European Communities

EUROPEAN PARLIAMENT

Working Documents

1983-1984

31 August 1983 **DOCUMENT**

Towards European Economic Recovery in the 1980s

Report presented to the European Parliament

by Mr M. Albert and Professor R. J. Ball

English Edition Revised Edition

TOWARDS EUROPEAN ECONOMIC RECOVERY IN THE 1980s

R E P O R T

FOR THE EUROPEAN PARLIAMENT

BY MR MICHEL ALBERT AND PROFESSOR JAMES BALL

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The annexes will be distributed separately.

FOREWORD

On 14 December 1982 the enlarged Bureau of the European Parliament, under the chairmanship of Mr DANKERT, authorized the 'Group for Recovery of the European Economy', consisting of the chairmen of the six parliamentary committees[1] whose terms of reference include economic matters, to appoint economists to draw up a report on the economic crisis affecting the European Community and on the ways and means of bringing about a recovery of growth.

The Group, whose chairman is Mr NIKOLAU and rapporteur Sir Fred CATHERWOOD, asked Mr Michel ALBERT, former head of the French Commissariat au Plan, and Professor James BALL, Principal of the London Business School, to draw up the general report. This report has been completed within the allotted time and is attached.

The Group also requested Mr J. WITTEVEEN, Professor L. SPAVENTA and Mr U. LANTZKE to submit contributions on specific points.

Mr Michel ALBERT and Professor James BALL wish to thank these three eminent personalities most sincerely for their contributions. They would also like to thank the European Institutions, the authorities of the Member States and the numberous individuals and bodies who have been kind enough to provide information and cooperation, and also the services of the European Parliament, especially the coordinator, Mr DEWAR.

They would like to convey their sincere gratitude to the three eminent experts who have kindly collaborated with them in conceiving, preparing, drafting and correcting this report: Mr John DREW, Mr Francesco PORRE and Mr Ludwig SCHUBERT. Their tireless commitment and, above all, the calibre of their work represent far more than a mere technical contribution.

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1 Mr Jacques Moreau, Mrs Hanna Walz, Sir Fred Catherwood, Mr Efstratios Papaefstratiou, Mr Pancrazio De Pasquale and Mr Michel Poniatowski.

There was not sufficient time to arrive at a compromise solution. Indeed, a compromise document would have been less effective than a joint analysis and a clear indication of the differences of view which emerged on economic policy guidelines.

The general report consists of two parts:

- the first part contains an analysis of the problem. The two experts agree on this analysis;

- the second part contains proposals on which there were certain differences of opinion: Chapter 4 'European economic recovery' was drafted by Professor J. BALL and the other chapters by Mr M. ALBERT.

Finally, Professor J. BALL and Mr M. ALBERT have each set out their personal comments in a brief note.

Brussels, 27 June 1983

INTRODUCTION

How can the European economy recover during the eighties? The European Parliament has given us four months to reply to this question. It is a challenge we have accepted with some trepidation. Yet such a deadline is justified given the urgent need for the economies of the ten member countries of the European Economic Community to emerge from ten years of stagnation and from the last three years of virtual standstill (the rate of growth between 1981 and 1983 was 0.1%).

The crisis is of international proportions, but its effects are being felt far more severely in the countries of Europe than in other countries. That is our first comment. Europe's surface prosperity masks a decline which is inflicting immense hardship. It has still barely impinged on the public consciousness. The initial stages of decay always have the gilded softness of the first days of autumn. But winter and sickness are not far behind. It grows worse with each passing day, and we shall see why there are no longer national remedies and why recovery can only be achieved by Europe.

But by which Europe? One torn apart by divergent exchange rates and conflicting policies? By a Europe which has evolved only one common policy since the first oil shock - a common policy of illusions?

So why has the European Parliament commissioned this report in 1983? There is a world crisis which has lasted 10 years. But now oil prices are falling. America is taking off again. It looks as if Europe will follow. There are two errors in this tempting commonsense argumetn. Because Europe was much harder hit by the world crisis than its OECD partners, it has no chance of getting in step with the US by practising a 'wait-and-see' policy: it will simply fall further and further behind. Secondly, it would be a mistake to imagine that the Ten can extricate themselves from the crisis by playing the role of wagons attached to the American locomotive: that would only accelerate their decline. This is apparent in 1983. It will be all the more so in 1984.

The Ten must look to Europe for a lead. It is there that they will find the necessary driving force. Demand-pull inflation has ceased to exist in the EEC and for the first time, in 1983, all governments have come to realize that lax financial policies only aggravate the economic crisis which they are trying to overcome. But what is particularly significant is that this truth is now also being grasped by the vast amjority of the social partners, as much by workers as by management.

This combination of change of circumstances and a change of attitude offers us a chance which we must be sure to seize. After so many disappointments we _must_ succeed this time.

'We must', 'it is necessary' .... It is quite natural that so much that is written by Europeans should be expressed in the optative mood. But there is too much talk about what is desirable, not enough about what is possible. Happily, however, the European Parliament has shown itself to be concerned with _practical possibilities_, and it is on these that it sought our advice. Europe has been much harmed by those who insist on talking about it as though it were a comforting dream world. The time of the Sleeping Beauty is over.

We shall exclude from our report all proposals which would require that the Community institutions should first be reformed. Admittedly, the Community institutions are ill-suited to decision-making and have been enfeebled by years of indecision. But reform takes years. Wisdom and the urgency of the situation require us to accept the institutions as they are and to make the most of what they have to offer.

In the same spirit, we shall be wary of the now fashionable practice of calling at every turn for a convergence of national economic policies, since we know full well that this is very difficult to achieve and that national attitudes to the problem of convergence differ markedly. By the same token, we shall have nothing to do with the old pretence that coordination is the key to the solution of all intractable problems: the Community has lost 20 years by clinging to such a myth. Let us not be too naive: there will be no convergence and no coordination of national policies unless and until the parties involved feel that such action will effectively serve their interests, and that is precisely one of the reasons why it is essential to ensure a _lasting_ recovery of growth in Europe. Instead of yet again denouncing the Community's notorious weakness, its 'lack of political will', which serves no useful purpose, we shall try to see how growth can be revived without continuing to insist that the governments adopt policies contrary to those on which they were elected.

Our proposals are no more Keynesian than monetarist. The important factor, in our view, is that they are practicable. In this regard, we are quite aware that you cannot simply decree that the growth rate shall be such and such a percentage. The present stagnation is in large measure the result of cyclical policies which were aimed at stimulating growth. The crisis compels us to be realistic: we can no longer expect any lasting solution to produce short-term results. That is why, in the french version of this report, we have been careful to use not 'relance' but 'redressement' to render the English term 'recovery'. We have proceeded on the assumption that this 'recovery' will take 5 to 10 years and have taken 1990 as a rough target date. With that time-scale, there will be ample room for manoeuvre and the partners, who may have some difficultires when their immediate interests are at stake, may find that they can approach the longer-term task of joint reconstruction with the necessary equanimity.

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This report, which we have tried to write as clearly and simply as possible, has two parts. The first part is analysis, while the second part puts forward proposals.

The central theme is that the main obstacle to the economic growth of the European countries is what we must call 'non-Europe'. This is less to denounce the sterility of the institutions or the defects in their construction than to underline how public opinion is too little aware of the role which it must play from now on. It is this non-Europe, lacking popular legitimacy, which is ossifying and declining on the slippery slope of non-growth.

As for our proposals, it would be utopian - everything will remain utopian so long as we fail to measure the evils which await us if we do nothing - if they did not address themselves specifically to the European Parliament. Their success or failure depends less on the political will of governments than on the economic intelligence of public opinion. The EEC has today all the resources necessary to pursue a European strategy of recovery, of lasting growth and of employment in stable conditions. Harnessing these resources is relatively easy on one condition, and one only: that a sufficient body of political, economic and social opinion identifies clearly a common interest.

The electorate will next year elect Members of the European Parliament. If only 5% of that electorate takes the trouble to examine, understand and discuss our analysis and proposals, even to reject them and produce others, then it will no longer be over-optimistic to count on the future recovery of the European economy.

CHAPTER 1

THE 1970s: TWO MISTAKES IN THE FACE OF THE CRISIS

It is urgent - especially for Europe[1] - to find once again a rhythm of sustained growth. As proof of this, we have only to point out that:

- the rate of growth of the EEC's economy fell from 4.6% per annum between 1960 and 1973 to 2.3% between 1973 and 1980. The corresponding figures for the United States are 4.0% and 2.2%. Up to 1973, then, the European economy grew at a significantly faster rate than the American economy[2]. But it has slowed down drastically in the last few years (2.3 points down as opposed to 1.8 in the United States). The longer the present situation continues, the more pronounced this difference will be: between 1981 and 1984, Europe's percentage lag will stretch to roughly 3-5% and will make it difficult for per capita income to catch up.

- whereas during the period of expansion of the 1950s and the 1960s Europe was able to maintain full employment, even managing to place millions of migrant workers, since 1973 it is the only area of the world to have failed to create jobs. Between 1973 and 1983 employment in the EEC actually decreased by 3 million, while in the USA it increased by 15 million. Consequently the unemployment rate in Europe rose much faster than in the USA and the average period of unemployment was six times as long (six months as opposed to one month). One can easily understand that the economic and social consequences of such a rate of unemployment (more than 10%) must be much more serious in Europe.

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[1] This word is used here to denote all the member countries of the EEC. The expression 'Non-Europe' is intended to convey the low level of cooperation and the weakness of common policies.

[2] Between 1959 and 1970, the Community of Six managed a growth rate of 5.7%, as against 4% in the United States.

During the years of rapid expansion the peoples of Europe evolved a variety of systems and institutions which were without parallel on the other side of the Atlantic and which left them dependent on sustained economic growth. A notable cause of this situation was the development of social security systems which risk being slowly suffocated by stagnation and unemployment. In Europe, more than anywhere else, the need for growth is vital. In the face of this evidence, however, the Ten committed two mistakes in the 70s, serious enough to mortgage the future.

11 - The first mistake: sacrificing the future to the present

In the early 1970s, Europe was suddenly confronted with a threefold challenge: inflation, the oil shock and competition from new industries. No other developed region of the world was so severely affected. Not only was it forced into a position of heavy dependence for its energy supplies, it also had to suffer the penetration of its industrial markets both by Japan and by the newly industrializing countries (NICs), all new forces bent on the conquest of the future. To make matters worse, Europe seemed suddenly to be caught up in the web of its past, adopting what the psychologists might call an 'escapist posture'. It tried to ignore the realities of the new situation by boosting wages at the expense of profits and encouraging consumption at the expense of investment.[1]

In all, between 1973 and 1983 consumption (private and public) as a share of GDP increased by 5 points (or 6% of the initial share), whereas the share of investment fell by 5 points (or 20%). Nothing demonstrates more clearly the full extent to which the EEC has been prepared to sacrifice the future to the present. Suddenly finding herself in financial straits, the old lady of Europe has sold her jewels in a bid to maintain her 'standing'.

It is quite remarkable that this reaction should appear to a lesser or greater extent in all the Member States, despite the differences in their avowed policies and theories as well as in company management and in the management of public finances within each of them.

111 - Analysis of table No. 1

On the difficult question of the relationship between income and employment, this table speaks for itself: it shows that faced with a slow-down in growth, the Europeans reacted in a very characteristic way, giving priority

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[1] See Annex 1

Table 1

UNEMPLOYMENT, EMPLOYMENT AND INCOMES
EUROPE, UNITED STATES AND JAPAN

	Rate of unemployment (% of total working population)			Discrepancy between growth in per capita real wages and GDP in volume per employed person (a)		
	EC	USA	JAPAN	EC	USA	JAPAN
Average 1961-70	2.1	4.6	1.2	100.0	100.0	100.0
1973	2.4	4.5	1.3	106.4	103.3	100.7
1975	4.1	8.0	1.9	114.0	106.5	107.2
1978	5.2	5.7	2.2	112.3	105.4	104.2
1980	5.8	6.7	2.0	113.0	106.8	98.7
1983 (estimate)	10.8	10.1	2.4	116.8	109.2	97.9
	Per capita real wages Δ % p.a. (b)			GDP in volume per employed person Δ % p.a.		
	EC	USA	JAPAN	EC	USA	JAPAN
1961-73	4.9	2.5	7.6	4.4	2.1	8.5
1974-80	2.5	0.3	2.3	1.6	- 0.2	2.8
1981-83 (estimate)	1.1	0.5	1.4	- 0.0	- 0.2	1.7
	Employment Δ% p.a.			GDP in volume Δ% p.a.		
	EC	USA	JAPAN	EC	USA	JAPAN
1961-73	0.24	2.0	1.2	4.6	4.0	10.3
1974-80	0.13	2.0	0.85	2.3	2.2	3.7
1981-83 (estimate)	-1.4	0.2	1.1	0.1	0.8	3.1

(a) 1961-70 indexes = 100, index of the remuneration of wage-earners per wage earner, deflated by the private consumption price and divided by GDP in volume per employed person.

(b) Deflated by the private consumption price.

Sources: EUROSTAT: National accounts; Employment and unemployment
OECD : Economic prospects

to individual incomes rather than to employment.

On employment, the contrast is marked: in 1983 American and European unemployment rates are comparable, but since 1973 the rate has only doubled in the United States whereas it has increased fivefold in Europe. Japan is of course a country of full employment.

Let us turn to the three right-hand columns. They show the discrepancy between growth in per capita real wages and GDP in volume per employed person. What does this discrepency mean? Simply that GDP in volume per employed person broadly represents the wealth produced by each individual, whether in employment or unemployed.[1] The real per capita wage gives the least distorted measurement of average individual incomes; wages represent approximately 3/4 of the national income and are better documented than other income. It is clear that wealth distributed in the form of income cannot in the long term increase faster than per capita GDP without some ill effects.

And yet this is what has been happening in Europe for more than 10 years.

In 1973 the difference from the average in the 1960s was 6% in Europe compared with 3% in the United States and less than 1% in Japan. It is easy to see how after the first oil price shock and the subsequent recession wage-earners everywhere attempted to maintain the increase in their purchasing power in spite of the slowdown in growth. But they succeeded more in Europe, where the difference reached 14% in 1975, than in the United States and Japan, where it was only half this level (7%). This difference became even more pronounced in the period between the two oil price shocks. The second oil price shock and the 1981 - 1983 recession widened the gap: 7 to 8 points higher in Europe than in the United States. In Japan, not only has the situation not deteriorated, it has actually improved slightly. This is reflected in the vitality and competitive ability of Japanese firms, which is linked to the effectiveness of their fight against unemployment. On the other hand, it is clear that behaviour such as that displayed in Europe, marked by an enormous growth in individual incomes compared with GDP, indicates a preference for consumption to the detriment of investment and results in an increase in the costs of undertakings which severely limits their ability to invest. Moreover, in view of the high level of wage costs, companies are attracted more by investments which save labour than by investments which create jobs. This is particularly true in Europe, since the taxes and related charges applied to wages are the highest in the world and, as we shall see, they have increased more rapidly than anywhere else over the last ten years.

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[1] For statistical purposes, the term 'active population' denotes all employed and unemployed persons.

Thus, the increase in individual incomes, which is excessive in comparison to the wealth produced, increases unemployment, reduces investment and compromises present and future growth.

The reason for this development in Europe is a particularly rigid posture on incomes. From 1974 to 1980 GDP increased at the same rate on both sides of the Atlantic (EEC: 2.3% - USA: 2.2% per annum). But in Europe real wages increased by 2.5% and employment scarcely grew at all (0.1% per annum), whereas in the United States real wages levelled off but employment increased by 2% per annum. Similarly, in Japan[1] the growth in real wages (2.3% per annum) was lower than the growth in GDP (3.7%) and employment increased by 0.8% per annum. Wage flexibility in Japan derives in large measure from the adjustments made to the annual bonus paid in the light of a company's performance, which often represents a third of a worker's wages.

