COMMISSION OF THE EUROPEAN COMMUNITIES

SEC (91) 1291 final

Brussels, 4 July 1991

Resuming progress towards convergence of economic policies and performances in the Community

(Communication to the Council)

Resuming progress towards convergence of economic policies and performances in the Community

(Communication to the Council)

The 1994 deadline for the transition to Stage II of Economic and Monetary Union is only two and a half years away, but some Member States still need significant changes to the stance of their policies and improvements in economic performance to be in a position to move to the final stages of EMU. The most recent forecasts show a mixed picture, with progress in some countries going hand-in-hand with worrying set-backs in others. There is therefore an urgent need to give a new impetus to the, presently faltering, process towards greater convergence. This should be done by reinforcing the multilateral surveillance procedure and establishing clear commitments from Member States with regard to convergence.

The economic situation is less favourable ...

The Community will need to take corrective economic policy measures to re-establish a process of strong and sustainable employment-creating growth and to strengthen convergence. The necessary corrective actions will take place against a background of a less favourable economic situation*. This is certainly unwelcome since adjustment is easier in periods of buoyant growth, but it does not affect the policy conclusions since the policies required to strengthen growth fundamentals are also those necessary to improve convergence.

The pace of economic activity in the Community slackened in the second half of 1990 and during the first few months of 1991. The economic slowdown in the Community, which had become evident early in 1990, was exacerbated by negative, although mainly temporary, consequences from the Gulf crisis. The outlook for the

---

* A fuller analysis of the economic situation in the Community and of the economic policy choices is contained in the revised Annual Economic Report for 1990/1991 (Document COM 198 (91), 23 May 1991) which the EcoFin Council will also examine during its July meeting.

second half of 1991 and for 1992 is for a modest upswing as a result of a recovery in internal economic growth and a better performance in a number of the Community's main trading partners. Economic growth in the Community in 1991 as a whole is now projected at 1.4 per cent. In 1992, output could expand in real terms by 2.3 per cent. In 1990, the weaker growth was not yet reflected in the employment figures. The strong employment performance of the period 1988-1990 is to be replaced by virtual standstill in 1991 and 1992 with the unemployment rate expected to increase by one percentage point to 9.2 per cent over the period, the first such increase since 1986.

Notwithstanding the weakening of activity, inflation remains a major policy concern. The 5 per cent average rate of inflation being forecast for 1991 is very disappointing given favourable terms of trade movements and declining rates of demand growth. Some easing of labour cost pressures is tentatively expected in 1992 with a consequent improvement in the rate of inflation to 4.6 per cent. The recent appreciation of the dollar may contribute positively to growth prospects, but will also add to existing inflationary pressures.

... and convergence is still far from adequate.

Notwithstanding the improvement which has taken place during the 1980s, the degree of nominal convergence that the Community has reached in 1991 is still far from adequate (see table 2)*. The average rate of **inflation** in the initial narrow band countries,** which have presently reached a degree of stability superior to that of the 1960s, is expected to rise from 2.8 per cent in 1990 to 3.2 per cent in 1991 and 3.6 per cent in 1992. This deterioration is largely the result of the expected worsening of the German price performance under the pressure of large wage increases. There could be, however, risks for price stability also in the other countries of this group if the two sides of industry were to be content with simply matching a temporarily less favourable German performance. This would clearly be a very unsatisfactory development.

---

* The Annual Economic Report for 1990/1991, like the Reports of previous years, contains a more detailed analysis of the convergence process over a longer time scale.

** Belgium, Denmark, Germany, France, Ireland, Luxembourg and the Netherlands.

In the other five countries, inflation rates still remain well above those achieved in the initial narrow band countries; they are especially high in Greece and Portugal. However, some reduction is expected this year and in 1992. Nevertheless, Community inflation rates in 1992 will still show large differences ranging from around 3 1/2 per cent in the initial members of the ERM narrow band, to 5 to 6 per cent in the United Kingdom, Spain and Italy and reaching about 10 per cent in Portugal and 13 per cent in Greece.

