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## R E P O R T

by the Committee on Economic and Monetary Affairs and Industrial Policy on the Commission's annual economic report for 1990-1991 (COM(90)613 - C3-73/91)

Rapporteur : Mrs Brigitte ERNST de la GRAETE

A Series: Reports - B Series: Motions for Resolutions, Oral Questions - C Series: Documents received from other Institutions (e.g. Consultations)

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\* = Consultation procedure requiring a single reading

\*\*II = Cooperation procedure (second reading) which requires the votes of a majority of the current Members of Parliament for rejection or amendment

\*\*I = Cooperation procedure (first reading)

\*\*\* = Parliamentary assent which requires the votes of a majority of the current Members of Parliament

C O N T E N T S

Procedural page .....	4
A. Motion for a resolution .....	5
B. EXPLANATORY STATEMENT .....	12
I. Assessment and short-term prospects	
1. Short-term risks affecting economic activity	
2. The Community's external dependence	
3. Economic balances and social imbalances	
II. Which economic policies geared to which objectives?	
A. Maintaining a climate of stability and growth	
B. Developing the Community's potential	

By letter of 12 February 1991 the President of the Council consulted the European Parliament, pursuant to Article 4 of the Council Decision of 12 March 1990<sup>1</sup> on the attainment of progressive convergence of economic policies and performance during stage one of economic and monetary union, on the proposal from the Commission to the Council for the adoption of the annual report on the economic situation of the Community and the fixing of the economic policy guidelines for 1991.

At the sitting of 22 February 1991 the President of the European Parliament referred this proposal to the Committee on Economic and Monetary Affairs and Industrial Policy as the committee responsible.

At its meeting of 19 June 1990 the Committee on Economic and Monetary Affairs and Industrial Policy appointed Mrs Ernst de la Graete rapporteur.

At its meetings of 18-19-20 December 1990, 10-11 January 1991, 29-30 January 1991 and 27-28 February 1991 it considered the Commission proposal and draft report.

At the last meeting on 28 February 1991 it adopted the motion for a resolution as a whole with 2 votes against.

The following took part in the vote: Beumer, chairman; Desmond, first vice-chairman; de Montesquiou, third vice-chairman; Cramon Daiber (for Ernst de la Graete, rapporteur; Rule 111), Barton, Beazley, Bofill, Cassidy, Caudron, Cox, Donnelly, Friedrich, Lataillade, Mattina, Metten, Papayannakis, Patterson, Pinxten, Read, Ribeiro, Siso Cruellas, Wettig, Titley (for Tongue) and Van Der Waal (for Ruiz Mateos) (Rule 111).

The report was tabled on 4 March 1991.

The deadline for tabling amendments will appear on the draft agenda for the part-session at which the report is to be considered.

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<sup>1</sup> OJ No. L 78, 24.3.90, p. 23

MOTION FOR A RESOLUTION

on the Commission's annual economic report for 1990-1991

The European Parliament,

- having regard to the proposal from the Commission to the Council (COM(90)613 - C3-73/90),
- having been consulted by the Council pursuant to Article 4 of the Council Decision of 12 March 1990 on the attainment of progressive convergence of economic policies and performance during stage one of economic and monetary union,
- having regard to the report of the Committee on Economic and Monetary Affairs and Industrial Policy (Doc. A3-0048/91),

THE WORSENING ECONOMIC SITUATION IN THE COMMUNITY

1. Notes that, according to the information provided by the Commission, the economic situation in the Community deteriorated in 1990 (growth rate 2.9%; inflation rate 5.1%; unemployment rate 8.5%; external trade imbalance) and that the slow-down in growth will continue in 1991 (growth rate 2.25 %; inflation rate 5.25%; unemployment rate 8.75%; net reduction in rates of investment; external trade deficits);
2. Notes, also, the clear deterioration in the world economic situation, notably in the United States, whose economy has entered a period of recession, estimates putting the growth rate at 0.3%, the inflation rate at 6.3% and the unemployment rate at close to 7%, and even in Japan (fall in the growth rate from 6% in 1990 to 4% in 1991), quite apart from the further increase in the indebtedness of the developing countries from US\$ 1200 billion in 1989 to US\$ 1340 bn in 1990;
3. Notes, further, that the situation and problems facing the economies of central and eastern Europe during their current transitional phases are contributing to the difficulties confronting the European and world economies;
4. Notes that a clear trend predating the Gulf crisis and a number of factors lie behind this considerable deterioration in the economic situation in Europe and around the world: the rise in the oil price due to the Gulf crisis, the fall in the value of the dollar, higher inflation, the rise in interest rates, the inadequate volume of international savings and the indebtedness of the developing countries;
5. Stresses that the crisis and war in the Gulf have had an impact on the trend and factors which lie behind this economic situation, causing fresh disruption and seriously exacerbating the uncertainty and unpredictability which characterize the world economy;

