup> The results calculated by the model are a synthetic indicator and cannot therefore be compared directly to those for the business sector presented elsewhere.<sup>(5)</sup> EUR 9 (EUR 12 excluding Greece, Spain and Portugal).

Source: Eurostat and Commission services.

For the forecasting period 1987 to 1991, the years 1987/1988 correspond to the short-term forecasts of the Commission services (*Economic Forecast* 1987/1988, September 1987) extended to 1991 with the help of the Compact model.

TABLE 25

The balance of growth on the demand side: GDP, private consumption, investment by enterprises and net exports in the Community (average annual changes at constant prices)

(in %)

	GDP	Private consumption	Private investment <sup>(2)</sup>	Net exports <sup>(3)</sup> (in % of GDP)
1961 to 1973	4,8	5,0	5,9	0,3
1974 to 1985	1,8	2,0	0,7	-0,2
1986 to 1988 <sup>(1)</sup>	2,4	3,2	3,6	0,6

<sup>(1)</sup> *Economic Forecasts*, September 1987.<sup>(2)</sup> EUR 10 to 1970 (excluding Spain and Portugal).<sup>(3)</sup> Balance of goods and services, current prices.

Source: Eurostat and Commission services.

TABLE 26

Intra-Community share of total imports of goods (at current prices)

	EUR 12	B/L	DK	D	GR	E	F	IRL	I	NL	P	UK
1958	35,2	55,5	60,0	36,3	53,7	31,8	28,3	68,9	30,2	50,7	53,4	21,8
1965	44,9	63,6	50,0	46,9	52,1	48,6	46,4	67,7	38,1	61,7	51,9	25,6
1970	50,3	66,3	48,7	51,7	50,9	40,9	56,0	70,1	47,5	63,4	52,6	29,4
1975	49,5	68,5	47,2	51,9	45,1	35,3	51,8	70,3	44,5	58,2	43,9	34,6
1980	49,2	61,6	50,3	49,4	40,9	31,3	52,0	75,3	46,2	54,7	45,3	40,9
1985	53,4	68,6	50,7	53,1	48,1	37,9	59,4	71,7	47,1	55,8	45,9	47,3
1986	57,8	69,9	53,2	54,2	58,3	51,3	64,4	73,0	55,4	61,0	58,8	50,4
1987 <sup>(1)</sup>	58,0	69,5	54,0	55,3	58,5	52,2	63,0	70,9	56,1	62,0	64,2	51,0
1988 <sup>(1)</sup>	58,4	69,7	53,7	56,6	58,4	52,6	63,0	69,4	56,3	61,7	64,0	52,0

<sup>(1)</sup> Economic Forecasts, September 1987.

Source: Eurostat and Commission services.

TABLE 27

Intra-Community share of total exports of goods (at current prices)

	EUR 12	B/L	DK	D	GR	E	F	IRL	I	NL	P	UK
1958	37,2	55,4	59,3	37,9	50,9	46,8	30,9	82,4	34,5	58,3	38,9	21,8
1965	49,6	70,8	52,1	46,9	46,6	53,6	51,8	83,8	51,1	69,2	44,0	29,6
1970	53,4	75,2	44,2	49,8	53,5	49,6	58,1	74,3	51,7	72,6	43,8	32,7
1975	52,4	72,4	46,6	46,9	51,6	48,1	53,2	80,4	49,2	73,0	53,8	35,2
1980	55,7	73,2	51,6	51,1	48,2	52,2	55,4	76,0	51,6	73,5	58,6	45,0
1985	54,9	70,1	44,8	49,7	54,2	53,4	53,7	68,9	48,2	74,6	62,5	48,8
1986	57,2	72,9	46,8	50,8	63,5	60,9	57,8	71,9	53,5	75,7	68,0	47,9
1987 <sup>(1)</sup>	58,1	74,5	47,5	52,9	63,4	63,3	56,1	74,0	53,9	76,3	70,0	49,0
1988 <sup>(1)</sup>	58,4	75,0	48,0	53,3	63,5	64,4	56,4	75,0	53,6	76,7	70,6	49,0

<sup>(1)</sup> Economic Forecasts, September 1987.

Source: Eurostat and Commission services.



TABLE 28

Direct effects on Member States' exports of a 10% increase in their imports (at constant prices) <sup>(1)</sup>

	Following a 10% increase in imports in:											
	B/L	DK	D	GR	E	F	IRL	I	NL	P	UK	EUR 12
<i>Exports increase (%) in:</i>												
B/L	—	0,1	2,0	0,1	0,1	2,0	0,0	0,6	1,5	0,0	0,8	7,3
DK	0,2	—	1,7	0,1	0,1	0,5	0,1	0,5	0,4	0,0	1,2	4,7
D	0,7	0,2	—	0,1	0,2	1,1	0,1	0,9	0,9	0,1	0,9	5,1
GR	0,2	0,1	2,5	—	0,1	0,9	0,0	1,5	0,3	0,0	0,7	6,4
E	0,3	0,1	1,2	0,1	—	1,9	0,1	0,8	0,4	0,4	1,0	6,1
F	0,9	0,1	1,8	0,1	0,3	—	0,1	1,2	0,5	0,1	0,9	5,8
IRL	0,3	0,1	1,2	0,0	0,2	1,0	—	0,3	0,5	0,0	3,6	7,2
I	0,3	0,1	1,9	0,1	0,3	1,6	0,0	—	0,3	0,1	0,7	5,4
NL	1,5	0,2	2,9	0,1	0,1	1,0	0,1	0,7	—	0,0	1,0	7,6
P	0,4	0,3	1,6	0,0	0,6	1,5	0,1	0,4	0,6	—	1,5	6,8
UK	0,4	0,2	1,4	0,1	0,3	0,8	0,5	0,5	0,6	0,1	—	4,8
EUR 12	0,6	0,2	1,3	0,1	0,2	1,1	0,1	0,7	0,6	0,1	0,8	5,7

<sup>(1)</sup> Estimates on the basis of the Quest model. The Quest model is being developed by the Commission services. For methodological details of the international trade sector in the model, see 'Estimation and Simulation of International Trade Linkages in the Quest model' in *European Economy* No 31, March 1987.

Source: Commission services.

TABLE 29

Effects of raising public investment in certain Member States taking account of interdependence in the Community: illustrative example assuming an increase in public investment of 1 % of GDP (annual averages during first five years)

(percentage points of GDP)

	Following an increase in public investment in:				
	D	F	I	UK	EUR 4
<i>Net lending or borrowing of the public sector changes in:</i>					
B	0,2	0,2	0,1	0,1	0,6
DK	0,1	0,1	0,0	0,1	0,2
D	-0,7	0,1	0,0	0,1	-0,5
GR	0,1	0,0	0,0	0,0	0,2
E	0,0	0,0	0,0	0,0	0,2
F	0,1	-0,8	0,1	0,1	-0,6
IRL	0,1	0,1	0,1	0,1	0,3
I	0,0	0,0	-0,8	0,0	-0,6
NL	0,2	0,1	0,1	0,1	0,5
P	0,1	0,1	0,0	0,1	0,2
UK	0,0	0,0	0,0	-0,7	-0,6
EUR 12	-0,1	-0,1	-0,1	-0,1	-0,4
<i>The current balance changes in:</i>					
B	0,3	0,3	0,1	0,2	0,8
DK	0,1	0,1	0,0	0,1	0,3
D	-0,3	0,1	0,1	0,1	-0,1
GR	0,1	0,1	0,1	0,0	0,2
E	0,1	0,1	0,0	0,1	0,2
F	0,1	-0,4	0,0	0,1	-0,2
IRL	0,2	0,1	0,1	0,3	0,6
I	0,1	0,1	-0,3	0,0	-0,1
NL	0,2	0,2	0,1	0,2	0,6
P	0,1	0,1	0,0	0,1	0,4
UK	0,1	0,1	0,0	-0,4	-0,2
EUR 12	0,0	0,0	0,0	0,0	-0,1

Source: OECD Interlink Model (1987) and calculations by the Commission services.

TABLE 30

## Real convergence, investment shares, capital productivity and current balances

	GR	E	IRL	P	GR, E, IRL, P total	other Member States	EUR 12
GDP per head (at constant prices, annual average changes in %)							
1961 to 1975	6,2	5,7	3,6	5,4	5,6	3,2	3,5
1976 to 1981	2,3	0,6	3,0	3,4	1,2	2,3	2,1
1982 to 1988 <sup>(1)</sup>	0,4	2,1	0,9	1,7	1,7	1,8	1,8
Investment shares (in % of GDP)							
1961 to 1975	22,3	24,7	21,0	24,3	24,2	22,9	23,1
1976 to 1981	23,4	22,9	27,7	27,7	23,8	21,2	21,6
1982 to 1988 <sup>(1)</sup>	19,2	20,4	21,2	25,3	20,9	19,1	19,3
Marginal capital productivity <sup>(2)</sup>							
1963 to 1975	0,23	0,22	0,16	0,17	0,21	0,13	0,14
1976 to 1981	0,09	0,02	0,11	0,12	0,05	0,10	0,09
1982 to 1988 <sup>(1)</sup>	0,02	0,10	0,04	0,07	0,08	0,09	0,09
Current balances (in % of GDP)							
1961 to 1975	-2,9	-0,4	-2,7	-0,6	-0,9	0,4	0,2
1976 to 1981	-1,2	-1,5	-9,6	-7,1	-2,6	-0,1	-0,4
1982 to 1988 <sup>(1)</sup>	-5,1	0,2	-4,4	-1,9	-1,0	0,5	0,3

<sup>(1)</sup> For 1987/1988: *Economic Forecasts*, September 1987.<sup>(2)</sup> Additional GDP for one additional unit of capital = change in GDP divided by gross fixed capital formation.

Source: Commission services.