The **budgetary positions** of the Member States also show substantial disparities with many worrying situations. Greece has initiated strong retrenchment plans which, if fully implemented, will lead to a significant reduction in net borrowing, which in 1991 is still above 15 per cent of GDP. In spite of repeated attempts to reduce it, the Italian budget deficit remains stubbornly high at a level near 10 per cent of GDP while the public debt/GDP ratio has climbed above the 100 per cent mark. Belgium and the Netherlands have only just managed to stabilize their high public debt ratios (128 per cent of GDP in 1991 for Belgium, the highest level in the Community), and they still have high deficits. Even if their public debt ratios are declining, the budgetary positions of Ireland and Portugal need further consolidation. The costs of unification have swollen the government deficit in Germany* by some 5 per cent of GDP between 1989 and 1991, and the public debt ratio is now on a rising trend. Overall, net government borrowing in the Community as a whole is forecast to deteriorate to 4.6 % of GDP in 1991 with little improvement expected in 1992. .

While Greece is the only country showing a really worrying **current account** imbalance, the position of many other Member States is far from satisfactory. In particular, the level of national saving is often either too low (Greece, United Kingdom, Denmark, Italy) or insufficient to finance the high investment levels needed to catch up with the richer countries (Spain, Ireland). The disappearance of the German current account surplus, following the substantial increase in domestic absorption resulting from the unification process, has resulted in the overall Community current account moving into deficit. Importing savings from the rest of the world is clearly an inappropriate position for a group of highly industrialized

---

* The definition used by the Commission services for the net borrowing requirement of Germany includes the German Unity Fund as well as the borrowing by the five new Länder. It therefore broadly coincides with the borrowing requirement of the unified Germany.

countries such as the twelve Member States, even allowing for the present special needs for investment in the Community due to German unification and the catching-up process.

Unsatisfactory inflation, budgetary and current account positions do not result simply from inappropriate macro-economic policies or external shocks, often they are a reflection of more deep-seated imbalances. Indeed, large discrepancies still exist among Member States in the functioning of their economies. The widely different levels of unemployment are probably the most conspicuous evidence of this. Improved convergence requires structural actions aimed at improving the flexibility of markets and the general efficiency of economies.

Progress towards convergence must be resumed.

The urgency of the need to resume convergence, towards the best possible results and not just towards the averages, calls for **commitments** by all Member States vis-à-vis their Community partners to improve economic convergence or to consolidate the results achieved where these are considered satisfactory. These commitments could take the form of communicating to all Community partners the medium term strategies which each Member State intends to follow in order to achieve or maintain economic convergence.

The formulation of commitments would be the responsibility of the individual Member States. The involvement of the Community would consist, initially, in an assessment and endorsement of the adequacy of the objectives and measures proposed and, later, in a monitoring of the implementation and of the results of the actions taken.

The contents and the form of the commitments will differ reflecting the nature and severity of the convergence problems in the various Member States. In certain cases, Member States may wish simply to communicate to the other partners existing programmes and strategies, in others they need to develop more ambitious and wide-ranging programmes.

The presentation of these convergence commitments to the rest of the Community partners could take place within the framework provided by the 1990 "Convergence" decision. Member States could communicate their strategies to the Commission. The Commission would provide an assessment of the objectives and instruments which would then be discussed in the EcoFin Council, following examination by the enlarged Monetary Committee. The EcoFin Council would endorse the individual convergence strategies and the multilateral surveillance exercises would provide the framework for the monitoring of their implementation and of their results. The European Parliament would be duly informed and in the case of formal recommendations the normal procedures of the "convergence" decision for involving the Parliament would be followed.