6. Notes, therefore, that after several years of sustained growth the Community economy has entered a period of uncertainty: once again, the European economy's severe short-term and structural dependence on outside factors, which it cannot or will not overcome, is jeopardizing its internal growth;
7. Fears that in this economic environment, the effects of which, in terms of the impact of the redistribution of income due to the high oil price or the extent of the slump in world trade, are difficult to assess, the risks affecting short- and medium-term trends in productive investment will be high;
8. Notes that the Commission has chosen an optimistic approach in indicating that 'the short-term outlook is less favourable', that 'the Community economy is in an ambiguous situation', and in preferring an analysis based on a best-case scenario for the Gulf crisis;
9. Stresses that social and economic developments in the Community may well jeopardize:
  - the establishment of an Economic and Monetary Union whose benefits are evenly distributed;
  - the economic integration of the countries of eastern Europe;
  - the future of the developing countries,should the Community and the Member States fail to take the measures which the current economic situation requires;

#### GUARANTEEING SUSTAINABLE ECONOMIC DEVELOPMENT

10. Shares the Commission's concern regarding the need to combat inflation (7 to 8% in Italy, Spain and the United Kingdom; 13% in Portugal; 20% in Greece) and not to repeat the errors made in the wake of the 1973 and 1979 oil price shocks;
11. Shares, also, the Commission's view that productive investment forms the basis of all economic and social prosperity;
12. Draws the Commission's and the Member States' attention, therefore, to the danger which would be posed to investment by excessively high interest rates resulting either from an over-restrictive monetary policy or from excessively high budget deficits in certain Member States;
13. Takes the view, therefore, in the present circumstances, that investment support must consist primarily of more specifically structural measures which seek to:
  - frame and apply a Community industrial strategy, with a view to achieving sustainable economic growth while taking account of the completion from and strategies of third countries;

- meet as far as possible capital needs engendered by technological change and the imperative of internal cohesion, needs which must compete with calls for funding from Central Europe;
- 14. Stresses, further, the need to secure economically and socially optimum value-added gain sharing without triggering an inflationary spiral;
- 15. Takes the view, that the level of public investment, both tangible (infrastructure) and intangible (R & D, education, training), must be increased in order to foster sustainable economic growth; investment made under the Structural Funds must also be assessed in this light and also, where necessary, redirected and stepped up;
- 16. Notes, like the Commission, that the level of domestic savings in the Community is inadequate to meet the needs engendered, in particular, by technological change, the imperative of internal cohesion and the considerable demand for capital from the countries of Central Europe; calls on the Commission to examine, with the Member States, ways of improving the level of productive savings in the Community;
- 17. Stresses, in general terms, and with particular regard to current circumstances, the need for a closely coordinated economic and monetary policy in the Community;
- 18. Asks the Commission to play a less timid role in the present stage of EMU and to test the limits of the available instruments;
- 19. Wishes to become more closely involved in the multilateral surveillance process;
- 20. Regrets that the Commission has not responded to the wish expressed in the previous report by the European Parliament that the Community should introduce procedures and instruments which would provide a precise and forward-looking analysis of the impact of Community policies (improved data collection, including at regional level; convergence indicators; establishment of a system to monitor foreign investment in the Community);

ATTACHING CENTRAL IMPORTANCE TO THE SOCIAL DIMENSION

- 21. Notes with satisfaction the increase in the number of people in work and the fall in unemployment which has accompanied the economic upturn; expresses concern, however, that the unemployment rate is likely to remain steady over the next two years, following a slight increase, and that the proportion of long-term unemployed in the overall total is continuing to rise;
- 22. Notes, however, that the improved situation on the labour market has been offset by social costs borne by certain categories of workers: an increase in the number of insecure jobs and 'pseudo-self-employment', more widespread involuntary part-time working, the maintenance, or indeed widening, of wage disparities, greater recourse to shift work, worsening working conditions;

