

COMMISSION OF THE EUROPEAN COMMUNITIES

COM(81) 344 final

Brussels, 22nd July 1981

**Draft of the 5th medium term economic policy programme drawn up in
accordance with Article 6 of the convergence decision of 18 February 1974**

(Communication from the Commission to the Council)

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COMMISSION
OF THE
EUROPEAN COMMUNITIES

Brussels, 22 July 1981
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The Vice President

Sir,

The Commission sends you with this letter the draft of the 5th Medium Term Economic Policy Programme drawn up in accordance with Article 6 of the Convergence Decision of 18 February 1974.

The Commission has not changed the preliminary draft prepared by the Economic Policy Committee, but in adopting it as the draft programme has included in it the annexed chapters which the Committee forwarded to it.

The Commission has however felt it necessary to set out in a "Foreword" the comments which it considers appropriate on this draft programme, to bring out the role of the Community in the overall strategy proposed.

This foreword is a development of certain of the ideas set out by the Commission in the report drawn up on 24 June in accordance with the Mandate; Part 1 of this report outlines the general framework within which Community policies and priorities have their place; the present Communication describes the economic strategy which must be implemented both inside the Community and by the Community, in order to restore the economic situation, and to offer the citizens of Europe better employment prospects and a better future. The Commission therefore attaches great importance to it.

The Commission requests that a wide debate now take place in the Community institutions concerned about the aims and the actions proposed, as well as on the overall approach which it envisages.

The Commission thus counts on the support of the Council and the Parliament for the guidelines it proposes. As far as the Council is concerned, this support could be expressed in a Resolution which, while including the overall structure of the proposed strategy, would clearly define the main lines of Community action made necessary by the dangers of the present economic situation which must not be underestimated.

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The Council should send a report to the European Council's meeting in November, in order to inform it of the work in hand and to give it the opportunity to confirm these general guidelines and to give political impetus to the further work which will be needed.

W. HAFERKAMP

enc.: doc. COM(81) 344 final

His Excellency,
Lord CARRINGTON,
President of the Council of the
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FIFTH MEDIUM TERM ECONOMIC POLICY PROGRAMME

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II. DRAFT PROGRAMME

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I. FOREWORD

1. The first point to be made concerns the scope of the Fifth Medium Term Economic Policy Programme.

1.1 Past experience argues against proposing a quantified programme which would be virtually impossible to draw up, given the uncertainties of the international economic situation and the diversity of situations in the Community. However, even with cautious interpretation, the models prepared on our responsibility bring out employment prospects sufficiently disturbing to warrant a major effort to reverse the trend. The foreseeable increase in the labour force combined with a much more sluggish rate of spontaneous economic growth than in the 1960s clearly show the danger of a continuing and possibly sharp rise in unemployment.

1.2 To meet this threat, the Commission joins with the Economic Policy Committee in recommending action combining the fight against inflation with a policy for the conditions of supply. This policy must be set in its true context.

The medium term policy programme is above all a policy issue. Its purpose is to win approval both for a strategy and for the means needed to carry it into effect. This is the more important since the course charted will demand discipline, sacrifice and change; and it needs a revival of the spirit of tackling the job and the will to succeed which was such a feature of post-war Europe. In brief, it demands an active consensus, and this will be obtained only if the aim is spelt out with clarity and the conditions for success are understood. The aim is not to change the inevitable: it is to bring about a lasting return to a satisfactory level of employment. This must be clearly stated by the Council.

- 1.3 To achieve this objective, less dependence on imported energy and very high competitiveness are essential preconditions. This is doubly obvious. If we are not competitive enough we lose to others our share of markets, both at home and abroad, undermining growth and employment opportunities. And excessive dependence on imported energy adds to balance of payments constraints and magnifies the deflationary bias which flows from any major net transfer abroad.

The employment factor therefore requires that absolute priority be given to the expansion of productive investment and the effort to establish competitive production costs. These two priorities, subsumed in the vital attack on inflation, must influence all the policies both macroeconomic and specific pursued by the Member States. But it is easier to obtain agreement on the general reasons for this strategy than to win acceptance of its necessary implications: a change away from consumption in the allocation of resources in the economy, a vigorous attack on structural rigidities and the questioning of vested interests. The fact that jobs can be saved and new jobs created only if these difficult steps are taken must therefore be driven home by forceful and unremitting argument. The debate on the fifth medium term policy programme gives the Community and each Member State an excellent occasion to do so.

2. In the form in which it is drafted for submission to the Council, the programme does not seek to settle a matter keenly debated in the preparatory stages: the respective role of supply and demand policies in the next few years.¹ The Commission does not want to see this problem become a conflict of economic doctrines - especially since there is general agreement that external constraints and the nature of the structural changes that must be made will inevitably constrict the room for manoeuvre in demand management. From one year to the next, the emphasis of policy will depend on the overall context and on national situations, even if action must remain firmly within the bounds dictated by the requirements set out above. The Commission believes that at present there should be agreement on the following points.

2.1 Practical measures are urgently needed to get rid of obstacles to economic growth. And to the extent that such measures give either general or selective encouragement to investment, or favour energy conservation and the development of alternative energy sources, they will of themselves strengthen overall demand.

This development policy based on increased competitiveness will normally require change in budget structures, through the introduction of real medium term budget programmes with the following aims:

- to reduce public deficits, especially those substantially larger than the average in the Community, which drain off savings that would otherwise be invested or which are financed by money creation;
- to allocate a larger share of public budgetary expenditure to the promotion of investment, to training and to cutting production costs - in other words, to a lasting expansion in employment;
- in a broader perspective, to make sure that financing the social security budget does not reduce the competitiveness of certain industries or service sectors.

This policy is particularly necessary for States whose budgetary situation has reached the point where there is no further room for manoeuvre. If

¹ See the letter from Mr. Rutten, Chairman of the Economic Policy Committee, and the annexed note by the Belgian members of the Committee.

only for reasons of confidence in government, it is essential in these countries to open up new avenues of action and to stop trying to use methods whose value for sound economic management has disappeared.

2.2 It follows that the opportunities for a selective revival of demand will be very different over the period, not only as a result of changing economic conditions but also:

- from one country to another, depending on how successfully the budget and key economic aggregates are brought under control;
- on the degree of success achieved by the measures taken together to bring down and stabilize interest rates, in view of the growing burden of public debt.

These two points underscore the importance of, at national level, bringing inflation under control and, externally achieving a fundamental improvement in monetary cooperation.

2.3 In addition, any inevitably limited means that our economies do offer for stimulating demand must be deployed in strict compliance with certain principles:

- as far as possible, they should be used in areas where manpower and production facilities are available and where their direct impact on the balance of payments is slight¹;
- where the action is intended to assist the economically weaker sectors of society, it should be so devised as to avoid follow-through effects on other incomes, especially through the operation of broadly applied indexation arrangements, whether these are de jure or de facto.

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¹ In connection with supply-side and energy policies, a more systematic appraisal should be carried out at Community level of the opportunities for growth, and how they should be turned to account, offered by public works and by the building and construction industry. As the Commission has recommended, the Member States should also as a matter of importance, draw up reserve lists of projects so that, when support measures are decided on, these do not for want of suitable projects have an inflationary impact or take effect later than intended with possible pro-cyclical effects.

2.4 Without provoking a doctrinal debate, the Community can help sustain as high a level of demand as possible. More active coordination of national economic policies is important in this respect: where policies are decided each year a systematic effort should be made to ensure that they are mutually consistent in order to achieve the multiplier effect, however limited, that Community interdependence will generate.

Other possible courses of action are to help in measures to promote investment and, where this is justified on economic grounds, practical measures of financial solidarity to reduce balance of payments difficulties.

2.4.1 The real contribution to growth, even if difficult to quantify, that such measures and joint opportunities for action can make must be systematically sought out. This is the substance of everyday life in our Community. But there is another component of demand that, if it is to be encouraged, requires decisions or initiatives at Community level: this is world demand of which the expansion (8% annually during the 1960s and 6% annually during the 1970s) helped growth within the Community and of which the marked slowdown (increase of only 1.5% in 1981) goes some way towards explaining our own gloomy growth prospects.

2.4.2 More extensive recycling of oil producers' payments surpluses would be an important factor in the recovery of world demand. The Community authorities are fully aware of this problem, which imposes a particular heavy burden on the developing countries, and have discussed it at length. The Community, which itself is heavily in deficit, has opted as a matter of priority to back the efforts by the Bretton Woods institutions to at least alleviate if not to eliminate these difficulties altogether.

Results so far have at best been limited and very often disappointing. More resolute action on a lasting basis is therefore needed immediately. The Council must periodically review the results

obtained and update its thinking on the trend of world demand, in particular in the developing countries. It must attach special importance to the contribution we can make in this respect (by way of external action, in cooperation with others, or directly).

2.5 Community action must therefore help at European level not only to identify the constraints we face together but also to put forward ambitious objectives. Year after year, it must impart a further stimulus to growth and hence to employment through closer policy coordination and joint measures and by exploiting the advantages offered by a wide market. It must also put to full effect, in the interests of securing more stable economic growth, the Community's strong position at the negotiating table, which is far greater than that of the individual Member States.

3. The Community has a role to play not only in implementing the wide-ranging policy advocated but also in each of the key policies that go to make up the strategy defined in the draft programme. The following paragraphs discuss this Community dimension, seen not as an end in itself but as an additional factor of success for the overall strategy.

The Commission proposes four main lines of action:

- the pursuit of decisive progress in establishing the European Monetary System;
- a substantial increase in the level of investment in the Community, more specifically investment in energy projects as part of an overall common energy strategy;
- systematic exploitation of the potential of the internal market and of its continental dimension;
- greater Community participation in an active employment policy.

4. With the European Monetary System, the Community has embarked on an ambitious, albeit gradualist venture aimed at stabilization and convergence. The contribution made by the system - greater certainty in economic activity, a strong incentive to keep the key economic aggregates in balance, a stimulus

to policy convergence and the added weight it gives to Europe in international monetary cooperation - should be a major factor in the success of the strategy set out in the fifth programme.

4.1 The Commission therefore urges the need to consolidate and develop joint action in monetary affairs.

It believes this is needed for two reasons:

- a stronger joint approach combined with the closer coordination of economic policies called for by the fifth programme, is essential to safeguard the degree of monetary integration so far achieved,
- there is an inescapable link between monetary stability, healthier economic prospects and increased employment.

4.2 As an immediate step, the Council should decide to strengthen internal monetary cooperation and to seek ways of organizing relations with major non-Community currencies on a more stable basis. For this purpose:

- a) Before the end of the year arrangements should be made, as the very purpose of the joint enterprise requires, for national monetary policies to be discussed in advance at Community level and actively coordinated on such points as the setting of intermediate objectives, interest rate policy and the introduction of important specific measures, together with policy on external indebtedness and the avoidance of any friction in the use and structure of monetary policy instruments.

Although some progress has been achieved, the diversity of national situations and differences of approach have slowed down progress in these areas. Recent events show the need to overcome reservations and to take more systematic, more resolute and more rapid action.

- b) Use of the ECU, the expression of the monetary will of Europe, should be encouraged on financial markets, as the European Council has urged. This development, which will inevitably be gradual and no doubt slow, will not take place without a tangible demonstration of interest on the part of Community and national authorities in the shape of the abolition of the technical or statutory rules which stand in its way.

In addition, plans must be made for developing the use of the ECU by the EIB and by the Community's borrowing and lending instruments.

- c) Cooperation with non-Community currencies must be stepped up. The Commission believes that, over and above the definition of European positions on sensitive questions like interest rates, and despite apparent doctrinal differences, the period we are entering must be one of more intense debate, more precise proposals and of reinforced conviction focussed on:
- the association of the Community as such with cooperation between major currency areas and the extension of such cooperation both to national policies where they have major external effects and to the management of the international monetary system (for example, questions relating to recycling);
 - the resumption of concerted action with our major partners with a view to containing fluctuations on the exchange markets within "zones of probability" that take account with sufficient flexibility of both trade and monetary factors;
 - management at Community level of the means of intervention agreed within this framework, for example by multilateralizing swaps and by expressing them at least partly in ECUs.

Even if they run counter to conventional wisdom, these ideas must be examined with an open mind - soon enough to allow the Community to clarify its thinking on international monetary cooperation by the beginning of 1982.

- d) Lastly, in the months ahead discussions must be resumed with the United Kingdom and Greece on the question of their full participation in the European Monetary System, which will no doubt require some of the mechanisms of the System to be reinforced.

In general such a decision is justified by the contribution of the EMS to economic stability, the framework which it provides for healthy growth and the benefit of reinforcing the external role of the joint monetary enterprise. In addition, and bearing in mind that Greece has only recently become a Member State, the nature

of the Community requires that all the Member States should participate in the next, the institutional phase in which the EMS will be formally integrated into the permanent Community framework.

The Commission firmly believes that the advantages of participation for the United Kingdom are greater than the disadvantages and that the characteristics of sterling, in particular the fact that it is an oil currency, are not an insurmountable obstacle to such a decision. In the present situation, greater stability in the rate for sterling would, by improving the domestic and external outlook, encourage investment and serve the aim of strengthening economic structures.

In the case of Greece, the first priority in preparation for its participation in the EMS must be the institutional development and reform of the banking sector (already started this year with the quotation of the drachma on the international market) and control of monetary aggregates by the authorities.

4.3 The Commission proposes that everything must be done to enable the Council to take a decision on the second stage of the EMS in 1982.

It is not only in order to abide belatedly by a decision planned from the outset of the system. It is now clear that what has been achieved so far must be given a permanent framework and further developed. In this way the monetary foundations for the overall strategy of the fifth programme must be consolidated. Europe's concern for a less unstable organization of international monetary affairs must be demonstrated by the example it sets.

Besides the decisions proposed above which would help to strengthen the present machinery, conclusions must be drawn over the coming months from technical work, now largely completed, on the following four questions.

- how to organize a European Monetary Fund consolidating the various Community monetary support systems;
- how to develop the use of the ECU in relations with other central banks;
- whether and under what conditions ECUs should be created in the absence of corresponding gold and foreign currency deposits;
- the nature, structure and powers of the institutions responsible for managing the European Monetary Fund.

5. Another priority aim is a substantial increase in the level of investment in the Community. This is essential to ensure competitiveness, energy self-sufficiency and growth. Public or private fixed capital expenditure should be - along with export demand - the main factor of growth, and thus of job creation.

