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THE ECONOMIC AND SOCIAL SITUATION IN THE COMMUNITY

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Short-term developments and prospects

Since the last meeting of the European Council there have been some signs of improvement in the European business cycle and an easing of world oil market pressures; but also worrying movements in interest and exchange rates across the Atlantic and much too limited progress in fundamental aspects of economic policy and performance in Europe.

Production in the Community probably reached its low-point in the early months of this year. The immediate outlook is subject to conflicting influences. The business cycle is showing signs of moving into the recovery stage, with some strengthening of export and private consumption demand. Community business surveys show this. But the balance of the changing trend as between a halt to the recession and a beginning of the upturn is still difficult to discern. For 1981 as a whole the Commission expects a fall of about 1/2 % in GDP volume, with an improving second half of the year leading to positive growth in 1982 perhaps slightly in excess of 2 %. This would be barely sufficient to stop the rise in unemployment in the course of next year. For the time being unemployment is still rising sharply and has reached 7.7 % of the labour force.

A negative influence has been the higher interest rates, and the general international monetary instability. Since the beginning of this year short-term interest rates have been forced up on average in the Community by over 3 points (to 15 % for 3 month inter-bank rates), restoring approximate parity with United States rates. Nevertheless even greater movements have been seen in exchange rates, with the ECU now having depreciated 21 % against the dollar and 24 % against the Yen in twelve months.

In time this depreciation should lead to substantial European gains in world export markets. Moreover the Community's large balance of payments current account deficit (nearly 40 $ billion in 1981, compared to a modest surplus in the United States, and a modest deficit in Japan) leaves no doubt about the need in Europe for a substantial adjustment. Some progress in reducing this deficit is likely in 1982, but a multi-year strategy adjustment in investment and world trading performance is basicall necessary.

The depreciation of the ECU means that Europe is currently experiencing a wave of import price increases as severe as last year when oil prices were the main cause. This is seriously retarding progress in reducing inflation. The average consumer price rise is now expected to be 11 1/2% in 1981 (up 1 point since the forecasts before the last European Council meeting, with the divergence between countries now ranging from 5,8% to 24%) and could well be still as high as 10 1/2% in 1982. As in the case of the oil price rise, it is vital to ensure that this unavoidable deterioration in the terms of trade does not have repercussions which lead to an increase in domestic inflation. This reinforces the importance of certain Member States to adjust extremely comprehensive and fast-acting income indexation mechanisms. As stated at the European Council's last meeting, this is in contradiction with the main aim of creating a zone of monetary stability in Europe.

The effects of the recession on public budgets is seen in an upward revision of the expected deficit of the general government accounts for 1981 from 4.0 to 4.3 % of GDP for the Community as a whole (compared to 3.6 % in 1980). For some countries, a stabilising effect from the budget should be accepted, and indeed welcomed, for example in Germany where there are already signs that stronger exports will soon take over as the main support to economic activity. In France, which alone among Community countries actually experienced a small budget surplus in 1980, some limited deficit in 1981 should not encounter financing problems if kept within prudent proportions. In several other countries, however, measures to restrict current public expenditure and deficits are overdue. Each year's delay increases the future burden of adjustment. Double-digit deficits as a share of GDP are not stable propositions, yet this is the order of magnitude of the Belgian deficit and nearly so in Italy; Dénmark's deficit also appears to be increasing alarmingly, while that of Ireland, already 15% of GDP, has recently been increased by substantial subsidies to households for food and housing items.

Medium-term challenges

The Council will shortly have to adopt a medium-term economic policy programme for the period 1981-1985. Preparatory work by experts has been completed (in the Economic Policy Committee), and on this basis the Commission plans to submit a draft programme to the Council before the summer recess.