TABLE 31  
Export market shares <sup>(1)</sup>

	1963	1968	1973	1979	1980	1981	1982	1983	1984	1985	Difference 1973/1968	Difference 1979/1973	Difference 1985/1979
<i>Total industry:</i>													
EUR 10 <sup>(2)</sup>	31,68	28,63	26,80	27,04	27,25	26,65	26,61	26,03	25,21	25,60	-1,83	+0,24	-1,44
USA	20,92	19,06	15,43	15,26	16,35	17,92	17,20	16,49	16,59	15,99	-3,63	-0,17	+0,73
Japan	6,39	8,92	10,53	11,38	12,43	15,16	14,62	15,60	16,94	16,75	+1,61	+0,85	+5,37
<i>Strong demand <sup>(3)</sup></i>													
EUR 10 <sup>(2)</sup>	35,00	31,39	27,96	27,40	27,00	25,79	25,75	25,23	24,01	24,86	-3,43	-0,56	-2,45
USA	24,26	22,47	17,51	18,08	19,18	20,70	20,91	20,11	20,74	19,32	-4,96	+0,57	+1,24
Japan	6,22	10,15	12,36	13,06	14,18	17,34	16,53	18,54	20,62	20,20	+2,21	+0,70	+7,14
<i>Moderate demand <sup>(4)</sup></i>													
EUR 10 <sup>(2)</sup>	31,52	28,17	26,98	26,69	27,66	26,49	26,32	25,34	24,32	24,27	-1,19	-0,29	-2,42
USA	25,43	23,26	18,65	17,66	18,26	20,42	19,12	18,21	17,95	17,87	-4,61	-0,99	+0,21
Japan	3,82	6,37	9,22	10,86	12,24	14,76	13,98	15,03	16,38	16,52	+2,85	+1,64	+5,66
<i>Weak demand <sup>(5)</sup></i>													
EUR 10 <sup>(2)</sup>	29,64	27,20	25,53	27,23	26,86	27,89	28,12	28,29	28,46	29,16	-1,67	+1,70	+1,93
USA	12,57	10,45	8,90	8,81	10,62	10,42	9,37	8,84	8,53	7,76	-1,55	-0,09	-1,05
Japan	9,98	11,64	10,93	10,53	10,99	13,43	13,52	12,90	13,02	12,38	-0,71	-0,40	+1,85

<sup>(1)</sup> Defined as share of exports of a certain country or zone in total exports of all OECD countries (at current prices); including intra-Community trade.

<sup>(2)</sup> EUR 10 excluding intra-Community trade.

<sup>(3)</sup> Products with strong demand: electrical equipment and electronics, information technology, automated office equipment and precision instruments, chemicals and pharmaceuticals. *World demand grew, at an average annual growth rate of around 6%.*

<sup>(4)</sup> Products with moderate demand: transport equipment, food, drink and tobacco, paper pulp, packaging and printing, rubber and plastics, industrial and agricultural machinery. *World demand expanded by an average of 2% to 3% a year.*

<sup>(5)</sup> Products with weak demand: steel and metal ores, metal goods, textiles, leather and clothing, construction materials and non-metallic minerals. *World demand grew by some 1% a year.*  
The average annual growth rate has been calculated on the basis of the average for 1981/1982 compared with the average 1972/1973 (in US \$ at 1975 prices and exchange rates). The classification is based on the growth rate for the area as a whole.

Source: Commission services, Volimex database.

TABLE 32

Gains (+) and losses (-) in shares of export markets over the period 1985/1979 (in declining order of importance) <sup>(1)</sup>EUR 10 <sup>(2)</sup>

Branches	Losses	Branches	Gains
Electrical goods	- 4,39	Leather and footwear	+ 5,45
Motor vehicles	- 4,25	Wood and furniture	+ 4,86
Rubber and plastic products	- 2,53	Textiles and clothing	+ 3,87
Agricultural and industrial machinery	- 2,49	Non-metallic minerals and products	+ 2,47
Other transport equipment	- 2,27	Food, beverage and tobacco products	+ 2,03
Office and data machines, precision and optical instruments	- 2,23	Paper and printing products	+ 1,25
Other manufactured products	- 0,84	Ferrous and non-ferrous ores and metals other than radioactive	+ 1,23
Metal products except machinery and transport equipment	- 0,65	Chemical products	+ 0,51

## USA

Branches	Losses	Branches	Gains
Other manufactured products	- 2,06	Other transport equipment	+ 5,45
Textiles and clothing	- 1,41	Rubber and plastic products	+ 3,63
Ferrous and non-ferrous ores and metals, other than radioactive	- 1,29	Office and data machines; precision and optical instruments	+ 3,30
Motor vehicles	- 0,86	Paper and printing products	+ 0,68
Food, beverage and tobacco products	- 0,52	Electrical goods	+ 0,66
Wood and furniture	- 0,46	Leather and footwear	+ 0,52
Non-metallic minerals and products	- 0,36		
Metal products except machinery and transport equipment	- 0,24		
Chemical products	- 0,01		
Agricultural and industrial machinery	- 0,01		

## Japan

Branches	Losses	Branches	Gains
Food, beverage and tobacco products	0,00	Electrical goods	+ 11,66
		Motor vehicles	+ 9,40
		Office and data machines; precision and optical instruments	+ 5,47
		Agricultural and industrial machinery	+ 5,26
		Other manufactured products	+ 5,24
		Non-metallic minerals and products	+ 3,17
		Rubber and plastic products	+ 3,04
		Other transport equipment	+ 2,71
		Textiles and clothing	+ 2,20
		Metal products except machinery and transport equipment	+ 1,75
		Ferrous and non-ferrous ores and metals, other than radioactive	+ 1,63
		Chemical products	+ 1,35
		Paper and printing products	+ 0,78
		Leather and footwear	+ 0,42
		Wood and furniture	+ 0,18

<sup>(1)</sup> Market share is defined as the exports of USA, Japan or EUR 10 to the rest of the world in relation to exports of OECD countries to the world.<sup>(2)</sup> Only extra-Community trade is taken into account.

Source: Commission services, Volimex database.

TABLE 33

Growth rate of industrial gross fixed capital formation by sector (at 1980 prices)

	1973 to 1979	1979 to 1985	1979 to 1982	1982 to 1985
<i>Total industry:</i>				
EUR 4 <sup>(1)</sup>	-0,4	1,1	-3,8	6,2
USA	5,5	-0,6	-3,4	2,2
Japan	-2,1	9,7	9,2	10,2
<i>Strong demand:</i>				
EUR 4 <sup>(1)</sup>	1,9	1,4	-5,5	8,9
USA	7,2	2,1	3,6	0,7
Japan	-0,8	15,8	13,0	18,6
<i>Moderate demand:</i>				
EUR 4 <sup>(1)</sup>	2,1	0,8	-2,3	3,9
USA	6,4	0,4	-4,1	5,0
Japan	-1,4	8,3	7,0	9,6
<i>Weak demand:</i>				
EUR 4 <sup>(1)</sup>	-5,0	0,1	-6,3	6,9
USA	3,0	-5,5	-10,0	-0,7
Japan	-3,6	5,4	8,4	2,5

<sup>(1)</sup> Federal Republic of Germany, France, Italy, United Kingdom.

Source: Commission services, sectoral data bank.

TABLE 34

Growth rate in employment by sector

	1973 to 1979	1979 to 1985	1979 to 1982	1982 to 1985
<i>Total industry:</i>				
EUR 7 <sup>(1)</sup>	-1,3	-2,5	-2,6	-2,3
USA	0,9	-1,4	-3,6	0,9
Japan	-1,7	1,3	0,9	1,7
<i>Strong demand:</i>				
EUR 7 <sup>(1)</sup>	-0,5	-1,6	-2,4	-0,7
USA	2,1	-0,3	-1,4	0,9
Japan	-2,0	4,9	4,3	5,4
<i>Moderate demand:</i>				
EUR 7 <sup>(1)</sup>	-0,6	-2,0	-1,8	-2,3
USA	1,3	-0,5	-2,9	2,0
Japan	-0,9	0,6	0,9	0,4
<i>Weak demand:</i>				
EUR 7 <sup>(1)</sup>	-1,9	-3,3	-3,5	-3,0
USA	-0,2	-3,3	-5,9	-0,7
Japan	-2,1	0,2	-0,6	0,9

<sup>(1)</sup> Federal Republic of Germany, France, Italy, United Kingdom, Netherlands, Belgium, Denmark.

Source: Commission services, sectoral data bank.

TABLE 35  
European Community general budget, 1985 to 1988:  
payment appropriations, millions of ECU as a percentage of total

	1985 <sup>(1)</sup> EUR 10	1986 <sup>(2)</sup> EUR 12	1987 <sup>(3)</sup> EUR 12	1988 <sup>(4)</sup> EUR 12
<i>Expenditure:</i>				
Agriculture — Guarantee Section	69,9	65,7	63,5	68,1
Agriculture — structural Funds	2,6	2,1	2,6	3,0
Fisheries	0,3	0,4	0,5	0,6
Social Fund	5,0	6,6	7,0	6,4
Regional Fund	5,8	7,1	6,9	7,4
Integrated Mediterranean projects	0,0	0,1	0,5	0,2
Transport	0,3	0,1	0,1	0,2
Energy and industry	0,5	0,2	0,4	0,5
Research and innovation	2,0	1,7	2,1	2,4
Food aid	1,9	0,9	1,6	0,9
Development aid	1,9	1,1	1,5	1,2
Other expenditure including refunds to Member States	9,8	14,0	13,3 <sup>(5)</sup>	9,1
<b>Total</b>	<b>100,0</b>	<b>100,0</b>	<b>100,0</b>	<b>100,0</b>
(Pro memoria: Absolute amount in millions of ECU)	(28 223)	(33 635)	(36 168)	(39 708)
<i>Receipts:</i>				
Agricultural levies	7,7	6,8	8,9	7,6
Customs duties	29,4	24,3	23,2	22,6
Value-added tax (VAT)	53,8	66,1	64,8	44,2
Special contributions	6,8	0,6	0,6	24,9
Miscellaneous	2,3	2,2	2,5	0,7
<b>Total</b>	<b>100,0</b>	<b>100,0 <sup>(6)</sup></b>	<b>100,0 <sup>(7)</sup></b>	<b>100,0 <sup>(8)</sup></b>
(Pro memoria: Absolute amount in millions of ECU)	(28 272)	(33 635)	(36 168)	(39 708)
Maximum rate of VAT	1,0	1,4	1,4	1,0
Effective rate of VAT	1,0	1,37 <sup>(9)</sup>	1,27 <sup>(10)</sup>	1,0 <sup>(11)</sup>
Budget total as a percentage of GDP	0,85	0,98	1,00	1,03

<sup>(1)</sup> Outturn. Management accounts 1985.

<sup>(2)</sup> Provisional outturn. Report on execution of the 1986 Budget.

<sup>(3)</sup> Supplementary and rectifying Budget No 1 1987 adopted on 3 August 1987.

<sup>(4)</sup> Preliminary draft Budget for 1988 proposed by the Commission on 15 June 1987.

<sup>(5)</sup> Includes an estimated deficit of 820 million ECU in respect of 1986.

<sup>(6)</sup> The correction of the budgetary imbalance for the United Kingdom which amounts to 2 685 million ECU gross is included in receipts.

<sup>(7)</sup> The correction of the budgetary imbalance for the United Kingdom which amounts to 2 366 million ECU gross is included in receipts.

<sup>(8)</sup> The correction of the budgetary imbalance for the United Kingdom which amounts to 2 513 million ECU gross is included in receipts.

<sup>(9)</sup> Except for the Federal Republic of Germany (1,33) and the United Kingdom (0,67).

<sup>(10)</sup> Except for the Federal Republic of Germany (1,35) and the United Kingdom (0,83).