5.1 Statistics clearly demonstrate the need for improvement. Since 1973, aggregate investment as a percentage of GDP has declined slightly (gross fixed capital formation represented 21.1 % of Community GDP on average from 1974 to 1980, compared with 22.5% from 1967 to 1973), while GDP itself has expanded only slowly. The share of investment in GDP in Japan (32% in 1980) is over 10 points higher than in the Community, a significant illustration of the relative dynamism of the two economies. Energy investment, which is not only important to industry but also eases balance of payments constraints, is stagnating at around 1.6% of GDP, at a time when the reasonable minimum is generally put at some 2.2%, and the figure for the United States is almost twice as high.

5.2 The Community's contribution should be not only a collective awareness, the participation in a series of general measures to promote stability and growth, and the establishment of the guidelines set out above for national efforts to change budgetary priorities towards increased investment.

5.2.1 The Community must also contribute more directly to the investment drive through the steady development of its financial instruments both long-established (EIB, ECSC) and more recent (Euratom, NCI). The symbolic value of demonstrating solidarity by intensifying this action should not be underestimated. Moreover, such a policy enables additional funds to be mobilised in the general interest on the basis of the political and financial standing of the Community, resources that should be increasingly devoted to aiding small and medium-sized industrial firms. This active solidarity is to the benefit of national and regional economies where Community loans can provide decisive extra help; it requires that priorities be defined jointly, that programmes be worked out, that financial resources and decision-making are brought together. The fifth medium term programme must be marked from the outset by the determined pursuit of one of the few initiatives that the Community can boast in recent years, on the understanding that it must support and not hinder national activities on the financial markets needed to cover investment needs or balance of payments deficits.

5.2.2 The Community can also help by defining the best framework for investment. The Commission has in view a systematic scrutiny of all financial or tax measures in favour of investment and of the savings required to finance it, not only to ensure that these measures are compatible with Community rules, but also to assess the efficiency of the means used and to identify the most effective techniques - in other words, to set in train a dynamic process of harmonization in this priority sector.

The Commission will provide the necessary support for this review which should cover all regulations relating to investment, for instance those which in restricting the use of equipment, increase its relative cost.

5.2.3 Energy investments continue to be studied at Community level as part of the process of working out an energy strategy that combines mutually consistent national policies with the mobilization of the Community's financial resources and legislative powers. The energy strategy, even if discussed only briefly here, should be an essential element of the fifth programme.

It will have five lines of development:

- market unity based on transparency, the gradual harmonization of the conditions of cost formation and optimal exploitation of Community energy resources, especially coal;
- with the same aim in mind, prices that reflect the true situation, accompanied by tax arrangements consistent with jointly defined economic objectives, in particular for the development of new Community resources and energy saving;
- Community crisis arrangements;
- a European contribution to research wherever the cost, the technical requirements or the bringing together of highly qualified research teams are such as to make this necessary;
- an increased rate of investment. On this point, it is important to draw up genuine programmes based on a realistic assessment of practical administrative and financial possibilities; the definition of a clear policy stance on the contribution of nuclear energy comes under this heading. Besides granting loans, the Community at its level can help both by objectively comparing projects and their results and by working for the introduction of the requisite statutory and financial measures such as subsidies or tax incentives and financing arrangements, particularly to foster energy saving.

6. Although competitiveness has become a matter of life and death for the Community, we are not making sufficient use either of economies of scale or of the positive constraint that flows from free competition within our large internal market - the backbone of our aspirations as a continent. Under the fifth programme three objectives must be pursued:

6.1 The methodical completion of the common market.

The Commission will continue to submit proposals for the removal of technical barriers, the harmonization of legislation which influences production, and the acceleration of Community work in the services sector; it hopes the significance of such proposals will be recognized by all the institutions. The decisions which the Council will regularly be called upon to take in these areas should be seen by the Council itself as important acts meriting careful and energetic preparation.

6.2 The introduction of a Community policy for technology and innovation based on the internal market.

Without a vigorous effort to develop new industries and technologies, the Community may well one day find itself trying merely to manage a declining economy, incapable of asserting itself on product and service markets in full expansion, and unable to create the jobs most characteristic of a modern, thriving society.

The importance of a Community contribution stems directly from the role which the market plays in high technology industries and services. Such measures must bear on the following:

- product standardization (which in turn presupposes joint or combined research efforts);
- coordination in the use of public purchasing;
- definition of the most suitable training techniques for which Europe of the Ten would be a useful testing-ground for research and experiment;
- study of the legislative framework which best combines the encouragement of innovation and the existence of the common market;
- European participation in research on a similar basis to participation in energy;

- lastly, the information effort necessary not only to gain acceptance of inevitable changes but above all to bring out the opportunities that these changes make possible.

6.3 Further real harmonization of the conditions of production.

In this regard¹, the Commission envisages the establishment of a "European Fiscal Model" with:

- a common approach, albeit both gradual and flexible, to the balance between direct and indirect taxation and parafiscal charges,
- a framework for value added tax comprising bands of tax rate within which all products subject to VAT would gradually be grouped according to a common approach.

A programme of this kind, in keeping with the principle of the single market, would flexibly underpin the change of emphasis in budgetary fiscal policy imposed both by the current situation of public finances, and by the need for some redirection of government action towards supply orientated measures. In time it would allow the abolition of tax frontiers, the long-awaited demonstration of the existence of a true common market. The fact that certain limited disparities would persist due to situations which are not entirely comparable, and to the need for Member States to preserve a real degree of financial freedom, should not be a greater obstacle to this step in Europe than in the United States.

¹ Without prejudice to the suggestions made above regarding investment and energy, and the pursuit of harmonization in certain specific fields, notably excises for which the Commission hopes that decisions will be taken shortly.

The Commission is well aware that alignment of this kind would be a bold political departure fraught with technical difficulties; but in establishing the principle the Community would be giving proof of its vitality and the step would be less revolutionary than was the establishment of a single market in 1958, at a time of high customs duties and, in some Member States, generalized quotas.

7. Increased Community participation in an active employment policy, i.e. action directed specifically at the organization of the labour market and access to it, is necessary on economic and technical grounds. It would also be a valuable demonstration of the collective will showing the high priority assigned to employment objectives.

The final elements must now be added to the overall approach outlined above which, if unemployment is to be reduced, will require both a major effort on the investment front and an assault on production costs, and thus moderation in wage trends.

The programme, previous communications by the Commission and notably the report on the May Mandate, and the conclusions of the joint Council of Ministers for Economic Affairs and Social Affairs together define the scope and the means for Community participation in employment policy. More generally, the Commission has many times referred to the need for a harmonized approach to social protection and the establishment of common features in the field of workers' rights, occupational health and safety and the improvement of working conditions which could be written into collective agreements. Some priorities may here be recalled:

- 7.1 First, more consultation between the Community institutions and both sides of industry.

The object must be to bring together the different points of view, to try to develop a common analysis of the situation, to seek agreement on the main lines of action and to establish the form and extent of the Community's contribution to the solution of problems. The Commission will play its part here, and hopes to see a return to conditions favourable to the holding of tripartite conferences.

7.2 Then, fuller, more concentrated and more flexible use of the Community's means of action, notably the Social Fund, as proposed in the Commission report prepared under the mandate of 30 May 1980:

7.2.1 Giving priority to job creation, especially in small and medium-sized firms and through fuller exploitation of local economic opportunities;

developing mobility on the labour markets thus making them more efficient;

making a special effort to pursue more imaginative policies in relation to labour markets in the regions where traditional industries are concentrated;

taking account of the regional dimension of unemployment problems, applying integrated programmes that link the Social Fund with other Community resources.

7.2.2 In view of the priority given to jobs for young people, the Commission proposes a common objective: setting up, over the period of the fifth programme, machinery and arrangements to ensure that, on leaving school, all young people obtain either a paid job or access to a vocational training course or both thus improving their employment possibilities.

The Council should explicitly adopt this objective. At the same time, it should:

- make arrangements to compare national experience so as to design the most effective machinery;
- require that national programmes be submitted to the Community by a given date;
- decide, in principle, to make available, through the European Social Fund, part of the funds which the public authorities would in any case have to spend (development of training schemes,

especially in firms, incentives for the recruitment of young people) either to facilitate the launching of these operations, or in a more permanent way;

- provide for the systematic examination, at regular intervals, of the decisions taken by the Community and of the results achieved.

7.2.3 In this context the Commission has proposed the implementation of a more vigorous regional policy that would help both to create the basic conditions for an increase in employment (infrastructure, vocational training, etc.) and to help with job creation in the regions which are hardest hit by youth unemployment and least able to remedy the situation from their own resources.

Such a policy is likely to contribute not only to reducing the imbalance between the regions of the Community, a permanent priority, but also to solving the specific problem of the young unemployed.

7.3 The third priority is to conclude the current discussions on certain aspects of the adaptation of working time.

Where the reduction of working time is concerned, situations and views differ between the Member States.

It is, however, necessary to continue at Community level the studies on the effectiveness of this measure and on the conditions (in particular the need to improve production costs) which must be fulfilled where it is taken. Similarly, the work on certain methods of adaptation (part-time work, overtime, flexible working hours, early retirement and so on) must be completed without delay and should, where necessary, lead to the establishment of general Community rules.

8. To avoid getting locked into a process of decline, the Community in the next few years must restore its economic balance, modernize its structures and reverse the employment trend. The justification of the medium term economic policy programme outlined here is that it provides the necessary framework for this process.

The ideas here put forward by the Commission, which flow from those expressed in the report drawn up under the Mandate of 30 May, do not try to cover the entire Community field, but rather seek to provide a concrete basis for the strategy of the programme. The political options and technical guidelines should, in the Commission's view, form the subject of a debate that will lead to framework conclusions.

The Commission hopes that such a debate will start without delay in the Community institutions. The elements for a political choice have been assembled. And the choice must be clear. The Community's citizens are aware of its existence, but perceive poorly its ambitions and find it hard to see the concrete role it can play in the economic recovery that all recognize is urgently needed. Drawing up a medium term economic programme has a meaning only if it is used as an occasion for clear political choice of convincing objectives and for demonstration of the determination to take the steps needed for their achievement.

II. DRAFT DECISION OF THE COUNCIL
AND OF THE REPRESENTATIVES OF THE GOVERNMENTS OF THE MEMBER STATES,
MEETING WITHIN THE COUNCIL,

THE COUNCIL OF THE EUROPEAN COMMUNITIES AND THE REPRESENTATIVES OF THE GOVERNMENTS
OF THE MEMBER STATES, MEETING WITHIN THE COUNCIL,

Having regard to the Treaty establishing the European Economic Community, and
in particular the preamble thereto and Articles 6, 105 and 145 thereof,

Having regard to Council Decision 74/120/EEC of 18 February 1974 on the attainment
of a high degree of convergence of the economic policies of the Member States
of the European Economic Community, and in particular Article 6 thereof,

Having regard to the Commission draft established on the basis of the preliminary
draft prepared by the Economic Policy Committee,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas the economic policies pursued by the Member States must meet the objectives
set out in Article 104 of the Treaty,

HAVE DECIDED AS FOLLOWS:

Sole Article

1. The fifth medium-term economic policy programme set out in the Annex is hereby adopted. The Member States express their intention of acting in accordance with the guidelines contained therein.
2. The programme will be kept under constant review during its period of application.

III. DRAFT OF THE FIFTH MEDIUM TERM ECONOMIC POLICY PROGRAMME

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1. SUMMARY AND CONCLUSIONS

1.1 Introduction

1.1.1 This programme is the fifth in a series of programmes for economic policy in the medium-term. It provides a framework for policy at national and Community level, based on a diagnosis of the economic problems confronting the Community, and on experience gained with economic policy in the recent past. These bring out the need for a programme which will help our economies to adjust to changed circumstances.

1.1.2 In the past few years, it has become increasingly clear that economic policies must be adapted to face the challenges of the eighties. We have not been able to withstand the inflationary impulses reinforced by oil price rises, to adapt sufficiently rapidly to changed international circumstances, or to create sufficient job opportunities. An intensified effort is needed to improve the outlook for employment and growth. This requires improved financial stability and greater emphasis on longer-run supply-oriented policies. This programme is the reflection of deliberations on economic policy which have been proceeding for some time, and does not offer any completely new insights. Nevertheless, it is useful at the present time to put forward a coherent strategy for economic policy. This should help both the formulation and the permanence of economic measures in the countries of the Community.

1.1.3 In many respects the situation of each Member State differs, and for this reason the concrete measures by which the strategy is implemented cannot be identical. Nevertheless, there remain important common elements in the problems that each face and in the way in which policies should develop. This makes it important that a medium-term strategy should be formulated by the Community, the more so as policies within a common framework will enable each to draw the maximum benefit.

1.1.4 The problems of unemployment, inflation and low growth are extremely persistent, and due only partly to cyclical causes. For this reason, major emphasis must be given to medium-term policy as set forth in this programme, which must provide the framework within which concrete policy measures are taken from year

to year, and against which such measures are tested. At the same time it will be necessary to review certain parts of the Programme as circumstances change.

1.2 Problems and prospects that confront us

1.2.1 Our present economic problems first appeared at the end of the 1960s when the inflation rate began to increase under the pressure of rising costs, especially labour costs. The oil price increases of 1973-74 and 1979-80 added an unprecedentedly violent shock: to the resulting increased inflation were added the problems flowing from erosion of real incomes due to losses in the terms of trade, and growing unemployment. In addition, the instability in the international monetary system which arose at the beginning of the 1970s played an important role. The countries of the Community have been unable to adapt sufficiently to these changed circumstances. Our competitive position in relation to Japan, the United States and the Newly Industrialised Countries weakened.

1.2.2 The trend growth of the real Gross Domestic Product of 5.0% a year before 1973 declined to 2.5% in the period following the first oil crisis. This was accompanied by a substantial increase in the level of unemployment, from 2% in 1970 and 4.3% in 1975 to 7.5% in March 1981. At the same time, inflation rose from about 6% in the 1960s to 10% in the period 1973-1980. In these circumstances, and faced by increasing external costs as the terms of trade deteriorated and by rising public taxes and social security payments, there was increased pressure to maintain real wage incomes and to pass the burden of adaptation to other economic groups. Increased labour costs and reduced profits, and the slowdown of economic growth and increased uncertainties in economic prospects, resulted in severe curtailment of the growth of investment. After 1973, investment rose by less than 1% per annum as compared with an annual growth rate of more than 5% in the preceding 10 years. This was associated with a decline in the rate of productivity growth, which can only in part be attributed to cyclical factors. Insufficient progress was thus made in adapting the structures of industrial production: this must be pursued in the 1980s.