23. Notes, in general terms, that social indicators (poverty, income distribution, living conditions for certain categories of citizens) do not tally with economic indicators and sometimes contradict them;
24. Shares fully the Commission's view that 'it is also important, if social cohesion is to be maintained and strengthened, to develop and expand policies aimed at securing more equal access to stable employment with decent working conditions across the Community'<sup>2</sup>;
25. Calls on the Commission, therefore, to strengthen and broaden its social measures with a view to:
- enabling each individual to exploit his or her talents and abilities to the full;
  - improving standards at the workplace;
  - ensuring that those whose position in society or on the labour market is insecure do not have to bear the full burden of change and uncertainty;
26. Regrets, in this context, that although the Commission made an effort to observe the 1990 timetable for the social action programme, the Council has thus far adopted only one common position (health and safety of 'atypical' workers);

#### CONSOLIDATING AND IMPROVING THE INTERNAL MARKET

27. Regards as inadequate the decisions adopted hitherto in preparation for 1993, on the one hand, because the final third of the White Paper which has yet to be adopted contains vital proposals and, on the other, because the smooth functioning of the internal market in the context of Economic and Monetary Union requires proposals which supplement those set out in the White Paper;
28. Regards as essential, in this connection, a rapid decision, prior to the complete opening-up of frontiers, on the harmonization of indirect taxes; takes the view that this harmonization must seek to:
- avoid excessive losses of national budget revenue;
  - prevent indirect taxes from becoming yet more regressive;
  - ensure that changes to relative prices do not jeopardize the health and energy policies of certain Member States;
  - incorporate into excise duty rates the social and ecological costs linked to the consumption of energy-generating products;
29. Takes the view that there is a pressing need to supplement the indirect taxation package by measures which seek to:
- harmonize corporation tax more closely;
  - establish a uniform withholding tax at a level which ensures that both earned and unearned income are taxed fairly;
  - harmonize more closely indirect taxation on road transport services, in particular freight transport;

awaits with interest the publication of the study of company taxation by the Committee on Independent Experts appointed by the Commission in December 1990;

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<sup>2</sup> Commission of the European Communities, 'Employment in Europe - 1990', COM(90) 290 final, p. 9

#### SPEEDING UP ECONOMIC AND SOCIAL COHESION

30. Echoes the Commission in welcoming the progress towards economic cohesion made by the least-favoured countries, with the exception of Greece;
31. Fears, however, that this progress:
- is not benefiting all the regions concerned;
  - will slow down over the next few years for a wide variety of reasons;
  - is inadequate to ensure a degree of cohesion which will enable the regions and countries concerned to enjoy the full benefits of the internal market and Economic and Monetary Union without paying an excessive social and economic price;
32. Regards it as essential, therefore, to make immediate provision for all the measures needed to secure genuine Community budget equalization which goes beyond the scope of the structural funds and which is similar, in qualitative and quantitative terms, to the systems designed to ensure the social, economic and political cohesion of federal states;
33. Cannot, therefore, agree with the Commission's conclusion to the analysis expounded in its report that 'the catching-up countries will, however, remain primarily responsible for their own development' (p. 21); prefers a different diagnosis, which states that 'the key to the catching-up process lies in obtaining synergies between Community and national efforts to upgrade the least favoured regional economies'<sup>3</sup>;

#### TOWARDS SUSTAINABLE GROWTH

34. Welcomes the fact that for the first time the annual economic report devotes a section to the environment in which it expounds the central idea of sustainable growth; however, the objectives and measures required to achieve such growth should be set out in clear detail, a request made by Parliament in its previous report;
35. Points out that:
- the ecological impact of economic growth accounts for a significant proportion of the Community's gross domestic product and that, without corrective mechanisms, many forms of pollution increase in line with economic growth and will thus be exacerbated by the extra activity stimulated by the internal market;
  - the Community has given an undertaking to stabilize CO<sub>2</sub> emissions at their 1990 level by the year 2000;
  - the appropriate response to many pollution problems consists of an absolute reduction in emissions;
36. Infers from this that these challenges call for a battery of measures which are more comprehensive and interventionist than the timid efforts made hitherto; takes the view, further, that these regulatory measures, which must be strengthened and harmonized, will have to be supplemented by economic and financial instruments, with a view to ensuring, through these two types of instruments, a 'high level of protection' (Article 100a);

