

COMMISSION OF THE EUROPEAN COMMUNITIES

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THE ECONOMIC AND SOCIAL SITUATION IN THE COMMUNITY

(Communication from the Commission to the European Council)

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1. Present trends and outlook

The pace of economic activity has slackened in the Community during the second half of 1980 as the recession which started early in year has gathered momentum. Since the summer, there have been some signs of a slowdown in the upward movement of consumer prices. The annual rate of growth in the money supply, now running at 10%, has thus moved closely into line with the trend observed during the 1960s, under the impact of the restrictive monetary policy stance in a number of Member States. Exchange rate fluctuations within the European Monetary System in 1980 have remained within the margins fixed.

2. In 1980, the Community has witnessed a further deterioration in its external position owing to the adverse swing in its terms of trade caused by the oil price increases and to some contraction in its share of world markets attributable in part to the erosion of its price and cost competitiveness; this year, the deficit on current account will probably reach 31 000 million ECU (\$43 000 million). As yet, the Member States have not encountered any difficulty in funding this deficit by way of capital imports.

3. Outlook for 1981

The forecasts prepared in October put the growth of gross national product in 1981 at 0.6% in real terms. Unemployment is likely to rise further, to average 6.8% in 1981. Private consumption should provide the main stimulus to internal demand. Consumer prices are expected to rise by 9.7% in 1981, compared with 12% in 1980.

4. Assuming that the growth in world trade starts to pick up again during 1981, the Community's current account deficit could be reduced to some 25 000 million ECU (\$36 000 million).

5. The sharp decline in the business climate indicators discernible in the summer came to a halt for the first time in October, a possible indication of a reversal in the trend of activity in early 1981. This would be in line with the assumption underlying the Commission's forecasts.

However, the risks of a more unfavourable trend in 1981 have increased recently, notably because of the growing uncertainty of the conditions in which the Community obtains its energy supplies.

6. Economic policy guidelines

The outlook for 1981 points to a further deterioration in the employment situation.

This cannot be remedied by a policy aimed at boosting demand which might very soon come up against the constraints imposed by energy supplies and by the external deficit and might exacerbate inflationary strains. The solution lies in a package of short-term and medium-term measures designed to strengthen competitiveness and to help achieve more effective adjustment of the structures of the Member States' economies in order to rebuild the foundations for more sustained growth.

7. In order to be fully effective, these measures must be coordinated at Community level and must form part of a concerted strategy comprising three key elements:

- (i) the fight against inflation and the pursuit of convergence towards low inflation rates, so as to promote both competitiveness and exchange rate stability;
- (ii) vigilance in the face of the dangers of more pronounced recessionary chain reactions;
- (iii) increased efforts to enhance the flexibility and adaptability of the European economies.

8. The continuation of an unduly rapid rate of increase in prices in most Member States and the widening inflation differentials within the Community mean that the strategy of enforcing monetary discipline must be continued. However, if this strategy is to be made more effective without becoming excessively strict, it is essential to secure wage moderation, particularly in the high-inflation countries, ensuring that in the majority of cases increases are restricted at the very most to maintenance of purchasing power.

9. The European Monetary System has operated to exemplary fashion since its establishment; making for greater stability and solidarity in monetary affairs in Europe. Such stability and solidarity can be consolidated by strengthening the EMS while at the same time making preparation for the transition to the system's institutional stage at the appropriate moment. The process of strengthening the EMS should involve extension to those Member States not yet taking part and adjustment and expansion of the mechanisms that reflect, both internally and externally, the existence of Community solidarity. This latter objective is pursued by proposals now before the Council which are concerned primarily with adjusting the Community loan mechanism to assist countries in balance-of-payments difficulties and with expanding gradually the role of the ECU.

10. Consolidation of Community cohesion on the monetary front is essential if the Community is to be in a position to make a more effective contribution to solving the serious problems arising, for it and for the Third World, from the international payments imbalances. It must enable the Community to take a more active part in recycling capital and to play an important role in creating a more balanced pattern of economic and monetary relationships at international level.

11. Although it is essential that Member States give effect to the adjustment policies and make every effort necessary to restore their external balances by improving competitiveness, they must rule out deflation as an instrument for restoring external equilibrium. While endeavouring to reduce gradually their external deficits caused by the oil price increases, Member States must, to the extent that these deficits are result of an imbalance in their relationships with the OPEC countries that can be rectified only in the course of time, tolerate them, at least for the time being. The purpose of adjusting the Community loan arrangements is precisely to assist Member States which might encounter difficulties in raising sufficient funds internationally during this period of transition and adjustment.

12. Rejection of deflation and vigilance on the part of the Community with regard to the risks of a cumulative recession must be reflected in the use made of economic policy instruments.

In the budgetary area, the immediate urgency of controlling the money supply and the need to improve the allocation of resources (in

terms of both budgetary expenditure and distribution over time) mean that there must be a reduction in budget deficits in a number of Member States (Belgium, Denmark, Ireland and Italy) and, in general, severely restrict the scope for making more intensive use of budgetary policy as a means of stimulating demand. However, the Member States must be aware of the danger of cumulative recessionary tendencies developing, and this might induce a number of them to accept some increase in budget deficits in 1981, where such an increase is seen as the consequence of slower growth in activity.

13. Short-term economic management policies must be accompanied by a collective effort to achieve the objective of restructuring and improving the capacity of the economies to adjust, this being the third element of action.

14. The policy on energy is obviously the major area on which efforts must be concentrated in this respect. An increase in conservation and in the indigenous production of energy, particularly nuclear energy, and the diversification of energy sources must be given absolute priority. They call for a higher level of investment and appropriate reforms with regard to energy product prices and taxes. In line with the conclusions of the previous European Council, and in response to various initiatives by the Commission, the Council of Ministers has begun discussion of these points at the appropriate Council meetings.

15. At the same time, much higher investment ratios must be achieved once again if there is to be faster growth in production potential. This need is particularly urgent in sectors where the Community can hope to win a competitive advantage in international trade.

16. Present systems of taxation and financing and the structure of public expenditure should be gradually adjusted to serve the restructuring objective.

17. For its part, the Community can, through its own financial instruments, provide significant support for the efforts undertaken by Member States. The Commission recently presented new proposals in this

connection to the Council, notably the proposal concerning the permanent establishment of the New Community Instrument for borrowing and lending.

18. The measures designed to conserve energy and stimulate investment will help to achieve a lasting improvement in the job-creating capacity of the Community economy. However, in view of the growth of labour force and the outlook for the international economy, the strategy of reinforcing production potential so as to increase employment must be accompanied by other measures in this area. Specific measures will have to be worked out and stepped up in order to solve the particular problem of youth unemployment, notably by helping to ensure that the training and vocational skills of young people are brought more into line with new demand structures. More generally, a greater effort on this point should be made through increased emphasis on continuing training.