1.2.3 The past decade was further marked by sharp growth in public sector spending- especially on health care and social security. While in 1970 public spending accounted for 37% of the Gross National Product, by 1980 this figure had risen to 47%. The resulting increased public financing contributed to the rise of production costs and the fall of profits, and thus represented a further burden on our international competitive position. At the same time, public sector

deficits followed an upward trend in many countries, and in a number of countries have reached such a size as to represent a serious threat to financial stability.

1.2.4 Any assessment of the medium term outlook is difficult because of the many uncertainties which confront us, particularly at the present time when the development of world trade and of oil prices is extremely hard to predict. Efforts to make quantified projections are particularly hard. The assumption that economic policies and behaviour remain generally speaking unchanged is arbitrary. Because of the many uncertainties the results must be treated with great caution; they can do no more than identify trends which might be improved if governments and the social partners adopt more effective approaches. Subject to these reserves, quantified projections suggest that growth is not likely to rise above the 2-3% range experienced since the first oil price rise. Unemployment may rise further as there is a very rapid increase in the total working population over the next five years, though the extent of this increase is difficult to gauge. While some reduction from current rates of wage and price inflation can be hoped for, this process may well take some time and inflation as a result will persist at undesirable rates.

1.2.5 This clearly shows that vigorous policy efforts are needed in the Community to attain acceptable economic developments. The central theme must be improvement of the employment situation. Both the reduction in inflation and increased competitiveness will in turn lead to higher growth and fuller employment.

1.3 Lessons for economic management

1.3.1 Economic policy in many Member States has given inadequate weight to supply considerations as opposed to the management of demand, and short-term concerns have meant that there has often been insufficient permanence in macro-economic management. And inadequate attention has been given to structural changes while government interventions in this area have sometimes tended to delay rather than to foster the adjustment of our economic structures. In many respects mobility and flexibility have been lost. Certain developments in the field of social security have contributed to this.

1.3.2 In the present situation, most countries have very little room for policy manoeuvre. High inflation rates, large government spending deficits and balance of payments deficits leave little room for stimulating overall demand. Within public spending, priorities should be selectively adjusted to favour productive activity. Recovery of economic growth and the provision of more jobs must

depend mainly on supply policies, directed at higher investment and at lower costs and greater flexibility of labour and of capital. But curtailed inflation and improved stability are the precondition for achieving other key objectives.

1.4 Some principles

1.4.1 In the light of this experience, the strategy should be based on a set of clear policy principles.

1.4.2 Permanence of policy aims, and steadiness and predictability in the conduct of economic policy is particularly important. Governments should do all they can to stabilise expectations, and to increase confidence of both investors and the public at large.

1.4.3 Second, in the context of rapid change, flexibility of systems and behaviour is essential for economic progress. The functioning of the market mechanism must therefore be strengthened by giving greater freedom to market forces eg by encouraging mobility of labour and capital.

1.4.4 Third, openness to the rest of the world must be maintained and balance of payments deficits corrected although the Community must for a while bear its share of OPEC surpluses. Community industry must respond to the pressures from an evolving international division of labour. Protection is a path leading to disaster.

1.4.5 Fourth, progress towards convergence of the countries and regions of the Community must be an integral part of the strategy. The cohesion of the Community must be strengthened by exploiting the potential for coordinated action, and by Community policies.

1.5 The main lines of strategy

1.5.1 Based on these principles, the strategy has two essential objectives:

- inflation must be curtailed and stability improved;
- structural change must be promoted for more growth and employment.

1.5.2 Stability. Inflation has taken deep roots, and is a threat to our prosperity. Large public sector deficits and excessive deficits in the current account of the balance of payments represent a danger for financial and economic stability. While the policy response in each Member State and its intensity must reflect its own circumstances, monetary and fiscal policies and incomes moderation must everywhere be combined together to reduce inflation in such a way as to leave

sufficient room for real growth. Monetary policy must help to reduce inflationary forces by gradually reducing the growth of the money supply to the level required for financing real economic growth. A clear presentation of medium term monetary policy will facilitate its acceptance as a factor to be taken into account in wage and price formation. In parallel, budgetary policy should aim at reducing government deficits by keeping the growth of government spending in the medium term below that of national income. In most cases, this will mean that the growth in the transfer of incomes will have to be checked. And moderation of wages is also essential. Increases in real incomes must not be higher than the growth in productivity corrected by terms of trade losses; indeed in a number of countries increases should be lower in order to help restore profits and thus favour investment. Indexation mechanisms used in certain countries have rigidifying effects. Modification of these and other wage bargaining systems is called for to restrict passing on oil prices rises and increases in indirect taxes. Incomes moderation must apply to the non-competitive as well as to the competitive sectors of the economy.

1.5.3 These policies are interdependent. Incomes moderation and reduced deficits will reinforce monetary policy in the fight against inflation, and will ensure that room is left for economic growth.

1.5.4 Growth and structural change. In parallel it is vital, by reducing costs and promoting investment, to improve the structural position and international competitiveness of our economies. This is the essential way to raise the level of growth and create new and stable jobs. Increased price stability will, by creating confidence in the future, improve the climate for business investment and innovation. But this may not be enough to ensure that valuable investment projects that structural change requires are realised. In many countries, there must be a recovery of profitability, improved expectation of sales and greater freedom for investors to react to market forces. There needs to be freedom for the market to produce relative price changes, to provide the necessary incentives for investment. Competition should be promoted and distortion of competition controlled. Public intervention must be clearly defined in its limits and its aims. Such intervention in the private sector should stimulate regional equilibrium, technical innovation and a reallocation of resources from declining to competitive activities; aids which slow down the adjustment of weak sectors should be phased out. Government measures should be transparent and should not distort competition. Action should be taken to encourage greater availability of risk capital. Particular attention should be given to small and medium sized firms.

1.5.5 Special importance must be given to energy and energy-related investment. In part this is because it contributes towards relaxing a long-term constraint on our economic activity, and will allow improvements in the balance of payments and in the employment situation. In part it is because energy investment can make an important contribution to a more general revival of economic activity. Present and prospective levels of OPEC prices are such that - if it is known to the private sector that these will be carried through to the final consumer - they justify a mass of investment to economise, to produce from alternative sources, to adapt industrial production to new techniques and new products which consume less energy. Where market forces work too slowly to stimulate energy saving and development of alternative sources other than oil a regulatory or financial stimulus should be provided by the public sector. The use of nuclear energy and of coal is an important contribution to relaxing the constraints of energy on the Community economies.

1.5.6 Public sector activity must also contribute to structural change. Public spending programmes, whether capital or current, should be reassessed in the light of their structural impact: some public investment programmes lead to or complement private sector activity. Particular efforts should be devoted to increasing the effectiveness of social security payments, while helping those most in need. And taxes should be modified so as not to discriminate against risk capital as opposed to other forms of financial assets.

1.6 Improved employment

1.6.1 For employment, the policy outlined above which is aimed at stability and economic growth, is of vital importance. In view of the present serious level of unemployment and the large increase in the labour supply to be expected in the coming years, reduced unemployment requires increased creation of jobs. High levels of profitable investment are needed to create new and secure jobs. Although moderation of incomes may at first dampen private consumption, it will tend to safeguard existing jobs, help employment and allow the recovery of profits and investment leading to higher growth.

1.6.2 While increased investment and restricted labour costs are the two main pillars of employment policy, specific measures are also needed to improve the match between supply and demand on the labour markets. A more effective approach to vocational education is of great importance. Particular attention should be given to the situation of structurally weaker regions, and to training of young people.

1.6.3 In the labour markets more mobility, increased skills and greater flexibility are essential. Greater flexibility is needed in wage structures, to take account of the different advantages and disadvantages that jobs may offer, including relative job security. Care should be taken to avoid a situation where the financial incentives to higher qualifications, extra effort and mobility are excessively eroded by the overall impact of taxes, social premiums and income-linked subsidies.

1.6.4 While further improvements in social security cannot at present be envisaged, indeed expenditures in this sector must be contained, there needs to be an openness to take into account temporary measures to alleviate unemployment over the initial years, to avoid excessive hardship to those directly affected.

1.6.5 In the years to come work-sharing will be an important topic of public debate. It must be accepted that work-sharing will have to satisfy the preferences of the workers involved, and must not lead to any increase in labour and capital costs, since this would jeopardize the competitiveness of the industry in question and thus its employment situation. Measures of this kind should also be reversible, as the rapid growth of the labour force now foreseen will later fall off. These considerations imply that a particular sharing of work cannot be prescribed either at national level or at Community level.

1.7 Community dimension

1.7.1 Community policies must also contribute to the implementation of the strategy, and to the cohesion of the Community. The full potential of the single market of the Community must be exploited. Intra-Community trade should be developed to provide the best possible base for productive investment and innovation while obstacles - notably in the field of technical standards - should be limited. Use of the Treaty rules should be consistent with the aims of the strategy, and ensure that subsidies which distort competition and inhibit structural adjustments are phased out. Coordination of national policies at Community level, and individual Community policies should contribute to structural adjustment, and help to reduce divergence between Member States' economies.

1.7.2 A balanced development of the external and internal adjustment process is of great importance for the further development of the Community. The coordination of monetary policy and the EMS have a major role to play in this respect.

1.7.3 At the world level, the Community should maintain its non protectionist position, and should play an active role in international discussions in trade,

finance and development.

1.8 The strategy's impact and implementation

1.8.1 The policy approach of the Fifth Programme opens a prospect of recovered stability, revived growth and improved employment, at a time when present problems and future prospects are discouraging. It is not possible to say how much improvement can be achieved if the overall strategy were fully implemented: there are too many uncertainties in the way of such estimates. But this approach is the essential means by which the Community can restore the basis for secure and stable growth.

1.8.2 Year by year, concrete measures will be required to give shape to the Programme's strategy. Progress in implementing the strategy should be reviewed regularly, so that the necessary policy adjustments can be made. This could usefully be done in conjunction with the annual reviews; moreover, assessments could usefully be made of the effectiveness of policies in particular key sectors, notably labour market policies.

1.8.3 The fruits of the strategy will only become fully visible after some time has elapsed. In a number of Member countries the structural position has become so weakened that it will take several years to restore. It will undoubtedly call for great political perseverance to restore certain weakened economies to full strength.

1.8.4 To put the strategy into effect, there must be widespread understanding of the need for adjustment as the essential means to restore competitiveness, to encourage growth and to create secure employment. In this respect the social partners have an important role to play.

1.8.5 Over the past decade, the Community has lost international ground which it is surely possible to recover in the coming years. Therefore there is no reason for pessimism. The Community has large economic potential. Given clear and firm implementation of policies within the framework of the strategy by all governments and social partners, the Community can turn its back on present fundamentally unsatisfactory trends and lay the foundations for its future prosperity.

2. CENTRAL ECONOMIC PROBLEMS

2.0.1 At the beginning of 1981, once again deeply affected by the second oil price round, the Community, in common with other countries, faces the double challenge of rising unemployment and high and lasting inflation, compounded by the widespread realisation that present low growth may prove lasting. The serious economic difficulties which the Member States and many of their major competitors share in varying degrees are based on a number of external and internal pressures to which the Community's economic strategy must be addressed.

2.1 External pressures

2.1.1 All countries - developed or developing - are at present confronted by the need to adjust to a series of profound changes in the world economy during the last decade: the problems encountered by the dollar and the abandonment of the Bretton Woods system which followed, the continuing monetary uncertainties and the inability of the international monetary system to rebuild sound foundations, the oil price rises of 1973 and 1979-80 and the accompanying burden on the trade balance of all consuming countries, developed or developing, the cost of other non-energy commodities, the increased economic and financial assets as they reach the limits of their capacity to develop, the rapidly growing role of newly industrialised countries whose comparative advantages challenge the traditional industrial producers.

2.1.2 At international level, the clearest indication of these economic problems has been the slowdown in the growth of world trade in volume. This rose at an annual average rate of 8.5% between 1960 and 1973; between 1973 and 1979 the annual increase fell on average to 4.5%, with a slight rise at the end of the period largely due to a rise in agricultural trade. This overall slowdown does not bring out the competition between the oil importing countries for new export markets. The Community was able to bring its current account back into balance by 1977, but the second oil price rise in 1979-80 again damaged the equilibrium of world trade: in 1980 the Community's trade balance fell to - \$43 billion after the \$15 billion surplus recorded in 1978, while in the same period the developing countries' balance fell from - \$35 000 million in 1978 to - \$60 000 million in 1980. At the same time, the current surplus of the OPEC countries has been rising, and may be some \$115 billion in 1981. As they do not have the

economic capacity to spend on imports of goods and services all the income they receive, their financial balances are large and rising - some \$350 billion at the end of 1980.

2.1.3 For the Community the result is that the external energy constraint - with economic, financial and strategic aspects - is a serious limit on its freedom of policy choice.

2.2 Internal pressures

2.2.1 The deterioration of the international environment over which the Community has little influence is combined, internally, with permanent pressures from the growth of costs and prices which both impede adjustment of our economic structures and yet make this even more necessary.

2.2.2 Since 1974, internal energy prices in the Community have been one of the factors pushing up production and consumption costs. The pricing policies of the oil producing countries, by the end of 1979, helped bring the Community oil bill back to the 1974 level, i.e. 4% of GDP, even though oil imports as a share of total energy consumption had fallen from 60% in 1973 to 48% in 1979. Reduced dependence on oil was due to the effect of price rises on demand and to the development of the Community's own production; but the underlying structural change in energy consumption patterns was however delayed by the relative slowness with which internal energy prices reflected external price rises, at least until the second oil price rise. Thus, up to 1978, the specific duties on a number of petroleum products which are fixed in relation to quantity, were increased significantly less than the level of inflation. This decline in the real tax burden softened the impact of the external price rises on consumers reducing both real tax receipt and the incentives to economize consumption. In part for the same reason, the relative cost of energy compared to labour, after a large rise in 1973-74, fell back to levels in 1973. It appears, however that, especially since the second oil shock, internal prices are being adjusted more rapidly to changes in import prices, thus helping to make it plain to the consumer that a steady rise in the price of energy products is inevitable.