Given the urgency of resuming progress towards convergence, the July 1991 EcoFin Council should invite all Member States to communicate their medium term convergence strategies. The national documents should be forwarded to the Commission as soon as possible and not later than October so that endorsement may take place during the EcoFin meetings of October to December 1991. Member States, however, should start implementing the necessary convergence policies as soon as the overall strategy has been finalized at the national level, in advance of Community endorsement, so that the first results will already be visible in 1992

Until now the Council has concluded its deliberations on multilateral surveillance by general statements made public by the President of the Council. Given developments in the overall Community economy and the lack of progress towards convergence, the Commission suggests that the procedures of multilateral surveillance be strengthened. The Council could conclude its deliberations by making specific suggestions and recommendations, on the basis of the assessment provided by the Commission, and these more specific conclusions could be made public.

The policy suggestions or recommendations would not only include specific measures to achieve convergence, but also more general policy orientations for the direction of the economic development of the Community

Table 1

MAIN ECONOMIC INDICATORS FOR 1991

	GDP (real % change)	Employment (% change)	Unemployment (% of active population) *	GDP per head in PPP (Community = 100)
BEL	2.3	-0.1	8.4	104.4
DAN	1.4	-0.3	9.0	108.5
DEU	2.7	1.7	4.5	113.8
ELL	0.8	-0.4	8.7	52.4
ESP	3.0	1.5	16.0	79.3
FRA	1.6	0.4	9.2	108.9
IRL	1.7	0.4	16.1	68.9
ITA	1.7	0.4	9.8	103.6
LUX	3.1	1.2	1.6	132.7
NED	2.6	1.1	7.8	103.9
POR	2.8	0.9	4.8	56.7
UK	-2.2	-2.5	8.6	101.3
EC	1.4	0.2	8.7	100.0

* Definition used by EUROSTAT

Source : May 1991 forecasts of the services of the Commission; the figures for Germany refer to the old FRG

Table 2

MAIN INDICATORS OF NOMINAL CONVERGENCE PROBLEMS IN THE COMMUNITY IN 1991

(figures from the May 1991 forecasts of the Commission services)

	Inflation		Public finances			External accounts	
	Deflator of private consumption	Nominal unit labour costs	General government net borr. requirement (% of GDP)	Public debt as a percentage of GDP		Current account balance (% of GDP)	National Savings (% of GDP)
				1991	change from 1990		
BEL	3.2	3.4	6.5	128.1	+ 0.6	1.1	20.8
DAN	2.4	1.4	1.3	62.3	- 0.1	1.6	19.0
DEU	3.5	5.4	4.6	45.4	+ 2.4	-0.1	23.4
ELL	18.0	14.2	15.3	86.0	- 0.3	-5.0	13.6
ESP	5.9	5.7	2.7	44.5	+ 0.3	-2.9	23.0
FRA	3.1	3.3	1.6	37.3	+ 0.9	-0.9	20.1
IRL	3.0	4.9	3.8	97.4	- 2.4	2.2	21.7
ITA	6.3	6.9	10.1	103.3	+ 2.6	-1.3	19.5
LUX	3.5	2.8	[-1.6]	4.7	- 1.6	26.4	57.4
NED	2.8	3.4	4.8	78.8	+ 0.3	4.0	24.9
POR	11.5	14.6	5.5	63.8	- 3.5	-1.2	27.1
UK	6.5	8.2	2.2	44.5	+ 1.3	-1.1	14.6
EC	5.0	5.9	4.6	60.0	+ 1.4	-0.6	20.3

The shaded cells give an indication of convergence problems

Table 3

NOMINAL CONVERGENCE EFFORTS REQUIRED

	Inflation	Public finances	External accounts
BEL	Consolidation	Adjustment	Consolidation
DAN	Consolidation	Consolidation	Vigilance
DEU	Vigilance	Adjustment	Consolidation
ELL	Strong adjustment	Strong adjustment	Strong adjustment
ESP	Adjustment	Consolidation	Vigilance
FRA	Consolidation	Consolidation	Vigilance
IRL	Consolidation	Vigilance	Consolidation
ITA	Adjustment	Strong adjustment	Vigilance
LUX	Consolidation	Consolidation	Consolidation
NED	Consolidation	Adjustment	Consolidation
POR	Strong adjustment	Adjustment	Vigilance
UK	Adjustment	Consolidation	Vigilance