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THE ECONOMIC AND SOCIAL SITUATION IN THE COMMUNITY

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INTRODUCTION

In the documents it has recently forwarded to the Council - the draft medium-term economic policy programme for the Community and the report on the present economic situation - the Commission has already developed its ideas on the economic problems facing the Member States and has outlined the possible contributions which the Community might make to solving them.

Secondly, in discussing the Commission's proposals pursuant to the Mandate of 30 May, the Community will have to endeavour to define the possible contributions which Community policies can make to solving economic problems.

This is why the Commission has confined itself in the present document to summarizing the most important elements in the Community's present economic situation and to a brief presentation of the main economic and social policy issues.

TRENDS AND PROSPECTS

The main developments in the economic picture since the European Council last met in June have been the following:

(i) the business cycle in Europe now looks as if it is gradually turning up. Most forecasts for 1982 indicate a resumption of modest growth (the Commission forecasts a 2% growth rate for the Community as a whole).

(ii) Unemployment is still rising very fast, and the average rate in the Community is already above 8%. There is, however, a chance that if the upturn picks up speed in the second half of 1982, the average level of unemployment in the Community might stabilize.

(iii) In the international monetary domain, important adjustments have been taking place. The dollar and sterling have moved down from their former very high levels. Within the European Monetary System, the realignment of 4 October has offset the accumulation of cost differentials. Aided by greater stability in oil prices the structure of current account balances is now moving towards a reduction in the European deficit and OPEC surplus in 1982, but also to an increase in the Japanese surplus.

(iv) The inflation outlook has not substantially changed. The Community average for 1981 is a little over 11%, and there is little chance of it falling below 10% in 1982. The range in consumer price rises in 1982 between the least and most inflationary Member States is likely to be from 4 1/2 to 22%, and the average degree of divergence in inflation rates is now as great as in the mid-seventies after the first oil shock.

These prospects are subject to major uncertainties.

First, the recovery of the European economies is not yet an established fact. It is true that recent business surveys point to an improvement in company confidence, but this is still very relative, and there is nothing to indicate whether it is a phenomenon associated with the end of the recent cyclical slowdown or whether it really heralds an upturn in growth. OPEC's recent decision to hold the price of oil at $34 a barrel until the end of 1982 certainly improves the assumptions underlying the present forecasts - in particular as regards balances of payments, inflation and output. But on the other hand the latest developments in the US situation suggest that 1982 will see the persistence of very high real interest rates and an appreciably lower level of activity than forecast.

It is also possible that the prospects for 1982 of a deterioration in the US current account balance will result in a relative strengthening of the European currencies; this could create the conditions for bringing down interest rates in Europe. As a result, the European economy in 1982 could move progressively toward a more moderate-than-forecast upturn in exports (with no growth in the US economy and a reversal in the trend of exchange rates) and higher domestic demand (which might be the result of the lower oil price and lower interest rates).

MAIN ECONOMIC POLICY ISSUES

The analyses which follow are in keeping with the guidelines adopted jointly last June by the Ministers for Finance and Social Affairs, and which consist in seeking to reduce unemployment by a resolute fight against inflation, by strengthening the economic structures of the Member States and by an active employment policy. The action to be taken on these guidelines is the subject of work in connection with the discussions pursuant to the Mandate of 30 May, with the examination of the medium-term policy programme and, for certain more specific points, in meetings of the Council in the most appropriate composition.

These guidelines will not thefore be restated in detail, but they are still fully relevant. The Community today has major problems of job creation and competitiveness that go well beyond the short-term horizon. Some comparisons with the United States and Japan are instructive. Between 1974 and 1980, the United States increased total employment by 12 million persons whereas for the Community the increase was a mere 118 000. Japan has already succeeded in absorbing the whole of the second oil shock through the current account of the balance of payments without its GDP growth rate falling below 4%; the Community is still burdened with a heavy external deficit, despite having incurred a recession.

Recent developments, notably in the Community, broadly confirm the diagnosis that a pre-condition of any lasting improvement in the economic and thus employment situation in the Community is an improvement in competitiveness and a reduction in dependence on imported energy. But if these conditions are to be met, they in their turn call for an increase in investment and better control over production costs. In both cases rapid and significant results in the fight against inflation will be of major importance.

This diagnosis, largely common to all the Community countries, calls for the appropriate national policies. But a number of common priorities must also be identified for the Community as a whole, notably in order to contain the dangers of unduly divergent developments in an economy as highly integrated as that of the Community.

The main economic policy guidelines should be the following :

1. Within national monetary policies centred on a stabilization or deceleration in the rate of growth of the main monetary aggregates, notably in the setting of money supply or credit targets for 1982, special attention should be paid to the advantages which a lowering of interest rates could bring in the present situation: in this connection joint action within the Community and more closely concerted action between

the Community and her main partners is clearly necessary and constitutes a priority objective. However, the desired interest rate reduction must accompany the reduction of other costs so as not to reduce real interest rates beneath the levels required to sustain saving.

2. The general wish to reduce interest rates in conditions of declining inflation, while partly an international matter, is fundamentally dependent on disciplined financial policies at home. In general, budget policy has to support the efforts to achieve the necessary economic adjustments. Thus, because of the need to improve the balance of payments and to slow down inflation, special importance must be attached to bringing public deficits under control.

This is particularly true in the Member States where the deficit is climbing to levels higher than the Community average. In these States, the gradual but determined reduction of public deficits is a sine qua non for the success of any economic policy which aims to slow down inflation and improve employment. On the other hand, in the States where this were to prove possible, the use of the leeway which exists as regards public finance must remain a measure which can be brought under control at any moment.