Projections for a five-year period are notoriously difficult to make, and those done by the Commission for 1981-1985 on the basis of present policies and historical economic behaviour - remain open to surprises for better or for worse. Subject to these important reserves, and assuming a moderate economic recovery from now to 1982, the projections suggest an annual average rate of growth in the Community as a whole of 2 1/2% in the four years 1982 to 1985 (1.9% for the five years 1981-1985), which compares with around 2.2% for the years 1974 to 1980, and a trend of 4 1/2% in the preceding decade. Assuming a 5% growth in world trade the present large balance of payments current account deficit could well be reduced very substantially by 1985 even with some renewed, but gradual, increase in the real price of oil. Progress in reducing public sector deficits seems likely to be more modest; the rate of inflation might on average decelerate to about 7 1/2% compared to the present 11%. The modest rate of real growth means that there is likely to be approximate stability in the total employment level. Combined with the exceptionally fast demographic expansion of the labour force (nearly 1% per year for the whole quinquennium), unemployment is quite likely - on the basis of spontaneous trends - to continue to rise still from the present average level of 7.7%.

Of course these trends are not immutable. Policy can, and in several respects should, change. Economic behaviour can change, and must be encouraged in the right direction. The uncertainties are not all negative risks. For example, we may manage to achieve faster progress in energy adjustment than expected, and we may underrate the capacity of the economy more generally to adjust for the better once given the right signals steadily over a period of years.

But the fundamental message is that the Community cannot hope that a new cyclical recovery - itself fragile and uncertain - will lead the economy back automatically onto a satisfactory trajectory assuring a substantial and durable improvement in employment prospects. It is not a question of waiting with a little more patience for trends to improve. The European economy needs still to embark on deep and lasting changes in public policy and in the economic performance of the social partners and households before we can hope for a much better economic future; i.e. to assure the development of the competitive capacity of our economies and their aptitude to respond to the opportunities of growing markets. Investment and savings must be increased. Consumption, employment costs and current public expenditure must be moderated. Investment and employment in energy production and saving in particular must be a massive priority as also the development of industries based on new technologies. Present investment trends in the Community are not yet on a par with that seen in the United States and Japan. The Community can and should provide a financial boost to this priority (in this connection proposals for a renovation of the New Community Instrument for investment financing are before the Council awaiting decision).

While abundantly debated, these issues are still not being sufficiently acted upon in many Member States. If this state of affairs persists the risks are for a relapse of the Community into serious financial and monetary instability and thence into great losses. For the Community as a whole this could mean eroding the achievements even of the Common Market as well as of the European Monetary System, and for individual Member States there would be the prospects of the large economic and social costs that always ultimately result from excessively delayed economic adjustment. A longer period of delayed adjustment and slow growth would also endanger the social and political balance in our countries and undermine the degree of social consensus so far achieved.

Current developments demonstrate the necessity for a stable framework for international economic relations. The Community should therefore intensify its policy of cooperation with third countries, especially establishing increased monetary and financial cooperation between industrialised countries, also with a view to aiding the economic situation of developing countries.

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Summary and Conclusions

The Commission suggests to the European Council the following assessment and policy orientations:

(i) It may be that the recession has now passed its low point in Europe, and that the chances for a moderate recovery are fairly good. However, great risks surround this uncertain and fragile improvement. With the short-term easing of the oil market, the main risks at present lie in the management of economic policy within the Community and internationally. The Social Partners also have an important rôle.

(ii). Within the Community, particular risks follow from the failure so far of several Member States to progress with urgently required public finance and income stabilisation measures. These failures weaken the cohesion of the European Monetary System. The Commission recommends to these countries accelerated programmes of economic adjustment. On the other hand, Germany, where a strong export recovery seems now assured, should not unduly precipitate the desirable medium-term reduction of its public deficits. In general, all Member States must aim at balance in the use of monetary and budgetary policies, and desist from descriminatory measures in either domain that threaten the basic economic principles of the Community; the prospects for export-led recovery can only be based on keeping open markets for trade.

(iii) The large depreciation of the ECU against the dollar and yen over the past months means that the Community have a new opportunity to improve its share in world markets, and increase investment and employment. But the inflationary impact of the depreciation must be contained, and this is a further reason why adjustments must urgently be made in indexation practices in some Member States, and expectations for real income gains be still lowered more generally for the time being.

(iv) Internationally, moreover, the volatility of interest and exchange rates is of major concern; indeed it represents a serious threat to Europe's incipient economic recovery, notably because of the great fluctuations in costs and in the continuing uncertainties that the enterprise sector has to face. The Community should pursue these issues in depth in discussions with the other major monetary powers. The Community, the United States and Japan basically share the same monetary policy objectives and there is much to be done, including in the Community (as mentioned with regard to budgets and incomes) to relieve the strain on monetary policies.

