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THE ECONOMIC AND SOCIAL SITUATION IN THE COMMUNITY

(Communication from the Commission to the European Council, Athens, 5-6 December 1983)

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CONTENTS

This Communication on the economic and social situation addresses the questions raised by the European Council at its meeting in Stuttgart on the extent of the upturn and the conditions for a lasting recovery of the European economies, as well as increasing employment and productive investment.

It follows on, in particular, from the Annual Economic Report 1983-84, which contains a detailed analysis of the economic situation and immediate outlook, the structural difficulties still confronting the Community and the conditions for consolidating the economic upturn. In addition the European Council has received a number of communications on the development of a range of new policies at Community level.

The first part of this Communication on the economic and social situation examines the economic outturn for 1983 and the outlook for 1984. The second part describes the factors of uncertainty affecting a lasting recovery, and the third part presents proposals for bringing about such a recovery.

I. THE EUROPEAN ECONOMY : THE OUTTURN FOR 1983 AND THE OUTLOOK FOR 1984

A. There are some signs of economic recovery in the Community, and this should be confirmed in 1984; real growth, which was negative in 1981 (-0.4%), is expected to be +0.5% in 1983 and +1.5% in 1984. This recovery has three characteristics :

- the upturn is slow and, for example, significantly weaker than in the United States (+3.5% in 1983; 4.5% in 1984) and in Japan (+2.8% in 1983; +3.6% in 1984);

- it is unevenly distributed amongst the Member States; the average figure for the Community is largely due to the performance of the economy in Germany (+0.7% in 1983 and +2.1% in 1984) and in the United Kingdom (+2.8% in 1983 and +2.2% in 1984); but in five Member States growth is expected to be negative in 1983 and still weak in 1984;

- it is fragile in that it is due mainly to rising private consumption, stock replenishment and a temporary increase in house-building. Investment and export demand will have contributed little in 1983; but in 1984 world imports could increase at a rate of some 3.5% in volume terms (0.1% in 1983), which will help to underpin the recovery.

B. The rise in unemployment slowed down in 1983, and even levelled off in the first half of the year. Two points must be made to qualify this statement :

- the initial levelling-off of unemployment towards the end of the first half of 1983 must be interpreted with caution; it is difficult to say whether, after three unbroken years of sharply rising unemployment, a change in trend has really occured in the Community. Uncertainties remain as regards behaviour affecting the trend of activity rates and the labour supply in general, and as regards the possible effect of incipient economic recovery and specific employment measures on the demand for labour;

- both the level of unemployment (10.4% of the labour force in 1983) and the outlook for 1984 (around 10.9%) confirm that, in spite of the recovery which is beginning, the problem of unemployment remains serious and, consequently, the objective of reversing the present trend and then reducing the rate of unemployment must remain a central consideration in the formulation of economic policies.

C. Convergence in economic performance has improved significantly :

1. inflation has fallen rapidly : after years of sharp rises in consumer prices (11.2% in 1980, 10.1% in 1981 and 8.7% in 1982), inflation should be down to 6.3% in 1983 and is expected to fall to 5.6% in 1984.

These Community averages mask increased convergence between national rates of inflation : the spread in 1980 was from 5.5% (Germany) to more than 20% (Italy and Greece) and will narrow in 1983 to a range of 3% (Netherlands) to some 15% (Italy and Greece) and, in 1984, to a range of 3.5% (Germany) to some 11.5% (Italy), leaving aside Greece where inflation will still be 18.5%.

2. The Community's balance of payments on current account is gradually moving back into equilibrium; following deficits of 1.3% of GDP in 1980 and 0.6% in 1981 and 1982, equilibrium should be achieved in 1984 (deficit of 0.3% in 1983).

Here too, the wide divergences between Member States in 1981 and 1982 should be reduced, mainly because of a significant improvement in the balance of payments positions of Belgium, Denmark, France and Italy.