<sup>(11)</sup> If the proposed reforms were not carried out, the VAT ceiling agreed at Fontainebleau (1,4 %) would leave a shortfall of about six billion ECU. Even an increased VAT ceiling (1,6 %) would not be sufficient to cover the expenditure planned in the preliminary draft budget.

TABLE 36  
Money and credit targets and outturns

	1981		1985		1986		1987	
	Objective	Outturn	Objective	Outturn	Objective	Outturn	Objective	Outturn (annual rate)
<i>D</i>								
MZ <sup>(1)</sup>	4—7	3,5	3—5	4,4	3,5—5,5	7,8	3—6	7,3 (July)
<i>F</i>								
M2 <sup>(2)</sup>	10,0	11,4	4—6	6,9	3,0—5,0 <sup>(6)</sup>	4,4	3—5	7,2 (June)
<i>E</i>								
M3	14,5—18,5	16				—	—	7,2 (June)
ALP <sup>(8)</sup>			11,5—14,5	12,8	9,5—12,5	11,4	6,5—9,5	13,7 (June)
<i>I</i>								
TDCE <sup>(3)</sup>	16,0	18,2	16,8	17,9		—		
PSCE <sup>(7)</sup>					7	11,4	7	14,2 (June)
M2					7—11	9,4	6—9	12,3 (June)
<i>UK</i> <sup>(4)</sup>								
£ M3 <sup>(9)</sup>	6—10	13,8	5—9	15,1	11—15	18,1	—	20,9 (July)
M0			3—7	6,0	2—6	5,2	2—6	5,3 (July)
<i>USA</i> <sup>(5)</sup>								
M1	3,5—6	2,3	4—7	11,9	3—8	16,5	—	10,5 (July)
M2	6—9	9,2	6—9	8,0	6—9	8,9	5,5—8,5	5,7 (July)
TDCE <sup>(3)</sup>			9—12	12,7	8—11	12,2	8—11	11,3 (July)

<sup>(1)</sup> Central bank money.

<sup>(2)</sup> For 1985 M2R (M2 residents) and for 1986/1987: M3.

<sup>(3)</sup> TDCE-total domestic credit expansion.

<sup>(4)</sup> Before 1985, objectives were annual rates for the change from February to April of the next year; from 1985 they concerned the rate of growth over 12 months and the result is for the 12 months ending in December.

<sup>(5)</sup> The United States also have a target for M3.

<sup>(6)</sup> M3, new definition.

<sup>(7)</sup> Domestic credit to the non-state sector.

<sup>(8)</sup> Liquid assets held by the public.

<sup>(9)</sup> The aggregate £ M3 was replaced by M3 in May 1987.

Source: Commission services.



TABLE 37  
Nominal long-term interest rates

Country	1961 to 1969	1970 to 1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987 <sup>(1)</sup>
B	6,1	8,1	8,5	9,7	12,2	13,8	13,4	11,8	12,0	10,6	7,9	7,7
DK	7,9	13,2	16,8	16,7	18,7	19,3	20,5	14,4	14,0	11,6	10,5	11,8
D	6,6	8,3	5,7	7,4	8,5	10,4	8,9	7,9	7,8	6,9	5,9	5,6
GR	—	9,8	10,0	11,2	17,1	17,6	15,4	18,2	18,5	15,8	15,8	17,4
E	—	—	12,0	13,3	16,0	15,8	16,0	16,9	16,5	13,4	11,4	12,1
F	6,2	9,6	10,6	10,9	13,1	15,8	15,6	13,6	12,5	10,9	8,4	9,0
IRL	—	12,2	12,8	15,1	15,4	17,3	17,0	13,9	14,6	12,7	11,1	11,5
I	6,5	10,2	13,7	14,1	16,1	20,6	20,9	18,0	14,9	14,3	11,7	10,6
NL	5,3	8,3	8,1	9,2	10,7	12,2	10,5	8,8	8,6	7,3	6,4	6,2
P	—	—	—	—	—	—	—	—	—	25,4	17,9	15,2
UK	6,7	11,8	12,6	13,0	13,9	14,8	12,7	10,8	10,7	10,6	9,8	9,3
EUR 12 <sup>(2)</sup>	6,5	9,8	10,3	11,2	12,9	15,0	14,2	12,6	11,8	10,8	9,1	8,9
EUR 10 <sup>(2)</sup>	6,4	9,5	9,3	10,2	11,8	13,8	12,6	10,7	10,4	9,6	7,9	7,7
EMS <sup>(2)</sup>	6,3	9,2	8,8	10,1	11,5	13,5	12,5	10,6	10,3	9,2	7,8	7,5
USA	4,6	6,5	7,9	8,7	10,8	12,9	12,2	10,8	12,0	10,8	8,1	8,2
Japan	—	7,7	6,3	8,3	8,9	8,4	8,3	7,8	7,3	6,5	5,2	4,5

Long-term interest rates adjusted by actual inflation <sup>(3)</sup>

Country	1961 to 1969	1970 to 1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987 <sup>(1)</sup>
B	2,7	0,2	4,0	4,9	8,1	8,5	6,0	5,1	6,4	5,2	3,4	5,5
DK	1,6	2,9	6,3	8,5	9,7	8,4	9,0	6,3	7,9	6,0	5,3	6,9
D	3,2	2,3	1,3	3,3	3,5	6,2	4,3	4,5	5,7	4,6	2,7	3,6
GR	—	-1,5	-2,6	-6,2	-0,5	-2,0	-7,6	-0,8	-1,3	-1,5	-2,7	0,6
E	—	—	-6,8	-2,9	1,8	3,4	1,9	4,7	5,0	4,3	0,2	6,1
F	1,9	0,9	1,0	0,5	0,8	3,6	2,7	3,7	4,9	4,7	3,4	5,5
IRL	—	-1,4	2,1	1,2	0,6	-0,1	1,1	2,3	7,8	7,3	5,1	8,4
I	2,1	-2,5	-0,2	-1,6	-3,7	1,8	4,0	2,3	4,3	5,1	3,4	4,8
NL	0,2	-0,1	2,6	5,1	4,7	6,4	4,2	6,8	6,3	4,8	5,6	7,3
P	—	—	—	—	—	—	—	—	—	3,1	-0,1	3,6
UK	2,7	-0,8	1,2	-1,3	-4,8	3,0	4,6	5,5	6,3	4,5	6,1	5,1
EUR 12 <sup>(2)</sup>	2,3	-0,4	0,0	0,2	-0,3	3,6	3,3	3,8	5,0	4,4	3,3	4,8
EUR 10 <sup>(2)</sup>	2,3	-0,3	0,2	-0,1	-1,1	2,7	2,4	2,6	4,3	3,8	3,0	4,0
EMS <sup>(2)</sup>	2,2	0,3	0,4	1,0	0,4	2,8	2,1	2,1	4,2	3,8	3,9	4,3
USA	1,7	-0,3	0,6	-0,2	1,7	2,9	5,5	6,6	7,9	7,3	5,8	4,7
Japan	—	-1,3	1,4	5,1	4,9	5,0	6,3	6,9	5,9	4,7	3,2	3,8

<sup>(1)</sup> Average of first seven months.

<sup>(2)</sup> For countries available in the years in question.

<sup>(3)</sup> GDP deflator.

Source: Commission services.

TABLE 38  
Synthetic indicators of budgetary policy in the Community

(% of GDP)

	EUR 12 <sup>(2)</sup> : General government									
	1970 <sup>(2)</sup>	1973 <sup>(2)</sup>	1981	1982	1983	1984	1985	1986	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
<i>Receipts:</i>										
1. Indirect taxes	13,1	12,2	12,6	12,7	12,9	13,1	12,9	13,1	13,1	13,1
2. Direct taxes	9,5	9,8	11,6	11,8	12,0	12,2	12,4	12,2	12,4	12,2
3. Social contributions received	10,3	11,3	14,0	14,4	14,7	14,6	14,6	14,5	14,6	14,8
4. Tax burden (1 + 2 + 3)	32,9	33,3	38,1	39,0	39,6	39,9	39,9	39,8	40,1	40,2
5. Other current receipts	3,0	3,0	3,7	3,8	3,8	3,8	4,0	3,9	3,6	3,5
6. Total current receipts (4 + 5)	35,9	36,2	41,8	42,8	43,4	43,6	43,9	43,7	43,7	43,5
<i>Expenditure:</i>										
7. Current expenditure (- of which interest)	30,8 (1,9)	33,0 (1,9)	43,1 (3,7)	44,4 (4,1)	45,0 (4,4)	45,2 (4,8)	45,1 (5,0)	44,7 (5,0)	44,5 (4,8)	44,3 (4,8)
8. Public investment	4,0	3,6	3,0	3,0	2,9	2,8	2,8	2,7	2,7	2,8
9. Other capital expenditure	0,8	0,7	1,0	0,9	0,9	1,0	1,1	0,9	0,9	0,8
<i>Budget balance:</i>										
10. Total	0,3	-1,1	-5,3	-5,5	-5,3	-5,3	-5,2	-4,7	-4,4	-4,4
11. Total excluding interest	2,2	0,8	-1,6	-1,4	-0,9	-0,6	-0,2	0,4	0,4	0,4
<i>Public debt:</i>										
12. Percentage of GDP	—	36,9	43,1	48,2	51,5	54,3	56,9	58,1	60,4	62,8
13. % change p.a.	—	—	—	11,8	6,8	5,4	4,8	2,1	4,0	4,0

<sup>(1)</sup> Economic Forecasts, September 1987.<sup>(2)</sup> EUR 12; without Greece, Ireland and Portugal in 1970 and 1973.

Source: Eurostat and Commission services.