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<sup>3</sup> Commission of the European Communities, 'One market, one money', European Economy No. 44, October 1990, p. 12



37. Proposes five practical types of measure:

1. Spell out the conditions governing recourse to the subsidiarity principle to ensure that it is applied more effectively;
  2. Incorporate ecological concerns into the discussions on the harmonization of excise duty rates;
  3. Revise the Community framework rules governing aid to undertakings so that priority is given to funding the ecological conversion of the production base (agriculture, industry and services);
  4. Develop environmental indicators to assess the impact of economic activity on the environment and the state of the environment in terms of its current situation, forecasts and comparisons; only an environmental accounting system of this kind will enable the Community to secure transparency of social costs and gear political and economic measures towards sustainable growth;
  5. Levy a tax on non-renewable energy sources, and invite the Commission to take all the relevant measures;
38. Spells out that the full social and economic success of a Community energy tax depends on it being levied at a significant rate and on the revenue being allocated to the funding of energy-saving equipment, a reduction in employers' contributions and an easing of the direct-tax burden on households; parallel to this, nuclear electricity producers should be asked to assume full civil liability;

#### THE INTEGRATION OF THE COMMUNITY INTO THE WORLD ECONOMY

39. Considers that recent international events should prompt the Community to review or broaden its external economic policy with a view to securing trade growth profitable to all its partners and reducing its external dependence. This revised external policy must be based on the notion of 'global security', which embraces not only conventional economic variables, but also the democratic and political stability of trading partners, their socio-economic development and interventionist responses to global ecological problems;
40. Proposes, in this connection, the introduction or fuller implementation of an external policy based on:
1. the establishment of a fair and stable international monetary system via:
    - the stabilization of exchange rates involving, if necessary, the taxation of speculative exchange transactions;
    - the provision of additional resources for the countries of Eastern Europe and the South;

2.the establishment of a fairer and more stable world economic order via:

- national economic programmes designed to promote the development of domestic products particularly by making up of indigenous human and natural resources;
- a wide-ranging programme of savings in raw materials, in particular energy, with a view to ensuring fair access to them and meeting certain ecological challenges;
- the constitution or consolidation of funds intended to provide the countries of the South and Eastern Europe with efficient energy systems and guarantee them access to clean technologies;
- the adjustment and stabilization of the terms of trade;

41. Takes the view, in this context, that a more thoroughgoing liberalization of international trade is desirable only if it offers three guarantees not currently provided under GATT:

- that it should benefit all trading partners in an equitable manner;
- that social and ecological costs should be reflected in the nature and pattern of trade;
- that it should not increase external dependence, in particular via greater short-term economic instability;

42. Asks the Commission to take all appropriate measures to prevent the abolition of internal frontiers from benefiting primarily undertakings from outside the Community whose access to the European market will have been improved without genuine reciprocal concessions being granted;

43. Instructs its President to forward this resolution to the Council, the Commission and the governments and parliaments of the Member States.

EXPLANATORY STATEMENT

## I. ASSESSMENT AND SHORT-TERM PROSPECTS

According to the conventional indicators, whose statistical inaccuracies and conceptual shortcomings cannot be pointed out often enough, particularly in respect of GNP/GDP, in recent years the EC has recorded faster economic growth than in the so-called crisis period from 1975 to 1985. However, before the events in the Gulf, a slow-down in growth was clearly signposted, principally in the findings of business surveys. Only Germany, which is enjoying the benefits of unification, seems to be bucking the trend.

Starting in August 1990, a clearer picture of the worsening international context did nothing to improve economic forecasts for 1991 and 1992. The following linked factors stand out in particular:

- slower growth in Japan;
- recession in the United States;
- rise in oil prices, even if the price in ECU was held down by the fall in the value of the dollar;
- loss of competitiveness on the part of European exporters;
- marked fall in international trade growth rates;
- increasing danger of financial problems in Japan and the United States;
- old and new problems in many developing countries. Two of these, the rise in energy prices and the crippling debt problem, are having a serious socioeconomic impact.

This brief diagnosis, set out in Chapter I of the economic report for 1990-1991, raises three questions:

- Has the likely slow-down in growth not been underestimated, in particular for 1991?
- Is it not time to consider in detail the Community's external dependence?
- Is economic growth, even if it were to be sustained, which cannot be guaranteed, sufficient to remedy the serious socio-economic imbalances in the Community?