When overall growth falls, the only two ways of maintaining increases in purchasing power are to increase the external debt and reduce company profits. Such was the course of action pursued by the Europeans. To all appearances, this is a 'social' choice. In reality it is a short-term calculation. A few years later it became apparent that, lacking investment capacity, many European companies were losing their competitiveness and, at the same time, their ability to create jobs. In Japan and the United States, on the other hand, it seemed as if employees had agreed implicitly and in advance to some arrangement for sharing income with new workers, which made further recruitment possible.

'The practice of increasing wages, which initially produces a favourable impression, ultimately exerts a negative influence on economic life as a whole. It generates an increase in demand which cannot be entirely satisfied and prevents the elimination of deficits and their evil consequences of which the workers are understandably resentful'.

Which economist sternly denounced increases in nominal wages in this way? It was none other than Mr Yuri ANDROPOV, First Secretary of the Communist Party of the USSR[2]. His analysis has much relevance to the situation in Western Europe.

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[1] Following the squeeze on profits resulting from the first oil shock, a deliberate policy of curbing costs, particularly wage costs, was pursued by Japan. This 'weight-reducing' policy enabled the country to recover and to prevent wage costs from again spiralling during the second oil shock.

[2] Revue Kommunist, February 1983

That is not to say, however, that our leaders have a monopoly of wisdom and that, irrespective of ideological differences, they are always right in their prescriptions to public opinion and irresponsible social partners. There can be no better proof of this than the dramatic rise in the rate of inflation which followed the first oil shock. This rate reached 17.5% in 1972/73 and continued at 13.5% between 1975 and 1978, that is, before the second oil shock. If wages were rising too fast, it was certainly with the blessing of the monetary authorities.

112 - Industry bears the brunt of the crisis

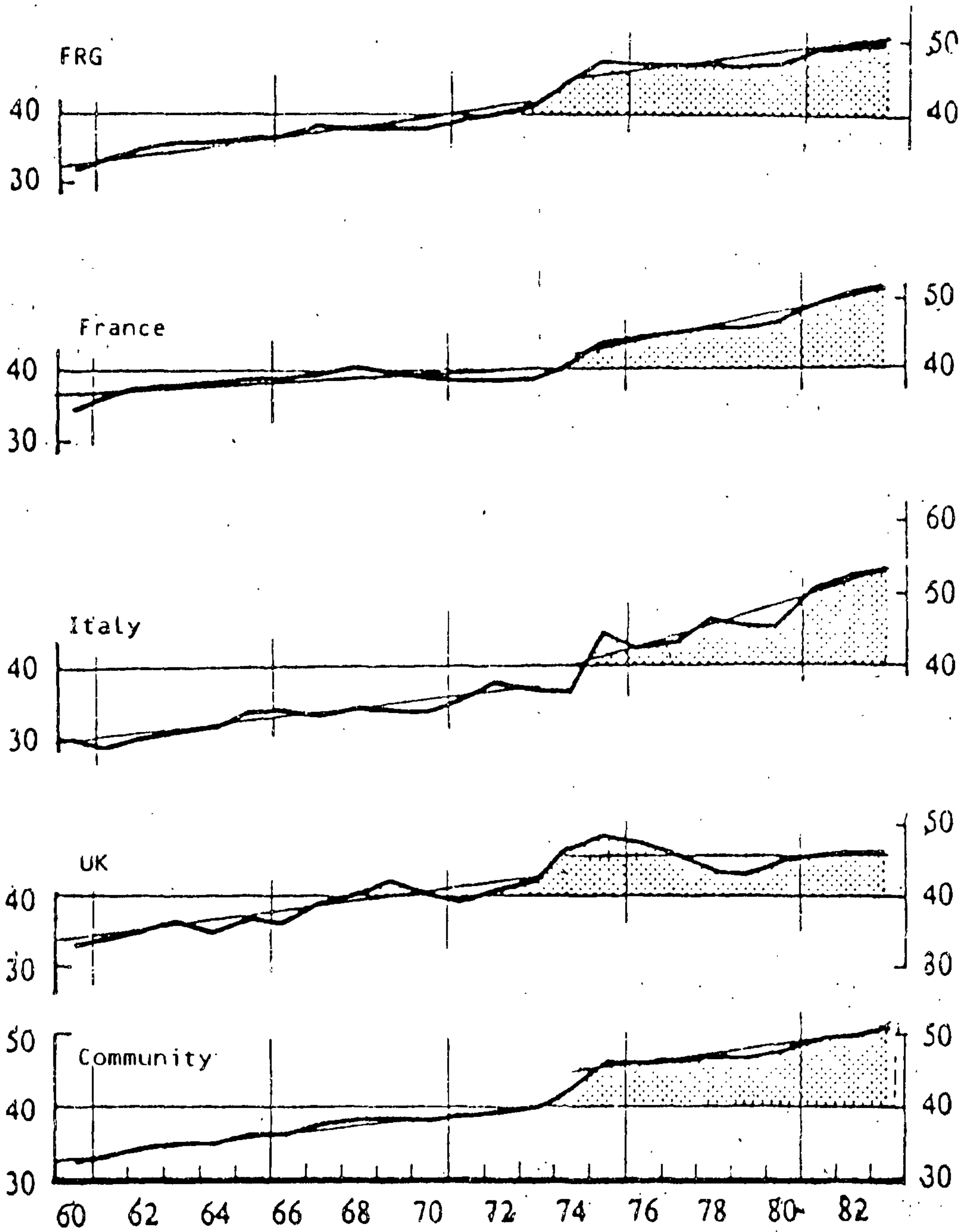
The performance of European industry has not been good. It is somewhat worrying. In 1980, the average net profit of the hundred largest European industrial groups represented 1.4% of their sales, whereas the corresponding figures for the hundred largest Japanese and American groups were 2.4% and 4.8% respectively. If we exclude the oil companies from this sample, the situation becomes even more disturbing, since we find that the American groups recorded a net profit on own capital of 11.5% and the Japanese groups 13.8% ... but that the European groups had a deficit of 0.1%.

This virtual disappearance of profit is particularly serious for investment since the risk premiums have increased considerably since the crisis and the return on capital has decreased. This largely explains the collapse of manufacturing investment in Europe. Measured as a percentage of GDP, such investment was twice as high in Europe as in the United States in 1970. Today, a fact without precedent since the fifties, it is only slightly higher. Certainly, the fall in the rate of investment was equally spectactular in Japan. Nevertheless, in 1979 Japanese investment stood at 5.2% of GDP, i.e. the European rate recorded in 1970, which today barely touches the 3% mark.

This general pattern of development is all the more dangerous, from the point of view of European competitiveness, in that most European countries have for several years now given first priority in their economic policies to the support of industrial investment. That this should be necessary is demonstrated by the fact that between 1973 and 1981 industrial output rose by 26% in Japan and by 16% in the US, but by only 8% in Europe. But investment has only been a theoretical priority: the real priority has been public finances, to the detriment of productive activities. This has created an unprecedented situation, fraught with consequences for the future of Europe, especially since the brunt of the crisis has been borne by industry rather than individuals.

Graph 1

Trends in public sector expenditure as a share of GDP, 1960-1983



	Average annual variation 1960-73	Average annual variation 1974-83
FRG	+ 0.7	+ 0.7
France	+ 0.4	+ 1.4
Italy	+ 0.5	+ 2.1
UK	+ 0.7	0
Community	+ 0.6	+ 1 0

Source: EC Commission

113 - The loss of control over public finances

Since the upheaval of 1974, public expenditure as a share of GDP has increased spectacularly in Europe (see Graph 1). In 1982, this share exceeded 50% whereas in the US and Japan it was approximately 35%. This is shown by Table 2.

The difference in the rates of increase revealed by this table weighs heavily on the prospects for growth. It merits careful attention and is explained by the following two factors:

- Firstly, corporations, of every description acted at the macroeconomic level in the same way as income-earners at the microeconomic level: they endeavoured to maintain the increase in their puchasing power by demanding some sort of compensation from public finances. They retained the habits acqnried during the years of expansion, expecting the State to continue to maintain the increase in collective consumption and in payments to households: yet another 'social choice', which in the long term will prove just as mistaken as the one already discussed.

An inevitable consequence of this 'choice' was that public authority investment as a share of GDP fell by a third between 1973 and 1982 (from 4.1% to 2.%). Over the same period, public authority current expenditure as a share of GDP increased by a third (from 35% to 47%).

- The second reason for the loss of control over public finances, namely the dramatic increase in social security expenditure, is even more important.

After the Second World War, Europe evolved a system of social welfare which is without parallel in the rest of the world: the Welfare State. Apart from making a vital contribution to improving the social conditions of an entire generation, the Welfare State also played a decisive part in cushioning the shock of the crisis, insofar as there was scarcely any slackening in the growth of transfers between 1973 and 1980 in spite of the fall in economic growth. The expenditure of the Welfare State, financed by compulsory levies (taxes and social security contributions), could easily be met in the years of vigorous growth.

Table 2

Public sector expenditure
(as a percentage of GDP)

	1960	1967	1973	1980	1981	1982
USA	27.8	31.2	31.2	33.2	33.5	35.5
Japan	20.7	[illegible]	[illegible]	32.7	33.4	34.8
EEC	32.1	37.5	39.9	47.1	49.8	50.8
France	34.6	39.0	38.5	46.2	50.8	51.9
FRG	32.0	38.2	40.5	46.9	49.3	49.7
UK	32.6	38.5	41.1	44.3	45.3	46.2
Italy	30.1	33.7	37.8	45.6	53.0	54.9

Source: OECD and EUROSTAT

The necessary resources were raised at the cost of a small increase in the share of GDP of the compulsory levies. However, the slowdown in growth had the effect of upsetting this equilibrium. Far from being stabilized as they should have been, social welfare costs continued to increase twice as fast as overall wealth.

This difference is attributable to the rigidity of social expenditure: even if things go badly, advances in health care and progress in medicine will continue to inflate the health bill. The growing numbers of elderly people will place an ever increasing burden on pension funds. The cost of unemployment will increase twofold because of the loss of social security contributions and increases in expenditure on compensation and allowances.

The financing of these services and benefits has become so difficult that the Welfare State is in a veritable state of crisis, while in some countries there is now strong resistance to the constant increase in the compulsory levies. As we shall see, no EEC country can go on authorizing a growth in social transfers which is too much in excess of the growth rate of the economy without jeopardizing the competitiveness of its industry and causing a sudden decline in purchasing power. In all European countries there is evidence of a contradiction between the short-term demand for social services and benefits and the medium-term exigencies of growth, investment and employment.

This contradiction is usually overcome in two ways, both of which have their limits: by increasing deficits, and by raising fiscal and parafiscal charges. From 1974, public sector deficits literally soared in the EEC. Whereas between 1968 and 1973 they represented on average only 0.6% of GDP, this share increased sixfold to 3.7% between 1974 and 1978 and ninefold to more than 5% in the years 1981 to 1983. These deficits have to be covered either by loans, which further inflate interest rates, thereby curbing company investment[1], or by increasing the money supply, which feeds inflation.

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1 In the FRG, the share of private savings available for the financing of companies fell from approximately 100% in the 1960s to 45% in 1982.

Thus, the ability of companies to invest - that is to say, to prepare for the future - is severely restricted by the inflation created both by the attitudes of wage-earners and by the management of public finances, which reflect the extent to which priority is accorded to the present.

True, public finances deficits are almost as high in the US and Japan as in Europe. Nonetheless, they tend to be larger in Europe for two specific reasons: on the one hand, the intolerably high level of the compulsory levies acts as a disincentive to the most active groups in the population (company directors, executives, technicians, etc); on the other hand, the rate of growth of social security expenditure - which has been excessive from the outset - tends to accelerate with the slowdown in economic growth and hence perpetuates the factors which sustain disproportionately large social security budgets.

Developments in the productive sector of the economy and in the management of public finances show that they have had a remarkably similar effect. In both cases, the lack of flexible public expenditure and incomes policies has depressed both investment and employment. Put another way, the exaggerated preoccupation with the present, the restless and disturbing search for the immediate satisfaction of needs, are inimical to growth. In this way what is feared is actually encouraged.

12 - <u>The second mistake: The Community of 'every man for himself'</u>

121 - Article 2 of the Treaty of Rome establishing the European Economic Community specifies that 'The Community shall have as its task, by establishing a common market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it'.

The message is clear: the creation of the Community was regarded by its founders as the <u>investment</u> par excellence. Each Member State was convinced that, through unification with its partners, it would find within the Community the means of facilitating the solution of some of its most intractable problems. In this belief, it was ready to make a number of <u>short-term sacrifices</u>, for example, the approximation of its economic policy with that of the other Member States, with a view to securing the <u>longer-term advantages</u> of expansion, equilibrium and stability. This required that the Member States should work together to achieve what is the very definition of an investment: a productive diversion of resources. What was the yield on this investment? No-one can say precisely, because it is impossible to rewrite history. But there can be no doubt that the remarkable progress made in all areas of economic and social life in Europe in the fifteen years following the establishment of the Common Market was in large measure attributable to the Common Market itself.

Be that as it may, everything tends to show that from the beginning of the 1970s, when Europe was confronted with the ordeal of slow growth and rapid inflation, the Member States, instead of redoubling their efforts to invest together in the Community, and jointly accepting the need for a further productive diversion of resources, were disposed to regard the Community, not as a collective investment asset, but as an object of individual consumption, in other words the means for each of them to consume more and to improve its own short-term situation by increasing its share of the benefits of the common budget on the basis of the principle of a 'fair return', with each convinced of its entitlement to a larger share than all the others.

122 - This evidently explains why, after energetically tackling the major problems of the time (coal and steel, atomic energy, the unity of the internal market and the common agricultural policy), Europe has for ten years been virtually paralysed by hair-splitting and protracted legal disputes and interminable budgetary debates, all of ridiculously small importance compared with the major challenges facing it.

This inaction is well illustrated by the following five examples:

1. As we have seen, Europe should have given priority to boosting its investments. Since the slowdown in growth and the resulting scarcity of savings made it difficult to finance them, it became essential and urgent to create a genuine common capital market. But the Member States preferred to maintain their own separate policies and arrangements[1].

   This had the following result. In the 1960s, direct US investment in the Community steadily increased, attracted as it was by European prosperity. The flow has since been so dramatically reversed, however, that in recent years Community investment in the United States has been 4 to 5 times

[1] See the communication from the Commission to the Council on financial integration (COM(83) 207 final of 18 April 1983).

greater than equivalent US investment in the Community. Paradoxically, Europe still has far larger savings than the United States (in 1980, 430,000 million dollars as opposed to 380,000 million dollars), but they are so badly mobilized that the loans issued by the Member States to their partners amount to barely one-fifth of those raised in the Community by third countries.

2. The absence of a genuine common market for public orders and for research and development and all the other obstacles to trade are equivalent to a fiscal surcharge which would certainly represent approximately one week's work per year on average for every family in Europe (see Chapter 6).

3. It is well known that the severity of the crisis owes much to the two oil shocks. It is equally well known that Europe is particularly vulnerable in the matter of its energy supplies. In 1957, it had immediately reacted to the threat signalled by the closing of the Suez Canal by creating EURATOM - to which some signatories of the Treaty of Rome attached such importance that they evidently regarded it as a more vital institution than the Common Market itself.

After the first oil shock, which left it with a few million unemployed, what did the Community do? Virtually nothing. And after the second oil shock which followed in the wake of the revolution in Iran? Again, virtually nothing. Indeed, instead of promptly taking up the challenge we seem intent on inflicting upon ourselves a third oil shock by neglecting our energy investments. The rate of energy investment in Europe remains, as a percentage of GDP, 2 to 3 times lower than in the United States and Japan.

4. There is, however, an even more striking illustration of this European malady. It is widely held that there is one sector at least in which the Common Market is effective: the agricultural sector. But what is the truth of the matter? Since 1969, the common market in agricultural products has been virtually non-existent, because agricultural products can no longer cross frontiers without being subject to positive or negative customs duties: the notorious monetary compensation amounts (MCAs). This veritable protectionist customs levy is steadily rising and today stands at 18% on average between France and Germany! And it is the most efficient producers, as well as all consumers, who have to bear the consequences.