TABLE 39  
General government expenditure, receipts and lending

(% of GDP)

	1970	1973	1981	1982	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
(a) Total current receipts										
B	36,5	38,2	45,2	46,8	46,1	47,3	47,8	46,1	46,5	46,3
DK	46,2	47,3	52,9	52,0	54,4	56,7	57,4	58,7	58,5	59,0
D	38,9	42,9	45,6	46,1	45,8	46,1	46,4	45,5	45,4	45,1
GR	26,5	25,1	28,9	32,0	33,2	34,2	34,5	36,0	37,0	37,4
E	22,9	24,1	31,7	31,9	34,0	33,8	35,4	36,4	37,2	37,2
F	39,8	39,4	46,7	47,6	48,2	49,1	49,2	48,8	48,7	48,9
IRL	:	:	38,4	40,5	42,7	43,0	43,1	43,3	44,2	44,3
I	26,7	26,7	34,1	36,2	38,1	38,0	38,5	39,2	39,7	39,9
L	35,8	39,4	54,7	54,1	56,4	54,5	56,9	55,2	54,2	54,2
NL	41,1	46,4	53,8	54,2	55,6	54,4	55,1	53,4	53,1	52,2
P	:	:	33,0	33,3	37,1	34,4	33,1	35,5	33,9	33,9
UK	39,8	35,6	41,8	42,5	41,8	42,0	41,8	41,0	40,6	39,7
EUR 12	35,9 <sup>(2)</sup>	36,2 <sup>(2)</sup>	41,8	42,8	43,4	43,6	43,9	43,7	43,7	43,5

(b) Total expenditure including capital <sup>(3)</sup>

B	38,6	41,5	58,0	57,8	57,5	56,7	56,2	54,9	53,1	52,4
DK	42,1	42,1	59,8	61,2	61,6	60,7	59,5	55,4	56,6	57,3
D	38,7	41,7	49,2	49,4	48,4	48,0	47,5	46,7	47,0	47,1
GR	:	:	39,9	39,7	41,5	44,3	48,1	46,7	47,6	47,3
E	22,1	22,9	35,6	37,5	38,8	39,3	42,2	42,1	42,2	42,1
F	38,9	38,5	48,6	50,3	51,4	51,8	52,1	51,8	51,5	51,3
IRL	:	:	51,8	54,3	54,5	52,9	54,7	54,0	53,2	52,1
I	29,7	32,8	45,5	47,6	48,8	49,5	50,8	50,5	50,1	50,3
L	33,1	36,1	57,9	55,7	56,2	52,5	52,5	51,4	51,4	51,2
NL	42,3	45,4	59,2	61,3	62,0	60,7	59,9	58,0	58,8	58,2
P	:	:	42,5	43,6	46,2	46,4	43,1	43,7	42,7	41,7
UK	36,9	38,3	44,4	45,0	45,2	45,9	44,6	43,6	42,6	41,7
EUR 12	35,6 <sup>(2)</sup>	37,3 <sup>(2)</sup>	47,1	48,3	48,7	49,0	49,1	48,4	48,1	47,8

(c) Total net lending (+) or borrowing (-) including interest payments

B	-2,2	-3,3	-12,8	-11,0	-11,3	-9,4	-8,4	-8,7	-6,6	-6,1
DK	4,1	5,2	-6,9	-9,1	-7,2	-4,1	-2,1	3,3	1,9	1,7
D	0,2	1,2	-3,7	-3,3	-2,5	-1,9	-1,2	-1,2	-1,6	-2,0
GR	:	:	-11,0	-7,7	-8,3	-10,0	-13,6	-10,7	-10,6	-9,8
E	0,7	1,1	-3,9	-5,6	-4,8	-5,5	-6,7	-5,7	-5,0	-4,9
F	0,9	0,9	-1,9	-2,8	-3,2	-2,7	-2,9	-3,0	-2,8	-2,3
IRL	:	:	-13,4	-13,7	-11,8	-9,9	-11,6	-11,2	-10,0	-7,5
I	-3,1	-6,1	-11,5	-11,3	-10,7	-11,5	-12,3	-11,3	-10,4	-10,4
L	2,7	3,3	-3,2	-1,6	0,2	2,0	4,4	3,9	2,8	3,1
NL	-1,2	1,0	-5,5	-7,1	-6,4	-6,3	-4,7	-4,6	-5,7	-6,0
P	:	:	-9,5	-10,3	-9,1	-12,0	-10,0	-8,2	-8,8	-7,8
UK	2,9	-2,7	-2,5	-2,4	-3,4	-3,9	-2,9	-2,7	-2,0	-2,0
EUR 12	0,3 <sup>(2)</sup>	-1,0 <sup>(2)</sup>	-5,3	-5,5	-5,3	-5,3	-5,2	-4,8	-4,5	-4,5

	1970	1973	1981	1982	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
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## (d) Interest payments on the public debt

B	3,4	3,3	7,9	9,2	9,4	9,9	10,6	11,1	10,9	11,0
DK	1,3	1,3	5,3	6,0	8,1	9,7	9,9	8,8	8,2	7,8
D	1,0	1,1	2,3	2,8	3,0	3,0	3,0	3,0	2,9	2,9
GR	:	:	3,2	2,6	3,7	4,6	5,4	5,9	6,5	6,9
E	0,6	0,6	0,8	1,0	1,3	2,0	3,4	3,9	3,7	3,7
F	1,1	0,8	2,0	2,0	2,6	2,7	2,9	2,9	2,8	2,8
IRL	:	:	7,4	9,0	9,4	9,6	10,9	10,1	10,4	10,7
I	1,5	2,2	6,2	7,2	7,6	8,1	8,1	8,5	7,7	7,9
L	1,1	1,0	0,9	1,0	1,0	1,2	1,3	1,3	1,3	1,1
NL	2,9	2,8	4,4	5,1	5,7	5,9	6,3	6,0	6,0	5,9
P	:	:	5,2	5,4	6,4	7,1	7,8	9,3	8,1	7,2
UK	3,9	3,7	5,1	4,7	4,9	5,0	5,0	4,5	4,3	4,1
EUR 12	1,9 <sup>(2)</sup>	1,9 <sup>(2)</sup>	3,7	4,1	4,4	4,8	5,0	5,0	4,8	4,8

<sup>(1)</sup> *Economic Forecasts*, September 1987.<sup>(2)</sup> Without Greece, Ireland and Portugal.<sup>(3)</sup> Net of capital transfers received.

Source: Eurostat and Commission services.

TABLE 40  
Share of selected items of general government receipts and expenditure in GDP

	1970 to 1973	1974 to 1980	1981	1982	1983	1984	1985	1986 <sup>(1)</sup>	1987 <sup>(1)</sup>	1988 <sup>(1)</sup>
(a) Gross fixed capital formation of general government										
B	4,4	3,7	3,7	3,4	3,0	2,6	2,2	1,9	1,7	1,7
DK	4,4	3,7	3,0	2,8	2,3	1,9	2,2	1,7	2,1	2,1
D	4,3	3,6	3,2	2,8	2,5	2,4	2,3	2,4	2,4	2,4
GR	:	:	3,9	2,9	3,3	4,1	4,4	4,1	3,7	3,5
E	2,7	2,2	2,3	3,1	2,8	3,0	3,6	3,4	3,6	3,7
F	3,7	3,4	3,2	3,4	3,3	3,0	3,1	3,2	3,2	3,2
IRL	:	5,3	5,7	5,1	4,4	3,8	3,8	3,5	3,2	2,9
I	2,6	2,9	3,6	3,7	3,7	3,5	3,7	3,4	3,3	3,4
L	4,7	6,3	6,7	6,7	5,4	4,9	4,8	4,6	4,6	4,6
NL	4,4	3,5	3,1	2,9	2,7	2,8	2,5	2,2	2,2	2,2
P	:	:	4,3	3,4	3,1	2,6	2,5	3,0	3,5	4,1
UK	4,7	3,6	1,8	1,6	2,0	2,0	2,0	2,0	1,9	1,9
EUR 12	3,8 <sup>(2)</sup>	3,3 <sup>(2)</sup>	3,0	3,0	2,9	2,8	2,8	2,7	2,7	2,8

## (b) Direct taxes

B	12,1	16,8	18,0	19,3	18,6	19,2	19,1	18,4	18,4	18,3
DK	23,8	25,2	25,8	25,4	26,6	27,6	28,5	29,0	28,5	29,5
D	11,5	12,8	12,2	12,1	12,0	12,1	12,5	12,2	12,2	11,9
GR	3,7	4,7	4,7	5,9	5,5	5,9	5,6	6,0	6,1	6,4
E	3,7	5,2	7,2	6,8	7,9	8,3	8,5	8,4	9,7	9,7
F	6,9	7,8	8,6	8,8	8,9	9,1	9,0	9,2	9,3	9,3
IRL	:	10,9	12,9	13,3	14,0	14,9	14,8	15,6	16,3	16,4
I	5,0	7,4	10,9	11,8	12,4	12,7	13,0	12,9	13,7	13,7
L	13,0	18,2	18,0	17,9	19,4	18,2	20,0	18,7	17,5	17,8
NL	14,0	17,0	15,1	14,7	13,6	12,7	12,7	13,4	13,7	13,5
P	:	:	7,7	7,6	8,5	8,3	8,3	7,1	6,4	6,3
UK	13,3	14,2	14,3	14,6	14,4	14,6	14,7	14,0	13,8	13,3
EUR 12	9,6 <sup>(2)</sup>	10,9 <sup>(2)</sup>	11,6	11,8	12,0	12,2	12,4	12,2	12,4	12,3

## (c) Social security contributions

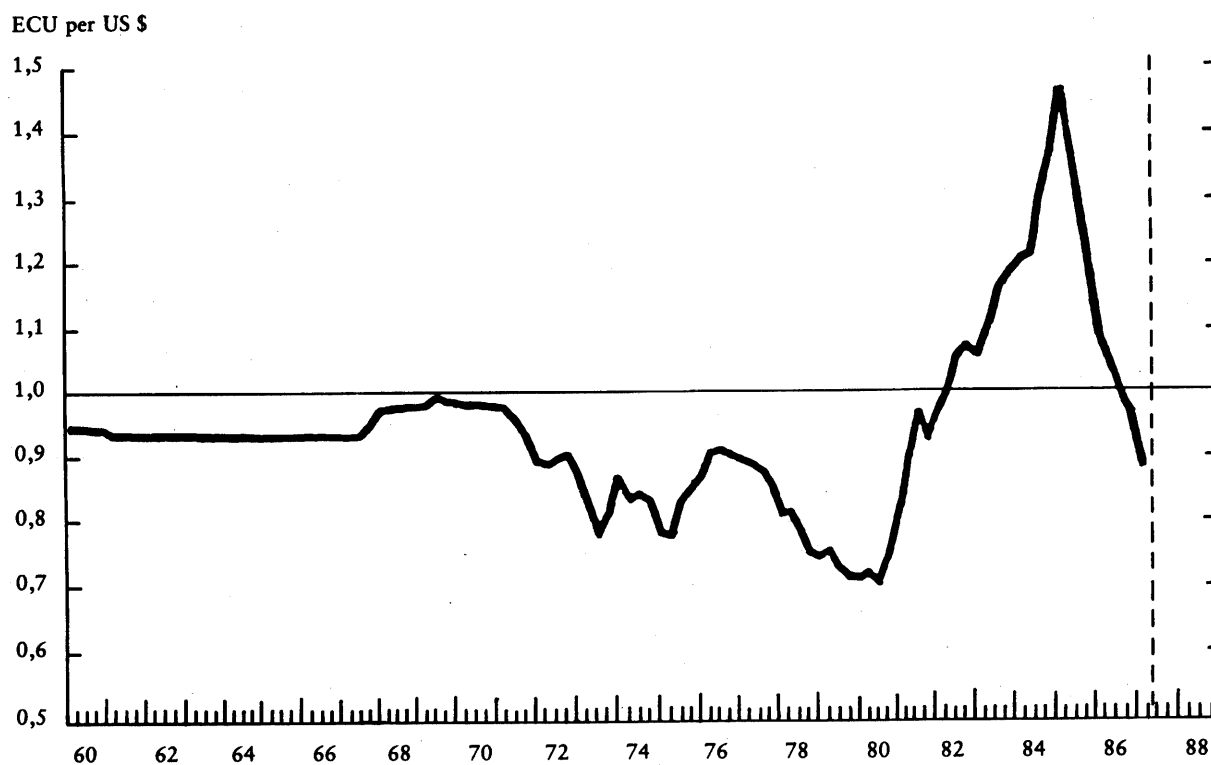
B	10,8	12,3	12,7	12,7	13,2	14,0	14,7	14,4	14,7	14,6
DK	2,3	1,6	2,1	2,4	2,9	2,9	2,9	2,5	3,0	3,1
D	13,5	16,4	17,4	17,8	17,3	17,3	17,5	17,4	17,6	17,6
GR	6,6	7,8	9,1	10,2	10,9	11,1	11,5	11,8	11,7	12,3
E	7,4	10,7	13,4	13,3	13,7	13,1	13,1	12,9	12,7	12,6
F	14,8	17,8	19,6	20,2	20,7	21,0	21,2	21,0	21,1	21,4
IRL	:	4,4	4,9	5,5	5,8	5,8	5,8	5,8	5,8	5,9
I	10,8	12,1	12,8	13,7	14,1	13,7	13,7	14,0	13,8	13,8
L	10,5	14,6	15,6	14,9	14,4	13,6	13,6	13,4	13,7	13,7
NL	14,8	17,4	18,7	19,7	21,9	20,7	20,6	19,5	20,0	20,0
P	:	:	9,3	9,6	10,0	9,3	9,0	8,3	8,2	8,2
UK	5,2	6,2	6,3	6,5	6,9	7,0	6,9	7,0	7,0	7,0
EUR 12	10,8 <sup>(2)</sup>	13,1 <sup>(2)</sup>	14,0	14,4	14,7	14,6	14,6	14,5	14,6	14,6