1. Short-term risks affecting economic activity

The economic report for 1990 - 1991 correctly predicts a slow-down in economic growth in 1990 and 1991, the figures being + 2.9% and + 2.2% respectively, as against + 3.3% in 1989. However, it suggests that growth could improve slightly in 1992 (+ 2.5%), stimulated by a more marked expansion in domestic demand. According to the Commission, the latter can be traced back to a rise in investment.

The recovery which began in 1985 was founded on a substantial, lasting increase in investment, particularly capital investment. However, even if rates of return were to be safeguarded by wage restraint, an increase in the investment growth rate cannot be forecast.

Instead, many factors suggest that there will be tight constraints on the expansion of private-sector productive investment in the short-term and that its rate of growth will not recover later. First of all, the factors determining investment are all set badly:

- forecasts for demand are down according to business surveys. Demand may be depressed even further once the full impact of the fall in the value of the dollar on the competitiveness of European exporters is felt;
- interest rates are rising, at least in nominal terms, and forecasts are for real interest rates to remain high, at a time when the ability of firms to generate their own financing is hardly increasing;
- the rate of utilization of production capacity in industry has been falling since the end of 1989.

In more general terms, the overall volume of productive investment in Europe:

- may suffer the repercussions of the greater investment attractiveness of Eastern Europe, even if only gradually;
- may be affected by financing problems connected with the lack of stock exchange confidence;
- will no longer be boosted, unlike in the period from 1985 to 1990, by an investment explosion like that experienced by Portugal or Spain following their accession to the Community or a catch-up trend after many years of declining investment.

Finally, given the general economic context, it is probable that the proportion of expansion investment in the overall total will fall, except perhaps in Germany. All things being equal in other respects, employment growth will be affected.

This brief analysis counsels, at the very least, very considerable caution.

## 2. The Community's external dependence

As a recent Commission report stresses, 'the Community market already forms a unit which is less dependent on the rest of the world than any of its member countries ... which would enable the Community (when it has reached the stage of one single market) to reap the same advantages as those long attributed to the United States of America alone in terms of attenuation of the impact of external shocks on its internal market.'<sup>4</sup>

This diagnosis, although correct, must be amplified:

- certain Member States are more sensitive to external shocks than others;
- in certain areas of trade, the degree of sensitivity is very great and of crucial importance: one thinks of the likely difficulties in the aeronautics sector in the light of the fall in the value of the dollar;

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<sup>4</sup> European Economy No. 46, December 1990, p. 64

- external shocks and, hence, external dependence, are not confined to movements of goods. They may also affect services, prices of raw materials, in particular of energy, exchange rates and interest rates.

In this connection, another recent Commission publication puts forward a much wider-ranging diagnosis: 'Current developments recall that the fragility of Western manufacturing economies should never be forgotten. (...) Nevertheless, the sensitivity to external shocks, in the field of exchange rates and of oil prices, remains high. In addition, the Community should be particularly attentive to the situation of developing countries, which are still more sensitive to external shocks by virtue of the fragility of their economies as a result of their level of debt, the fall in the price of certain raw materials, and difficulties encountered when exporting traditional products. Helping developing countries to escape from the crisis is also in the Community's own interest. This makes it even more important to strengthen international cooperation in order to avoid world-wide turbulence'<sup>5</sup>.

A considerable proportion of the jobs which will be created, or which it is claimed will be created, by the completion of the internal market will result from an increase in the market shares of Community undertakings following an improvement in their competitiveness. In the current debate, it is interesting to speculate whether these gains will actually materialize and, if so, at whose expense (industrialized countries, countries of the South, tiger economies of South-East Asia?).

Conversely, the Community still does not have sufficient guarantees that the abolition of internal frontiers will not primarily benefit, at least in certain sectors, undertakings from outside the Community which have been offered improved access to the Community market, through the establishment of subsidiaries or through imports, without genuine reciprocal concessions being granted.

Finally, the degree of economic dependence cannot be measured solely on the basis of commercial and economic fluctuations. The concept of 'global security', which embraces the democratic and political stability of trading partners, their socio-economic development and appropriate responses to global ecological challenges, should be a central concern for the Community. Naturally enough, such an approach would call for a degree of external policy coherence and political will which is either lacking or difficult to secure in institutional terms.