5. There remains a fifth factor - surely the most serious - which helps to explain the crisis - monetary disorder. The more the economies develop, the more they become interdependent and the greater becomes the need for a stable international legal and financial framework within which they can function effectively. The central element of this framework must be monetary and exchange rate stability. Today, however, incessant fluctuations in exchange rates represent, for interdependent economies, a handicap almost as serious as would be the instability of weights and measures. Can we imagine doing business with a 'floating' metre and kilo? In this connection, the floating currencies which should allow the States concerned a larger measure of autonomy and reinforce their 'national sovereignty', had the opposite effect. They aggravated the international crisis and the resulting international constraints and hence narrowed the limits within which economic policy could operate freely in each country.

Encouraged by the abandonment of the discipline of fixed exchange rates, the economic policies began to diverge in 1973: restrictive in Germany, strongly expansionist for a while in Britain, Italy and France. Thus, these countries made no joint effort to deal with the crisis and the differences between them grew. It was only in the spring of 1979, just after the second oil shock, that the decision was taken to implement the European Monetary System (EMS). In terms of monetary cooperation, the EMS has undoubtedly brought about considerable progress - the only real progress achieved, in fact, in this decade. But it must also be recognized that, despite stagnation and unemployment, free trade has more or less been maintained within a Common Market orginally created for a world of growth and full employment.

However, such advances as have been made need to be consolidated, and they should not make us forget the essential point that never, since its creation a quarter of a century ago, has the Common Market been so torn between such markedly different economic policies, as reflected in the different rates of inflation which, without counting Greece, today exceed 12 points.

We are now in 1983. Three years have elapsed since the deadline for the attainment of the objective which the Paris Summit set itself in October 1972: 'to transform, before the end of this decade and in strict conformity with the treaties already concluded, all Member States' relations into a European Union', including an economic and monetary union, which, as we have seen, is now totally out of the question.

The two mistakes outlined in this chapter give rise to four simple questions:

- <u>What happened to the countries of Europe in the 1970s?</u>

  The 1970s saw the beginning of an historic change with immeasurable consequences: the loss of those ancient privileges bequeathed to us by our history and our culture. They also saw the beginning of a massive upheaval of the world's economic geography with the result that Western Europe, in addition to being the most threatened area of the world from the military point of view, is now also the most threatened area economically. For a long time to come, Western Europe will be a focal point of historical change.

- <u>What should they have done?</u>

  In the face of the crisis they should have united and invested to safeguard the future. These two objectives are not unrelated; the propensity to consume and the priority given to the short term have always militated against European unity.

- <u>What did they in fact do?</u>

  They did the opposite of what they should have done, opting for immediate consumption and disunity, as if the period of prosperity and plenty had never ended. It is instructive to note that Europe reacted to her problems in the 1970s just as France had done in the 1930s: by throwing in the sponge. Not only was there a drop in population growth and a fall in investment, but both decades saw the emergence of policies of self-delusion and escapism, the spirit of Munich and neutralism ... The 1930s saw an ageing France in a rejuvenated Europe; and today, we have an ageing Europe in a rejuvenated world.

- So what now?

Europe's two grave mistakes will cost her dear. Let us hope that she will not commit the further, equally serious, mistake of counting on the upturn in the United States economy to bail her out of her own difficulties. Not only has the slowdown in the rate of growth been much more serious in Europe than in the United States over the past ten years, it has also been aggravated by the following four handicaps:

- inflation: as far as this handicap is concerned, only half the Community countries have obtained results comparable to those obtained by the United States and Japan.

- under-investment, which has had a significantly greater impact in Europe than in the United States.

- the increase in compulsory levies. Here, Europe has had to pay a terrible price, the magnitude of which may perhaps be appreciated by imagining that the OECD is made up of three competing enterprises, two of which, the United States and Japan, pay 35% of the overheads, while the third, Europe, pays more than 50%. From this point of view, the economy of Western Europe tends to bear some small resemblance to that of Eastern Europe.

- lastly, unemployment: since this has increased twice as fast as in the United States, it represents a major handicap for Europe.

Together, these four handicaps are establishing a dangerous pattern. They constitute the penalty for the mistakes committed by Europe in the 1970s, for which it is only just beginning to pay the price, i.e. from the beginning of the 1980s.

CHAPTER 2

THE PRICE TO BE PAID IN THE 1980s

After the two mistakes it made in the 1970s, the worst thing would be for Europe to believe that it can avoid paying for these errors in the 1980s. On the contrary, it is bound to face specific problems which will continue to inhibit growth, worsen employment and accentuate the lag in the technological field.

21. Medium-term growth prospects remain poor

211. A relatively 'optimistic' projection

In 1983 the economic growth of the United States should be around 3%. Europe's will be of the order of 0.5%. Precious as they are, the direct benefits of the upturn in the American economy will be limited according to the volume of trade: 6% for exports and 8% for imports.

Tables 3 and 4 summarize the most recent projection worked out by the Commission's services on the basis of the Comet model.

This projection is based on a set of relatively favourable assumptions[1]. It forecasts an annual growth rate of 2.3% between 1984 and 1986, which would mean not only an end to the recession of the 1981-83 period but also an economic performance approaching that of the 1970's (2.9%). Even so, given that the rate of increase in productivity is close to the rate of growth, employment will increase by only 300,000, leading to an unemployment rate in 1986 of 12.4% (14.9 million out of work), that is to say, an increase of over 2 million in three years. Assuming a continuation of this trend, unemployment is likely to reach 13% in 1983 or almost 16 million out of work, in spite of a slight decrease in the size of the working population.

[1] These include an increase of 3.7% in the volume of world imports outside the Community between 1983 and 1986; long-term interest rates in the US down from 12.2% in 1983 to 8% during the reference period; oil at $29 a barrel in 1983 and maintaining this level in real terms during the ensuing years; no major problems raised by the financing of the developing countries' deficit; etc. ...

Table . 3 GROWTH AND EMPLOYMENT HYPOTHESES FOR THE TREND FORECAST - EUR-10 — 27 June 1983

	1961-70	1971-80	1981-83 c)	1984-86 Trend Forecast d)
	1	2	3	4
	Average annual variations as %			
1. Working population	0.2	0.6	0.4	0.7
2. GDP (volume)	4.7	2.9	0.1	2.3
3. Employment	0.2	0.2	- 1.3	0.1
4. Productivity 4 = 3 : 2	4.5	2.7	1.4	2.2
5. Working hours a)	(-0.8)	(-0.8)	-	(-0.7)
6. Hourly productivity 6 = 4 : 5 b)	(5.3)	(3.5)	-	(2.9)
	Final levels			
7. Working population (millions)	109.2	116.2	117.6	120.1
8. Employment (millions)	107.1	109.1	104.9	105.2
9. Unemployed (millions)	2.1	7.1	12.7	14.9
10. Unemployment rate as % 10 = 9 : 7	2.0	6.1	10.8	12.4

a) and b) Estimates or hypotheses.

c) Latest available estimates early June 1983.

d) Latest Comet trend forecast.

Table 4 shows, on the other hand, that since 1982 real wages have stopped rising faster than productivity. Even the gap between real wages and GDP, which was characteristic of Europe in the 1970s, is closing and will continue to do so up to 1986: the overall trend is towards zero growth of real wages. It is interesting to note that this is accompanied by rising unemployment and a virtually parallel slowing down of inflation and of the rate of increase in nominal per capita incomes.

The results of these 'optimistic' projections are hardly encouraging. However, they have to be taken seriously. Contrary to the genral belief, medium-term projections of this type have forecast major trends fairly accurately in the past: e.g. slower growth, rising unemployment and higher inflation. Where they have erred it has almost always been on the side of optimism. All the indications are that this forecast will be the same. There are technical and psychological factors which suggest that the EEC is unlikely to achieve a growth rate of much over 2% by 1986. In fact, it is very likely to be less taking certain qualitative changes into account, such as the decline of the welfare state, public deficits and the adverse effects of unemployment on investment.

212. Now the welfare state is restricting growth. As we have seen, up until the beginning of the 1980s the countries of Europe were able to maintain their standard of living in spite of the slowdown in growth, but in so doing they sacrificed the future for the present. Basically, they have brought off the crisis on credit. This cannot go on forever. For three years public deficits and the increase in compulsory levies have not only become intolerable, they have also tended to aggravate the stagnation which caused them. It is a vicious circle: in order to finance the deficits it is necessary to cut investment, which in turn further reduces growth and deepens the deficits by the same amount. Because of this it will be more difficult for Europe to avoid economic depression in the 1980s than it was to avoid stagnation in the 1970s. This is especially true given the fact that Europe's population patterns - i.e. an ageing society - militate against consumption (housing, cars, etc.) and in favour of social expenditure (unemployment and retirement benefits, etc.).

[1] See Chapter 1, point 111

Table 4

WAGES, PRICES AND MONEY HYPOTHESES FOR THE TREND FORECAST - EUR-10 - △ % p.a.

27 June 1983

	1961-70	1971-80	1981-83 a)	1984 - 1986 b) Trend forecast: 1984	1985	1986	Average 1984-86
	1	2	3	4	5	6	7
1. Nominal per-capita wages	8.9	13.3	9.4	6.4	6.0	5.6	6.0
2. Price of GDP	4.3	9.8	8.4	6.0	5.8	5.5	5.8
3. Real per-capita wages = 1 : 2	4.4	3.2	0.9	0.4	0.2	0.1	0.2
4. Productivity: GDP per employed person	4.5	2.7	1.4	1.9	2.3	2.4	2.2
5. Corrected salary portion = 3 : 4	- 0.1	0.5	- 0.5	-1.5	-2.1	-2.2	-2.0
6. Wages costs per unit produced: (WCUP) = 1 : 4	4.2	10.3	7.9	4.4	3.6	3.1	3.7
7. Nominal GDP	9.1	13.0	8.5	7.8	8.4	8.3	8.2
8. Money supply M2/3	10.4	14.0	10.5	9.0c)	9.5c)	9.5c)	9.4c)
9. Liquidity = 8 : 7	1.2	0.9	1.8	1.1	1.0	1.1	1.1
10. Real money supply = 8 : 2	5.8	3.8	1.9	2.8	3.5	3.8	3.4
11. M/WCUP = 8 : 6	6.0	3.4	2.4	4.4	5.7	6.2	5.5

a) Latest available estimates.
b) Latest Comet trend forecast, see annex.
c) Illustrative data not derived from model.

This burden of public spending, which is already handicapping the European economy, is becoming heavier and penalizing Europe in relation to the United States. The difference between the burden of compulsory levies on either side of the Atlantic has risen from 5 points in 1960 to 13 points in 1982. Over the last ten years these levies have increased twice as fast in the EEC: yet it was the Americans who elected Ronald Reagan!

This situation leads, by an invisible but inexorable process, to an increasing burden of compulsory contributions which gradually weakens the system of production itself. We are slowly killing the goose that lays the golden eggs. This is especially true in some countries, such as France or Italy, where industry has to bear the main brunt of social contributions. The inevitable consequence of this inflated growth of the welfare state is discouragement, the impoverishment of industry and the loss of enterprise.

If we are to find a way out of this vicious circle without delay, Europe needs to make a collective effort, of which there is as yet no sign. Instead, the crisis has created a mood of lethargy, made worse by psychological attitudes - scepticism, inflexibility, fear of the future and of technical progress, despondency and a refusal to face facts - which unemployment helps to engender. Europe is growing sluggish and letting herself slip into a fatalistic mood of apathy. She is too worried to find fresh hope but not worried enough to pull herself together.

22. The problem of unemployment predominates

'The increasingly marked slowdown in growth over the last nine years has affected attitudes towards the future. After the first oil shock, eocnomic forecasters still considered the high growth of the 1960s as the norm to which the world economy might return. In the 1980s it has been realised that this norm should be revised downwards. This lowering of sights alone is a formidable obstacle to rapid recovery and any policy which lacks a convincing basis for an improvement in long-term prospects is doomed to failure.'[1]

This analysis is particularly relevant to the problem of unemployment.

221. Prospects

As we pointed out the EEC had not created any jobs for 10 years: in fact 3 million jobs have been lost as unemployment has increased 5-fold. It is in fact in the country whose economy has remained strongest - Germany - which has the worst record in this respect. It must be recognised that this trend will not be reversed of its own accord, and the employment crisis will not be resolved simply by a rise in growth or investment. Nor will anyone any longer accept - however effective it may be in the very short-term - the solution proposed by President Carter, namely a slowing down in productivity. Although a number of countries may have had more success than expected in reducing inflation, none have managed to reduce unemployment.

If strong growth is not going to be sufficient, what can one expect from slow growth, which is the more likely?[2] Add to this the increase in the active population (0.7 per annum over the next few years, taking account

[1] Source: Alfred Steinherr, 'The Great Crisis: a repeat in the 1980s?' Economic studies by the Commission of the European Communities - November 1982

[2] The average for 1981-84 will be of the order of 0.5% per year; consequently a growth rate of 3% will be needed in the subsequent years to reach an average of over 2% for the decade as a whole.

of the increase in female employment which is still small in Europe)[1] and it is obvious that unemployment is bound to increase in the EEC: this will ineviatbly lead to a further dismantling of the welfare state, with all the attendant risks. Since the start of the 80s, throughout Europe, governments have been trying to curb health expenditure: by increasing patients' contributions, introducing flat-rate payments for hospital treatment and so on. Even the Netherlands, the champion of social protection, has called for a freeze on all social benefits in 1983 and a return to voluntary health insurance for people with incomes above a certain level.

This is only a beginning. Every citizen of Europe must realise this because he is both a victim of and responsible for the situation. At the moment, an individual who is sick or old can be looked after in a hospital which is generally free, clean and well-equipped. In less than ten years' time, if the present state of affairs continues and unless we begin to revive growth and employment, the same individual will have to pay for treatment in a hospital which is dirty and ill-equipped. This trend had already begun: in 1980, Europe had ten times fewer scanners per inhabitant than Japan and fifty times fewer than the United States.[2]

222. Unemployment means anti-investment

In America unemployment which has always existed and mainly affects minorities, scarcely seems to alter the vitality of industry or the individual's taste for technical progress; in Japan the system of life-long guaranteed employment has made it easier to introduce technological change into industry. Facing these two competitors, Europe, with its 12 million unemployed - likely to become 20 million in 1990 - seems to be powerless. Unemployment is not only placing a heavy burden on its economy, it has become a kind of cancer.

For the nations which, for a generation, have staked everything on the possibility of achieving - as Beveridge put it - 'full employment in a free society, by developing social benefits of all kinds without equal

1 50% in the EEC as against 60% in the United States. The difference is 8 million people. Even if labour productivity improves by not less than the current 2% per year, certain countries such as the Netherlands and Ireland are likely to reach more than 20% unemployment around 1990 (projections of the Netherlands Economics Institute).

2 Telesis, the European Initiative Meeting Report, March 1983

elsewhere in the world, unemployment is becoming a veritable mental illness. Not the physical pain of empty stomachs, but the psychosis of empty hearts, the cancer of the soul. A cancer which is spreading into all the organs of society and which saps energies, weakens the motivation to invest, provokes the rejection of new technologies and brings a general demoralization. Here are some examples of the warped 'public spirit' which results.

The first occurs at national level and is too familiar to require much explanation. It is protectionism. A country in a situation of full employment which closes its borders is likely to harm its own population's interests as much as those of its partner countries. But when certain imports threaten the national economy and lead to factory closure after factory closure and lengthening dole queues, where is the national interest? What is the duty of the politicians? Unfortunately this is becoming less obvious and that is dangerous.[1]

The second expression of this warped public spirit is the tendency to stand in the way of progress in industry.