(1) Economic Forecasts, September 1987.

(2) Without Greece, Ireland and Portugal.

Source: Eurostat and Commission services.

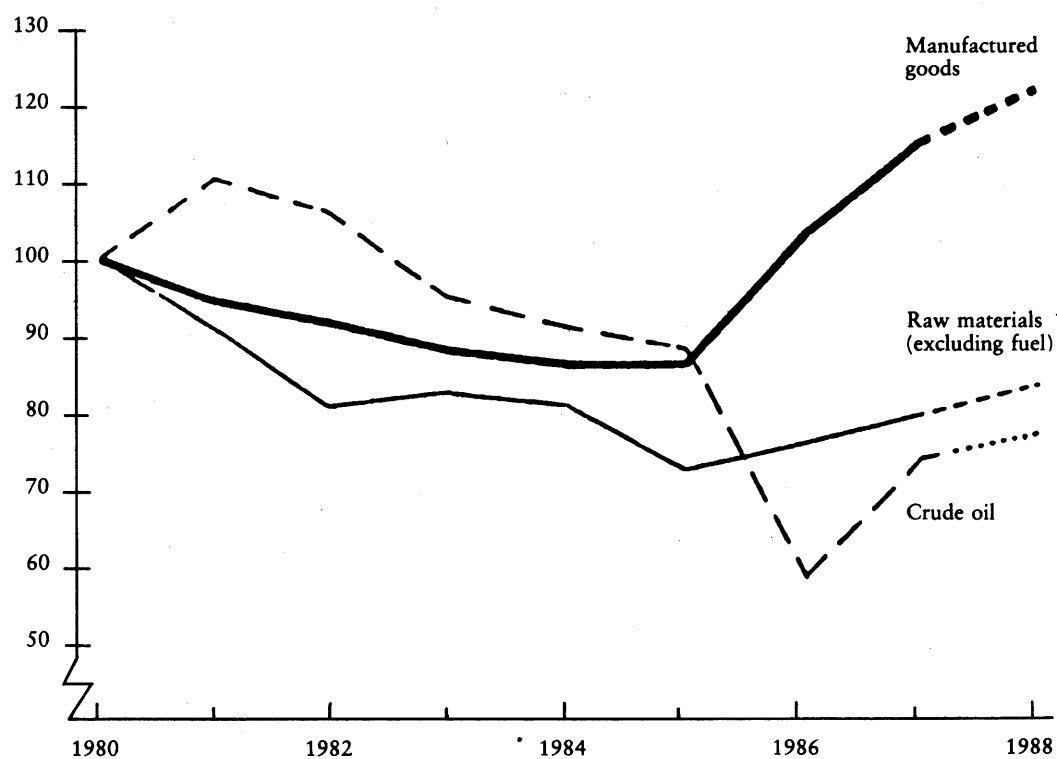
GRAPH 1  
ECU/US \$ exchange rate (quarterly averages) <sup>(1)</sup>



<sup>(1)</sup> For 1987/1988: *Economic Forecasts*, September 1987.  
Source: Commission services.

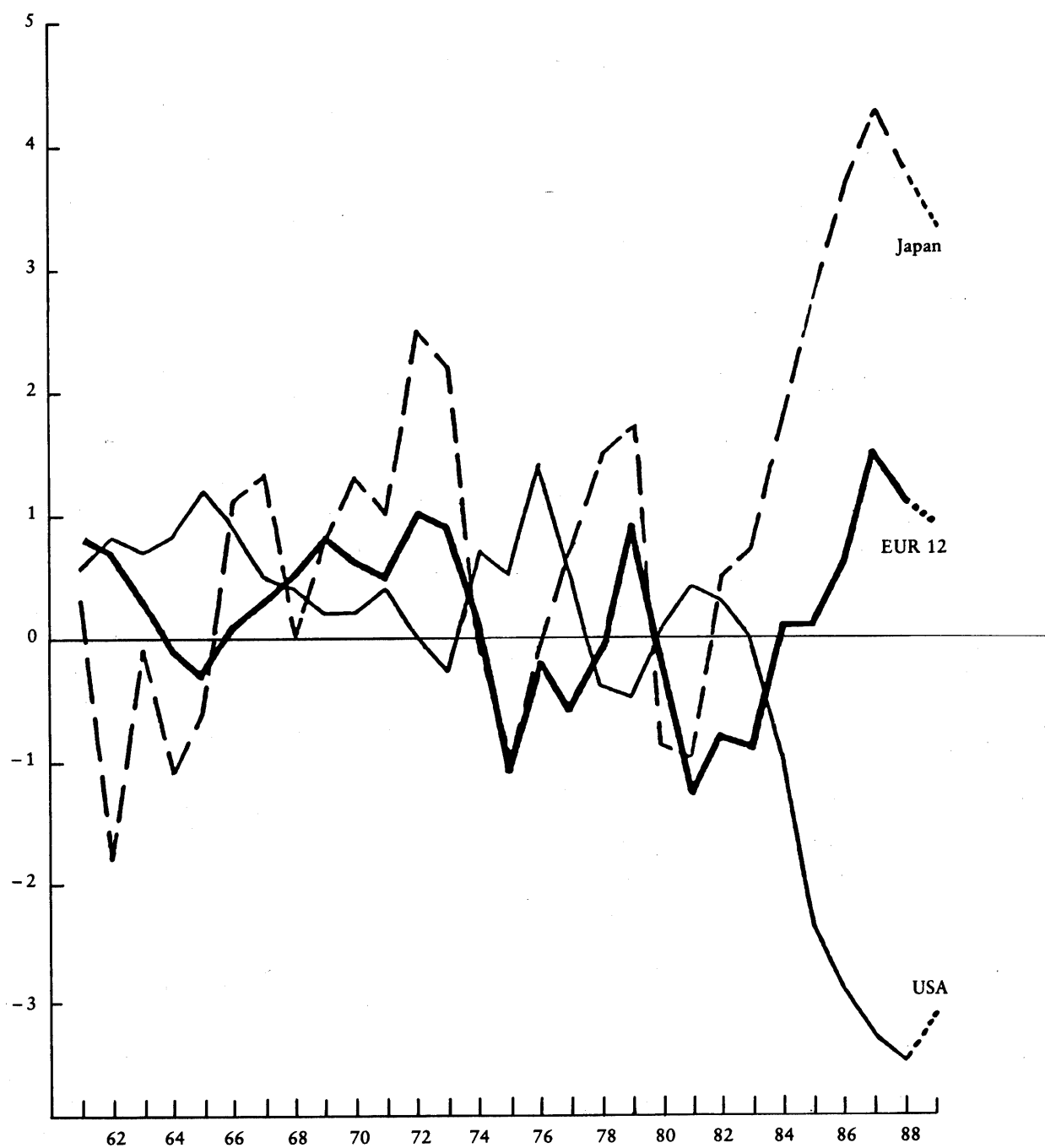
GRAPH 2

World prices for crude oil, raw materials (excluding fuel) and manufactured goods US \$

(Index 1980 = 100) <sup>(1)</sup><sup>(1)</sup> For 1987/1988: *Economic Forecasts*, September 1987.

Source: Commission services.

GRAPH 3

Balance on current transactions with rest of the world as a percentage of GDP <sup>(1)</sup><sup>(1)</sup> For 1987/1988: *Economic Forecasts*, September 1987.