### 3. Economic balances and social imbalances

The macroeconomic indicators which supply information for economic diagnoses tell only part of the story. They reveal nothing about the social realities which form the fabric of citizens' daily lives. In particular, there is no systematic correlation between economic performance and social well-being.

Labour market trends offer a good example of the legitimate concerns regarding the social cost, borne, in this case, by certain categories of worker, inherent in the economic growth now being achieved: an increase in the number of insecure jobs and 'pseudo-self-employment', more widespread non-voluntary

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<sup>5</sup> Commission of the European Communities, 'Industrial policy in an open and competitive environment', COM(89) 556 final, November 1990, p. 4

part-time working, the maintenance and, in certain cases, widening of wage disparities<sup>3</sup>, greater recourse to shift work, whose adverse impact on health and social life is widely recognized, and worsening working conditions for production workers.

Nevertheless, the most blatant form of inequality on the labour market concerns access to employment. Despite a significant increase in the number of jobs, the unemployment rate remains high. After several years marked by slight falls, the Community unemployment rate has bottomed out since the beginning of 1990 and the Commission is predicting a slight increase in 1991. Moreover, in many countries the proportion of long-term unemployment in the overall total is remaining stable, or even increasing.

There are also more serious forms of socio-economic exclusion: poverty, marginalization, etc. It is difficult to analyse the extent of these phenomena and the recent trends involved. However, the economic recovery does not seem to have reduced the number of people affected. At all events, efforts must be made to improve on the, at best, relative success achieved hitherto in combating socio-economic exclusion.

These various problems certainly justify talk of worsening social indicators, particularly as these problems are set against a background of growing inequality in the distribution of income and inherited wealth.

Economic growth is perhaps one precondition for securing better living and working conditions and a greater degree of social justice, but, on its own, it is not enough.

## II. WHICH ECONOMIC POLICIES GEARED TO WHICH OBJECTIVES?

Economic policies are simply means of ensuring evenly distributed prosperity. However, this task would be impossible without them. There is a need, therefore, to spell out the substance and scope of the economic policies which the Community needs today.

### A. Maintaining a favourable socio-economic climate

#### 1. Preventing an inflationary spiral

An increase in inflationary pressures would not be desirable. However, the danger must not be exaggerated, for two reasons: firstly, because the current situation cannot be compared with the first two oil price shocks, as regards both the general context and the size of the increases in the prices of petroleum products; secondly, wage controls would seem to be the key to ensuring an economically ideal distribution of the fall in purchasing power resulting from the rise in energy prices. However, except in certain countries, the nominal wage increases permitted would still leave scope for rises in real terms, which would also be essential to bolster consumption. Finally, the forecasts for trends in retail prices offered by industrialists do not point as yet to an inflationary surge.

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<sup>3</sup> This is clearly visible in respect of direct wages, but is even more marked in respect of fringe benefits.

## 2. Safeguarding the fundamental conditions for sustained, job-creating growth

Given that the Commission has based its short-term diagnosis on an increase in investment, it is natural that it should lay great stress on the need to safeguard investment returns. This concern, which underlies the whole economic report for 1990-1991, prompts four remarks:

- profitability is very far from being the sole determining factor behind investment (see section I.1.);
- is the Commission not stressing two contradictory ideas, i.e. the need for a strict monetary policy, which will keep interest rates high, and the need for productive investment, which will necessarily be checked by those high interest rates?
- at this stage in the economic cycle, and given that balances have been restored, investment support policy calls for measures which are more specifically structural in nature. In this connection, the Commission stresses that the level of domestic savings in the Community is inadequate to meet the needs engendered by, in particular, technological change, the imperative of internal cohesion and the considerable demand for capital from the countries of Central Europe. Moreover, there is a very good case for framing and applying a Community industrial strategy with a view to establishing sustainable economic development taking account of the competition from and the strategies of third countries<sup>4</sup>;
- finally, the policies implemented throughout the 1980s led to a marked fall in the wages-value added ratio. This adjustment was needed to improve company balance sheets. However, in the long term, value-added gain sharing which is excessively disadvantageous to workers may prevent private consumption from taking over as the main driving force for growth.