Imagine asking company managers the following question: 'Suppose you had the opportunity tomorrow to invest in a highly profitable venture, which would involve dismissing 10% or 20% of your workforce, would you go ahead with that investment without hesitation?' The question causes a good deal of hesitation. Indeed, above a certain level of unemployment there comes a point, whether one likes it or not, where a kind of latent public spirit comes into play in Europe and where company managers prefer to slow down investment rather than reduce their workforce. This compounds the loss of ground in the technological field. On the other hand, the two countries which are by far the most advanced in the use of robots happen to be the two developed countries which have been most successful in maintaining full employment: Japan and Sweden[2]. That is no accident.

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1 Are those who complain that the EEC is too open to imports and too insensitive to the needs of the Third World aware that out of 6000 tariff headings, there are around 1000 quotas on imports from the Third World? (OJ of the EEC, 9.2.1982).

2 The number of 'developed robots per 10,000 workers in 1980: Sweden = 8. Japan = 6, USA = 1.6, Germany = 1.1, Italy = 0.9, France = 0.7, United Kingdom = 0.3 (see annex 3, table 3B). These disparities in the order of 5 to 10 are disturbing for the future. They are surely not unrelated to reactions of the kind voiced by the Socialist Group in the European Parliament whose Members 'warn against the consequences of ill-considered use and uncontrolled dissemination of micro-electronics ... and therefore call, before the introduction of a new technology, for its social and ecological impact to be assessed through participation in undertakings and careful evaluation of its compatability' (Report on the employment situation in the European Community, amendments 37 and 38, 20 April 1983).

But it is not only at national and company level that unemployment is distorting public and community spirit; it also strikes at the heart of the individual worker. At this level unemployment not only fosters resistance to technical progress in industry, in particular by questioning the value of education as a means of social advancement, but it also lends currency to the idea that by working a little less, by reducing his efforts, the person who is in the privileged position of not being unemployed is helping his comrades queueing outside the factory or the office to get a job. In the extreme case an individual who works too hard or too well comes to be seen as a 'blackleg' or a 'scab', whose zeal is preventing the unemployed from getting jobs: not working too hard is a sign of 'altruism'. As a result production and distribution circuits seem to be operating less efficiently everywhere, and delays and errors and a general laxity are on the increase in certain countries, particularly in the tertiary sector.

These phenomena become increasingly widespread until ultimately, in Europe, unemployment generates yet more unemployment. Because it never stopped rising in the 1970s, it is becoming even worse in the 1980s.

23. The Balkans of the third industrial revolution

The famous statement: 'the Balkans, a geographical expression' was made a century and a half ago. This was the period of the first industrial revolution, the age of steam. The Balkan countries at that time were rich in cultural achievement, geographical diveristy and professional skills. As hard-working peoples with a gift for commerce, they could have become a driving force in the process of industrialization. At any event their situation was sufficiently enviable to arouse the interest of the major powers at that time. However, already they were 'balkanised', obsolete, divided. They slipped on to the downward path of relative underdevelopment, until in the end they are not even 'a geographical expression', because they are now cut off by the Iron Curtain. All credit to Greece for having managed under these conditions to consolidate its autonomy and its democratic institutions up to the time when it joined the European Community.

In many ways the situation of Western Europe today, facing the third industrial revolution is very similar. Instead of pooling their resources in the fields that are vital for the future, the Ten seem intent on rendering them unproductive by each attempting to act in isolation.

231. The European economy under the impact of the technological revolution

Even excluding intra-Community trade, the Community is still the world's foremost importer and exporter. Better still, it is the world's major exporter of products with a high technology content. And yet its trade is indisputably declining: it is losing ground on most of the product markets of the future, those which represent a source of growth.

The figures in Table No. 5 show both how far the Community has fallen behind in terms of its export structure and the worsening of this position, which must inevitably reduce the scope for the growth of the European economy. If we are to bring back expansion, we must be prepared to make even greater efforts to compensate for the poor results of the past.

But these figures are alarming for another reason: products with a high technological content include the new energy sources, aeronautics, space and biotechnology, areas where the European position is still strong. Thus they tend to conceal the tragic nature of our poor performance in the field of information technology. 8 out of 10 personal computers in Europe are imported from the US; 9 out of 10 video-recorders sold in Europe come from Japan. Europe's dependence is even greater in electronics than in energy. It has suffered a veritable 'technological shock' no less formidable than the 'oil shock'.[1]

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[1] Annex 3 illustrates this extremely well. The tables are taken from the report drawn up by Mr Michel Richonnier (April 1983) for a meeting of the working party of the French Planning Commission, in Paris, chaired by Mr Jacques Moreau, chairman of the EP Committee on Economic and Monetary Affairs.

Table 5

External trade in high-technology products

Specialisation figures 1963-1981

(OECD average = 1.00)

	1963	1970	1978	1981
COMMUNITY (Total)	1,01	0,90	0,88	0,87
U S A	1,27	1,18	1,27	1,19
JAPAN	0,72	1,07	1,27	1,37

Source: B. CARDIFF. Technological innovation in European industry. 1982

Indeed, every type of economic activity - banks, factories, administrations, hospitals and so on - will be drastically changed by the electronic revolution. At a time when $100,000 will buy a multifunctional robot which can replace a number of workers extremely profitably, the countries which are not competitive in the manufacture of these robots will be condemning themselves to stifling the growth of their economy, to multiplying the number of unemployed and intensifying the resistance in industry to technological progress.

Even if cutbacks in staffing levels resulting from the application of electronics were not to exceed 5% over the next 10 years, the number of jobs lost in the EEC would be seven million.[1] This figure alone shows how vital it is for the European economy to respond to the electronics challenge. In practice the opposite is happening. The number of jobs lost due to the application of electronics is multiplying in Europe while, increasingly, corresponding jobs are being created in Japan and America. Another vicious circle: the steady loss of jobs in the front-line sectors increases the decline in confidence in the economies of Europe and the draining away of European resources.

We have to look back in history to understand the implications of this sudden sterility, this dramatic eclipsing of Europe. For the first time since the 18th century the major formative initiatives of an industrial revolution are not originating in Europe. Europe is 'missing out' on the third industrial revolution.

232. The cost of non-Europe

In fact, it is not Europe which is missing out on this third revolution but non-Europe. In those areas where Europe is united, it constitutes a market equivalent to that of the United States. Thus, the necessary demand for development of new products and processes is there. So is the necessary supply, since together we have as much scientific, technological and industrial capacity as our competitors. Taken as a whole the countries of the EEC spend twice as much on research as Japan: between 1977 and 1981, $500 million was earmarked for microprocessor development in the EEC compared to 250 million in Japan. And yet the Japanese have managed to catch up with the United

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[1] See, in particular, Michel Richonnier 'Crises and new technologies', Paris 1982.

States, capturing 40% of the world micro-processor market, while Europe supplies less than 10%. Why? Doubtless there are several reasons, but the main reason is clear: the word 'Europe' can only be used in this context in an ironical sense. In this respect there is no such thing as Europe, there is only a non-Europe. As a result the same expenditure which in Japan is channelled into productive and job-creating investment is squandered in our countries on efforts which only destroy jobs.

Despite the fact that European cooperation is at its most relevant when it comes to the development of high technology, where economies of scale are most vital, our efforts seem, through some kind of perverse reaction against organizing our forces, to have concentrated on yesterday's sectors and sectors in which we have practically nothing to gain by working together. It is not Europe which is declining on the downward path of relative underdevelopment and non-growth. It is non-Europe.

We are beginning to pay the price. Not only in the form of increasing taxation, accumulating debts, failure to respond to the challenge of new technologies, and loss of jobs. More seriously we are suffering from laxity, irresolution, demoralization and insecurity. It is only a beginning.

How long will we go on paying this price? It is up to the Europeans to decide: we have seen in the preceding pages that there is nothing inevitable about what has happened, but that it is the result of many errors and in particular a lack of awareness. If things continue there will be, in less than ten years' time, a new category of country alongside the developed countries and the developing countries: namely the countries which are becoming underdeveloped. Lack of unity will have made of Europe a new 'geographical expression'.

CHAPTER III

THE IMPOTENCE OF THE STATES

31. A unique case

The Member States of the Common Market have retained control of all the various instruments of economic and financial policy. Up to 1973 these instruments were, on the whole, used to achieve closer economic convergence and to pave the way for genuine economic and financial union.

The crisis put a stop to this development. Over the last ten years or so a wide variety of policies have been pursued, based on widely differing, often diametrically opposed, doctrines ranging from Keynesianism to monetarism which, taken as a whole, constitute a unique body of experience.

On inflation and the external balance of payments there are increasingly marked divergences in performance from one country to another. Growth rates, on the other hand, have tended for several years to converge, but around zero. Even countries like Italy and France, which consistently managed to achieve growth rates around 1% above the average prior to 1973, have gradually lost this lead and are now running at around the average rate. This is especially puzzling given that the two main constraints affecting growth-orientated policies are precisely the inflation rate and the external balance of payments.

There are two explanations to this paradox. The first - which is well-known - is that certain countries suffer from internal imbalances which penalize them even if their performance is on a par with the others. The second aspect - less well-known - is that none of the Community countries, even the most powerful among them, is able to achieve a growth rate significantly above the average.

It might be thought that the countries which, like Germany and the United Kingdom, have had the most success in their efforts to restore a healthy economy in recent years would have a growth rate considerably higher than the others. Closer examination shows that this is not the case.

32. <u>The obstacles to the countries in disequilibrium</u>

These countries can be divided into two categories.

The first consists of the small countries (Benelux, Denmark, Greece and Ireland). In order to escape the recession, all these countries began, after the first oil shock, to run up deficits, either internal or external, and quite frequently both. Today they are not only suffering the full effects of the world recession but they are also forced to pay a higher price for their earlier profligacy, since in their case demand is by definition almost all external. Thus, they are only just setting out on a long road of tribulation where they will be obliged to depress domestic demand, including household consumption. Not only will they be unable to benefit as they should from the current economic upturn, but they will also have to make further drastic cuts in their production system in order to restore balance.

The prospects for growth in France and Italy are also poor because of the imbalances which persist in these two countries: the gap between unit costs and productivity, the inflationary trend constantly being fuelled by index linking, and so on.

But that is not all.

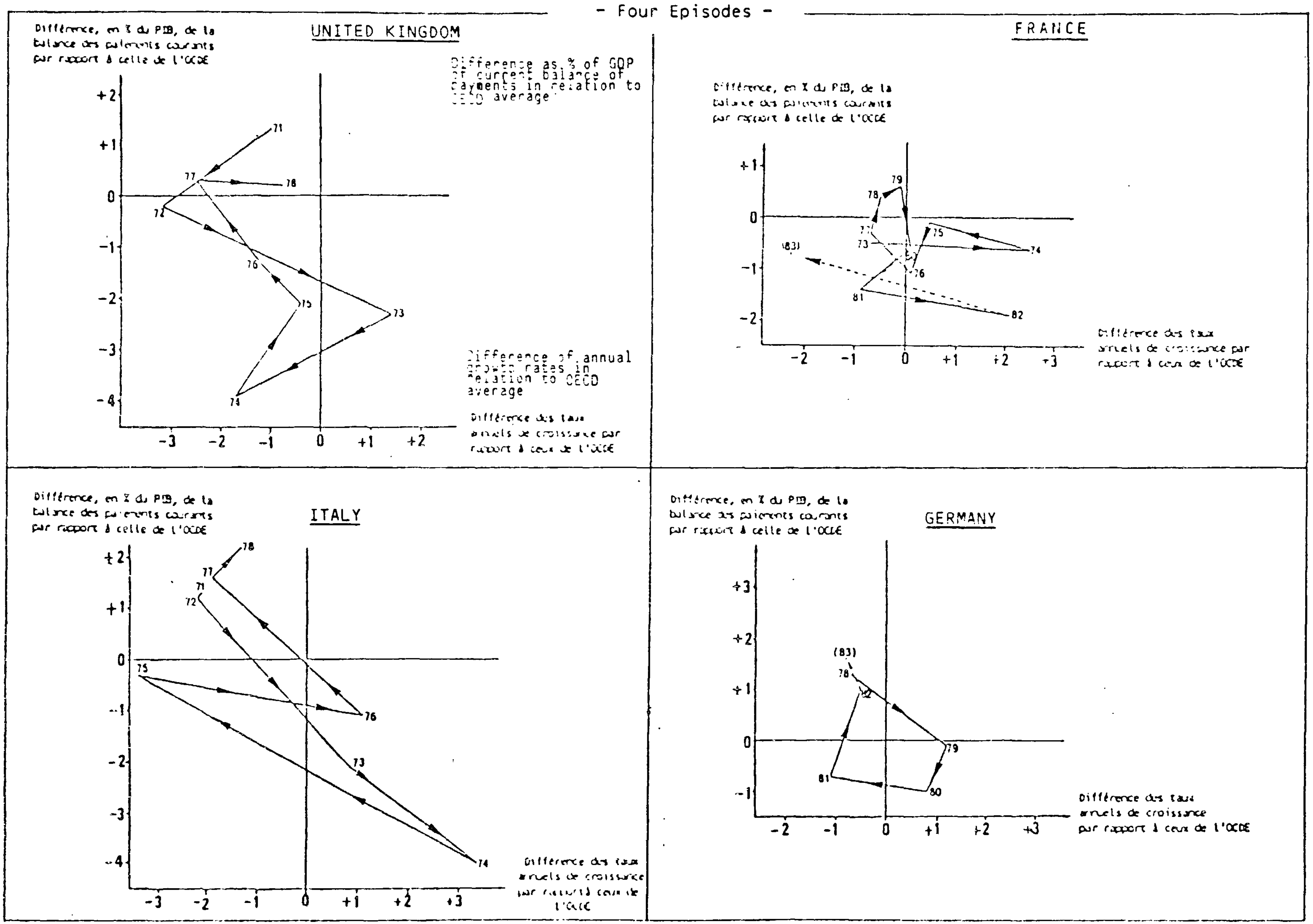
Shortly after the first oil shock, the two Latin nations of the Common Market discovered to their cost that, if they attempted in isolation to improve their growth rate, they ran into the problem of external disequilibrium. But, in this context, the case of the United Kingdom is possibly the most significant.

In 1973, as the reader will recall, a system of floating exchange rates was introduced. A number of countries believed at that time that this would free them from external constraints and that, at the risk of a fall in the parity of their currency, they should take advantage of the new system to get rich more quickly. This temptation was particularly strong in the United Kingdom's case since its economy had been stagnant for a long time. So, as Graph No 2 shows, it reflated its economy in 1973 to the point where its growth rate was 1.5% above the OECD average. However, at the same time it amassed an external deficit of almost 4% more than the OECD average of

Graph 2

GROWTH DISPARITIES AND RELATIVE POSITION

OF BALANCE OF PAYMENTS ON CURRENT ACCOUNT



GDP in 1974 and ended up in 1978 with a growth rate of 6 points below the OECD average as the price for the small gain of 1.5 points in 1973!

The even more pronounced zig-zag trend in the graph for Italy indicates here too, the same clear pattern of cause and effect.

The French example undescores the same point (graph No 2): the two comparable experiments carried out in 1974 and in 1982 underline the severity of the increasingly harsh law that in Europe even the 'major countries' must subject themselves to external constraints as soon as they have increased their growth rate. This was true in the case of France which, after taking steps to expand consumption in 1981-82 which enabled the growth rate to be increased by 0.2% in 1981 to 1.8% in 1982 was obliged to adopt restrictive counter-measures equivalent to a reduction in growth of at least 3 to 4% of GDP.

These policies for stimulating the economy by reflating demand, when pursued in isolation, have therefore been self-defeating. They have had the opposite effect to that intended: instead of providing a boost to growth, the ultimate outcome was a net decline in growth.

33. Can the 'locomotive' work?

But, the argument goes, these three countries were already in a precarious or even unbalanced situation in certain respects. This is not true of the Federal Republic of Germany today. What has been said above merely serves to highlight Germany's potential as a 'locomotive' for growth in Europe.