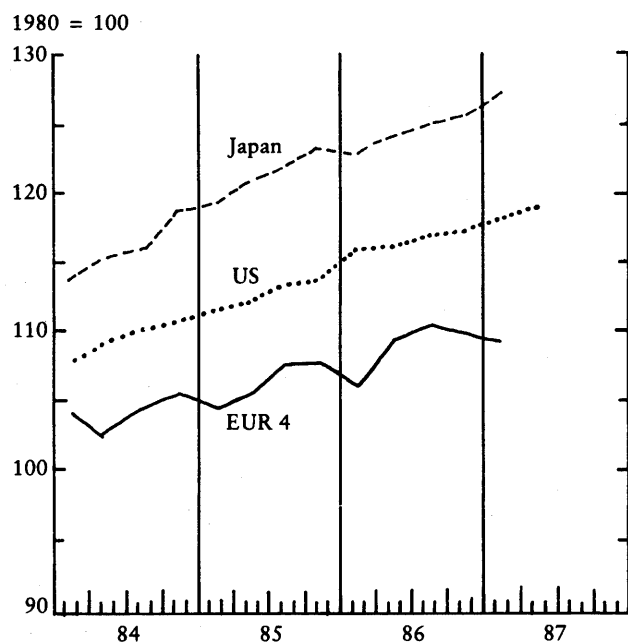
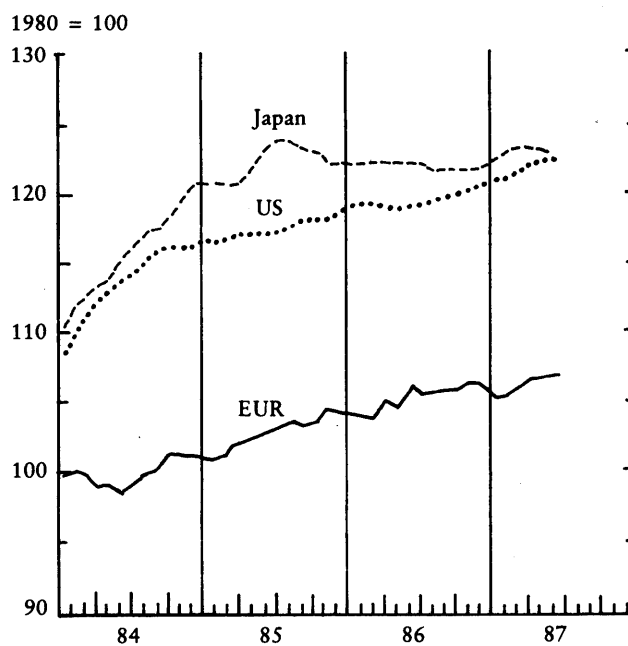
Source: Commission services.



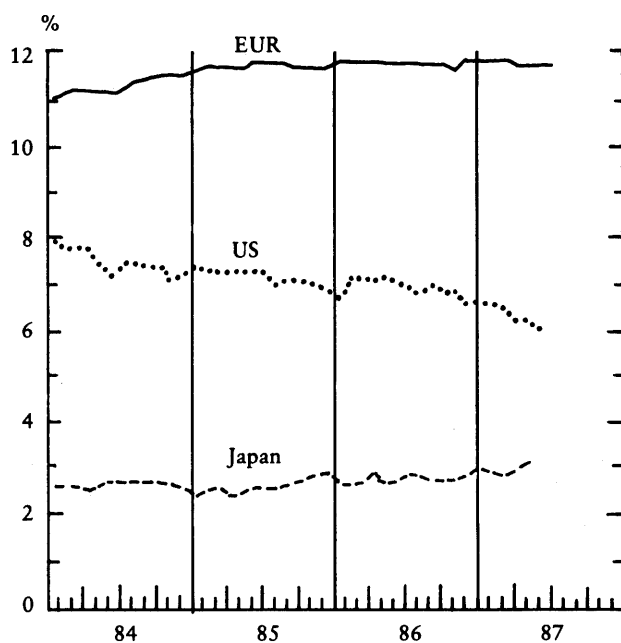
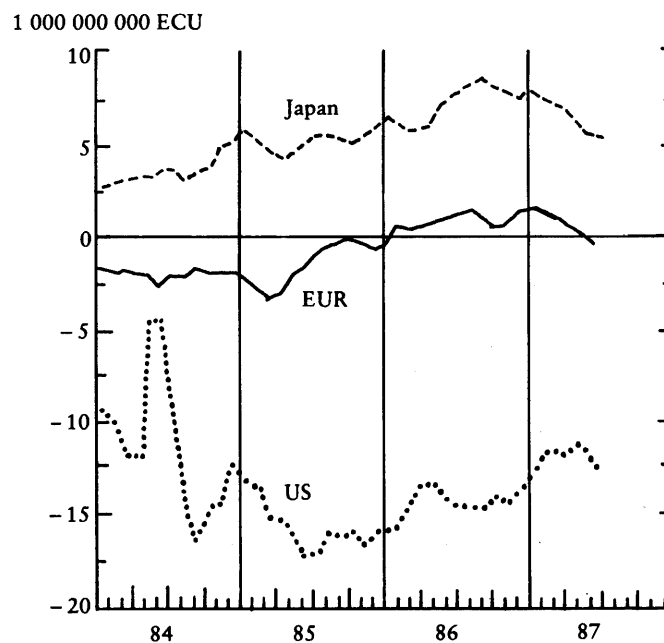
## GRAPHS 4 to 7

## Comparative evolution of the Community, US and Japanese economies, 1984 to 1987

4. Gross domestic product, s.a.

5. Industrial production  
three-month moving average, s.a.

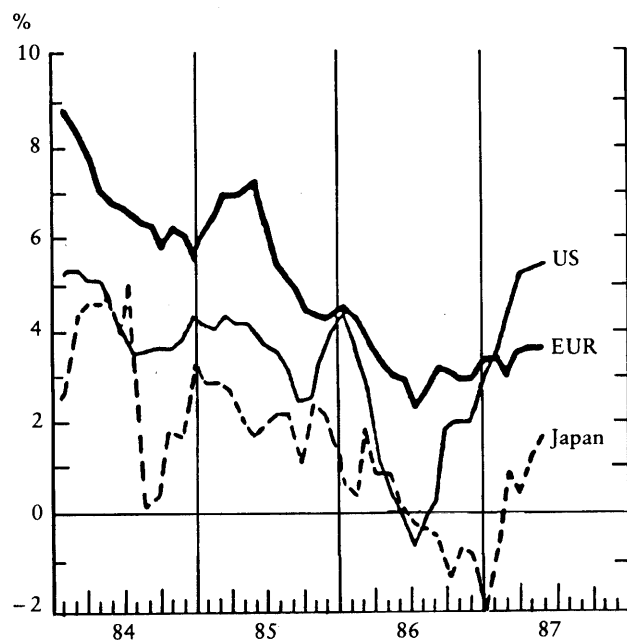
6. Unemployment rate, s.a.

7. Trade balance  
fob/cif, billions ECU, three-month moving average, s.a.

## GRAPHS 8 to 11

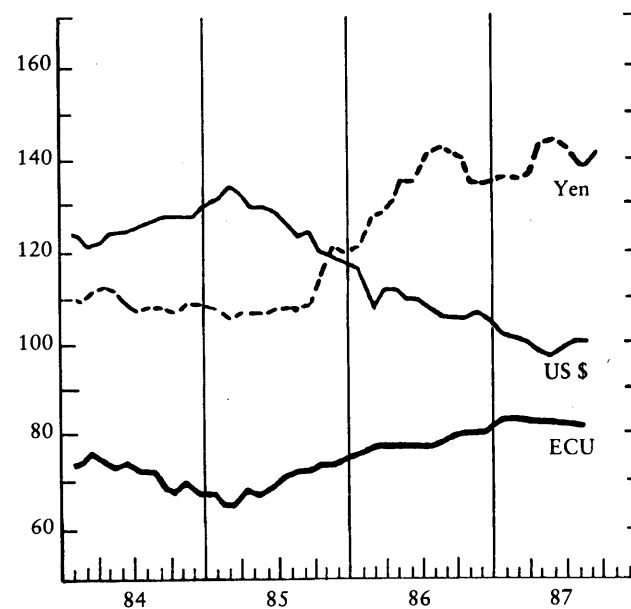
## Comparative evolution of the Community, US and Japanese economies, 1984 to 1987