2.2.3 The first oil shock was followed in 1974-75 by a general wage explosion in the Community as wage earners sought to offset the effects of inflation. As a share of net domestic product at factor cost wages rose from 82% to over 88%.

This acceleration in the rise of wage incomes had a large impact on the profitability of firms and on their investment capacity. Since that date, despite some decrease in wage rises, the increase in employers' social security contributions has meant that this share has remained high (87% on average in the Community in 1980). The result in terms of the nominal labour cost per unit of output was an average increase in the Community of 10.6% a year from 1973-1980 compared with 5.8% from 1960-73, while real wages rose more than productivity gains. Thus, compared with the level in the early seventies, there is a difference of almost 7% in 1980, between the growth of real per capita wages and the growth of the apparent productivity of labour. This gap appears to be still higher, if the negative terms of trade effects which occurred in 1980 are taken into account.

2.2.4 The trend for public spending to grow more rapidly than national income also represents a major structural shift in the Community economies, and an increasing burden on firms and households. The long term trend in every Member State has been for public spending to increase more rapidly than output and in the Community as a whole the share of government expenditure in GDP has grown from 37% to 47% over the last decade. The most rapid increase has been in social security spending which in many Member States is contained in special budgets; this rise is in part due to rising standards of health and other care, in part to growing levels of unemployment. Employers' and employees' social security contributions have increased sharply - one third as fast again as GDP in value in the Community as a whole. The size of public deficits increased steadily, as expenditure connected with the economic and social situation continued to rise; the main consequence of efforts to restrain this growth has been to limit the volume of public investment.

2.3 Inflation and loss of competitiveness

2.3.1 The persistence of high inflation at widely differing rates between countries is the first consequence of the permanent pressure of costs and prices on the behaviour of all economic agents. In the Community as a whole, the two main inflation indicators - the GDP price deflator and the consumer price index - have risen by an average of 10% over the last five years as against an average of 2.5 to 5% between 1960 and 1973. By raising the consumer price index each time by some 3.5 percentage points the two oil shocks are responsible for the two peaks of over 12% inflation in 1974-75 and in 1980. However, this Community average hides a further widening of differences in price movements from one Member State to another: the rates of annual increase in 1980 range from 5 to 20%.

2.3.2 A decade of rising inflation has now established inflationary expectations which are very difficult to eradicate. This is particularly difficult where circumstances do not allow any significant increase in real incomes. And while the flexibility of exchange rates that - in some countries - may have increased inflation early in the decade has now given place, at least within the Community, to greater stability, other external factors favouring inflation cannot be expected to disappear in the short term.

2.3.3 High and variable rates of inflation reduce the growth of output in several ways but in particular by increasing uncertainty and undermining confidence. In recent years, for example, the high level of savings by household has been in part a reaction to the erosion of the value of financial assets due to high levels of inflation. The impact of inflation on taxation can also distort information about the real profitability of firms and, as a result, can mislead both investors and the negotiators of wage agreements. Unforeseen levels of inflation can have undesirable effects on the relative costs of labour and of capital.

2.3.4 Perhaps the most important consequence of inflation is its negative effect on investment decisions. Inflation has discouraged investment by reducing profit margins, raising nominal interest rates and fostering uncertainties as to future capital costs, the long term outlook for demand and the real rate of return. This contributed to a marked deterioration in the rate of increase of investments in most Member States which seriously undermines the potential economic development of the Community. The growth of investment began to decline as early as 1970, even though the years 1970 to 1973 were years of expansion: this was followed by a real collapse in the rate of growth of investment in the years 1974-75. Despite an upturn in 1976 and a more favourable situation in some countries, investment increased by only 0.7% a year in the Community between 1973 and 1980. Among the major industrialised countries Japan stands alone since there the growth rate of investment was three times as much as in the Community bringing the share of investment in GDP to 31.7% in 1979 compared with 21% in the Community and 18% in the United States.

2.3.5 By major economic sector national experience has varied, but for the Community as a whole over the last decade market services and agriculture have been taking a steadily rising share of total investment, while energy's share has been stable despite ambitious programmes in some countries for investment in nuclear

energy, alternative energy sources and for energy savings. Energy investment in 1980 was some 8% of total fixed capital formation, or 1.7% of GDP; this is of the same order of magnitude as over the years 1968-74. The share of public investment has fallen since 1977. The share of industry has declined consistently over the whole period; industrial investment as a share of value added in industry fell from 15.5%, at the beginning of the last decade to 12.5% at the end. This fall is the more important since it has gone with a slow but steady reduction in the share of industry (at current prices) in the total value added of the Community.

2.3.6 The growing importance of the tertiary sector and less capital-intensive growth go a long way towards explaining the smaller productivity gains recorded since the early seventies: from 1973 to 1979 the apparent productivity of labour increased by only 2.2% ie half the average rate of increase between 1960 and 1973. In addition, if capital resources and structural trends of labour productivity are taken into account, potential growth has slowed down; this fall in profitable production capacity reflects lower levels of investment and increased delays in substituting factors of production as well as the fact that certain types of equipment have become uneconomic more rapidly as a result of the increase in energy prices. And now that slack economic activity is established, rigidities exist which make it difficult to restore higher levels of growth: labour has become less mobile, public finance constraints persist, and inflation is reducing investment and the mobility of capital. These constraints will have to be eased if growth potential is to be increased.

2.3.7 The poor results in controlling costs and developing competitive production capacities have affected the Community's competitiveness and damaged its position in world trade. Overall, not only the US and Japan, but also other countries - and especially the newly-industrialised countries (NICs) - are major competitors at least in particular sectors. If sometimes this has been helped by a more favourable energy price situation, it is more generally due to a lower wage cost and often to exploitation of sophisticated technology as much in production methods as in product design. And most countries are under pressure to increase their export earnings to try to offset the rising cost of oil. As a result, continuing a long term trend the Community's share of world trade in manufactured goods fell slightly from 1973 to 1979, while that of the US also fell and those of Japan and the NICs rose rapidly.

2.3.8 In some areas, the Community's industry has been able to maintain its world position through concentration either on quality production or on areas of high technology. And other areas of relative expertise - notably services - have so far maintained their position. The development of the NICs also of course opens new markets as well as providing additional competition. But in certain major sectors, performance has been disappointing. The share of third markets has fallen, and - more selectively - import penetration has risen rapidly. And if the areas where this has occurred are limited, their importance is high both in terms of employment - often heavily concentrated in certain regions - and technology, while the impact can go wider (eg car imports also mean reduced demand for Community steel). In the "growth" area of office and tele-communications equipment the ratio of exports to imports for the Community fell from 1.26 in 1973 to 0.93 in 1979, whereas for Japan there was an increase from 2.5 to 3.8. In engineering products the Community's ratio fell from 2.6 to 2.2, while Japan's rose from 5.5 to 7.6.

2.3.9 As we have already seen, this performance is reflected in the deterioration of the Community's current account balance which in 1980 registered a deficit of 1.5% of GDP whereas the OPEC surplus increased further. And while the overall current deficit for the Community remains of a manageable size, the difference of performance between Member States means that several had very large external deficits in 1980.

2.4 The rise in unemployment

2.4.1 The large increase in unemployment reflects the delay with which the Community's production structures and the behaviour of economic agents have adapted to the many pressures to which they are subject and thus create new jobs. Unemployment in the Community as a whole has risen very sharply in recent years: in March 1981 it had reached 7.5% of the active civilian population, or some 8 million people, compared to 2% in 1970 and 4.3% in 1975. Particular groups have been particularly affected: women now account for almost 45% of total unemployed even though they represent only 36% of the active population; young people (women included) for 42% of total unemployment compared with 14% of the active population. It is true that not all who are registered as unemployed may be actively looking for work: national arrangements differ in their means of control as in their definition of those who may receive unemployment benefits; but this does not alter the scale of the problem.

2.4.2 Employment has fallen drastically in some sectors: for example in 1961 6.25 million persons were employed in the Community's textile, clothing and leather industries: in 1978 only 3.8 million remained. The extent of such job reductions, which are unavoidable for industrial restructuring, has often been lessened by measures designed to postpone redundancies particularly in the labour intensive industries. While these policies have alleviated immediate social problems, they have generally not helped to improve firms' competitiveness, but have tended to build up a larger "overhang" of change for the future.

2.4.3 The growth of wage costs has not fully reflected the pressures of unemployment whereas the social security burdens have further increased. This increased the pressure of wages on inflation which has affected overall growth.

2.4.4 At the same time job creation has not kept pace with the reductions in employment, while it is often difficult to match the skills available with those needed for the jobs vacant. This is why the measures taken to help employment have favoured parafiscal relief to encourage recruitment, professional training and greater flexibility in working arrangements. These measures have not yet enabled the rise in unemployment to be halted, let alone reversed.

2.4.5 One factor of importance for the development of unemployment rates over the next few years is the demographic trend to which should be added the net effect of migration, which has however fallen off in recent years. Although the total population is growing slowly, the population of working age has a much less even growth path: after an average increase of 0.5% a year between 1950 and 1978, the rate began to rise in 1979 and 1980. This marked the beginning of a period of very rapid growth between 1980 and 1985, when the annual increase will be 0.9%; thereafter there is a drastic reduction to an average level of 0.1% between 1985 and 1990. However, this marked fall may not be reflected in the number of those within the active working population (i.e. those of working age who will actually have or seek work), which is much less easy to forecast. But there has recently been a rapid increase in the number of women in the active working population: in 1979 of the net increase of 800 000 in the labour force, 700 000 were women. It is to be expected that this will continue, even if it is moderated by the difficulties of finding jobs which may discourage some from registering at least for a time, and will probably mean that the annual increase in those actively seeking work will not fall after 1985 as much as that of the total population of working age.

2.4.6 It is also a source of concern that the parallel ("informal", submerged", "black") economy, while difficult to measure, seems now to be a major feature of our economies. This may mean that the recent deterioration in growth and employment recorded in official statistics is overstated. However, it carries with it serious problems, not least resource misallocation in favour of untaxed activities which are likely to have a lower social return, a reduction of tax revenue and corruption of social standards of respect for law. The growth of the parallel economy may in part reflect the qualities of small-scale decentralised activities, but also shows the importance of severe rigidities in labour markets, in pay and State regulation aspects, and the heavy burden of taxation on employment and production. Thus policies to favour structural adaptation have to include efforts to ease the factors that have boosted the emergence of the parallel economy.

2.5 Divergence between Community economies

2.5.1 The external adjustment problems faced by the Community are made worse by the internal divergence in the economies of the Member States. Real labour costs per unit of output and rates of inflation have increased at much more variable rates between countries since 1974 than in the previous decade. These and other factors have as a result impeded the gradual convergence of living standards which occurred during the first decade or so of the Community: for the Community of 6, their percentage differences in GDP per head measured by purchasing power parities fell from 26% in 1960 to 13.5% in 1970, 15% in 1973 and 13% in 1980; for the Community of 9 it was 20% in 1973 and 21% in 1980.

2.5.2 These divergences between countries' standards of living go with even greater differences between regions. The impact of unemployment also varies widely by region: in the Stuttgart region in 1979 it was 1.4% while in Calabria it was 12.8%, and in the structurally weaker areas unemployment is often of longer duration and is accompanied by low participation rates.

2.5.3 But these indicators of divergence point to the different abilities of Member States to cope with the need for adjustment. The sharp deterioration in the economic environment which occurred several years ago has tended to reinforce their comparative advantages, the maturity and diversification of their systems of production, their flexibility in adjusting production and employment structures, their choice of export specialization and their degree of openness to foreign products and capital, not forgetting the degree of consensus achieved as to the problems and the type of solutions to propose. Thus, the situations of the

Member States vary widely, and the results achieved by some only serve to highlight the scale of the difficulties which the others have to overcome.

2.6 Lessons for economic management

2.6.1 It is important that the policy lessons of the last decade should be drawn. In many Member States, there was insufficient emphasis on supply oriented measures as opposed to demand management. This resulted in increased domestic inflation which was reinforced by currency depreciation. And public intervention in the economy sometimes tended to maintain jobs in declining industries. Low levels of productivity and of investment have in turn become constraints on renewed growth.

2.6.2 Faced by present constraints, there is little freedom of manoeuvre for economic policy. The exchange rate flexibility of the early 1970s now appears to have had disadvantages as well as benefits. The persistence of high inflation and balance of payments deficits limits the flexibility of monetary policy. The traditional approach of macro economic policy has thus been seen as insufficient to resolve present problems. While incomes policies have not managed to hold inflation back, in some countries rising public sector deficits have increased the burden on monetary policy in fighting inflation. And demand is not sensitive to macro economic adjustment because basic structural constraints have not been overcome.

2.7 The Outlook: a tentative projection

2.7.0.1 In preparing the 5th Programme a quantitative projection has been drawn up to provide orders of magnitude for the possible future development of the main economic aggregates. The results have to be approached with great caution: any forecast of this kind is, inevitably, based on a number of working assumptions - including continuation of present policies and behaviour of the economic operators - which can turn out to be wrong. The results can do no more than suggest trends. If the social partners and governments respond well to the challenge facing us, then there is no doubt that better results can be achieved than set out in the following projection.

2.7.1 International developments

2.7.1.1 In the light of the oil price shocks of 1973-74 and 1979-80, future

increases in oil prices form one of the major uncertainties in the world economic outlook for the years to come. The working assumption is that oil prices will continue to rise gradually in real terms although in practice this may not be a steady process, as recent developments on world oil markets show. This rise, especially in the case of countries which are highly dependent on imported oil, will lead to a deterioration in the terms of trade.

2.7.1.2 The variation in the value of Community currencies against the dollar is very difficult to foresee while exchange rate variations can have a major impact on forecasts. Purely as a technical hypothesis it has been assumed that in the medium term exchange rates will remain fairly stable.

2.7.1.3 The growth of world trade in the coming years is partly dependent on OPEC balance of payments determined in turn by the price of oil and by the absorption capacity of the OPEC countries, for both of which it is not easy to make assumptions. However it seems reasonable to suppose that the balance of payments disequilibria will not disappear for the present. It seems likely that the growth in world trade will not increase beyond the level experienced since the first oil price shock. The growth rate for extra-Community world trade has been estimated at 5% per annum on average, on the hypothesis that imports of OPEC countries and Japan will grow somewhat faster than in the period 1973-1980.