First of all, it is the most powerful and therefore the most autonomous economy. Secondly, since 1982 it has recorded a substantial external surplus and a negative growth differential. Thirdly, in Germany, as in Switzerland and Japan, control over incomes appears to be firmer than in the Anglo-Saxon countries since it has been arrived at not so much by the disciplinary method of monetarist constraints imposed from outside but more by a 'social consensus' based on trust involving free negotiation between both sides of industry, each aware of the urgent need to avoid a return to cost-push inflation.

In assessing the extent to which Germany might be able to play this role of locomotive effectively, it is illuminating to study the experience of the period 1978-79.

In 1978, the economic situation was not unlike that of 1983: oil prices were beginning to fall in real terms, inflation was falling and so were interest rates. Business confidence and investment were picking up. Nevertheless, as Graph No 2 shows, Germany was paying for a substantial external surplus with a growth rate nearly 1% below the OECD average. Its public spending programme was being trimmed and the gap between real wages and productivity had been significantly narrowing since 1975. Hence there were very good reasons, both nationally and internationally, why Germany should exploit its unused margin for growth and play the role of 'locomotive' which its European partners and the United States were asking it to play.

This it agreed to do after much hesitation, implementing the decision taken by the Bonn Summit of 16/17 July 1978 which organized concerted action to stimulate the economy by increasing the budgetary deficit of the Community countries by an average of around 0.6% of GNP. However, Germany played the principal role in this concerted action, accounting alone for half of the increase in the overall deficit in 1978 and being virtually alone in pursuing the same policy in 1979. This joint experiment was interrupted in February 1979 by the revolution in Iran which was to trigger the second oil shock.

Nevertheless, the results obtained are significant on two counts:

- at the level of the Community, the results for the first half of 1979 were up to the new target, namely 4.5% as compared to the previously forecast growth rate of around 2.7%; this was the best performance achieved by the European economy since 1973.

  This helps to explain why certain of Germany's partners are now urging it to reintroduce a similar policy;

- domestically, the stimulation of demand enabled Germany to speed up investment until 1980, accompanied by a slight drop in unemployment which made it unique among the Community countries in the period between the two oil crises. However, this acceleration of growth made the German economy more vulnerable to the second oil shock, causing a deficit in the balance on current account for the first time in Germany which persisted from 1979 to 1981. This prompted restrictive counter-measures and these brought in their train a dramatic increase in unemployment which contributed more than somewhat to the resignation of Chancellor SCHMIDT in 1982. It is understandable that this 'locomotive policy' has not left only good memories in the Federal Republic of Germany.

As a result certain misunderstandings have arisen regarding the new margin of expansion achieved by Germany. In 1983, it will have a surplus on current account of around 1% of GNP. How much extra growth could this surplus sustain? The reply is to be found in Table No 6 (upper part): this example shows that if the Federal Republic's growth rate were 1% higher the result would be a decline in its external balance of payments equivalent to 0.5% of GNP. The net increase in growth would therefore be around 2%, but the public sector deficit, already difficult to bear, would increase by around 1.2% of GNP (2 x 0.6%). It should be stressed that, in view of the size of Germany's budgetary deficit, the German authorities consider that it cannot be increased any further under any circumstances. Consequently, Germany is trapped: even with its powerful and healthy economy it can do virtually nothing to improve its growth during the 1980s because of the errors which - though to a lesser extent than others - it committed during the 1970s. In spite of its disinflation and its external surplus, the course of sacrifice on which it has embarked leads only to a dead end[1].

Furthermore, however desirable it might be for Germany's partners to make use of the German margin for expansion, it would only have a limited effect on their economies. The mechanical effect of an additional one per cent growth in Germany would, in the second year, amount to no more than approximately 0.1% for France and Italy (0.12%); it would be slightly higher for the Netherlands (0.24%), Belgium (0.2%) and Denmark (0.16%), but insignificant for Ireland and the United Kingdom.

The lesson to be drawn from these experiments is extremely important for the Community, namely that any Member State - even the most powerful of them - which autonomously pursues a policy of recovery will soon discover that

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1 The German authorities should not be unaware of this since they are extremely anxious to find an escape route without compromising the gains they have made in the fight against inflation. The issue of 'Der Spiegel' for 6 June 1983 reported on a 'confidential' study drawn up by the Federal Ministry for Economic Affairs which, on the basis of hypotheses described as 'fairly optimistic', anticipated unemployment at around the 3 million mark from 1988 onwards, the 1983 average being roughly 2.3 million.

Table 6

EFFECTS OF AN INCREASE OF PUBLIC INVESTMENT OF 1 % OF GDP AFTER 2 AND 3 YEARS *

Effects on ↓	EC-10		D		F		I		UK		NL		B		IRL		DK		GR	
	Year		Year		Year		Year		Year		Year		Year		Year		Year		Year	
	2	3	2	3	2	3	2	3	2	3	2	3	2	3	2	3	2	3	2	3
										Individual action										
GDP growth	-	-	1,0	0,6	0,4	0,2	0,5	0,4	0,9	1,1	0,4	0,5	0,3	0,3	0,2	0,1	0,3	0,4	0,6	0,8
Trade balance/GDP	-	-	-0,5	-0,4	-1,0	-1,0	-1,0	-0,5	-0,6	-0,5	-0,6	-0,5	-1,3	-1,3	-1,0	-1,0	0,4	-0,6	-0,1	-0,3
Budget balance/GDP	-	-	-0,6	-0,8	-1,0	-1,1	-2,0	-2,3	-0,9	-1,0	-0,9	-0,9	-1,2	-1,4	-1,2	-1,4	-1,1	-1,1	-1,1	-1,1
										Concerted action										
GDP growth	1,6	1,5	1,9	1,8	1,3	1,1	1,4	1,5	1,6	1,8	1,3	1,5	1,3	1,4	1,5	1,6	1,1	1,2	2,1	2,3
Trade balance/GDP	-0,4	-0,4	-0,4	-0,5	-0,5	-0,5	-0,4	-0,4	-0,4	-0,3	-0,4	-0,5	-0,4	-0,4	-0,4	-0,4	-0,5	-0,5	0,1	0,1
Budget balance/GDP	-0,6	-0,7	-0,2	-0,2	-0,6	-0,7	-1,7	-1,9	-0,5	-0,6	-0,4	-0,5	-0,6	-0,8	-0,4	-0,5	-0,7	-0,7	-0,6	-0,6

* Comet III simulations

it is fooling itself. Any country that goes ahead and reflates derives only a short-lived advantage and must then pay the price of its gains and for a much longer period. Meanwhile, the short-term improvements which it has achieved merely benefit its trading partners. Thus, thanks to the economic revival of Germany in 1979, the sales of French cars in Germany beat all records. Thanks to the French economic revival, 1982 saw a spectacular increase of German car sales in France. In essence this means that in the EEC, where national economies have become so interdependent, those who take the initiative - and the risks - of an economic revival are working for the others .....

34. <u>It is no longer possible to go it alone</u>

It was not until 1982 that this fact became fully clear, i.e. that the EEC countries have virtually no scope any longer for autonomous medium-term expansion. <u>External</u> constraints, as we have seen, are all the more restrictive the smaller the country: France is less autonomous than Japan, and Belgium less so than France. However, France and Germany have now realized what Italy and the United Kingdom discovered after the first oil shock: as far as economic policy is concerned, they have become <u>small countries</u>.

<u>In other words, in the EEC it is no longer possible for a national economic policy to diverge above the average of the others without in due course prejudicing the national interest of that country. Any government which opted for such a course, moreover, would be playing into the hands of its opposition</u>.

In these conditions, the only way that national policies can continue to converge, as they have done since 1982, is towards a lower level, through curbs and restrictions of all kinds, in other words by cutting back growth and increasing unemployment. The vicious circle of Community recession is thus self-perpetuating.

Why this distressing dilemma? Why these harsh constraints? Because the more close-knit and developed an economy is, the more deeply it is involved in the fabric of international trade. International trade is, at one and the same time, a source of constraint and wealth. During the great period of prosperity, it increased twice as rapidly as the growth in production. That was no accident. In the medium term, the rate of increase in imports outstrips the rate of increase in per capita incomes. In the short term, the income elasticity of demand for imports is of the order between 2 and 4 in the European countries[1]. There are many examples of this: the development of tourism abroad or the purchases of Japanese audio-visual equipment increase far more rapidly than our incomes.

This new constraint is imperative. Any country attempting in isolation to free itself from it can do so only by drastically cutting the purchasing power of its people.

35. The multiplier effect of Community action

Does this mean that nothing can be done? That since no European country is able to act as a locomotive for the Community, the Community has no future other than as a goods waggon for the United States?

The answer is a definite no. All the studies show that Community action has a multiplier effect and that this multiplier only needs to be applied skilfully to revive growth without jeopardizing equilibrium. This is shown in Table No 6 based on the Comet III model on simulations.

The principle of these simulations is simple. It is assumed that the EEC countries' public investment during a given year is increased by 1% of GDP. It then examines two hypotheses:

(a) that this action is undertaken by each country individually

(b) that the same action is taken at Community level in a concerted manner.

The model then calculates, country by country, the effects of this initial impetus over the following two years on growth, external balance of payments and public expenditure. In each case, for the various countries and aggregates considered, concerted action is seen to produce a far better result. Hence the multiplier effect of Community action does exist. Joint action pays dividends. Depending on the individual country, the effect is of the order of 2 to 4 for growth and, compared with isolated action, an improvement of 20 to 66% for the external balance of payments and government spending.

[1] Having increased its growth rate by 1.6% between 1981 and 1982, France's imports increased by some 5% in 1982.

The finding is not confined to the COMET model used by the Commission in Brussels. All the studies carried out over a number ofyears confirm the existence of this multiplier. This is a factor and, to all intents and purposes, an instrument of extreme importance which could drastically alter the prospects for the European economy in the second half of the 1980s.

It is explained on the one hand by the fact that since half of the external trade of the Member States is intra-Community trade, any imbalances tend to cancel each other out. It will be readily appreciated that if Germany reflates its economy in isolation, its exports to France will tend to decline and its imports from France to increase. However, if France does the same thing at the same time, the two opposing movements will tend to cancel each other out. We have seen above (paragraph 33) that the smaller a country is, the greater the external constraint. Overall, the Community's rate of external dependence is of the same order as that of Japan and the United States (10 - 15% of GNP), while the rate of individual countries such as Germany or France is 25 - 30%. This demonstrates the wisdom of the maxim 'strength through unity', provided this unity is put to proper use.

For the purpose of these simulations it has been assumed that public investment is financed by an increase in the budgetary deficit. However, it is obvious that, with public spending deficits which are reminiscent of the financial management of the last of the Czars or of the Ottoman Empire, the Member States of the European Community are no longer in a position to increase these deficits, even in order to stimulate growth. We shall have to take account of this fact in the proposals in Chapter 5. It is clear from this last remark that in order to make effective use of the Community multiplier, the Member States must begin by putting their own house in order.

Putting a house in order involves cleaning up and straightening out. What scope there is for national autonomy in the medium term consists essentially of a choice between policies which accommodate inflation - a source of impoverishment - and policies to combat inflation which impose lasting sacrifices but are not sufficient in themselves to bring a growth rate noticeably higher than the average.

36. Two roles: policeman and Father Christmas

It is up to each individual country to fight inflation because inflation is due principally to three national variables: budgetary policy, monetary policy and the behaviour of prices and incomes. Of these three it is the last which is the most important, but it is also the most difficult to control because it is based on a paradox: in order for there to be lasting disinflation, in a world where market forces have little influence on the fixing of incomes, the two sides of industry must jointly acknowledge the validity of the following paradoxical equation: 5 is greater than 10. Indeed, if the nominal increase in incomes is 10, this will lead in the short-term to further inflation and in the medium term to lower average purchasing power. A nominal increase of 5% will ultimately result in greater purchasing power than a nominal increase of 10%. Unless these social responsibilities are recognized, the only way to a healthy economy is through monetary restraint. Ultimately it is the national governments who determine which course is adopted. Although the European Monetary System implies and encourages the convergence of economic policies, it cannot impose that convergence.

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Thus, future recovery of the European economy will become less and less the responsibility of the Member States; it now depends primarily on the international context in which these states act - first and foremost the Community. From now on we must accept this basic rule: Any country wishing to go it alone in pursuit of growth is bound to lose. Any country which, having put its own house in order, agrees to go for growth with the others and according to rules reflecting the collective interest is sure to gain by this action. Only the latter approach, the Community approach, is compatible with the interests of the 270 million Europeans and in particular the 12.5 million unemployed who have been somewhat short on good news in recent times.

The existence of the multiplier effect of Community action is of fundamental importance. Nevertheless, it calls for three remarks:

- this new situation as regards growth, namely that the repressive function is of necessity national and the permissive function is increasingly international, is the opposite of the distribution of roles which most of the Member States are trying to maintain within the Community - condemned to play the role of policeman when really they would prefer to play that of Father Christmas.

- by playing the role of Father Christmas, many governments are tempted to have people believe that in order to improve the economic situation of a country it is necessary to rely on them and to mistrust everything that comes from abroad. This is a fable, but the real moral of this fable is one of the best kept secrets. In fact the tendency of national economic policies to diverge so much stems from the widespread feeling that each country should distinguish itself from the others. This belief in the virtues of every man for himself, of national corporatism, runs counter to the new reality and goes a long way to explaining what, according to the chairman of the European Parliament's Committee on Economic and Monetary Affairs, is the most salient feature of the current situation in Europe: 'In 25 years the European Community has established itself as a real influence at international level; on the other hand, there is no longer a clear perception of the usefulness of the Community on the part of many of those who are active in the political, economic and social fields in the Member States[1].' But the result of all this is that the more the Member States refuse to practise convergence, the more they condemn themselves to play the stern policeman.

- but, even if governments and public opinion have not yet fully grasped it, this new reality is bound to establish itself more and more firmly because it is linked to the very development of their economies: the paradoxical recipe for growth in a developed i.e. interdependent, world is that real charity begins by being on good terms with the other members of the family.

At the same time, the traditional problem of sharing out roles between national governments and international organizations has been reversed. Public opinion rightly calls for a limit on the power of international organizations where such power is likely to be contrary to national interests. Today, however, where growth is concerned, exploiting the potential of the international organizations - and in the case of the Europeans this means above all the institutions of the Community - is the key to national progress.

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[1] 'Which European strategy for France in the 1980s? Report by Mr Jacques MOREAU and Mr Michel RICHONNIER for the Commission for National Planning. La Documentation Française, April 1983

Some ten years ago zero growth was the fashionable new idea in Europe and many people saw stagnation as a kind of perfect state.

It is now generally acknowledged that three years of zero growth have been enough to raise the number of unemployed in the ten countries of the Community to over 12 million. But that is not the whole story.

In the fossilised societies of zero growth each person becomes an obstacle to the other. Anyone who is already established can only remain by keeping out the newcomer, the young person, the foreigner - in other words, the weak. No one can improve his situation without worsening someone else's. Soft growth makes for hard societies and slow growth for run-down societies.

It is no accident that the history and geography of democracy and public freedoms coincide with the history and geography of economic growth. The two must be consolidated if we are to restore the growth of the European economy.

PART II

EUROPE'S STRATEGY FOR RECOVERY

The European economy has not merely been stagnating for three years: it has been in decline for ten years. This decline - if it continues - will be increasingly painful for individuals and dangerous for society as a whole.

However, no state is capable any longer of escaping from it by its own resources. The recovery will be Community-wide or there will be no recovery.

How is it to be organized?

1 - First by beginning to understand where the common interest lies. At first sight this seems utopian: the social, economic and political forces - particularly the individual states - are constantly vying with each other, each trying to increase its share of the cake. But precisely where does this lead? To the opposite of what was intended. The reason the growth in real incomes in Europe is tending towards zero is largely because for nearly 10 years we have been doing our utmost to raise them excessively: the more a particular professional group or state tries to increase its share of the cake at the expense of the others, the smaller the cake becomes. Ultimately, therefore, they are damaging their own interests.