3. The relative adjustment of production costs, and notably wage costs, has already been initiated by exchange rate changes over the last year as between the ECU, the dollar and the yen, and through the recent realignment of central rates within the European Monetary System. The next step in the adjustment process has to be to prevent the inflationary effects of exchange rate depreciation from eroding the real gains in competitiveness. This adds further urgency to efforts to limit the secondary impact on incomes of the oil price rises of last year. Institutional traditions in income and notably wage determination vary widely between countries and the approach to keeping the growth of incomes and wage costs within limits compatible with the requirements of lasting growth, the key to expanding employment, will have to vary accordingly. In this connection the Commission recalls that it recently placed

before the Council a Communication on the principles which should be followed, in the present economic situation, with regard to the indexation of incomes.

4. The problem of unemployment will find no lasting solution until hard efforts of adjustment have been completed. In the meantime the Member States must demonstrate their solidarity, provide mutual backing in developing their investment policies, and avoid protectionist responses to the present difficulties. The social dimension of Community policy must also be affirmed, in the directions adopted by the joint Council of Ministers for Finance and Social Affairs. To this end, the Commission has inter alia proposed that the Member States set themselves the common objective of seeking a systematic alternative (vocational training or work experience schemes, or perhaps a combination of the two) to the unemployment of young people in the 16 to 18 year age group, which is developing extremely worrying proportions. The Commission stresses the importance of the dialogue with the social partners in implementing the advocated overall policy at Community level.

To sum up, and without prejudice to the more general decisions taken at the time of the Mandate, the Commission considers that the Community must set itself the following guidelines :

1. First, the objectives of fighting inflation and unemployment require the conduct of determined policies to bring public deficits under control, to keep monetary policy within the limits necessary for equilibria to be restored, and to ensure that production costs, and notably wage costs, are at the proper level. Such guidelines must be seen as an important contribution to the problem of unemployment.

   Combined with the depreciation of the ECU which has taken place over the last year, and at a time when there are signs of an upturn, however moderate, this disciplined strategy must provide the opportunity for a start to be made on improving employment, based on the greater competitiveness of the European economy. The Community can make a contribution by actively coordinating national policies so as to exploit the - even small - multiplier effects of growth associated with the interdependence of our economies.

2. Secondly, such policies would encourage interest rates to ease and this would help investment to expand. A fall in rates is already perceptible on the money markets. Closer monetary cooperation between Member States would consolidate this trend, thus helping activity to recover, while keeping the expansion of the monetary aggregates on the appropriate trajectories.

3. Thirdly, the Community must commit itself to seeking organized monetary cooperation with its main partners. The objectives are to seek greater monetary stability and interest rates and exchange rates which are sufficiently in line with the underlying trend of the economy.

4. On a more general note, the next meeting of the European Council will take place after the EMS has been in operation for three years: at that meeting the Commission wishes the European Council to review the system and outline its future prospects.

Main economic aggregates, 1980-82

	1980	1981	1982	1980	1981	1982
	GDP volume, % change			Private consumption price deflator, % change		
B	2,4	-1,0	0,2	6,4	7,5	7,0
DK	-0,2	0,0	3,0	11,9	11,2	9,4
D	1,9	-0,3	2,2	5,4	5,8	4,5
GR	1,7	0,4	2,1	23,7	24,1	22,5
F	1,3	0,5	3,0	13,2	13,5	13,0
IRL	0,9	1,7	3,6	18,2	20,0	16,0
I	4,0	-0,3	1,8	20,3	19,4	16,9
L	0,4	-3,3	-0,3	6,3	8,0	7,0
NL	0,5	-1,1	0,9	6,9	7,5	6,0
UK	-3,0	-2,0	1,4	15,5	11,8	10,5
EC	1,1	-0,5	2,0	11,9	11,6	10,5
	Unemployment rate, as % of civilian labour force			Balance of payments on current account, as % of GDP		
B	9,3	11,6	12,3	-5,7	-7,2	-7,0
DK	6,2	8,2	8,7	-3,8	-3,3	-3,3
D	3,4	4,8	5,6	-1,8	-1,4	-0,3
GR (1)	(2,8)	(3,3)	(3,6)	-2,4	-2,8	-3,0
F	6,5	7,8	8,1	-1,4	-1,4	-1,8
IRL	8,2	9,7	10,9	-8,3	-14,8	-12,3
I	8,0	8,6	9,0	-2,5	-2,3	-1,4
L	0,7	1,0	1,2	+22,8	+18,6	+17,6
NL	4,9	7,3	9,2	-1,4	+0,6	+2,2
UK	6,9	10,2	11,3	+1,2	+1,2	+0,5
EC	6,1	7,8	8,5	-1,4	-1,2	-0,9
	General government net borrowing (-) or net lending (+), as % of GDP			Money supply, % change, end of year		
B	-9,1	-12,4	-12,0	(M2H) 2,7	6,1	5,8
DK	-6,0	-9,8	-10,8	(M2) 10,9	9,3	12,0
D	-3,5	-4,0	-3,0	(M3) 6,2	5,4	5,7
GR	:	:	:	(M3) 24,7	31,7	19,9
F	0,4	-2,1	-2,6	(M2) 9,7	15,0	13,0
IRL	-13,1	-14,3	-13,7	(M3) 16,9	14,3	15,9
I	-7,8	-9,0	-9,0	(M2) 12,0	16,7	16,0
L	-1,3	-3,0	-3,6	:	:	:
NL	-3,7	-4,1	-3,2	(M2) 3,6	6,6	7,9
UK	-3,5	-2,2	-1,6	(£M3) 18,6	11,5	7,8
EC	-3,6	-4,4	-4,3	10,5	11,2	9,9

(1) Data not comparable with those for other countries.
Source: Commission departments, figures based on data available at the beginning of October 1981.