However the United States should also bear in mind the significant international consequences of different choices that are open to it in the framing and execution of its budgetary and monetary policies. The main policy stance of the major industrial countries does affect the functioning of the world economy and should, therefore, be discussed in the forthcoming international meetings.

(v) The medium-term outlook reinforces the need for the accentuation of adjustment policies in many Member States, and persistance throughout the Community in efforts to promote investment in energy saving and production and in new industrial capacity, and to moderate labour costs (including both incomes and social security levies).

(vi) The Joint Council of Ministers of Employment and Social Affairs and of Financial Affairs, which was held on 11 June 1981, discussed the unemployment situation and the type of strategy and actions which needed to be adopted in order to ensure a fundamental improvement. It was generally agreed that unemployment and inflation were problems which should be tackled jointly and that an improvement in the overall economic situation, and hence in employment, could be assisted through reinforced action at Community level. The Commission accepted to follow up certain policy issues, in particular: the review of methods for combating inflation and encouraging economic growth; the development of investment and new areas of employment growth; analysis of public expenditure and the financing of social security; the promotion of flexibility in working time; and the development of an integrated framework of education, training and work opportunities for young people. It was foreseen to follow up these questions in a further Joint Council.

Table 1: Main Economic Aggregates, 1979-81

	1979	1980	1981		1979	1980	1981
	GDP volume, % change				Private consumption deflator, % change		
B	2,4	1,1	-0,6		3,5	6,3	7,2
DK	3,5	-0,8	0,1		9,5	11,0	10,0
D	4,6	1,9	-0,6		3,9	5,4	5,8
GR	3,8	1,7	1,5		17,7	23,7	23,3
F	3,2	1,8	0,5		10,5	13,5	13,0
IRL	1,9	0,9	1,9		12,2	18,2	17,5
I	5,0	4,0	-0,2		14,9	20,3	21,0
L	3,6	0,4	-3,1		5,8	6,3	7,5
NL	2,2	0,9	-0,6		4,6	6,9	7,3
UK	1,3	-1,4	-2,2		12,2	15,5	11,2
EC	3,5	1,4	-0,4		8,9	11,7	11,5
	Unemployment rate, % of civilian labour force				Current account of balance of payments % GDP		
B	8,6	9,3	11,0		-2,9	-5,7	-7,3
DK	5,3	6,2	8,2		-4,6	-3,8	-3,8
D	3,4	3,4	4,6		-0,7	-1,7	-1,9
GR(1)	(2,2)	(2,9)	(3,2)		-2,9	-2,4	-2,6
F	6,1	6,5	7,7		+0,1	-1,4	-1,6
IRL	7,9	8,2	9,7		-10,1	-8,6	-14,2
I	7,6	8,1	8,4		+1,6	-2,5	-2,3
L	0,7	0,7	1,1		+28,7	+22,8	+20,8
NL	4,2	5,0	7,2		-1,4	-1,5	+0,7
UK	5,4	6,9	10,5		-0,9	+1,2	+0,6
EC	5,5	6,1	7,7		-0,5	-1,4	-1,7
	General government net lending (+) or borrowing (-), % GDP				Money supply, % change end of year		
B	-7,2	-9,3	-11,0	(M2H)	6,0	2,8	3,9
DK	-3,1	-5,4	-8,6	(M2)	9,9	10,9	8,1
D	-3,0	-3,5	-4,0	(M3)	6,0	6,2	5,4
GR	:	:	:	(M3)	18,4	25,2	22,4
F	-0,8	0,4	-1,6	(M2)	14,4	9,7	12,5
IRL	-11,9	-13,2	-15,2	(M3)	19,0	16,9	12,2
I	-9,4	-7,8	-8,5	(M2)	20,3	12,0	11,0
L	+0,1	-1,4	-2,5		:	:	:
NL	-2,0	-2,8	-3,3	(M2)	7,6	3,6	6,2
UK	-3,3	-3,7	-2,3	(£M3)	12,7	18,6	8,5
EC	-3,6	-3,6	-4,3		11,9	10,2	8,8

(1) Not comparable with other countries
Source: Commission services, based on information available to early June 1981