This surrealistic process is absurd to such a degree that one day it must inevitably come to an end. Chapter 5 has been written in preparation for that day. It demonstrates how, as from now, we can improve the outlook together, in a modest but radical manner and at little cost. The most difficult part is not making the effort but understanding - and making everyone else understand - where the real point of that effort lies. Assuming that they can satisfy that condition, Europeans are capable collectively of generating the momentum for growth with stability proposed in Chapter 5.

2 - The three chapters which follow propose a response to the three major challenges of our time:

- the <u>technological challenge</u> which is endangering European industry (Chapter 6);
- the <u>energy challenge</u> and how to ensure that not only the least-favoured regions of the Community but also the applicant countries, the African, Caribbean and Pacific (ACP) States that have signed the Convention of Lomé and the countries of the Mediterranean basin share in the progress achieved (Chapter 7);
- the <u>challenge of unemployment</u> and how to open the way towards a <u>new concept of full employment</u>. We shall look at ways of reducing and reorganizing working hours in a manner which does not affect the competitiveness of the economy (Chapter 8).

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These broad guidelines do not amount to a complete programme nor a detailed list of decisions. But they do form a coherent entity whose individual components are interactive. None of the proposals is above discussion. They will have a far greater collective impact if they can be further enriched by greater awareness and debate.

CHAPTER 4

EUROPEAN ECONOMIC RECOVERY

by Professor R. J. Ball[1]

We are substantially in agreement about the diagnosis of the economic problems of the European Community. I accept much of the analysis of the situation as presented in the first three chapters of the report which might be summarised as follows:

41. **The Economic Problems of Europe: Analysis**

The economic problems of Europe have in part stemmed from the general problems of financial instability reflected in fluctuations in interest rates and exchange rates following the breakdown of the Bretton Woods Agreement.

In addition, the response of the Community to the two oil price shocks have resulted in an excessive burden being imposed on the private sector as a result of the failure of governments to ensure that the public sector shared equally in the adjustment process.

Furthermore the expansion of fiscal deficits, in some cases also associated with substantial monetary growth, has been used to protect public consumption including social transfers at the expense of the business sector.

At the same time, the burden imposed on private industry has been borne in the main by profits rather than wages, which has reduced the rate of investment and impacted on the level of employment.

Finally, the inflexibility of the labour market, when combined with major increases in non-wage labour costs, has reduced profitability and had led to the substantial loss of jobs in the Community so that companies could maintain international competitiveness and survive in the long term.

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[1] In preparing this chapter, I am grateful for the assistance I have received from Mr J.S.N. DREW.

This analysis does not imply that the growth in unemployment in Europe is simply related to the inappropriateness of real wage levels. Equally it does not say that the explanation of rising unemployment that cannot be ascribed to an excessive growth of real labour costs can be attributed to something that is described as a general deficiency of demand. Those who believe this recommend that part of the programme for European recovery should entail a general relaxation of fiscal policy and we do not support this.

Those favouring fiscal policy relaxation fail at the outset to distinguish whether they are talking about real or nominal demand. Of course, the approximate cause of a rise in unemployment is a fall in real demand. But this is nothing more than a truism. Policy does not directly affect real demand. It affects it only through its influence on nominal demand. A starting point for the argument that, in some significant sense, demand has been deficient and therefore accounts for the rise in unemployment since the second oil price shock must rest its case on a deficiency in nominal demand. But nominal demand or expenditure in the Community since the second oil price shock has risen at an average rate of 11% per annum compared with 13% between 1971 and 1980 and 9.1% between 1961 and 1970. Since the second oil price shock, the overall money supply in the Community, as measured by the broader definition of money, has risen also by 11% a year in line with total spending. By historical standards, in nominal terms these are not excessively restrictive figures.

It is, I believe true that the rise in unemployment in the Community, as elsewhere, is not due solely to inappropriate levels of real wages. It is surprising that certain recent commentary suggests that anyone would suppose that it was. However, the rise in unemployment is equally not due in any significant sense to a lack of demand, but in the main to a major imbalance between monetary and fiscal policy. This is not to discount other factors such as demographic trends, new technology, the employment of women and the rate of anticipated growth.

It is hard to believe that the monetary targets pursued generally, both within and without the Community, have been in any historical sense particularly tight. They have in a sense been made so by substantial fiscal deficits which have resulted in both high nominal and real interest rates for given monetary targets. For a given monetary target, the more governments have to borrow as their deficits rise, other things being equal the higher will be the level of interest rates. In the case of the United Kingdom in 1980 and the United States more recently, this kind of imbalance between monetary and fiscal policy has had material effects on interest rate levels and subsequently on exchange rates, with concomitant effects on the profitability of existing business and of new investment. But this has not been the result of any general lack of monetary demand as such, but of the inherent inconsistency of fiscal and monetary policy.

The European situation regrettably reflects all these influences. In the case of the United States, there is no evidence that the oil price shocks have reduced either the underlying rate of economic growth in absolute terms or the underlying rate of return on investment. It is true that productivity growth overall in the United States has shrunk to zero. Nevertheless, both the United States and Japan were able to generate major increases in employment between 1974 and 1980.

42. The Economic Problems of Europe: Seven key observations

Much of the remainder of this report deals with industry and employment and suggested policy areas where action could be taken at the European level. We have broadly agreed on the analysis, the seriousness of the present situation and the desirability of certain ends. Although we are not able to agree the means and we write separately about these, we do wish to make a number of observations in common which follow in part from our analysis:

- The importance of dialogue with the United States
- Exchange rate stability and the EMS
- The balance between fiscal and monetary policy
- The importance of creating the right economic environment
- The importance of economic and political expectations
- The importance of a genuine change of will on the part of Member States
- The importance of changes in labour market expectations, private sector growth and public sector restraint.

The importance of dialogue with the United States

Fiscal and monetary policy in the Communtiy cannot in general be set without regard to the international world as a whole. Any consideration of the Community's absolute and relative stance with regard to fiscal and monetary policy should be seen in the context of the Community's relations and dialogue with the United States. The future behaviour of the United States' fiscal deficit and the associated effect on interest rates must remain the most serious threat to sustaining the recovery in output that is taking place both in the United States and elsewhere. International financial stability should be achieved in cooperation with the United States and Japan. While the Community has achieved something through the existence of the EMS, as is reflected by the recent round of exchange rate adjustments, there are strict limits to what can be achieved in the absence of any general agreement with the United States as to the future of the international monetary system. The Community should take the initiative to establish a more effective working dialogue with the United States with regard to the international implications of fiscal and monetary decisions. Such a dialogue should move on a working and continuous basis rather than be related to sporadic summit meetings, and might be conducted within the framework of the International Monetary Fund. Such a development might pave the way toward a more general agreement with regard to the convergence of policies, which is currently so hard to achieve.

Exchange rate stability and the EMS

As far as the more internal considerations of the Community are concerned, it must be reiterated that exchange rate stability is ultimately rooted not in institutions *per se*, but in the conduct of national economic policies. Those who are sceptical about the EMS have felt that, to some extent, the founders of the EMS put the cart before the horse, and judge that the current system is in effect no more than a crawling-peg arrangement which has at least facilitated the responses to divergent macroeconomic policies rather than brought about any further convergence. Views on this matter differ. However, further development of the EMS and any extension of its influence makes necessary the participation of the United Kingdom and a more generalised use of the ECU. Some of the initial objections of the United Kingdom to joining the system, such as the substantial initial divergence between its monetary stance and that of the Federal Republic, no longer seem as relevant as they did and indeed - apart from the benefit to the Community - there may be some logic from the United Kingdom's own point of view in using membership of the EMS as part of the process of preserving monetary and price stability that has been achieved domestically.

The balance between fiscal and monetary policy

We continue to believe therefore that there is some way to go in the Community to restore a proper balance between fiscal and monetary policy as a step toward the lowering of inflation and real interest rates and stabilising exchange rates. In this context we believe that monetary growth, taking into account changes in velocity, should be targetted on an acceptable rate of inflation plus a realisable rate of economic growth. Such targets will clearly vary from country to country. At the same time, there should where appropriate be a progressive reduction in the observed fiscal deficits as part of a general process of lowering both real and nominal interest rates. The precise mix of fiscal and monetary policy will clearly vary from country to country. However, any general relaxation of fiscal policy in the Community as a whole is likely to increase both inflationary expectations and nominal interest rates. A belief in the power of incomes policies to alleviate the effects of a major expansion of nominal demand on prices and incomes is little more than wishful thinking. Attempts to divert domestic expansions of nominal demand to domestic outputs by the use of import controls of one kind or another would only return us to the trade conditions of the thirties, and are in any case inconsistent with the spirit and raison d'etre of the Community.

The importance of creating the right economic environment

Our view about economic policy is that it is substantially about creating environments within which economic agents can function more efficiently. Whatever changes one makes in the economic environment to enable agents to behave more efficiently, one can never guarantee that they will. There are, however, some medium term policies which we describe below in paragraph 25 and which we support. There is a margin of manoeuvre for better growth, employment and stability given the will of member states in the medium term.

The importance of economic and political expectations

Economical and political expectations are a key, if not the most important, part of that environment which dictates how economic agents will behave. Europe's economic problems, in our view, have originated in excessive expectations about increases in real incomes in changed economic circumstances, and excessive expectations as to the provision of increased real public welfare which is mistakenly perceived to be provided free. These expectations have been manifested in wage and price behaviour and the imbalance between the public and private sectors since the oil price shock of 1973 and probably before. Inflation and employment in Europe, which is in large measure of a different kind from that in the US is, in our view, a reflection of the gap between expectations and reality. The political process in Europe has in large measure accommodated those expectations. Europe's position in the world is largely its own fault. Moreover, on top of these expectational problems which, to some degree or other, have existed throughout the Community, the interests of national governments have seriously prevented any attempt to make the Community an economic reality.

The importance of a genuine change of will on the part of the Member States

This leads us to the two most important conclusions that we would like to get over both to politicians and to the public, before any detailed consideration whatsoever of specific economic policies. In the first place, without any genuine change of will on the part of national governments, economic initiatives, whether promoted by the Parliament or by the Commission, are likely to be quite ineffective. This change of will requires a change in public opinion. We hope this report will contribute to this change.

The importance of changes in labour market expectations, business sector growth and public sector restraint

Secondly, no real and lasting change in European competitiveness and growth potential is likely to come about unless associated with changes in labour market expectations and their associated costs and changes in expectations as to the importance of the private sector and the need to restrain public sector growth. Given the fundamental nature of the problem that has arisen over a period of years, we need to be cautious. There is no set of short term economic policies that can be devised to produce a rapid alleviation of the problems of slower growth and high unemployment. It is for this reason, we believe, that we have wisely chosen to reject the word 'relance' in favour of the word 'redressement'.

43. Industry and the European Community

With regard to the industrial position of the Community, I am in much agreement with many of the sentiments put forward by M. Albert in Chapter 6 of the Report. The Community has failed, and continues to fail, to produce a common market. National interests continue to predominate in industrial matters. The need for increased standardisation in the Community is paramount if it is to mean anything to its member states in the immediate future. The need for a common public procurement market is a part of the story. But little is likely to happen without a major change of will and an increased commitment among the member states.

If the Community is to mean anything in industrial terms, there must be a meaningful European industry. The development of such an industry requires a new perception of and commitment to the integration of European industry at the company level. It is not Europe that competes with Japan and the United States. It is ICI that competes with Dupont, BMW that competes with General Motors, Olivetti that competes with Xerox, Philips that competes with Matsuchita. Strength must be created at the level of individual companies. Specialisation within the Community must become a reality. Rationalisation of basic commodity industries within the Community must not simply represent a sharing of the pain among its members.

Much of this does not require vast amounts of money. It requires leadership, commitment and organisation. If the will and commitment are not there, no amount of money will make a reality of European industry exploiting in any significant way the benefits of a large internal market.

An essential element in the development of the concept of a European industry must entail a radical re-appraisal of Community competition policy as applied by the Commission. Indeed, in the light of the recent decision with regard to Philips and Thomson Brandt, national competition policies should be examined with regard to European needs. It is a clear nonsense that, while many - (including M. Albert in Chapter 5 of the Report) - call for a European policy for information techology, the major European companies in the field are busy signing agreements for Japanese technology rather than undertaking a programme of European integration. A revised competition policy should apply equally to private and public corporations where they are competing in the same markets.

As part of the process of establishing a dialogue with regard to the integration of European industry, I propose that there should be established, under the auspices of the European Parliament, a European Industrial Council of business leaders within the Community and members of the European Parliament. Such a Council would provide a forum for discussion of the problems of the development of European industry. It should be supported by the Commission services to the extent this is consistent with its rights and duties under the Treaty of Rome.

Some options are discussed at Appendix A. The role of the Economic and Social Committee and its relations with the Parliament is fundamental to this suggestion. It may be that the ESC could be involved in the proposed European Industrial Council in a positive way. We are aware of the difficulties in suggesting yet another organisation. However there is an urgent need to provide informed input to the Parliament to improve the level of its knowledge and debate on complex industrial issues.

44. Employment and the European Community

We turn lastly to the important and difficult question of unemployment. Unlike many commentators, I personally do not see unemployment in Europe growing continuously and inexorably without limit, for the reasons given below. It is clear that, whatever policies are pursued, however, unemployment levels in the Community as a whole will continue to rise in the immediate future, but I am not at all clear that this trend will continue beyond 1984. M. Albert's views and mine differ not on the seriousness of the issue but on the likely trends and therefore on the type of policies which might need to be adopted.

The truth of the matter I believe is that forecasting the behaviour of unemployment in the Community is an even more uncertain occupation than ever before. The forecasts that have been made with regard to unemployment, given certain forecasts about the future growth of real output, are in most cases relatively naive extrapolations based on mechanical interpretations of the past. None of the economic models of which I am aware for any of the Community countries has adequately modelled the behaviour of the supply side of the economy in general, and the behaviour of the labour market in particular. Most existing forecasts do not reflect the influence of real wage behaviour and profitability on the level of employment. To the extent that one believes that real wage behaviour is likely to be moderated at least for some time by the very existence of heavy unemployment in itself, one cannot but believe that there are some corrective forces operating through the market system that will mean that the generality of unemployment forecasts into the eighties are likely to be pessimistic. Wine lakes dry up, butter mountains melt and, in the long run, even unemployment will fall if we are to place any modest credence in the working of market forces.

None of this is to predict an early fall in unemployment levels in the Community, or to suggest that nothing should be done to alleviate the economic and social consequences that are abundantly clear to us. However this does mean in my view that we should start from the premise that, in the end, market forces will tend to reduce unemployment and that the market will work to price people back into work. However, given the intransigence of organised labour which has contributed to the inflexibility of labour markets, this is a process which will take years rather than months

From this point of view it is therefore crucial, I believe, that nothing should be done within the Community to inhibit the process of market adjustment in getting people back to work. Against this background, proposals for work-sharing and a re-organisation of the basic economics of work are merely attempts to treat the symptoms of the disease rather than the underlying problem. It is about time that the Community as a whole had the courage to face the reality of the unemployment problem which has in part been rooted in restrictive labour practices, which devices like work-sharing will only paper over and underwrite. Michel Albert's views which differ from mine are set out in Chapter 7 and my further comments are in Chapter 8.