3. Lastly, the average level of general government borrowing requirements, while remaining high at around 5.4% of GDP in 1983, is tending to stabilize and could indeed be reduced to some 4.7% of GDP in 1984. The public debt burden accounts for a considerable proportion of the deficit : if net interest payments were excluded, the deficit would account for only 0.6% of GDP in 1984.

II. THE FACTORS OF UNCERTAINTY

The prospects for a lasting recovery with satisfactory stability are influenced by three factors, namely the international monetary and financial situation, the revival of investment and the strengthening of the Community's economic structures.

A. The instability of the international environment

(1) The level of interest rates, in real terms, is still too high, largely as a result of the fiscal policy pursued by the United States. Quite apart from the fact that it is not normal for the cost of money to be so high during a period when activity is picking up again, persistent high real interest rates are seriously handicapping the economies of the developing countries, where the burden of the external debt continues to stultify development potential. In addition, they could

affect the recovery in the industrialized countries, where a fall in interest rates is needed for the revival in investment that is crucial to a return to lasting growth.

(2) Similarly, exchange rates continue to fluctuate widely, at levels which do not reflect basic economic realities. This sort of situation inevitably encourages purely speculative activities that absorb an undue proportion of savings. It is also liable to provoke protectionist reactions; it is therefore a factor of uncertainty hampering the recovery in investment in the exporting sectors.

The sharp rise in the dollar during recent months has improved Europe's competitiveness vis-à-vis the United States; but since at the same time the yen and the currencies of the other South-East Asian countries have remained weak, the Community's real gains have been rather limited.

(3) Lastly, the question of international indebtedness : stabilization of the financial situation, accompanied by appropriate adjustment policies, the reinforcement of the financial resources and of the supervisory rôle of international institutions, and, above all, the strengthening of the recovery in the industrialized countries,are the main conditions for a lasting solution to this problem.

B. The revival of investment

Only a revival of investment, and especially productive investment, can sustain the recovery and gradually increase the potential rate of growth of the European economies [1], which has fallen from 4.7% per year over the period 1969-73 to some 2% over the period 1975-83. At the same time, investment as a proportion of GDP has fallen from 21% per year over the period 1971-80 to less than 19% in 1983.

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[1] The potential rate of growth is defined as the rate of growth which can be achieved assuming maximum use of productive capacity.

C. The reinforcement of the Community's economic structures

The European economy has suffered a number of rude shocks over the last ten years : oil prices have tripled in six years; the labour force has grown on average by 0.8% per year; the international monetary system has been disrupted, whilst an immense international financial market has grown up which has facilitated massive capital movements; and competition from newly industrialized countries has considerably increased.

Generally speaking, Europe has reacted effectively to the shocks which have befallen the world economy. In the energy sector, for example, it has made significant progress in uncoupling essential energy consumption and GDP growth : the elasticity of energy consumption with respect to GDP growth fell from 1 in 1973 to 0.65 in 1981.

However, Europe lags behind its principal competitors (notably the United States and Japan) in certain fields which, by reason of their technical and technological content, will determine, in future, whether or not Europe can maintain and increase its market share : an improved performance in these fields would contribute, directly and indirectly, to strengthening the productive base of European economies and to the creation of viable employment.

For example, Community exports of plant and machinery over the period 1978-81 increased by only 5.2% per year in real terms compared with an increase in United States exports over the same period of 8.7% per year and in Japanese exports of 11.5% per year. The situation concerning the spread of new technologies is the same : at the end of 1982, for example, the number of robots in use stood at 3 000 in Germany, 1 000 in the United Kingdom, 750 in France and 600 in Italy, compared with 13 000 in Japan.

To sum up, although the European economy has begun a series of structural adaptations, it is still faced with the dual imperative of modernization and competitiveness, on which the solution of the employment problem largely depends. It is therefore still of paramount importance to continue, and in some fields step up, the process of adapting productive structures to the new conditions governing international competition and demand. This medium term action cannot be separated from that required to correct fondamental disequilibria (prices and balance of payments). Short-term economic policy and structural policy must be mutually coherent : they interact with each other.