Moreover, the marked fall in public investment and the problems encountered by the education and training systems in many countries (intangible investments) suggest that an analysis of public-sector deficits should be accompanied by detailed consideration of the contribution of certain forms of public expenditure to growth. Making excessive cutbacks in public expenditure in order to meet fiscal and monetary consolidation targets too quickly may jeopardize medium-term growth, at least in certain countries. Neglecting the maintenance and renewal of the infrastructure may also have unpleasant financial repercussions.

### B. Developing the Community's potential

#### 1. Improving the internal market

The apparently favourable assessment set out in the report - more than two-thirds of the proposals contained in the White Paper have been approved by the Council - omits to point out that the final third contains the vast majority of the most problematical proposals.

Taxation offers particular cause for concern. Recent and likely trends in indirect taxation in the Member States do not point to greater convergence.

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<sup>4</sup> Commission of the European Communities, 'Industrial policy in an open and competitive environment', op. cit.

In this context, the harmonization proposals on the table raise many questions and problems. They prompt the following remarks.

1. Not for the first time, the proposals on the table are being presented as the only possible compromise. However, some Member States still have reservations on certain sensitive issues, in particular the gradual abolition of tax-free allowances.
2. Many political doubts remain regarding the switch to the definitive VAT system. Whereas some Member States regard the Commission proposal as a 'definitively transitional' system, others are proposing to attach conditions which will ensure that the switch to the definitive system is not automatic.
3. While allowing for certain tactical ulterior motives, it is possible to share the doubts held by the Member States regarding the smooth functioning of certain mechanisms, e.g. those in respect of controls.
4. The problems encountered by Germany with its road tax, and the growing interest at Community level in various ecological taxes, clearly demonstrates that the harmonization of indirect taxation must, in practice, embrace an area much wider than just VAT and excise duty. This area is still largely uncharted, even though it is becoming more important every day.
5. Close examination of the proposals suggest that the British ideas have held sway. The dynamic set up by the transitional VAT system, the liberalization of markets which are heavy consumers of products liable to excise duty, in particular road transport, and pressure from interest groups should serve to approximate VAT and excise duty rates applied in the Member States without a prior harmonization agreement being necessary.
6. Full application of the tax harmonization proposals published hitherto would reduce the room for manoeuvre open to various national policies by virtue of:
  - the reduction in tax revenue,
  - the abolition of VAT rates higher than the normal rate,
  - changes to relative prices, which are of crucial importance to energy policy, for example,or would have a greater impact on certain sectors or certain social categories, at least in some countries. These problems must be resolved by striking the desired balance between efficiency and social fairness and between growth and prosperity.

In general terms, a growing number of observers feel that the smooth functioning of the internal market and Economic and Monetary Union will also necessitate the introduction of a more closely harmonized corporation tax, a standardized withholding tax on income from moveable assets and a rationalization of business support schemes.

## 2. Strengthening economic and social cohesion

The introduction to the 1990-91 report notes 'the acceleration of the catching-up process in the less-favoured countries and regions'. It is undeniable that progress has recently been made towards genuine convergence, except in the case of Greece, as the table on page 21 of the report shows.



However, this progress should be set in the much less favourable overall context.

1. To a very great extent, the progress recorded in Spain, Ireland and Portugal in the period 1985-1990 merely served to make good the deterioration in the indicator chosen (per capita GDP measured in terms of PPPs) noted during the preceding decade, in particular during the periods following the two oil price shocks<sup>5</sup>. Greece has fallen well short of its best ever result.
2. The Commission forecasts tend to indicate that, in the short term (1991-1992), annual progress towards convergence, where such progress is achieved, will be much slower than that observed in the period 1985-1990.
3. Even if the progress recorded then were to continue, there is still a very long way to go before the per capita GDP of the less-favoured countries can be brought fully into line with the Community average. Setting aside Greece, which is falling further behind, it would take 20 years in Spain, 19 years in Ireland and 38(!) years in Portugal. Is this the reasonable period which the Commission refers to?<sup>6</sup>
4. There are doubts as to the possibility of a marked, sustainable pick-up in the convergence process:
  - (a) In the short term, because
    - the rise in the oil price will affect three of the countries involved in particular. Spain, Portugal and Greece have become much more intensive energy consumers;
    - the macroeconomic context will be less favourable.
  - (b) In the medium term, because
    - the speed of convergence over the last five years has probably been boosted by the accession process;
    - the countries of Eastern Europe, including the five new German Länder, could prove highly attractive to many investors;
    - real interest rates should be higher than those seen in the period 1985-1988.
5. Although no recent information is available, it is unlikely that per capita GDP differentials have been narrowed to the same extent in all the regions of the countries concerned, quite apart from any relative changes which may have affected the less-developed regions of other countries.
6. Finally, the statistical indicator chosen must be used and interpreted with caution, particularly because GDP is an imprecise indicator of prosperity.