45. Towards a European policy for economic recovery

Against the background of the seven key observations (paragraphs 8-15), we would support the following policies, which we think would assist in the process of achieving a more satisfactory economic environment and encourage the development of a new sound basis for the further growth and prosperity of Europe.

a) Measures designed to reduce monetary growth in line with a sustained inflation target in Europe of less than 5%, coupled with a progressive reduction in the budget deficits of member states overall.

b) Measures to alleviate the social distress caused by unemployment, including aid to early retirement and the provision of training facilities and special job schemes for young people.

c) A reconsideration of capital expenditure programmes by member governments, and an encouragement to undertake public capital ventures designed to provide increased services and facilities for private industry.

d) The development of an effective energy policy, combined with possible initiatives both with regard to energy saving and energy augmentation at both the country and the Community level, possibly linked to the suggestion of an import tax on oil.

e) Measures to facilitate a greater flexibility in the labour market.

f) Community initiatives to facilitate the rationalisation of basic commodity industries within the Community, and to encourage and support the creation of European companies through mergers acquisitions and joint ventures, particularly in the high R and D technology and energy fields. (Added to a reconsideration of Community competition policy in this context - see paragraph 19).

g) Consideration to be given to the way in which the Community might facilitate restructuring by bearing some of the costs that normally fall on private companies in this process.

h) The development of a constructive Community policy with regard to overseas investors, integrating their contributions into the development of the Community rather than treating them as invaders hostile to domestic industry.

These constitute broad headings under which, no doubt, there are many specific things that might be done with which we would have sympathy. I would not have sympathy with any of the following, which roughly speaking divide into two. The first is any policy or set of policies which seem to represent the treatment of the symptoms of Europe's underlying ecomomic problems, with the sole exception of the alleviation of the distress directly experienced by the unemployed. These include incomes policies, protectionism, the subsidization in general of private investment other than, perhaps, in energy creation or energy saving, all of which represent a papering-over of the cracks, and which will encourage politicians to go on trying to accommodate expectations that are inconsistent with reality.

Secondly, we do not believe that expansion in Europe is synonymous with accelerating monetary growth and rising national fiscal deficits. This is not to say that, over short periods, monetary and budgetary policy in any one country may not be too tight. We have sympathy, for example, with the argument that US monetary policy may have been too tight during part of 1982. But none of this gives credibility to the view that there should be some major expansionary shift in fiscal and monetary policy. Much will be gained from a continued attempt to achieve a more appropriate long-term balance between monetary growth and the fiscal balance associated with a further reduction both in interest rates and the rate of inflation.

As regards policies under the headings mentioned in paragraph 25, many are already being actively developed by the Community institutions. We would like to see the European Parliament proposing a comprehensive and consistent set of actions to support these policies.

In Chapter's 6, 7 and 8 Michel Albert proposes certain actions which he believes will contribute to the debate. I have studied them with interest and we have discussed them during our meetings with experts from business, trades unions, government and academics across Europe. My comments on these proposed actions and the reasons why I cannot agree to them are set out at the end of this report.

CHAPTER 5

THE NEW MOMENTUM FOR GROWTH WITH STABILITY

Since the establishment of the Common Market, the Member States have passed through three stages: a high level of growth without inflation during the 1960s; low growth and high inflation during the 1970s, and finally inflation with zero growth. Even though some countries (United Kingdom, Federal Republic of Germany, Netherlands) have brought inflation under control, they are still suffering from the recession. Each country is in fact its own and the other countries' prisoner, when only a slight increase in overall growth - albeit under quite specific conditions - would be sufficient to alter the climate, to create a new momentum which would be self-sustaining, in a word to change from decline to recovery. The EEC would thus contribute to the preparation of a new world economic order based on the stabilization of exchange rates and the development of trade and solidarity between nations.

How is this to be achieved?

The main difficulty is psychological rather than technical. Before spelling out the proposed macroeconomic policy[1], we must emphasize again that, in isolation, the Member States are powerless, paralaysed.

51. An extra 1% for three years would be enough

511. The paralysis of the Member States

Let us look first at the countries which have managed to shrug off inflation.

After all their efforts, and at a time when it is urgently necessary for them - particularly because of worsening unemployment - to reap the benefit, they appear to be paralysed. First by what we have called in Chapter 3 the 'Father Christmas and policeman' approach and secondly by the size of the persistent deficits. Investment, which is at the root of all lasting growth, cannot be self-generating as long as public budgets and company balance sheets have not been restored to a balanced state. On the one hand, it is no longer possible to continue raising taxes as in the past and, on the other hand, President Reagan's experience is a demonstration of how difficult it is to cut public spending.

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[1] See annex 2.

This paralysis in budgetary policy is so inhibiting that in the spring of 1983 the UK and the FRG have been obliged to expand their money supply, by around 4% and 7% respectively in real terms. Even though there was some room for slackening the control over the money supply, these figures are nevertheless very high. They indicate that the monetary authorities in these countries are so worried about the risk of stifling any cyclical upturn that they prefer, by relaxing the controls over the money supply, the risk of a return to inflation in two years' time.

This is a serious risk. It is our duty to emphasize this, especially since it is likely to rebound on the second group of Member States, i.e. those who like France and Italy are still in the grips of inflation. These countries, which are still only at the first stage in the essential reorganization of their economies, are even more paralysed than their partners.

What do all these countries need most? The answer is more collective growth. This can only lead to a real recovery, however, if certain very strict conditions are observed.

52. <u>The conditions for collective pump-priming</u>

In order to define these conditions we have used the forward projections for 1984-86 which are summarized in Tables 3 and 4 (Chapter 2 - No. 21). This projection is reproduced in Tables 7 - 9 and in graph 3 which compare the likely development on the basis of current trends with the assumption of a 1% annual increase in growth over three years (end columns)[1].

These tables show that it is possible to achieve three very important objectives simultaneously:

- a stabilization of real per capita incomes (Table 9 - line 10 - columns 9 to 11) in spite of a slowdown in the growth of nominal wages and a further reduction in working time (1.9% as opposed to 0.7% according to current trends) (Table No. 7 - columns 6 and 7, line 5); without this reduction, real wages would rise by as much as 0.8% p.a.[2].

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[1] This period (1984 to 1986) has been chosen merely to illustrate the argument. Naturally in more detailed studies more complex timescales would have to be considered

[2] This is particularly important, for the trend in real wages tends towards zero - and may well become negative - without a recovery in growth

EEC

Table 7 ASSUMPTIONS CONCERNING GROWTH AND EMPLOYMENT UP TO 1986

EUR - 10

	1961-70	1971-80	1981-83	1984 - 1986			
				Comet projection based on current trend e)	Example 'Super-growth'	1% extra growth assumption	
						A: without Δt c)	B: with Δt d)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Average annual percentage variation						
1. Working population	0,2	0,6	0,4	0,7	0,8	0,7	0,7
2. GNP in volume	4,7	2,9	0,1	2,3	7,1	3,3	3,3
3. Employment	0,2	0,2	- 1,3	0,1	1,1	0,3	1,1
4. Productivity 4=3:2	4,5	2,7	1,4	2,2	5,9	3,0	2,2
5. Working hours a)	(-0,8)	(-0,8)	-	(-0,7)	(-0,7)	(-0,7)	(-1,9)
6. Hourly productivity 6=4:5 b)	(5,3)	(3,5)	-	(2,9)	(6,7)	(3,7)	(4,2)
	Levels at end of period						
7. Working population (millions)	109,2	116,2	117,6	120,1	120,4	120,1	120,1
8. Employment (millions)	107,1	109,1	104,9	105,2	108,4	105,8	108,3
9. Unemployed (millions)	2,1	7,1	12,7	14,9	12,0	14,3	11,8
10. Unemployment rate in % 10=9:7	2,0	6,1	10,8	12,4	10,0	11,9	9,8

a) and b) Estimates or assumptions
c) Assumption A : no additional reduction in working time (trend = 10.7% per year)
d) Assumption B : including additional reduction in working time (1.2% per year, giving a total of 1.9%)
e) Most recent Comet projection adjusted to allow for new data for 1983

EEC

Table 8

ASSUMPTIONS CONCERNING WAGES, PRICES AND CURRENCY

	1970/1960 a)	1980/1970 a)	1981 b)	1982 b)	1983 b)	Comet c)			Assuming extra 1% growth B d)		
						1984	1985	1986	1984	1985	1986
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1. Nominal per capita wages	8,9	13,3	11,5	9,6	7,2	6,4	6,0	5,6	6,0	5,2	4,2
2. GNP prices	4,3	9,8	9,1	9,2	6,8	6,0	5,8	5,5	6,0	5,2	4,2
3. Real per capita salaries $\frac{1}{5}$	4,4	3,2	2,2	0,4	0,4	0,4	0,2	0,1	0,0	0,0	0,0
4. Productivity $\frac{GNP}{POC}$	4,5	2,7	1,2	1,7	1,5	1,9	2,3	2,4	1,7	2,6	2,5
5. Corrected salary share $\frac{3}{4}$	-0,1	0,5	1,0	-1,3	-1,1	-1,5	-2,1	-2,2	-1,7	-2,6	-2,5
6. Wages costs per unit produced $\frac{1}{4}$	4,2	10,3	10,2	7,8	5,6	4,4	3,6	3,1	4,2	2,5	1,7
7. Nominal GNP	9,1	13,0	8,7	9,6	7,3	7,8	8,4	8,3	8,7	9,1	8,2
8. M2/3O	10,4	14,0				9,0	9,5	9,5	9,7	10,1	9,2
9. Liquidity ratio $\frac{M}{GNP}$ = 8:7	1,2	0,9				1,1	1,0	1,1	1,0	1,0	1,0
10. M/P : 10 = 8:2	5,8	3,8				2,8	3,5	3,8	3,5	4,7	4,8
11. M/WCVP = 8:6	6,0	3,4				4,4	5,7	6,2	5,3	7,4	7,4

Sources:
a) European Economy No. 14
b) Economic budgets May/June 1983
c) Reference simulation, 'spontaneous' evolution based on economic budgets for May/June 1983
d) Simulation including additional 1% growth, incomes policy and additional reduction of working time having no effect on costs

Table 9 | ANNUAL MOVEMENT IN CERTAIN STRATEGIC VARIABLES INCLUDED IN FORECASTS | 20 June 1983

EURO-10 Δ % p.a. or % GDP

	1970/1960	1980/1970	1981 a)	1982 a)	1983 a)	Trend Projection b) 1984	1985	1986	Simulation European Recovery c) 1984	1985	1986
1. GDP volume	4,7	2,9	-0,4	0,3	0,5	1,7	2,5	2,7	2,5	3,7	3,8
2. Employment	0,2	0,2	-1,6	-1,4	-1,1	-0,2	0,2	0,3	A 0,0 B 0,8	0,3 1,1	0,5 1,3
3. Unemployment rate	2,1	4,2	8,3	9,8	10,9	11,6	12,1	12,4	A 11,4 B 10,7	11,8 10,4	11,9 9,8
4. Productivity = 1:2	4,5	2,7	1,2	1,7	1,6	1,9	2,3	2,4	A 2,5 B 1,7	3,6 2,6	3,3 2,5
5. Investments	5,7	1,6	-4,7	-2,5	0,0	1,7	3,7	3,9	4,6	5,6	6,2
6. Public deficit as % GDP	-0,4	-2,8	-5,2	-5,3	-5,4	-5,2	-4,8	-4,4	-4,8	-4,6	-4,1
7. External balance as % GDP	0,2	0,1	0,05	0,3	0,6	0,8	0,6	0,6	0,4	0,3	-0,1
8. Prices in GDP	4,3	9,8	9,1	9,2	6,8	6,0	5,8	5,5	6,0	5,2	4,2
9. Nominal per capita wages	8,9	13,3	11,5	9,7	7,2	6,4	6,0	5,6	A 6,8 B 6,0	6,0 5,2	5,0 4,2
10. Real per capita wages = 9:8	4,4	3,2	2,2	0,5	0,4	0,4	0,2	0,1	A 0,8 B 0,0	0,8 0,0	0,8 0,0

a) Last available forecasts.

b) Last trend forecasts in Comet model, see annex 2.

c) For the simulation of European recovery see annex 2. This simulation was effected with the Comet model on the basis of the hypotheses used by the authors and is not binding on the Commission's departments. A: Hypothesis excluding further reduction in working hours; B: Hypothesis excluding further reduction in working hours.

- Table No. 7, line 9 shows that if there is no change in the trend in average working time the impact on unemployment of an extra 1% growth is slight; there will be 14.9 million unemployed instead of 14.3 million, a drop of 0.6 million. The average reduction in working time assumed in hypothesis B (1.9% per year) could, however, help to bring about a further reduction of around 2.5 million in the number of unemployed over 3 years as compared to current trends[1].

- Lastly, this stabilization of real incomes and this reduction in the number of unemployed are accompanied by an appreciable improvement in company profit margins since all the increases achieved in productivity, i.e. 2 - 3% per year on average, are channelled in that direction (Table 8, lines 4 and 5, column 6).

In Chapter 8 we shall look at the conditions under which the reduction in working time can be compatible with an increase in company profit margins. It should be emphasized straight away that the cure would be worse than the illness itself it if were to lead to either a deterioration in industrial competitiveness or further inflationary pressures. This is why one of the essential conditions for the success of the policy described in this simulation is that shown in Table 9 (lines 8 and 9, columns 9 to 11), namely a more pronounced slowing down in nominal wages than indicated in the forecasts coupled with a reduction in inflation[2].

To summarize:

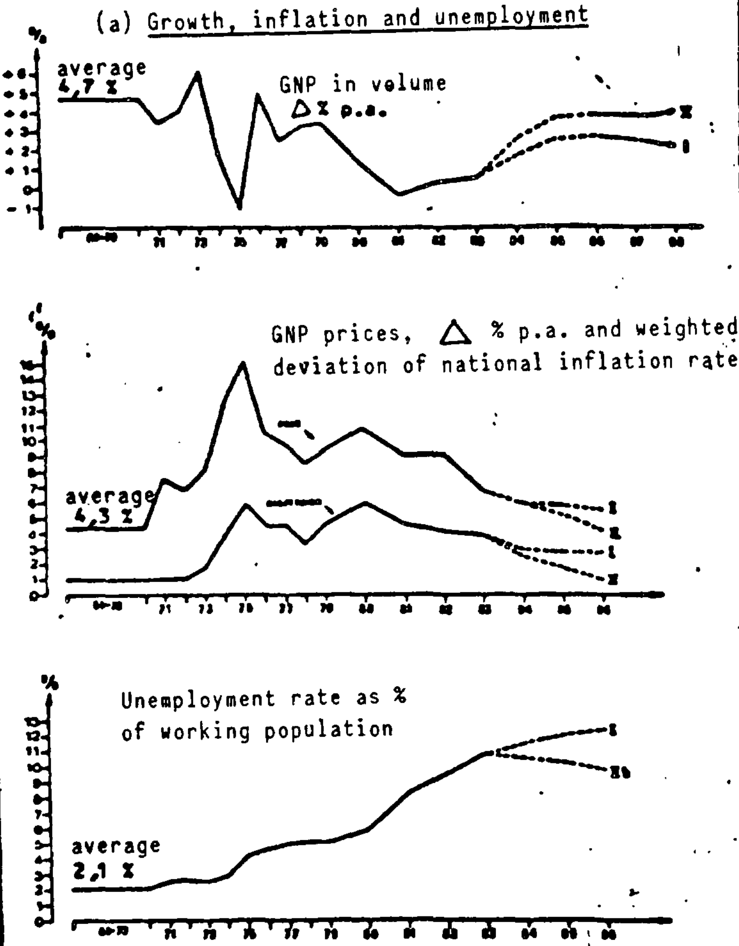
- Even assuming an optimistic international climate, the countries of the EEC - including those which have made the greatest effort to emerge from the crisis - are now paralysed and incapable of achieving a lasting upturn in growth.

- A modest amount of additional collective growth for the Community as a whole would be enough to ease the situation and considerably improve the outlook, provided it is accompanied by a more marked fall in the average rate of inflation in the EEC and provided productivity gains are used to improve company profit margins.