III. ECONOMIC POLICY GUIDELINES

While economic developments in 1983 and the forecasts for 1984 firmly indicate that the corner is being turned, they also show that recovery so far is limited, patchy and hesitant.

The present upturn - the first since 1979 - must be consolidated as a first stage in re-establishing lasting and stable growth. However, the room for manoeuvre available to each Member State is limited and the influence of external uncertainties is powerful : organizing and establishing the conditions for a lasting recovery are, therefore, at least as important as the first signs of an improvement, perhaps short-lived, in the economic situation.

The attainment of this objective will require both coherent national economic policies and the full use of the Community framework.

A. Domestic economic policies

Economic policies in 1984 should be such as to :

- reaffirm the priority given to reducing the rate of inflation;
- establish the conditions for a progressive, lasting and stable revival of activity, especially by the introduction of policies which stimulate investment, in order to boost the confidence of producers, distributors and consumers;
- be credible, which means that these policies must be applied with determination; this implies, in particular, the establishement of realistic objectives, careful timing, and, if necessary, flexibility in application;
- within this framework, the growth of incomes must be compatible with the objective of restoring fundamental equilibrium and competitivity.

1. In the budgetary field, the Member States have already initiated difficult adjustments without waiting for recovery to begin : these efforts must continue. At a time when the first successes are being won, priority must, indeed, continue to be given to the drive to reduce deficits and steadily bring down the share of output accounted for by public expenditure. This stance is necessary, both because of the economic effects of excessive deficits, on investment for example, and because of the high level of national debt in most Member States. However, budgetary policy should not be pursued without regard for the impact it may have on supply and demand. Account must be taken of economic developments when pursuing the clear objective of reducing deficits; for example, those countries which have made large strides in their adjustment process (in terms of inflation and external balance) and have modest public deficits should not try to make further inroads into those deficits too abruptly. Whatever the circumstances, in the event of a renewed deterioration in activity, the automatic stabilizers should be allowed free play.

2. In the monetary field,external factors continue to exert a strong influence. Experience shows, however, that a policy which gives priority to an easing of real interest rates, albeit at the cost of increased differentials in relation to rates obtaining on international markets, is feasible: so important is the need for a fall in interest rates to consolidate recovery that such a policy should be maintained provided that there is a continued slowdown in inflation. This approach means that monetary agregates should be managed accordingly and, at the same time, that abrupt changes in monetary policy should be avoided.

B. The Community's contribution

1. As the experience of the last few years has shown, the close coordination of economic policies at Community level - both overall policies and those in specific fields like public finances - enhances their impact and boosts confidence. The EMS has become an essential frame of reference for the conduct of economic policies at Community level. It assists the processes of analysis, diagnosis and the agreed ordering of priorities; it is a direct, fundamental force for convergence and for the economic cohesion of the Community. In addition, the EMS has the effect of strengthening and amplifying the results of policies introduced in each Member State by emphasising the linkages between these policies within the Community. Strengthening the EMS would therefore be one means of making progress towards monetary stability, greater economic discipline and more effective policies.

On the international scene, exchange rate uncertainties, high interest rates and the consequences for the financial situation of heavily indebted countries, are still a very serious threat to the economic situation. International monetary and financial relations must, therefore, be stabilised. Recent developments like the undertaking by the United States and Japan on the rate of the yen confirm, as the Community has urged on many occasions, that national economies cannot cope with exchange rates that, for too long, are utterly divorced from basic economic realities. Member States must adopt, particularly in the discussions following the Williamsburg Summit, a tightly co-ordinated position on the need to organize concerted international action in the monetary field. It is most important that the Community should be committed to arriving at common positions and, if possible, to putting forward commonly agreed proposals in forthcoming discussions on such matters as the role of the IMF, the problems of liquidity creation and distribution, and on exchange rates.