2.7.2 Economic trends in the Community

2.7.2.1 The growth of GDP in the Community for the period 1981-1985 may on average be on the same scale as that of the period since the oil price shock of 1973, that is to say 2-3%. This would represent a slightly increased growth rate following the present recession. Investment may revive somewhat. There will however be little if any increase in employment. Unemployment may rise further. It is difficult to predict to what level, because it is uncertain to what extent the whole of the rapidly increasing potential labour supply - bearing in mind the weak labour market - will attempt to enter the labour market. But it is clear that the employment problems of the coming years will be extensive. During the period 1980-1985 the price index may rise by around 8% per annum as compared to 10-11% since 1973, if some increased moderation in wage rises occurs: the increase in per capita real wages may remain about 1% per annum. As this may be less than the increase in labour productivity, this would allow a modest recovery of profits.

2.7.2.2 On the hypothesis of unchanged policies which already involve some constraints on public spending, it seems that there can be some reduction in public sector deficits, even if in some member countries they may nevertheless remain so high as to continue to cause concern.

2.7.2.3 The Community's balance of payments could be in virtual equilibrium by 1985. Future deterioration in the terms of trade could be offset by an improvement in the ratio between export volume and import volume.

2.7.2.4 The following table sets out results for certain important aggregates. Despite the precision of the figures given, as already underlined they contain a large and inevitable margin of uncertainty.

Main results of the "base" projection for the Community as a whole

(Average annual growth rates in % except where otherwise indicated)

	1973/60	1980/73	1985/80	1985/81
GDP	4.6	2.2	1.9	2.5
GDP price	4.9	10.4	8.1	7.7
Investment	5.4	0.7	1.1	2.1
Employment	0.2	0.0	- 0.2	0.0
Purchasing power of per capita wage	5.0	2.0	0.8	1.0
(Corrected) wage share in GDP	0.2	0.0	- 1.1	- 1.4
End of period balance of goods and services (GDP percentage points)	0.4	- 1.4		- 0.2

2.7.2.5 This forecast illustrates that vigorous policy efforts are required if an acceptable level of economic performance is to be achieved. The central aim must be to improve the employment situation. This will require an increase in the economic growth rate and a decrease in the level of inflation.

3. THE OVERALL STRATEGY

3.1 Need for a medium term strategy

3.1.1 The fundamentally unsatisfactory trends facing the Community cannot be accepted as inevitable. The production structures and consumption patterns of our economies must be adapted to meet the pressures of rising external prices for oil and other raw materials, and of increasingly competitive activity - both industry and services - elsewhere in the world. Improved price stability in all Member States, and particularly in those where inflation is above average, is an essential precondition for achieving other key objectives. The inflationary gap between aspirations and possibilities must be narrowed. Better price stability will revitalise the private sector and encourage profitable investment. And the structural strengthening of the economy will in time allow a gradual easing of overall demand restraint. The resulting growth-oriented structural adaptations are the means by which the rising level of unemployment must be halted and if possible reversed.

3.1.2 These objectives will take time to be achieved. The experience of the last decade has shown the limits of economic management if this contains or offsets basic pressures for adaptation in our economies. It is therefore essential to have a medium term strategy which is aimed at harnessing all aspects of economic policy to achieving the structural changes on which our future prosperity depends.

3.3.3 Such a strategy is particularly necessary to provide a framework for short term economic policy. Governments are often under pressure to take actions to meet short term needs and priorities - often social. It is less often appreciated that some measures taken in response to such pressures delay or make more difficult the structural changes that are essential for future sound economic activity and secure jobs. A clear statement of the policy requirements that medium term objectives impose must therefore guide short term management.

3.2 Principles of the strategy

3.2.1 The medium term strategy must respect the following principles :

- There must be permanence of policy aims, and steadiness and predictability in the conduct of economic policy, so that governments do all they can to stabilise expectations and leave room for the development of market forces.
- Mobility of labour and capital must be encouraged by greater freedom for market forces to adapt the occupational, sectoral and regional structure of our economies to the pressures of energy and external competition.

- The policy-mix to be adopted must be judged by its effects on structural adaptation and its contribution to the growth of potential output as much as by its impact on demand.
- Openness to the rest of the world must be maintained and the loss of external markets made good; though progress needs to be made towards balance of payments equilibrium, the Community must for a while bear its share of the creation of OPEC surpluses.
- Progress towards convergence of the countries and regions of the Community must be an integral part of the required structural adjustment.
- The cohesion of the Community must be strengthened by exploiting the potential for common action.
- The strategy's aims and justifications must be fully understood so that all the partners are ready to play their full part in its implementation.

3.3 Main lines of the strategy

3.3.1 On the basis of these principles the programme's strategy has two essential objectives : inflation must be curtailed and price stability improved, while structural change must be promoted.

3.3.2 To continuously reduce inflation stabilisation is critical; it requires a combination of policy approaches. Monetary and credit policies need to reduce inflationary expectations through a progressive but consistent reduction in the growth of money supply to the level required for financing real economic growth. Public budgets must adapt to these lower monetary limits : deficits should not rise as a share of GDP and in some countries should be reduced. In addition, real public expenditure growth should be kept slightly below the rise of real national income. In parallel, there must be moderation in the growth of nominal incomes and a reduction in the growth of real wage rates compared to that of labour productivity, corrected for terms of trade changes, coupled with more freedom for relative price movements balanced by active competition policies and voluntary restraint. Interest rates should be kept as low as other policy objectives permit. The discipline in public deficits and incomes will enable monetary policy to leave sufficient room for real growth.

3.3.3 In parallel, there must be adaptation of our economic structures - socio-economic, sectoral, regional and occupational - to the demands of energy and increasing international trade pressures. The stabilisation of macro economic conditions to allow higher growth must be accompanied by the creation of productive activities

which can exploit this potential. The climate for private investment and innovation must be improved by giving greater scope to the social partners, consumers and investors to react more efficiently to market signals; public interventions in the private sector should be subject to more rigorous scrutiny to ensure that they do not impede reallocation of resources towards competitive activity. Special importance however must be given to energy and energy-related investment, partly because it contributes to loosening a long term constraint on our economic activity, partly because it can make a substantial contribution to economic activity. In the readjustment of economic structures, a limit is needed in the medium term to the increase in the growth of government spending as a share of GDP, while within total public spending priority should be clearly given to these activities which contribute directly to structural change or which lead the private sector in this direction.

3.3.4 Both stabilisation and structural change are the essential means to produce a lasting improvement in employment although - in part because of temporary demographic trends - unemployment is likely to rise further in the immediate future and only fall significantly towards the end of the period. Smaller wage increases should help to improve international competitiveness, and to adjust the relative cost of labour as a factor of production; rebalancing of the costs of different categories of labour within the Community may also be needed. While moderation in incomes and reduced public sector growth will initially hold back the growth of demand, these factors should help increase employment as overall activity picks up. Structural improvements in the labour market are a necessary accompaniment, to ensure a better match between labour supply and demand which can also help to reduce inflation. The social partners' discussions of work sharing need to recognise that moves in this direction must not worsen the Community's competitiveness which it is essential to improve.

3.3.5 Faced with these problems, the full potential of the Community dimension must be exploited to help towards the basic objectives. More economic activity occurs between the Member States than with third countries. For this reason, economic and monetary policies should be more effectively coordinated, to exploit the greater impact of actions undertaken together. Intra Community trade should be developed to provide the best possible base for productive investment and innovation to confront international competition, while barriers to world trade should continue to be lowered. Individual Community policies should contribute to structural adjustment and help to reduce divergence between Member States' economies.

3.4 Interdependence of the strategy's policies

3.4.1 The strategy forms a whole. Without a larger degree of price stability other objectives - economic and social - cannot be assured. To achieve better price stability, strict monetary policies are needed: but reduction of public deficits and moderation of incomes should enable the possible restrictive impact of these policies to be avoided. Control of public spending and incomes moderation will at first reduce internal demand for current consumption. But incomes moderation will help to improve the competitiveness of our goods and services and the resulting external demand should provide some increased activity: even if balance of payments deficits cannot be eliminated in the short term, the Community should be able to make up the ground it has lost in world markets in recent years. Moreover, further internal activity will flow from increased investment. While demand expectations, a major determinant of investment, may initially be dampened, determined implementation of the strategy will provide prospects of sounder economic growth and increased activity which will favour private sector investment, as will reduced inflation and the increased profitability flowing from incomes moderation. Moreover, greater freedom for market forces will also open up new areas of investment as well as speeding up change in declining sectors. It is vital that in this way investment contributes to the improved competitiveness the Community needs. In parallel labour markets must also be improved and made more flexible so that they can also respond to the need for structural change. And the containment of public spending in the medium term will leave room for private sector expansion. As investment decisions are shaped by a mix of longer term prospects of prices, costs, profits, and especially real sales it is crucial to reestablish confidence in the future and reduce uncertainty through a longer term strategy of continuity aiming at lower inflation and sufficient profits.

3.4.2 Productive investment is thus critical on two counts: to provide the structural changes so badly needed and to contribute to renewed activity. Special attention must however be given to investment which will loosen the energy constraint. Present and prospective levels of OPEC prices are such that if it is known to the private sector that these will be carried through to the final consumer no further incentive is needed to justify a mass of investment to economise, to produce from alternative sources, to adapt industrial production to new techniques and new products which consume less energy. Where market forces work too slowly to stimulate adaptation a regulatory or financial stimulus may also be provided by the public sector, which in many countries carries a large part of this investment effort. Given the importance of this investment for the overall strategy, special measures may be needed to

provide adequate finance, both external and domestic. A firm effort to launch energy and energy-related investment by the private sector is part of the demonstration of the determination to implement the overall strategy and will provide confidence in a viable future economy: this and the demand flowing directly from these investments will relaunch investment more generally.

3.4.3 A significant reduction in wage increases is also an essential condition for the success of the strategy. For the social partners to accept the change in their behaviour that this moderation implies, it must be clear that the strategy will be implemented in its entirety. Only in this way will the increased margins for competitive activity flowing from incomes moderation give rise to investment and job creation. Thus increased profitability in industry will be matched by growing real income for employment. The public authorities must therefore fully implement all the elements of the strategy which depend on them, and in this way give greater freedom to the market forces which will provide incentives to the private sector. Incomes moderation must not be limited to the competitive sector but also apply to the non-competitive and sheltered sectors. While further improvements in social security cannot at present be envisaged, indeed expenditure in this sector must be contained, there needs to be an openness to take into account temporary measures to alleviate employment over the initial years, to avoid excessive hardship to those directly affected.

3.4.4 The following chapters examine the strategy's component parts, and its impact and application.

4. STABILISATION

4.1 Monetary policy

4.1.1 There is increasing consensus in the Community over the role and broad techniques of monetary policy, especially in the medium term as monetary authorities show their determination to reduce inflation significantly. In the four large Community economies objectives are announced for the monetary or credit aggregates considered by each to be the most appropriate for their financial structures. These objectives have been lowered over the years, though these reductions have also been influenced by the fall in rates of growth. Thus the Bundesbank's target range for central bank money growth has fallen from 6-9 % for 1979, to 5-8 % for 1980, and now to 4-7 % for 1981. Similarly the Banque de France has reduced its target for money supply growth from 12 % for 1979, 11 % for 1980 and 10 % for 1981. The Banca d'Italia's target for total domestic credit expansion was lowered from 18 1/2 % for 1979 to 17,4 % for 1980. In the United Kingdom the authorities have gone one step further in setting a medium term objective for the money supply: 4-8 % for 1983-84 compared with 6-10 % for 1981-82. Credit targets also exist in most of the smaller Community economies although for the members of the EMS their exchange rate commitment largely links their monetary policy to the rest of the Community.

4.1.2 Not only have the target limits been lowered but, more important, they have generally been met; although not always at an even rate in the decade or between countries, the overall growth of money supply has slowed down significantly.

4.1.3 This trend should be maintained and further convergence in policies and performance be achieved. A firm stand of monetary policy is needed not only to curb inflation, but also to induce capital inflows to help finance current account deficits and structural adaptation of our economies. To provide permanence of policy aims and predictability in the management of policy instruments and thus increase their impact on economic behaviour, targets for monetary growth in the medium term, or the criteria on which short terms targets will be fixed should be announced; the exact means by which this is done must vary from country to country.

4.1.4 It is important to stress that a given monetary policy will only be restrictive if the behaviour of the private sector, and indeed of governments in their budgetary responsibilities, makes it so. If the policy strengthens expectations that inflation will decline and makes companies, households and trade unions more willing to accept moderation in pay and price increases, the given rate of monetary expansion

will allow a stronger rate of economic growth and employment creation. Conversely a disregard for monetary constraints, either on the part of companies, trade unions or the budgetary authorities, will result in the squeezing out of the scope for real economic growth.

4.2 Public Sector Balances

4.2.1 In the strategy, monetary policy must be matched by effective discipline over public deficits and incomes moderation: past experience has shown that counter-inflationary policy cannot be based on monetary instruments alone. In most Member States the volume of public deficits in GDP has tended to rise in recent years.

4.2.2 The economic ill-effects of excessive deficits are clear in the extreme cases in the Community. When inflation remains relatively low they push up real interest rates, thus penalising private investment and employment creation (such as in the Belgian case). When combined with high inflation and nominal interest rates, they become difficult to reverse because of large interest payments to holders of public debt, which in turn come to be regarded by their beneficiaries essentially as compensation for the loss in the capital value of savings (such as in the Italian case).

4.2.3 Public deficits must be reduced as part of the gradual process of restructuring public spending priorities and containing the overall growth of the public sector in GDP. In the short term budget deficits may well have to increase somewhat in some member states in order to counterbalance possible deflationary impacts of the strategy. However, to avoid short term uncertainty, governments should fix medium term public expenditure targets slightly below the expected growth of real national income and should keep closely to these targets, accepting if necessary some increased financing if growth is temporarily lower. This should help to produce a trend reduction in public deficits over the 5 year period.

4.2.4 Discipline over public deficits is not of itself sufficient : since it will largely depend on containment of social transfers, it must be part of a more general strategy to help investment, and more general renewed activity leading to job creation. But the need to give priority to forms of public spending that contribute to structural adjustment must not be at the expense of the control of overall deficits.

4.3 Income and price policy

4.3.1 Monetary and public deficit policies will be unable to control deeprooted inflation without threatening growth and employment unless firm discipline on incomes and prices is accepted by all the social partners. This is a key element in the strategy.