8. Consumer prices  
six-month change, s.a., annual rates

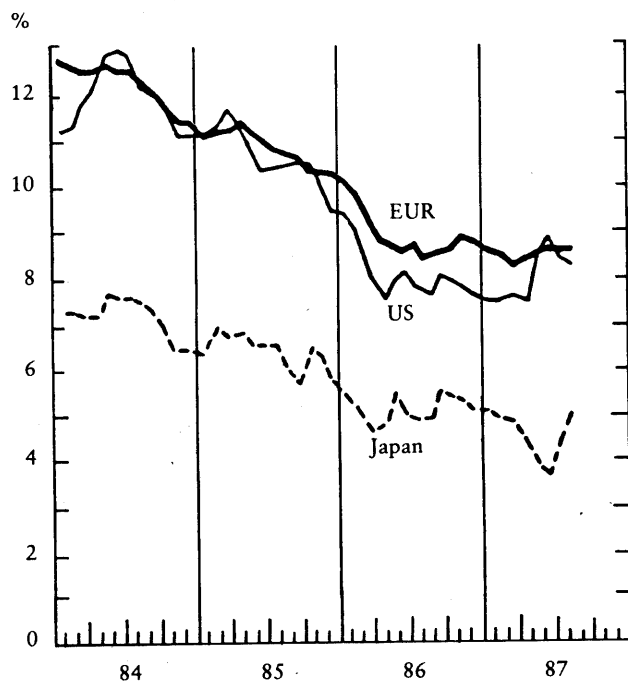


9. Exchange rates  
Index of SDRs per currency unit

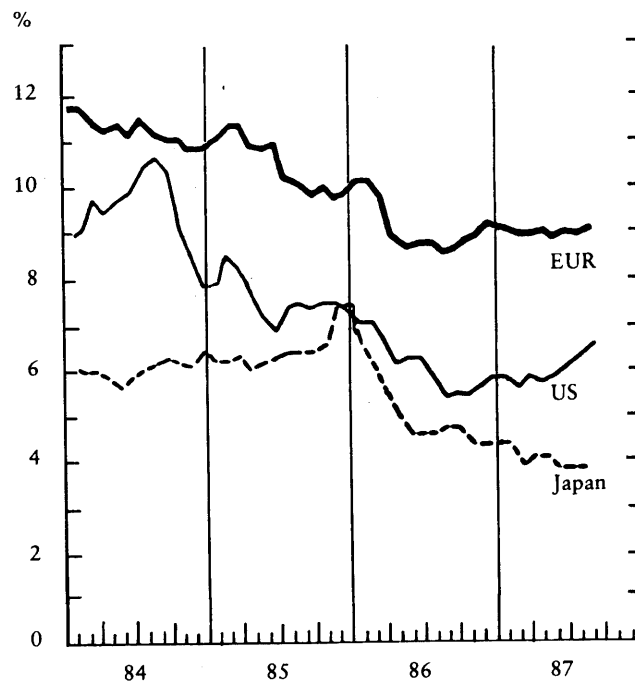
March 1979 = 100



10. Long-term interest rates

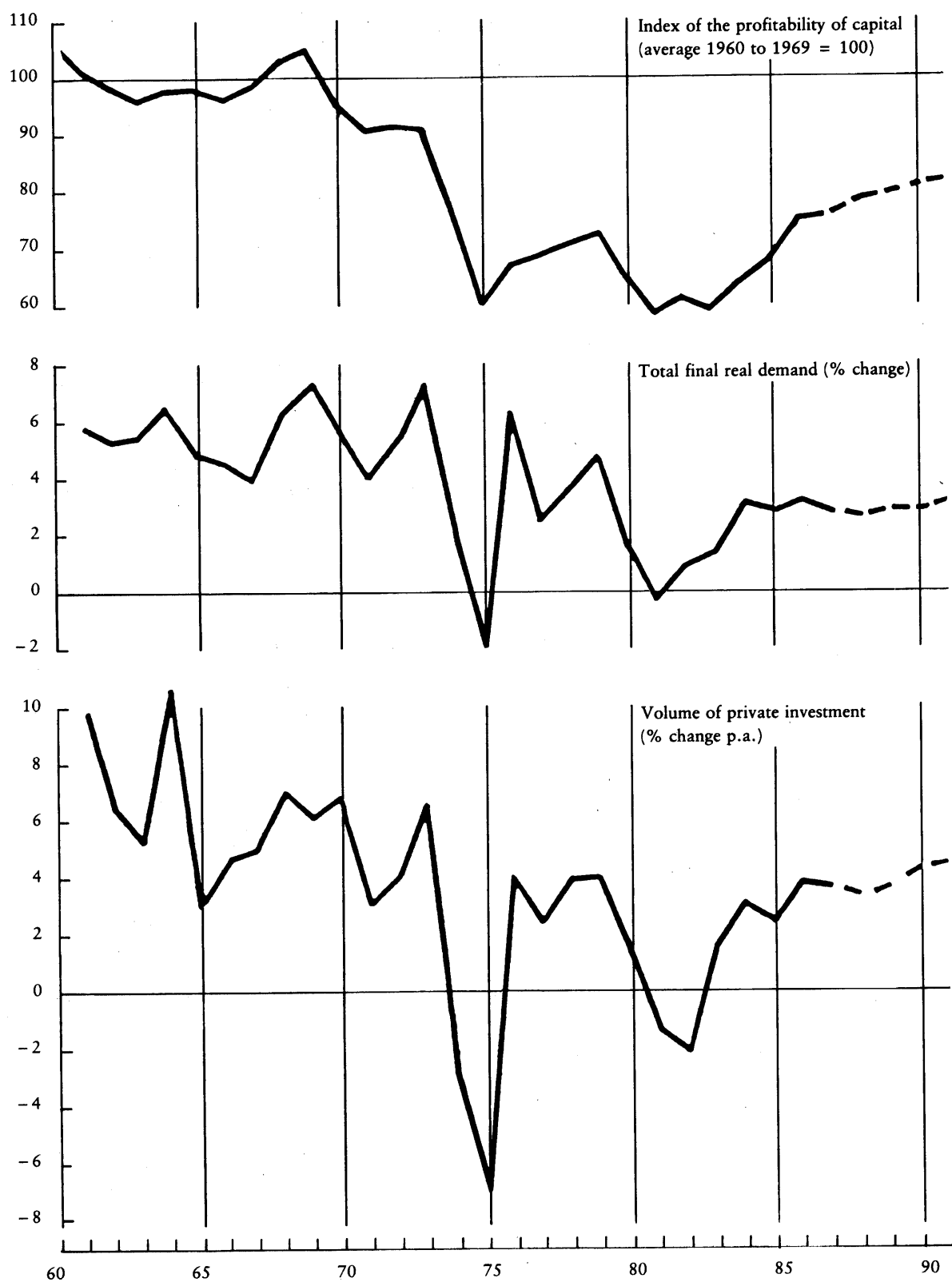


11. Short-term interest rates



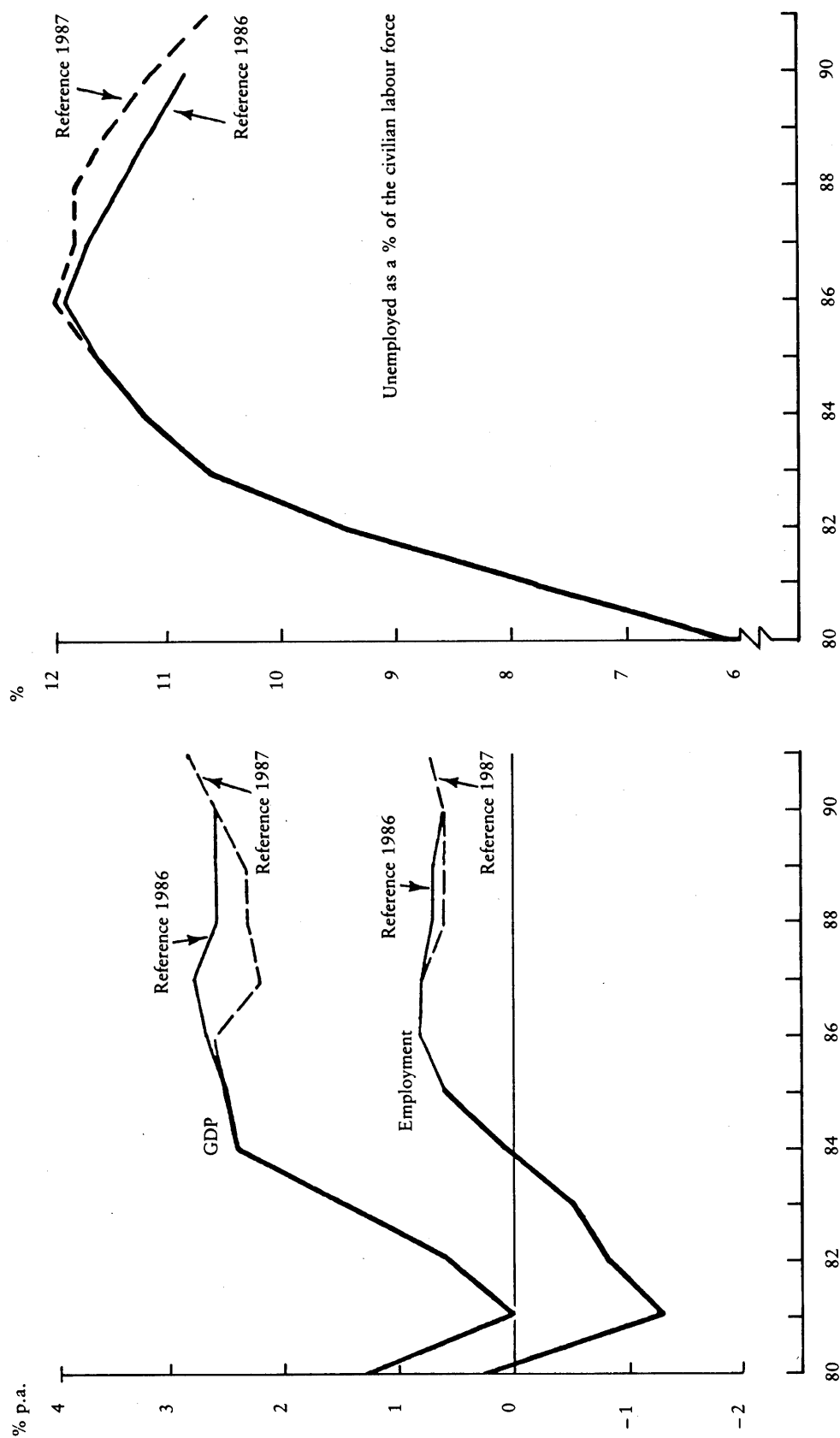
GRAPH 12

Profitability, total final demand and private investment (past developments and medium-term projections)



GRAPH 13

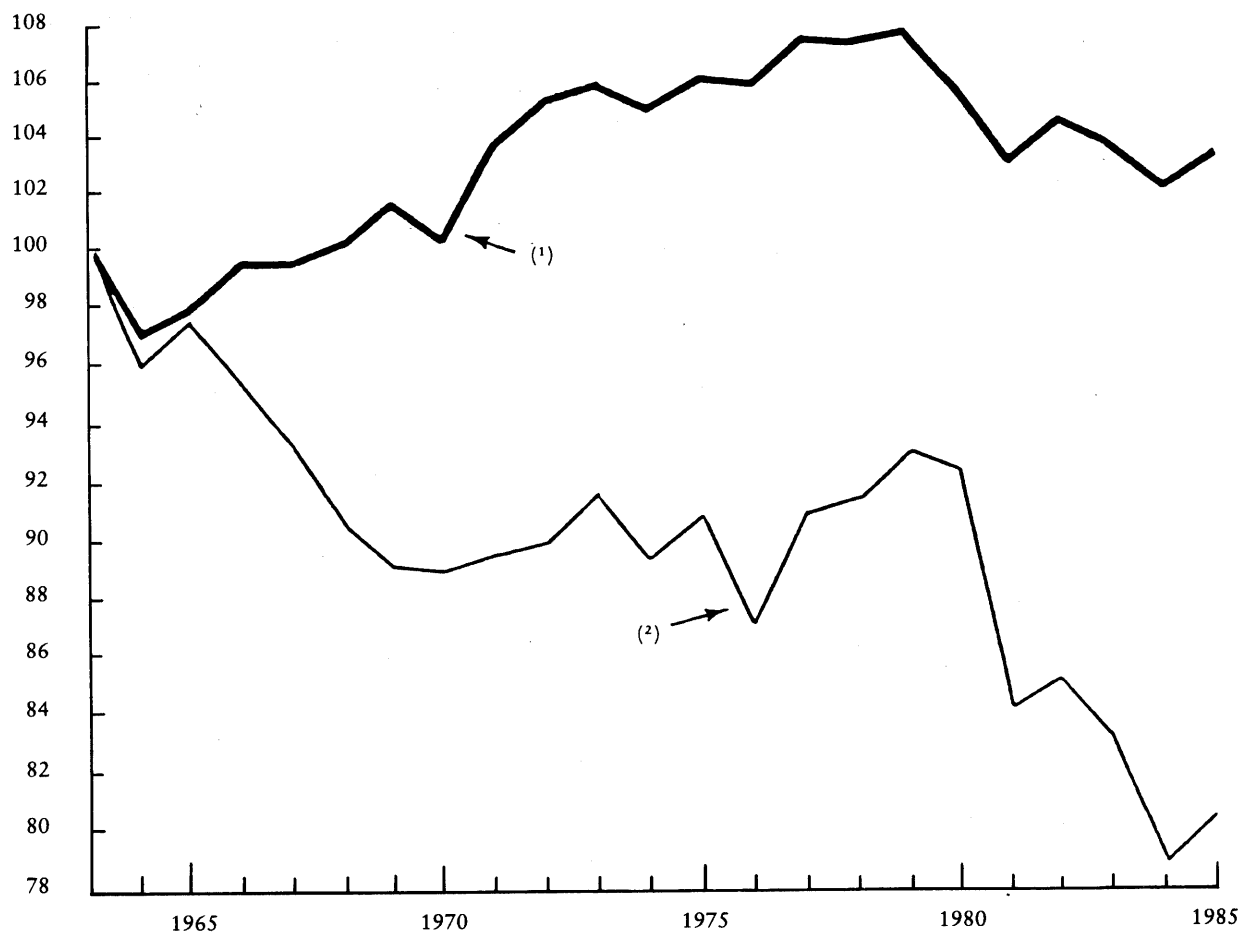
Growth, employment and unemployment in the 1986 and 1987 reference projections — EUR 12



Source: Commission services.