Speedier convergence will require a wider range of instruments and genuine federal budget equalization. Even in 1993, the structural funds will fall well short of achieving this objective, in both qualitative and quantitative terms.

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<sup>5</sup> See 'European Economy', No. 46, December 1990, Table 2, p. 104

<sup>6</sup> 'European Economy', op. cit., p. 103

### 3. The introduction of sustainable development

The section in the 1990-1991 report devoted to the environment is a welcome innovation. Various recently published studies, in particular the report of the Task Force on the Environment and the Internal Market, confirm that, unless corrective measures are taken, many forms of pollution increase in line with economic growth. They will therefore be exacerbated by the additional activity triggered by the internal market.

Particular attention has been drawn to the energy problem. The Community has given an undertaking to stabilize CO<sub>2</sub> emissions, the main cause of the greenhouse effect, at their 1990 level by the year 2000. However, various studies have noted that even relatively slight economic growth gives rise to a 'spontaneous' increase in CO<sub>2</sub> emissions<sup>7</sup>. Moreover, just as the abolition of frontiers will primarily benefit those modes of transport which cause the greatest pollution, i.e. heavy goods vehicles and aeroplanes, the completion of the large internal market will lead to a relative increase in sulphur dioxide and nitrous oxide emissions. What is more, the objective must be to reduce emissions from their current level if global warming, which is in any case inevitable, is to be kept within bounds.

The switch to sustainable economic growth therefore calls for a battery of measures more comprehensive and interventionist than the timid efforts made hitherto. The regulatory measures will naturally have to be strengthened and harmonized, taking into account both ecological considerations and the imperatives connected with the opening-up of frontiers.

However, they will not be sufficient, and greater use will have to be made of economic instruments.

The effective implementation of those instruments will call for a determined political approach which focuses on the medium and long term and gives precedence to collective prosperity over special interests. In practical terms, priority should be given to:

1. Ensuring the more effective application of the subsidiarity principle. The conditions for the implementation of this principle must be clarified and, if possible, their scope broadened in order to avoid unnecessary disputes between the Commission and the Member States and government by judges, via over-frequent appeals to the Court of Justice, so as to allow the Member States real freedom to harmonize improved environmental standards.
2. Broadening the discussions on the harmonization of indirect taxation to incorporate genuine ecological concerns. The opposition encountered by various European countries to their road tax proposals demonstrates that tax harmonization must in practice go beyond VAT and excise duties. Moreover, all the estimates of the social and ecological cost of the use of petroleum products suggest that the excise duty levels proposed by the Commission will be inadequate.

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<sup>7</sup> The elasticity of CO<sub>2</sub> emissions with respect to economic activity is lower than 1, however.

3. Revising the rules governing Community, national and regional aid to undertakings to ensure that priority is given to the ecological conversion of products and production processes (R and D in respect of clean products, funding of the investment needed to meet environmental standards, aid for the introduction of clean technologies, support for the technical and economic conversion of undertakings affected by bans on the use of harmful substances).
4. Developing a statistical apparatus designed to gear Community action towards sustainable economic growth and to measure the progress achieved.
5. Levying a tax on non-renewable energy sources in accordance with their carbon content. Such a tax is vitally needed to combat the greenhouse effect. Its political feasibility, its economic credibility and its effectiveness can be guaranteed only if the following conditions are met: it must be a Community tax, levied at a significant rate (stabilization of CO<sub>2</sub> emissions at their 1990 level calls for an average rate of at least 20%), and the revenue must be allocated to the funding of energy-saving equipment, a reduction in employers' contributions and easing the direct tax burden on households. Parallel to this, market-compatible measures will have to be taken to ensure that the tax does not merely benefit the nuclear electricity industry. The most justifiable, and also most effective, measure would probably be that of taking into account producers' full civil liability when calculating the insurance premiums paid by the nuclear sector.