4.3.2 Some reduction in the rise of nominal salaries is in any event likely over the next five years, and there will also be a reduction in inflation and improvement in profitability. But not only does it seem likely that without specific policy measures wide divergence would remain in rates of inflation and nominal income growth, but confronted by the need to stimulate structural change and improve employment a greater effort should be made.

4.3.3 Further moderation of incomes would provide fundamental support for the strategy as it aims at improving financial and economic stability and at promoting economic growth and employment. It would curb inflation. The competitive position of the Community would be reinforced, and at the same time the recovery of profits would be helped. It would thus favour a shift away from consumption towards investments. Real wages per head would rise little but overall private consumption would drop relatively less because of increased employment.

4.3.4 In many countries real wage rates should grow less than labour productivity, after adjustment for the terms of trade. This will help towards an essential restoration of profitability. And it will also tend to reduce the relative cost of labour and thus favour job creation in the balance of factors in investment decisions. Another possibility which could reinforce this effect might be to transfer some part of the cost of social payments to general taxation: this however raises complex issues and difficulties and needs further study.

4.3.5 This moderation in incomes will not be easy to achieve, because it requires a change in behaviour on the part of the social partners for which the counterpart is the prospect of sounder activity and secure jobs in the future. And it comes at a time when real standards of living are unlikely to grow much, although this will depend on the extent to which productivity can be increased. Nevertheless, it is essential for the success of the strategy as a whole.

4.3.6 Wage bargaining mechanisms - and especially indexation - must also be reviewed in this context. Indexation has had mixed results in the past; in a period with large changes in relative prices, especially of oil, it carries risks of insulating prices and costs from these developments and thus slowing down adjustment.

4.3.7 It is important that wage moderation, to be acceptable, should not be concentrated on certain sectors alone. It must also be borne by the non-competitive and "sheltered" sectors and reflected in social welfare payments, as well as having its impact on the competitive sector; while it should be reinforced by measures against tax fraud and evasion.

4.3.8 The need for structural adjustment towards competitive sectors also means that the market must be free to produce relative price changes. Existing price controls should be reviewed and if possible reduced. This is a pre-condition for expanded economic activity in some sectors which are critical for future growth provided increased profitability gives rise to increased activity and investment. But active competition policies should be pursued in parallel. The need for voluntary restraint must be stressed.

5. STRUCTURAL CHANGE

5.1 Investment and innovation

5.1.1 In parallel with and helped by the stabilisation measures, the strategy aims at a major revival of investment by which alone the Community economy can adjust to the constraints of the energy situation and to the developing international division of labour.

5.1.2 This is a challenge to all market sectors of the economy, and not to industry alone. There is a long term trend for industry's share in the economy to contract in the Community, as in other advanced economies. The pace of decline of industry's share of wealth generation and employment however seems recently to have been faster than the long term trend would justify. The Community must try to develop those industrial activities which are or can be competitive. The decline in industry's share of the economy should therefore level off, although the Community's expertise in the field of services can contribute very significantly to its position in world exchanges.

5.1.3 To promote the social and economic conditions needed for a durable revival of profitable investment, governments must have recourse to a wide range of measures, according to the circumstances of each Member State. But the design of all such measures must reflect the strategy's aim to promote growth oriented structural adaptation.

5.1.4 New competitive activity largely depends on innovation - the process of converting ideas and inventions thrown up by technological advance into new products, processes or services which reflect the market demands which flow from private and public needs. Innovation is required not only in growth sectors but also to provide new growth points in traditional sectors. Although the Community as a whole has the resources for innovation on a scale comparable to the US or Japan, the effort is normally dispersed between the Member States. And elsewhere, there seems to be a less deeply embedded resistance to such change than in Europe.

5.1.5 In order to compete with our partners, there has to be adequate basic long range technological research. Considerable public funds are spent in this area, but there seems to be relatively little effort to direct these to activities whose nature is proportional to the number and spread of enterprises which can effectively profit from them. Research of immediate economic value must not be neglected. And while large firms can often mount their own research effort, better solutions are needed to help smaller firms which make up a large part of our industrial capacity.

5.1.6 The availability of risk finance to industry and services is also essential. In part this relates to the need to reduce public deficits: public financing needs can compete with those of industry and help to keep interest rates high thus contributing to the opportunity cost of equity capital and to the attractiveness of government bonds instead of investment in plant and equipment. In addition public authorities need to permit and promote conditions in which private investors and financial institutions prefer to undertake - directly or indirectly - investments in equity or similar participations rather than by loan finance. The willingness of savers to supply capital to the productive private sector, rather than to take refuge in property or government bonds, depends on tax neutrality, adequate rates of return and on clear evidence that the economy is set on the right course of structural change.

5.1.7 It is also important that the cost effectiveness of interventions by public authorities in the private sector, found in all Member States, should be reassessed. As much quantitative and qualitative information as possible must be provided as to the social, financial and inflationary impact of subsidies, regulations and interventions. These interventions arise from social and regional objectives, and can help to gain acceptance for structural change. But in practice they can be inconsistent between themselves, or with the macro-economic policies pursued and can therefore be ineffective yet expensive. In addition, some of these measures serve to slow down the adjustment of industrial structures, without encouraging the restructuring needed. It is an essential element of the strategy that such interventions should not become more frequent, and existing interventions be phased out to allow market forces greater freedom. The need for some aids may continue, to offset major obstacles to adjustment such as regional handicaps. In general, the principles of such interventions should be transparency and stability in the choice of instrument (frequent changes reduce the extent to which incentives can be included in investment decisions). They must of course respect the competition rules of the Treaty. They should be aimed at new investment promoting structural adjustment; operating aids must be avoided. Although the selective approach will be appropriate in some cases, particularly geographical limitation to tackle regional problems, in other cases horizontal measures will deal better with several important pressures for adjustment which cross the boundaries between sectors (eg energy, research).

5.1.8 Small and medium-sized firms in all sectors are a particular category to which attention should be given, because they are sometimes the focus of technological growth and can also be a flexible source of employment increase. Already these firms are often encouraged in various ways (eg help with research). Such measures should also be examined for their efficiency, but should be viewed with more favour than more general measures.

5.1.9 The importance of revived investment to the success of the overall strategy has been stressed. An illustration is given by a variant to the "base" projection, which suggests that an additional rise of 1 point in investment's share of GDP by 1985 would result in an increase in the annual average growth rate of 0,6 %, and of 0,25 % in the average annual growth of employment. The effect on the balance of payments would vary according to the content of the investment. But if - as is important - the investment is directed to improving economic structures it should have only limited impact on the Community's external balance.*

5.2 Adaptation of energy supply and use

5.2.1 While the climate for general investment must be improved, energy related investments can make an important contribution. At least since the second round of oil price rises, it is generally accepted that the constraint on our economic activity must be loosened that flows from external dependence on high cost oil imports beset by supply and price uncertainties.

5.2.2 The investment needed to adapt to the new energy situation is very large, and is spread over all sectors of the economy. Industry needs to adopt less energy intensive technologies to substitute other energy sources for oil, and to produce less energy-consuming products. Households also have to invest to save energy and in particular oil. In their respective roles the private and public sectors have to ensure directly or indirectly that energy from alternative sources is produced and distributed. The public sector should invest in energy saving in the public sector - which can include a large part of the housing stock.

5.2.3 Estimates of the overall level of effort required can only be tentative. Provisional estimates on the basis of a limited Commission enquiry in 1980 suggest that the total of national programmes at present for the period 1981-90 is some 500 bn Ecu, of which 80 % is for energy production and 20 % for measures to increase the productivity of energy (eg. energy saving). These programmes would represent some 2 % of GDP compared with about 1,5 % in the last decade, or about 9 % of total investment compared to 6,8 %. Although some countries' efforts are already ambitious - particularly in France with a large nuclear programme - the overall level of energy investment implied is no higher than in the 1960s. It is essential that these programmes be fully realised and - at least in some cases - developed further.

* Some members expressed reserves about the quantified results of the COMET model as indications for economic policy. They are of the opinion that the model does not mirror the core properties of a common policy approach by Member States based on a strengthening of market forces.

5.2.4 The scale of this effort shows that an energy policy by itself powerfully underpins economic activity and thus encourages job creation. The Member States plan investments in energy saving and substitution of some 65 000 million Ecu between now and 1985. According to a variant of the "base" projection, concerted implementation of these programmes should produce positive results on the principal economic indicators as early as 1985. Growth should accelerate permitting the creation of up to some 400 000 jobs and with slight gains on the external balance; concerted implementation by the Member States eases the public financing constraint and increases the employment gains.*

5.2.5 Given present and prospective levels of OPEC prices, more investment should already be under way, especially as the medium to long term scarcity of oil and political factors make it probable that the trend will be for continued real increases in the external price. Uncertainties over external and internal price movements have however delayed energy users' investment plans. As elasticities of demand are significant, it is essential that governments, on the basis of guidelines adopted by the Community, take the necessary steps to pass on to the final consumer the full cost of all external oil price increases, to adapt domestic taxation on energy products in the light of energy policy needs and to ensure the direct and hidden costs of each and thus provide the appropriate incentive or disincentive to consumption and investment patterns. Given present and prospective oil prices, the determined implementation of such a policy should of itself through market prices stimulate the private sector to undertake much more energy related investment than at present; it would also help to correct distortions in the present relative cost of energy compared to other industrial inputs, notably of labour.

5.2.6 In addition to this evolution of energy prices, which is critical to promote private sector investment, other measures may also be needed - both by fixing regulatory standards and by providing financial incentives in some cases where market forces are inadequate. The scope of such government help for private energy saving and oil substitution is limited, the more so because of constraints on public spending and as in most countries the public sector has itself to undertake a large part of the total investment needed in this sector. But the public authorities must ensure by all means at their disposal - including financial and budgetary - that the necessary effort is undertaken.

* See footnote to Para. 5.1.9

5.2.7 Over the past few years, the Community and each Member State has committed itself to energy saving, and especially to reducing oil consumption. Extensive energy policy measures have been adopted in Denmark, France, Germany, the Netherlands and the UK; they include action to help the efficient use of energy, and certain investment incentives to both the household and (at a lower level) industrial sectors. Little action to encourage private energy investment has yet been taken in Belgium, Greece, Ireland, Italy and Luxembourg.

5.2.8 The importance for the overall strategy of rapidly increasing energy investment, and the scale of the financing required for accelerated implementation of public energy programmes, underline the need to make sure that the financial means are available, including recourse to external financing. It may also be appropriate to consider special measures to mobilise domestic savings.

5.2.9 While energy has occupied the central position in policy making, it is important to bear in mind as well the supply needs of other raw materials. To this end efforts should be made to reverse the decline of investment in developing countries for the exploitation of raw material as well as energy resources.

5.3 Structural priorities for public sector spending and receipts

5.3.1 While control of public sector deficits is important for stabilisation, reallocation of resources requires that the priorities of public spending and receipts be adapted in the light of their impact on economic structures.

5.3.2 There is first a problem of scale. General government expenditure is now of the order of half of GDP. Its growth is chiefly due to the provision of health, social security and welfare, and, to a lesser extent, education. Much of this growth occurred before the extent of present economic problems was realised. But as a result the part of our economies sheltered from market forces has grown while private investment and productivity have been weakened. In international trade it has increased the competitive disadvantage which the Community encounters vis-à-vis countries which have not yet developed all the apparatus of a modern welfare state. Moreover, the level of taxation and social contributions in some countries may now be such as to encourage avoidance and evasion, and to make it more difficult to share fairly the overall burden. Increases in direct taxation are likely to run counter to the aim of improving profitability and incentives to work; increases in indirect taxation directly feed the inflationary process; there is little fiscal flexibility.

5.3.3 A limit to the increase in government expenditure is necessary. It implies continuous scrutiny of all government spending policies as well as control over public service employment and pay to take account of the impact that different spending programmes - current or capital - may have on structural adjustment. It is essential to be selective in exercising discipline, to avoid the perverse effects that some spending cuts may have eg reductions in those investment programmes which contribute to improving economic structures and which provide jobs.

5.3.4 Control of social security spending is critical. The rise in social security contributions has kept up the relative cost of labour despite growing unemployment and some reduction in wage increases. And the deficits of social security budgets are likely to increase: increased wage moderation will reduce the level of the wage-related payments into those budgets. In a situation of continuing high unemployment, the need for social security is clear and the room for manoeuvre is therefore limited. But control over the growth of social security budgets remains an essential part of the limitation of public spending and deficits. An effort should be made to prevent social security spending from growing faster than GDP. This will be particularly difficult in the beginning of the period when GDP will grow only slowly and unemployment is likely to rise further. Therefore ways must be found to improve the effectiveness of social security and to reduce the hardship of those in genuine need. There may also be some scope for the public sector to make higher charges for some services or return them to the private sector.

5.3.5 Tax structures are also relevant. At present, these often favour property as a form of saving rather than investment in productive activities - a discrimination reinforced by the impact of inflation. Inflation can also distort the effect of taxation on companies (eg valuation of stocks, depreciation). It is important that the tax system does not tend to direct savings towards unproductive areas which do not contribute to structural change.

5.3.6 The pressure of social security budgets and the financing constraints of recent years have led to a shift of emphasis in public spending away from investment. Yet public investment in some areas - eg telecommunications, transport, research and development - encourages structural change and leads or complements private investment: such spending must be favoured at the expense of other activities which make a less direct contribution to structural adaptation or which actually impede it as in the case of government aid to maintain uncompetitive activities. Energy investment - which in some countries falls largely within the public sector - must be given a particular priority given its importance for the strategy as a whole.

6. IMPROVED EMPLOYMENT

6.1 It is a fundamental objective of the strategy to restore conditions in which employment will increase. High unemployment involves loss of welfare, produces serious social tensions, represents unused resources, gives rise to major burdens on public budgets, and may encourage the growth of the informal economy.

6.2 In the immediate future unemployment is likely to rise further - particularly in some regions - and will only fall significantly towards the end of the five year period. There is a very rapid growth in the potential work force over the next five years - growth that is expected to fall in the following five years to the end of the decade. And the general renewed activity which the strategy is designed to achieve will only develop as its different components take effect over the five year period, while the growth of public sector employment will be more restricted by budgetary constraints than in the last decade. The impact on employment of new technologies is an additional factor: it may lead to job creation although it will make even more necessary more developed professional training.