GRAPH 14

Shares of world market for exports of Community industrial products  
(Indices, 1963 = 100)



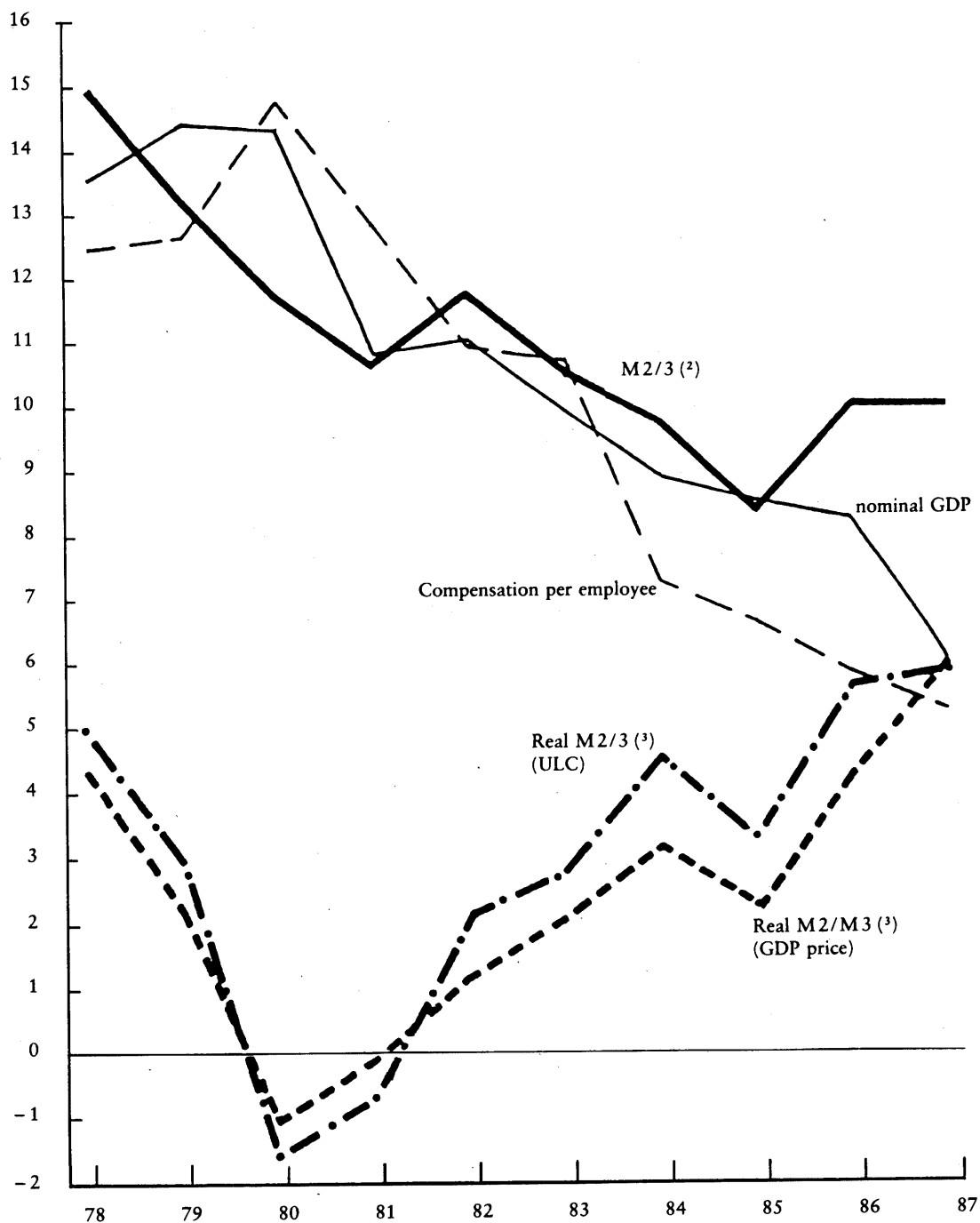
(<sup>1</sup>) Index of the market share of intra-Community (EUR 10) exports with respect to OECD countries' exports to the Community (EUR 10).

(<sup>2</sup>) Index of Community (EUR 10) exports to third countries with respect to that of exports of OECD countries to the same destination.

Source: Commission services, Volimex database.

GRAPH 15

Money supply in real terms and the deceleration of nominal variables (EUR 12) (average annual percentage change) <sup>(1)</sup>

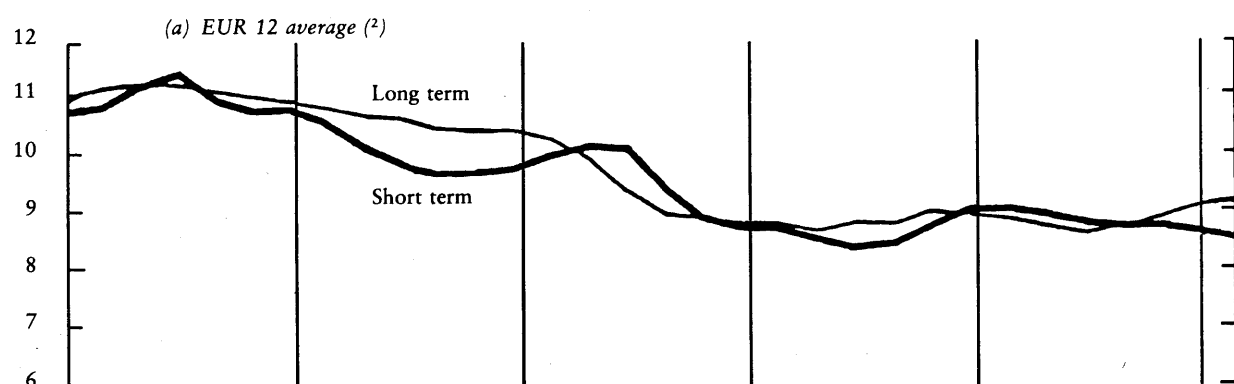


<sup>(1)</sup> Economic Forecasts September 1987.

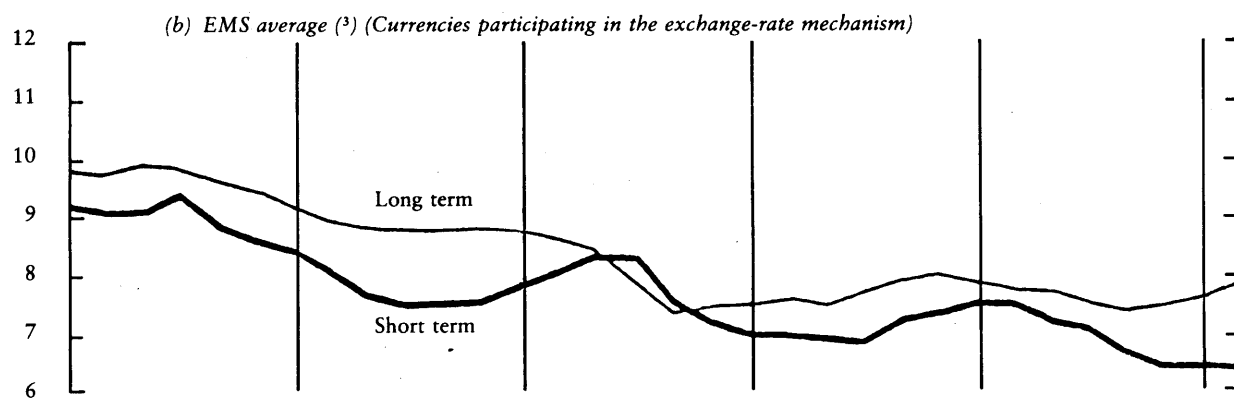
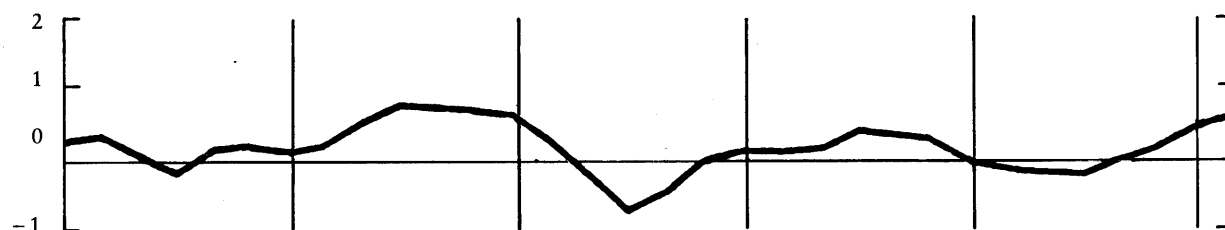
<sup>(2)</sup> Broad money supply, annual average.

<sup>(3)</sup> Broad money supply deflated by the index of unit labour costs or GDP prices.

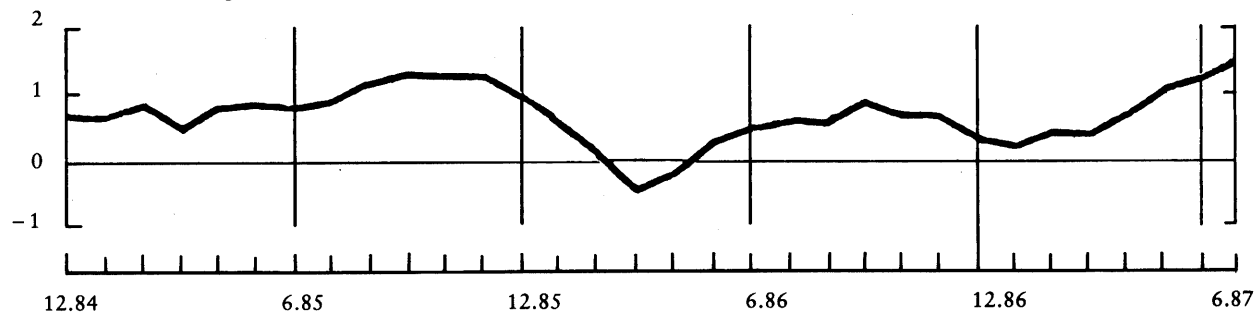
GRAPH 16

Long-term and short-term nominal interest rates <sup>(1)</sup>

Difference between long- and short-term rates:



Difference between long- and short-term rates:

<sup>(1)</sup> Representative rates in the various countries on the money market (in general three months) and for long-term government securities.<sup>(2)</sup> Private consumption weights.<sup>(3)</sup> Weighted by relative weights of currencies.