6.3 Despite this delayed impact, the basic means to create new and stable jobs must be through profitable investment and structural change in favour of branches and enterprises with a potential for growth. Higher levels of investment may not at first provide many new jobs. Immediate job creation must not be the objective of individual investment decisions; indeed in particular cases they may produce job losses. But the additional activity which will flow from all investment - with other internal and external factors - will contribute to the revival of the level of overall demand. And although gradual this remains the only way to provide competitive jobs in the future: the last decade has shown that jobs in uncompetitive industries are insecure, and increasingly costly to maintain both financially and in more general economic terms.

6.4 To achieve increased investment, the strategy underlines the need for moderation in incomes growth to improve profitability which will also help continued employment in some sectors. In addition, there needs to be greater flexibility in wage structures and in the relationship between wages and social security benefits, to encourage the movement of labour in line with the adjustments of the economic structures of our economies that market forces require.

6.5 More specifically, however, the match between supply and demand on the labour market must be improved. Many governments have a wide range of measures designed to help the working of the labour markets. All such measures should be assessed to ensure that their impact and cost effectiveness is as great as possible. It is particularly important that reallocation of physical resources should be matched by investment in the Community's human capital to enable the labour markets to provide the skills that growing competitive activities need. Professional training must be increased and its quality and relevance improved. The need exists at several levels - initial training, further development of skills already acquired, and retraining for changes between the sectors - each of which is different. The Member States' situations also vary. Particular attention should be given to the structurally weaker regions where there are often fewer skilled workers, and to training of young people: the policies followed in some countries (especially in Germany) show that the young are ready to accept a temporary loss of income to undergo training, because they recognise the benefits that they can gain in due course. This brings out the fact that, while such training costs money, often from public sources, such expenditure can at least in part be offset by savings on social security budgets and possibly by future increased tax revenue. It is not clear that the net cost need be significant. And the benefits flow not only to the economy in general, through increased competitiveness, and to employers by higher profitability, but also to the employees whose earning capacity will be increased. Better professional training requires more forward manpower planning by firms, which is also one of the ways by which the efficiency of labour market agencies should be increased. By such means, not only can the full benefit for employment be taken from the job possibilities that investment will open up, but existing unfilled vacancies can be filled as much as possible.

6.6 In addition to these points, other major issues fall to be discussed between the social partners.

6.7 In the past questions of working time have not been linked to levels of employment. There is an underlying tendency for actual working hours to fall. This reflects both adjustments in agreed weekly working hours, in actual overtime and in annual holidays, and increased part-time working and more flexible retirement arrangements. Over the past two decades annual working hours have fallen on average by 0.8% a year, although in most countries the rate of reduction seems to have been smaller in recent years. The gradual underlying trend is likely to continue, and indeed more flexible working arrangements (eg part-time working) are to be encouraged. However in present circumstances, confronted by persistent high

unemployment, there is pressure to share the available jobs among more people by means of accelerated reduction in individual working hours. However, one of the critical problems facing the Community is to increase its competitiveness on world markets, and moves towards work sharing must therefore be compatible with this objective. It follows that such moves need to be carried out without any increase in costs per unit of output, and must therefore satisfy two conditions :

- the increase in hourly costs due to compensatory wage adjustments must not be higher than the productivity gains which might be achieved;
- unit capital costs must not rise.

It would moreover be necessary for any such measures to be reversible as the rapid growth of the working population now foreseen will later fall off. It is clear that it will be difficult to satisfy these conditions especially in those industries in which there is a high unskilled labour content and in which wages are generally low. It is also clear that it is only at the level of the industrial sector, company or indeed establishment that it is possible to assess with sufficient accuracy the potential productivity gains and the opportunity for reorganising manufacturing processes that would allow production capacities to be maintained or indeed increased. Discussion of such possibilities that the social partners will have at the appropriate level needs to respect the basic constraint that competitiveness must not be worsened by measures of this kind.*

6.8 The social partners may also wish to review broader aspects of working relationships. These could include the overall economic impact of unemployment, the problems arising from the division between jobs with secure tenure and unstable employment, the balance between income and working hours, worker participation especially in the context of increasing technological production, employees contribution to company financing and possibly the ways in which social security benefits are provided.

* Some members suggest adding the following text : "An accelerated reduction of working hours could produce some savings in public spending by reduced unemployment benefits reflecting the new jobs created. This easing of public budget deficits would indeed be welcome, but governments should be very cautious about letting economies in social security budgets spill over into improved budgetary positions. The reason for this is that increased employment due to shorter working hours will not add to aggregate real disposable income whereas savings on social security budgets will detract from such income and therefore total demand for goods and labour will decline and counteract the job creating effects of shorter working hours."

7. THE COMMUNITY DIMENSION

7.0.1 The recognition that economic activity is the cement of political interdependence was the foundation of the Community, and more than two decades of its existence have seen this interdependence grow substantially. Over this period, the rapid growth of the 1960s gave way to slower growth in the 1970s. This has not always made it easy for the Community to achieve common action, the more so as economic situations between the Member States have diverged. There have also been two enlargements. Yet the basic logic remains: despite its openness to the world the Community does more trade between its Member States than with third countries and is deeply joined through movements not only of goods and services but also of capital and of people.

7.0.2 The extent of economic interpenetration means that coordinated economic action is more effective than dispersed national measures. The present Programme provides such a framework within which the Member States can pursue the necessary structural changes conscious that the efforts of their partners, though perhaps differently modulated, are compatible and will help towards the common goal. Its translation into shorter term measures must also pass via the Community's coordinating process, to ensure the internal consistency which is needed to exploit the Member States' interdependence and the potential of the single market, monetary cooperation and the Community's international role.

7.1 The single market and structural adaptation

7.1.1 The full potential of the single market of 270 million people is not yet fully realised. After the rapid growth of the 1960s in trade between the Six, the growth of their trade between themselves has slowed, though this has been masked by the rapid expansion of trade between three new Member States and the rest of the Community to which will now be added trade with Greece. While this slowdown may in part be due to slow growth, it suggests that the market's full potential is not being exploited. This may reflect the different levels of economic activity in the Member States: it is important to achieve a better balanced industrial structure throughout the Community in which the strengths of each can be developed. The promotion of convergence is also necessary as a means of encouraging structural adjustment and increasing the Community's production potential. In these ways, the single market, by providing the basis for renewed internal activity and investment, can help the Community to meet increasing international pressures.

7.1.2 The structural changes which are needed to achieve these objectives will flow primarily from the increased interplay of market forces which the overall strategy is intended to produce. The Community must ensure that its own policies also contribute to this end. But where it is not at first possible to leave adjustment to market forces, there should be effective Community disciplines within which national measures must be placed. In the industrial field, the exercise of specific responsibilities in the competition and commercial policy fields, as well as the special tasks laid down in the Coal and Steel Community, means that the Community is directly concerned with the situation of certain industries at national level notably those facing the greatest need for structural adjustment. In this context, while the special difficulties of particular regions may affect the speed of adjustment, the priority objective must be to strengthen the Community's competitiveness.

7.1.3 The need for discipline in public interventions in industry has already been stressed: the Treaty rules of competition provide a framework within which this can be applied. Rules have already been laid down for State aids for certain sectors in difficulty. The Commission should ensure that when new sectors are proposed for assistance, such initiatives do not lead to delaying the adjustment required but are consistent with the aims of the strategy. Regional aids are a special category: all Member States have such aids at central, regional or local government level, where transparency is often difficult to establish. The extent of such national aids and their broad geographic coverage even in countries with high standards of living suggests that in some cases these aids compete with each other both within and between Member States at considerable cost to national budgets. The Community's discipline over such aids is already exercised in such a way as to distinguish between the degree of priority for the development of each region; a greater degree of regional differentiation should be sought through increased disciplines over these aids.

7.1.4 The Community's rules on public purchasing should be fully respected in the framework of wider international obligations: but in addition means should be explored by which major public purchasing programmes and their technical specifications can be announced sufficiently in advance to enable industry to prepare the necessary capacity. This can be important in providing an adequate basis for innovation in areas of great specialisation.

7.1.5 More generally, a determined effort must be made to stop the rising number of technical standards at national level becoming a barrier to free market pressures within the Community. A recent judgement by the Court of Justice has shown the limited role that such standards should play. Each Member State should take administrative steps to ensure that they are not a barrier to free trade in products made and sold in the Community that respect the standards of the country of origin and do not give rise to health, safety or security problems. Although harmonisation of standards is inevitably a long task, special efforts should be made to ensure that standards for new products, especially in certain key sectors are developed at the Community level rather than by each Member State with the participation of the national standards offices; as much as possible such standards should also be compatible with standards at the international level.

7.1.6 The development of internal freedom for service industries is also important to provide a better base for international competition. Progress should be made in liberalising activity in this sector - especially banking and the large risk categories of insurance.

7.1.7 The agricultural sector poses problems of structural adaptation, for which the Community has special responsibility. Major adjustment has taken place in this sector: in 1980 some 8 million people were directly employed in Community agriculture, compared with 18 million in 1958. In parallel there has been rapid growth of labour productivity: the Community has become largely self-sufficient in agricultural products, at a time when long term world prospects of food supply are uncertain. However, there is little chance of new market opportunities for certain products - notably milk and butter - in which there is already excess supply. And in present circumstances there are only limited opportunities for labour to move to other sectors. Real farm incomes per person employed have fallen in the last two years, despite increased real Community spending per capita. It is difficult to reconcile support of agricultural incomes with the need to achieve a better balance in agricultural markets and to reduce agricultural spending. But this has to be done. A better balance between production and outlets must be sought, which will help match spending and the available resources. In addition, the role which agricultural policy can play in promoting macro-economic aims, and its contribution through structural adjustment to the improvement of the supply side of the economy, also need to be given greater emphasis. These wider considerations need to be taken into account in reaching specific decisions about agricultural policy.

7.1.8 Structural adaptation must also extend to the labour market. Policies in this area will have to be implemented essentially at national level, although the Community plays a role as a useful framework for common examination of problems and for discussions of these with the social partners. The Community can however contribute directly through the Social Fund to the professional training which is an essential part of adapting labour supply to demand. Faced with present problems, the resources available to the Fund should be used to help to improve its contribution to adjustment by supporting training for new skills. Its success will depend on the ability of the Member States to develop forward policies and programmes for training and employment needs. In addition exchange of experience between national employment agencies can be particularly valuable.

7.1.9 While in this way helping to free market pressures to encourage structural adaptation generally, the Community has a special role to play in energy policy because of the scale of the effort required and its implications for all the Member States; this is already reflected in the guidelines laid down by the Council in June 1980. Community positions should be established for international discussions with other consumers or producers. The Community should evaluate national programmes to examine both the adequacy of their objectives and their overall compatibility, but also the sufficiency of the means available in the Member countries to assist in energy saving and in substitution for oil. It should also check whether the guidelines adopted by the Community on prices are respected so that the market can give the right signals: in particular, Community action should seek to ensure that prices are properly related to production costs to avoid distortions in intra-Community trade. Research and development into alternative sources of energy are also important: in view of the benefits to all that can flow, the Community should coordinate national efforts and even support them when necessary. In this area as in others, the best way to achieve adjustment efficiently is via the free play of market mechanisms. In this context, the Member States and the Community should concentrate their effort on supporting the adjustment process by defining a proper frame of reference (notably the general investment climate, environmental standards, a social consensus) and by back-up measures.

7.1.10 In parallel with freer flows of trade and services must go free private capital flows for direct investment. Intra-Community flows are

important particularly for investment in certain structurally weaker regions. The Commission, in administering the Community's rules on internal capital movements, should attach priority to the dismantling of the remaining control on such flows.

7.1.11 The Community's financial interventions in support of structural adaptation include the Social Fund, the Regional Fund, the Agricultural Structures Fund, and certain actions in the energy field. These instruments make a useful contribution to investment especially in the structurally weaker regions, as also do the EMS interest subsidies which represent a special case. They are grouped with other activities, and notably agricultural support spending, in the Community budget. This has characteristics which distinguish it from national budgets; yet it cannot be considered outside the constraints which now apply to public expenditure as a whole throughout the Community. The need to rebalance the Community budget is generally agreed. As part of the implementation of the strategy and in accordance with its priorities, the greatest possible efficiency should be sought in the use of the Community's budget instruments.

7.1.12 The Community also makes a substantial direct contribution to investment through the range of borrowing and lending instruments built up over the life of the Community - the European Coal and Steel Community, the European Investment Bank, Euratom and the New Community Instrument - which for example lent some 4 bn Ecu for energy investment in the Community between 1973 and 1979. In total their lending, even after allowing for inflation, has grown fourfold over the last decade. These instruments should be reinforced.

7.1.13 The present strategy aims at macro-economic stability and structural adaptation as the foundation for sustained economic activity. While overall growth seems to have been important in helping progress towards convergence, the openness of the Community economy makes it necessary to encourage structural adaptation in the weaker regions, to help improve the overall economic potential of the Community and maintain its cohesion. Through influencing the location of investment, regional policies - national and Community - which abstain from subsidising declining sectors are necessary for structural adjustment. In this respect, the Regional Fund, in coordination with the other Community financial instruments, can help to promote economic convergence. In the context of enlargement it is essential to ensure full integration of Greece into the Community. This will mean a concentrated effort to help this country with the structural adjustment that its recent accession makes especially pressing.

7.2 Monetary Action

7.2.1 Monetary solidarity is all the more necessary in the face of the external pressures which confront the Community. The repeated oil price rises, the consequent emergence of large payments imbalances, the resurgence of inflation and the increasing quantity of freely transferable funds are all elements which unsettle the international monetary system and require a concerted Community response, both in the international fora where these issues are discussed and within its own frontiers.

7.2.2 Substantial progress has been made with the setting up of the European Monetary System. Although exchange rate parities in the EMS can be adjusted from time to time, the system is meant to achieve downward convergence of inflation rates at a moderate level. This will also help to reduce interest rates. The system is thus an integral part of the wider strategy, and it is necessary to develop and maintain the exchange rate cohesion it has ensured. It is important during the life of the Programme to consolidate the provisions and arrangements of the EMS and at the appropriate moment to pass to its institutional phase, entailing the creation of a European Monetary Fund and the full utilization of the ECU as a reserve asset and means of settlement.

7.2.3 An important aspect of the medium term strategy and of the durability of the EMS is that of the system's relationship with third currencies. This relationship - particularly that with the dollar - directly affects the internal cohesion of Community currencies and calls for improved coordination of exchange rate and intervention policies, in close concertation with the monetary authorities concerned, to dampen erratic exchange rate movements between the world's major trading blocs and thus provide a less uncertain climate for investment, trade and growth. More fundamentally, however, given the impact of the movement of major third currencies on the rate of inflation, the competitive position and the balance of payments of member countries, the Community should arrive at a common view and assessment of the development of fundamental factors affecting the level of the ECU in relation to other major currencies. This would involve closer cooperation and consultation between the Community and the monetary authorities concerned.

7.3 World context: trade and development policy

7.3.1 Strengthening of the Community's economic structures and internal market

is a prerequisite for the development of its trade beyond its frontiers. World trade indeed is the motor on which the Community depends for much of its economic activity and growth. The Community has for long been committed to maintaining a liberal and open system of world trade; for example in successive rounds of tariff reduction in the GATT, in the OECD Trade Declaration of June 1980 and in the UNCTAD resolution which recognizes the importance of adjustment to prevent the growth of protectionism.

7.3.2 In the light of these obligations, and in view of its fundamental interests, Community industry must respond to the pressure for adaptation of economic structures which comes from outside - as much because the Community is losing ground to third country competition in traditional export markets as because of direct imports. The Community, as the biggest world trading partner, carries special responsibility with the US and Japan for maintaining free trade. In this context, the Community should continue to press Japan to achieve a greater opening of her market to our goods and services. The Community should also encourage the more advanced among the developing countries to make more efforts to lower import barriers and to accept the discipline of free trade from which they benefit.

7.3.3 Renewed growth of world trade is important to reduce the importance of the loss of income to oil producing countries. This cannot collectively be made up by trade amongst the consuming countries, but provided oil imports do not rise rapidly its relative scale can be diminished. To maintain and increase world trade, however, adequate measures must be taken to recycle OPEC surpluses and to ensure that these are put to uses that will help economies to adjust - by way of new investment - to the new demands of the international environment. The private banking market should continue its central role, especially for recycling towards industrialised countries. It is however important that the strength of this market be maintained by adequate surveillance.

7.3.4 The Community is already involved in financing but should develop its role. Its borrowing and lending activities already find much of their funds on the international markets; balance of payments support lending is being developed. There should also be further encouragement of cofinancing of investment projects to which Community finance is provided with other sources of funds. Arrangements already exist for this in the case of projects in developing countries, which could be strengthened and extended.

7.3.5 The international financial institutions and regional development banks have a major role to play in present circumstances in helping flows of recycled funds and in helping deficit countries to meet the burdens resulting particularly from the need to adapt to higher energy prices. The Community should seek in the international organisations in which it and the Member States participate to develop the help provided.

7.3.6 There are clearly limits to the debt burden which can reasonably be accepted and sustained by developing countries which do not have prospects of generating adequate external earnings or internal savings. Official aid flows remain indispensable; increase should be concentrated on the poorest countries, in forms - including better programming - which ensure the greatest possible impact. The Community's own aid instruments should play their part in this effort.

7.3.7 The Community is not alone in facing problems due to changing pressures at world level. We must be ready to play an active part in international discussions - and in particular the Global Negotiations in the United Nations - to look for ways which lessen these problems and enable renewed growth in both industrialised and developing countries.

8. IMPACT OF THE STRATEGY

8.1 The success of the strategy depends on the parallel implementation of all its parts reviewed in the preceding chapters. No quantified assessment of the impact of the overall strategy can be given. Apart from the uncertainty of any projection, it is particularly difficult to assess in quantified terms the impact of the monetary and structural adjustment policies which form an integral part of the strategy.

8.2 However over the period to 1985 the application of the strategy would increase overall growth and reduce inflation, compared to the tentative projections described in chapter 2. Incomes moderation would reduce the growth of per capita real incomes, but the increased employment which would result in due course would offset the impact on overall private consumption. There could be an important rise in the annual increase in investment, and employment would also rise significantly by the end of the period with a clear beneficial impact on unemployment.

8.3 It is clear that despite putting each part of the strategy into effect, the benefits will not necessarily flow at an even rate. Energy related investments are unlikely to have an early impact on oil imports because of the lead times they involve but they can and should generate economic activity much sooner. Retraining of labour necessarily involves long delays. Readjustment of government spending priorities may take time to be translated into practical results. These variable delays in achieving results must not reduce the commitment to make progress on all fronts. The course of development of other major variables is also difficult to foresee. For example, OPEC oil price increases may either evolve gradually or change abruptly. And the movement of the Ecu vis-à-vis the yen and the dollar cannot be clearly forecast.

8.4 A final view cannot be given now of the detailed application of the strategy over the whole of the five years ahead, nor in particular of the possibility of using any margin of manoeuvre which may emerge as and when inflation, financing and energy constraints ease and as cyclical developments may require. It will be appropriate to review regularly progress in implementing the strategy, so that the necessary policy adjustments can be made. This could usefully be done in conjunction with the annual reviews of economic policies. For these regular reviews, moreover, it would be helpful for assessments to be made of the

effectiveness of policies in particular key sectors - notably labour market policies. The application of the strategy to the Member States must also be flexible to take account of the different circumstances of each. But a degree of possible flexibility in the application of the strategy must not be confused with the fundamental need to implement all its component parts.

8.5 The extent of the economic difficulties which now confront us and the delay which may occur in achieving improvements - especially in employment - may produce pressures to change course. It must be stressed that an improvement in the underlying structural position of the Community economy such as the strategy is designed to achieve is essential for the future prosperity of the Community. Short term pressures must therefore not be allowed to lead to policies incompatible with the strategy, but rather produce more vigorous effort to achieve the goals the strategy has set out.

8.6 The need for the strategy and its unity must be clearly presented to the social partners. Their understanding of the strategy as the only way to restore the long term competitiveness of the Community's economy is essential to ensure cooperation on their part without which the strategy cannot be implemented. The importance of the contribution of the social partners is however a further reason for governments to ensure that their implementation of the strategy respects the essential balance between stabilisation and investment.

8.7 The Fifth Programme is based on the potential that flows from common action by the Member States and by the Community. In view of the economic difficulties and the opportunities that now confront us, it is essential to reinforce Community cohesion by acting together, and in this way improving the situation of each. The strategy described offers the way to break out of the present vicious circle of slow growth, unemployment and inflation and to lay the basis for stable prosperity for the Community in the world economy.

IV. LETTER OF TRANSMISSION OF THE PRELIMINARY DRAFT OF THE FIFTH PROGRAMME TO
THE PRESIDENT OF THE COMMISSION, FROM THE CHAIRMAN OF THE ECONOMIC POLICY COMMITTEE

EUROPEAN COMMUNITIES

ECONOMIC POLICY
COMMITTEE

Brussels

9. VI. 1981

The Chairman

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814683

Sir,

I have the honour to transmit to you herewith the preliminary draft of the Fifth Medium term Economic Policy Programme. This preliminary draft was prepared by the Economic Policy Committee in accordance with Article 6 of the Council Decision of 18 February 1974, relating to the attainment of a high degree of convergence of the economic policies of the Member States of the European Community. It was adopted at the Committee's meeting on 21 May 1981.

Chapter 1 "Summary and Conclusions" sets out the central message of the Programme and contains the principle guidelines which have been approved in detail by the Committee. Chapters 2 to 8, annexed, contain a more detailed analysis of the themes dealt with in the first chapter, and while the Committee has agreed on their general approach, the final drafting has been drawn up on my responsibility as Chairman.

The preliminary draft is the result of an effort of compromise between several approaches which became clear during our discussion. However, the Belgian members maintained throughout the Committee's examination of the Programme that the weighting and time-path of the different elements of the strategy should be balanced in a different way from that contained in the preliminary draft. The majority of members of the Committee were opposed to aligning the preliminary draft on this position. It has therefore been agreed that the document which the Belgian members presented to the Committee to define their position should be sent to you with this letter of transmission of the preliminary draft.

The position of the Belgian members was also largely shared by the Danish members who had wished that the preliminary draft could more clearly bring out the risk of insufficient growth during the implementation of the strategy which, apart from its negative impact on employment, could lead to a reinforcement of protectionist pressures.

The French members of the Committee have explained that in the light of the recent change of government in France they are not able to take a definite position on the preliminary draft, and are therefore obliged to express a general reserve. The position of their authorities will therefore be made plain in the later stages of the procedures for the adoption of the Medium Term Programme.

Yours faithfully,

Prof. Dr. F. W. RUTTEN

11/590/4/81

11/282/81

Mr. G. THORN
President of the Commission
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POSITION OF THE BELGIAN DELEGATION WITH RESPECT TO THE
PRELIMINARY DRAFT OF THE 5TH MEDIUM TERM PROGRAMME

1. The Belgian delegation entirely concurs in the need for a coherent and stable medium term strategy, as the only way to correct the cumulative and interdependent imbalances affecting our economies.

The principal elements of this strategy are to be found in the draft of the 5th Programme; however, the Belgian delegation believes that the present draft places excessive emphasis on stabilisation policies (restrictive monetary and budgetary policies, wage moderation) and on the spontaneous action of market forces.

It is true that such stabilisation policies are a prerequisite, on the one hand, to reducing the costs of enterprises, restoring profits and consequently the propensity to invest, and, on the other, to curbing inflationary expectations, strengthening confidence and improving the general environment for investment and innovation.

The strategy of the 5th Programme should not however confine itself to this necessary, but insufficient, condition any more than it should place exaggerated expectations on the positive and spontaneous effects of market mechanisms.

2. A more balanced strategy

The different propositions of the 5th Programme should be re-arranged and weighted around five main points :

- reduction of all costs of enterprises;
- selective support of domestic demand;
- energy saving and substitution policies;
- reduction of the public sector's net borrowing requirement;
- work-sharing and specific employment policies.

2.1. Reduction of all costs of enterprises

a) Given the rapid increase of relative social costs within the European Economic Community compared with our principal competitors and the fall in profits and consequently in the propensity to invest, a deceleration of wage costs is clearly indispensable.

It should, however, be noted that this policy, if pursued at the same time by all Member States, is in part a "zero sum game" and will moreover only gradually affect investment, while the decrease in private consumption will be immediate, hence the need for a policy of selective demand support (cfr. infra).

b) On the other hand, the reduction of the costs of enterprises should cover all these costs.

- Reduction of the cost of capital, especially by avoiding (within the OECD as well as within the EEC) an excessive emphasis on restrictive policies and, among these, on monetary policy.

- Energy costs, hence the importance of energy saving and substitution policies.

- Amount of the costs imputed by the sheltered sectors to the sectors open to competition, hence the importance of an active competition policy.

c) Finally, the counterpart of this reduction of the costs of enterprises must, from a social as well as from an economic point of view, be a concerted investment strategy, especially in those sectors supported by growing world demand where enterprises, either at national or Community level, possess important potential as far as R+D, production and marketing are concerned and where, in several cases, the public authorities in any event occupy an important position (telecommunication, energy, new transport techniques, computer industry, etc....).

The recovery of industrial investment, initiated by both a re-establishment of profit margins and a reduction of inflationary expectations, should thus be supported by active industrial policies at Community and national level.

2.2. Selective support of domestic demand

In spite of the domestic and external constraints which are correctly emphasised in the draft of the 5th Programme, there is room in the proposed strategy for a selective support of demand which, together with the recovery of external demand and of private investment based upon the reduction of the costs of enterprises, would prevent our economies from falling into a deflationary spiral and could, on the contrary, bring them gradually back to a path of sustained growth.

Within this framework, particular attention should be paid to :

- the evolution of the public investment, which has often been the first victim of efforts aimed at reducing public deficits, whereas a support of public investment in areas selected to help industrial redeployment should play an active role in the proposed strategy;
- direct and indirect incentives to a policy of rational energy utilisation supporting elasticity of energy consumption with regard to price increase;
- the social security system, where it is not impossible to conciliate a slackening of the general progression of social allowances with a higher efficiency of the redistributive effects and a selective support of certain categories of domestic demand.

2.3. Energy saving and substitution policy

As confirmed by the preliminary quantitative projections for the 5th Programme, the combined application of the investment plans presently foreseen in this field in the different Member States would have positive consequences on growth, employment and the balance of payments, without increasing inflation. It is therefore necessary to emphasise these positive points by means of the analysed quantitative variants and by clearly demonstrating that the effects of this policy are strengthened if applied simultaneously in all Member States of the Community.

2.4. Reduction of the public sector's net borrowing requirement

This goal obviously constitutes an essential element of the proposed strategy, to reduce the costs of enterprises, ease inflationary tensions and avoid a unilateral restriction of monetary policy.

This objective should not, however, be realised either too unilaterally nor too rapidly, if one does not want to cause negative indirect effects : indeed, the deflationary effect would reduce public receipts more than proportionally and the additional unemployment would provoke an increase in expenditure.

The reduction of public deficits should therefore result from both

- a coherent and progressive application of the proposed general strategy, in particular by a slower advance of unemployment and by and easing of interest rates as the public authorities reduce their demand on financial markets;
- an extensive re-examination of the volume and efficiency of social security transfers, which are largely responsible for the increase of public expenditure in recent years.

2.5. Work-sharing and specific employment policies

- a) In spite of the positive effects expected from the proposed strategy, unemployment will continue to increase until 1985 : it is therefore essential to limit its economic and social costs.

This involves a greater solidarity between workers having an employment and those which have lost or might lose it, a new trade-off between incomes and employment and, more particularly, a reduction of working hours without increase in the costs of enterprises. This reduction in working hours should be both decentralised in order to be adapted to the different situations prevailing in member countries and in the various sectors and sub-sectors, and co-ordinated in order to avoid an increase in existing divergences.

b) It is furthermore urgent to draw up a critical balance-sheet of specific employment policies in order to be able to specify, in a short delay, their contribution to the reduction of unemployment (and of its economic and social costs) over the period concerned.

3. A strategy with a better time-path

The time-path of the strategy deserves careful study. Indeed, if at the beginning of the period, the improvement of conditions on the supply side should be emphasised (without prejudice to a modest and selective support of demand), one should not under-estimate the risk of a mismatch between the short term effects of the strategy on private consumption and its more gradual effects on the recovery of exports and/or the restoration of investments. On the other hand, if one can normally hope that the improvement of supply conditions will progressively involve a spontaneous recovery of demand, this should be firmly sustained by a more active support of demand as soon as the public finance and balance of payments constraints are loosened.