[1] To achieve the same result without speeding up the reduction in average working time, the growth rate would have to reach 7% (Table 7, col. 5)

[2] This applies to the Community average and is vital for countries with a high inflation rate; in countries with low inflation, the rate must be held steady as must the growth in nominal wages

(a) Growth, inflation and unemployment



Graph 3

SOME KEY PROJECTION VARIABLES
EUR = 10

I. Reference projection

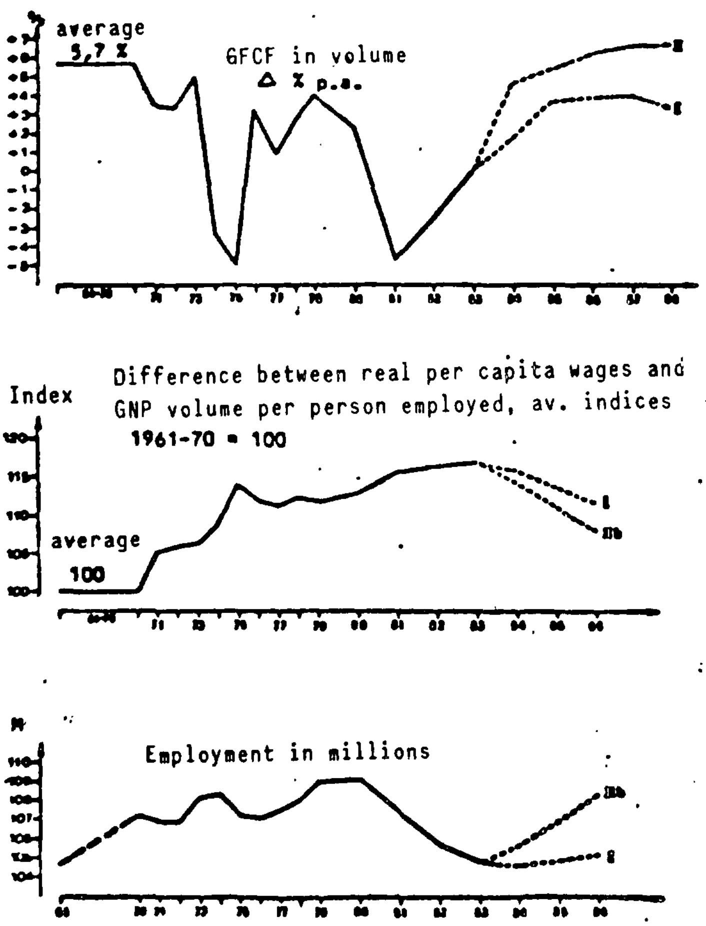
II. 'Recovery of European economy' simulation

II(a) without a further reduction in working hours

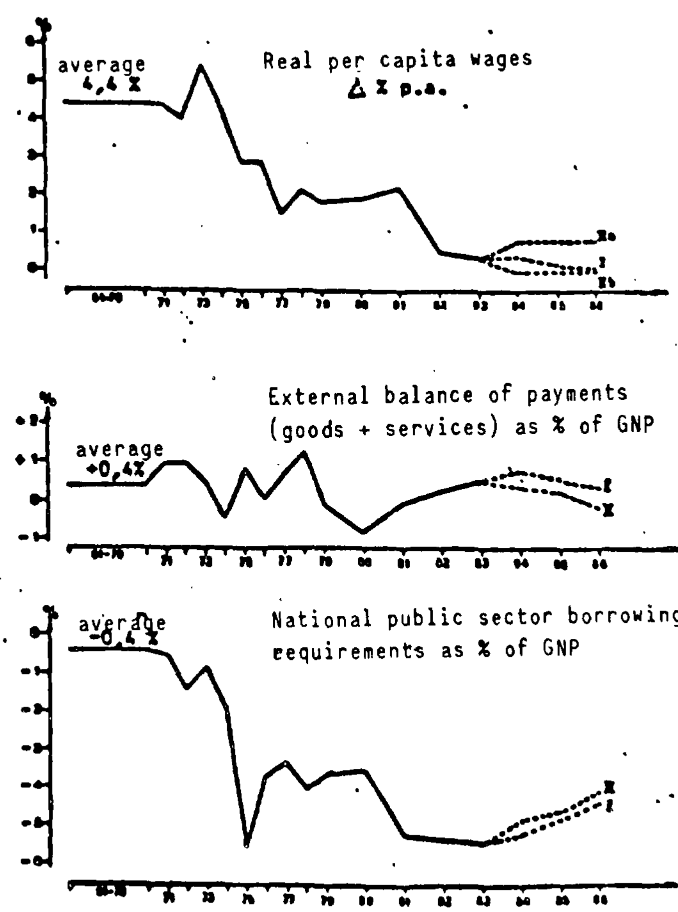
II(b) with a further reduction in working hours

See Annex 2

(b) Investment, difference between real wages and GNP per person employed and employment



(c) Real wages, external balance of payments and public spending deficit



- With this dual proviso, the efforts of the most advanced countries in the fight against inflation could be rapidly rewarded by a new upturn in growth. However, countries that squander the fruits of this growth by adding to inflation would thereby be making a further rod for their own backs.

- Above all, and this is perhaps the most important lesson from this simulation, once the effects of growth and higher profits combine to encourage investment, the process becomes self-sustaining (as long as it does not side-slip into price, income, budgetary or monetary disequilibrium). Graphs 3a and 3b show this clearly with regard to growth and investment.

Given all these conditions, it is possible in a Community framework to set in train a real medium-term recovery in the growth of the European economy on the basis of a modest initial stimulus.

The key question now is:

53. How is this additional growth to be achieved?

A number of studies have been carried out since the 1970s on the subject of economic recovery. Generally speaking they have proposed that the Member States should undertake a coordinated increase in their budgetary deficit to provide a collective economic stimulus. It takes someone who is badly out-of-touch with reality to recommend such a course of action nowadays, even in more or less camouflaged form. The public sector deficits in the Community are now so high that no government can countenance increasing them any further.

The issue now is no longer about stimulating consumption by deficit budgeting but about stimulating investment - above all productive investment - to be financed other than from national budgets.

How is this to be done? This is the first question to address, from two angles, namely additional borrowing and an oil tax. The crucial factor for providing a fresh impetus to growth in the medium term is not financing but a combination of all the conditions needed for disinflation and a rebirth of corporate investment, which presuppose a kind of vast creative compromise at Community level (see No. 54 below).

531. Additional borrowing

How much additional investment is needed to raise the EEC's growth rate by 1%? Approximately 0.6% of its GNP, or not even 15,000 million ECU[1] per year.

Are sums of this size unreasonable? Certainly not in relation to Community GNP: a stimulus of 1% is within the range of 0.5% to 2% of GNP common to traditional economic recovery programmes. Nor are they unreasonable in relation to the overall flow of investment: 15,000 million ECU are equivalent to no more than 3% of gross fixed asset formation in the Community.

Will the financial systems and capital markets be able to provide the Community with credit on this scale without difficulty for three years in succession? The reply to this question is composed of three parts.

5311. In fact the additional 15,000 million ECU would have to be borrowed in the first year only because a 1% rise in the growth rate will lead, on the present simulation and despite company tax relief worth 11,000 m ECU, to a reduction in national public sector deficits equivalent to 0.2 to 0.3% of GNP[2]. Thus, from the beginning of the second year the additional borrowing required for the initial stimulus would be not more than 8 to 10,000 million ECU.

5312. In the event, in 1983, the Community will be borrowing around 10,000 million ECU[3] on the markets through various borrowing and lending instruments, the main one being the European Investment Bank (EIB)[4].

There are three good reasons for making use of these instruments: first, loans contracted by the Community increase neither the budget deficit nor the external debt of the Member States even if these are ultimately guaranteed by them. Secondly, although any increase in the growth rate does have an adverse effect on the external balance, this effect is approximately halved

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1 The value of the ECU is very close to that of the dollar; as at 3 January 1983, 1 ECU was worth $0.9688.

2 See Table 9 and graph 3c.

3 This figure reflects a rapid growth in the volume of borrowing, which was only 4,800 million in 1982.

4 The EIB is responsible, inter alia, for administering the New Community Instrument (NCI) which was in fact created in 1978 when the policy for recovery referred to in Chapter 2 was being launched; the other instruments are the ECSC and EURATOM.

if the action is taken on a Community basis; in the context of the policy proposed here the effect would in fact be quickly offset by the upturn in investment. The third advantage is that by using the Community instruments the complications of coordinating the positions of the ten Member States are avoided: it is sufficient to establish the general rules which the Community institutions must apply in the general interest.

5313. There is no reason why the additional investment programme should not be financed entirely by Community loans. There is nothing to prevent the EIB, for example, from undertaking co-financing transactions in association with the banking systems concerned, along the lines of the World Bank. Whatever the case, it stands to reason that a medium-term programme that closely combines stability with growth must base its financing, year after year, on the state of the markets, avoid disturbing them in any way and seek as a priority to maintain the excellent credit rating enjoyed by the Community instruments. This would appear to be possible since this programme will have only a marginal effect if sufficient banks and financial institutions are associated with it[1].

In addition, two aspects of this programme are conducive to the vital lowering of interest rates in Europe: the reduction of budgetary deficits directly related to the improvement in growth and the more pronounced slowdown in inflation.

532. <u>Oil tax</u>

5321. Why a tax?

From the macroeconomic viewpoint an additional annual investment of 15,000 million ECU per year is enough to generate an additional 1% growth. However, as soon as one gets down to the specifics of implementing the recovery programme, it becomes clear that the Community needs new resources[2] for three reasons.

The first reason is that a large proportion of the loans contracted to finance additional investment will have to be at cheaper rates of interest. While

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[1] In 1982 the combined value of international bond issues plus international banking Eurocredit amounted to around $170,000 million. There is no reason why the EEC should not be able to absorb 5 to 10% of that amount especially since the net balance of its direct investment in the United States was over $10,000 million per year on average in 1981-82 and purchases of American stock - mainly treasury bills - amounted to $18,000 million in 1982.

[2] See annex 5.

we are not unaware of the risks of distortion of competition to which the use of this procedure may give rise, only investment which complies with the criteria laid down in Article 130 of the Treaty of Rome can qualify: this covers investment in projects of regional or Community interest whose purpose is to create new activities connected with the gradual establishment of the Common Market, with particular emphasis on investment with high innovative content, for the introduction of advanced technologies or to assist SMUs and craft industries. The only exceptions to these criteria are investments in applicant countries and in the associated ACP and Mediterranean countries. Lastly, the choice of projects would be left, in the main, to the EIB which is normally responsible for such matters. There are a good many viable projects, of all kinds, which cannot be financed because of current interest rates[1] and worsening company balance sheet situations.

The second reason is that some investments which should be given priority attention require financial support from the Community's budgetary resources. This applies particularly to investment in energy and in new Community research and development programmes. These two sectors, which require large amounts of additional investment, are described in Chapters 6 and 7.

The third and final reason is the following: we have seen that, increasingly, the source of growth in Europe is the Community itself. But this source is being gradually polluted by the ridiculous, even catastrophic manner in which the institutions operate, spending their time bickering over the common budget. Expenditure under the Community budget will soon burst through the ceiling of own resources. Although economies are admittedly necessary and this is where a start must be made, this must not provide an excuse for the proliferation of Community bureaucracy: the Community administration employs less than 20,000 officials, equivalent in size to the municipal council staff of a town of 2 to 3 million inhabitants. What is more, unless new resources are found for top priority investments, the Community will no longer be able to avoid dissolution and bankruptcy. If that happens, the source will no longer be polluted but dried up. In order for it to nourish and fertilize the Community economy, much greater use must be made of it and common interests must be created which are so closely interrelated that ultimately the term 'Community' will take on its real meaning.

1 Currently at such a high level that in most industrialized countries pension-holders are in a privileged position compared to entrepreneurs

5322. Why an oil tax?

First of all, the situation lends itself to it: oil prices have fallen by around \$4 per barrel since the end of 1982. Admittedly this fall offers an opportunity for the recovery of the European economy which has been so badly hit by the two oil shocks. On the other hand, in spite of its extreme dependence on energy, Europe invests between 2 and 3 times less in energy than Japan and the United States.

With blithe disregard and childlike irresponsibility we are therefore paving the way for the third oil shock just as we did with the two previous ones. Would people have us believe that it is wiser to use the gains from the fall in oil prices for immediate consumption rather than to invest them to safeguard our future? Do they believe that we should squander rather than husband our resources, even though this still means putting millions of jobs at risk?

Ultimately the question of a tax on oil is about choosing between the short term and the long term, between consumption and investment, between the impulses of instinct and the path of reason, between the temptation to fatalism and the call to recovery.

In fact it was this argument that, after careful deliberation, convinced the Commission (see Chapter 6). The tax it has in mind, however, is a tax on consumption. We, on the other hand, are proposing an import tax for a reason which is central to the thesis of our project: it can be adopted very quickly without the need for ratification by the national parliaments.

An initiative by the European Parliament along these lines would therefore assume a symbolic value. During our talks with government representatives it was occasionally pointed out to us that such a tax would be too favourable to the United Kingdom. This argument is typical of the devious way of thinking and the obsession with 'a fair return' which have become the poison of the Community institutions. Lastly, this oil tax would be flexible and highly productive: it would raise around \$2,500 million if the charge were 1 ECU a barrel. The Commission's energy programme calls for 1,500 to 2,000 million ECU per year and an interest rebate of 2% on the entire additional borrowing requirement proposed would cost around 2,000 million per year for three years. This tax could therefore be set at between 1 and 2 ECU per barrel.

54. The basis for a creative compromise

Let us make no bones about it. Even if the Community's debts are minimal at present (less than 10,000 million ECU), its borrowing capacity is not unlimited. It must be managed carefully as an irreplaceable asset. Similarly, even if the Community budget amounts to barely 2% of the budgets of the Member States it has to be administered in an exemplary fashion. This is why the implementation of these financial proposals must be made subject to a specific and firm commitment by the Member States and the two sides of industry to the overall project. Otherwise it would be better to do nothing at all and to wait for collective suffering to bring collective common sense ...

We have therefore proposed the basis for an overall compromise in such a way as to benefit each of the parties.

541. The Member States

In addition to their agreement on the general financing arrangements (which would involve, inter alia, an increase in the volume of the NCI), the Member States would be required to give three undertakings:

- To contribute to the gradual deceleration of prices and of nominal personal incomes. Naturally, this reduction would have to be adjusted from one country to another on the basis of Community recommendations. In countries with high inflation it is essential to enable the initial collective stimulus to be translated into real growth and into jobs instead of fuelling even higher inflation. In those countries it will generally be necessary to demand temporary sacrifices especially from civil servants and the like: firstly, the effect for example on the public sector is considerable: secondly, the high level of unemployment places a greater premium on job security. If the plan is to succeed, it is essential that more moderate rates of increase in personal incomes should quickly be extended to the entire economy. In low-inflation countries, the task is easier. Personal incomes and prices must not be allowed to get out of hand when growth resumes. Naturally, national traditions in these areas will continue to play a decisive role. The more highly developed the social dialogue, the more these traditions facilitate the recovery of growth.

- An additional 1% growth would mean, ceteris paribus, a reduction in the public administration deficits of 0.6 to 0.7% of GNP after two years. In view of the urgent need for a sharp upturn in investment and, hence, in industrial performance, the Member States would have to undertake to set aside much of this reduction in their budget deficit to lower taxes on company profits. Estimating this reduction at 11,000 million ECU per year and assuming that it is set aside on a statutory basis for corporate investment, such investment would increase as a result of this action alone by 3% per annum. Moreover - as we saw in 5311 - the national deficits would be reduced by around 0.3% of GNP[1]. This should help in particular small undertakings and firms in zones receiving priority aid under the regional policy. Without going into details, as that is not strictly the purpose of this report, we should note nevertheless that in line with the proposed tax cuts it would be appropriate, from a social viewpoint, to formulate an assets policy at national level and, from an economic viewpoint, thus to increase the fluidity of financial resources and the strategic flexibility of undertakings by improving their capital situation.

- Lastly, it is essential that the recovery of growth is not compromised by an excessive expansion in the money supply. In the proposed programme, the addition to the money supply from external borrowing is offset by the increase in investment and the fall in nominal incomes, ensuring that the liquidity ratio of the economy does not increase.

Surely these three conditions would cost relatively little compared to the advantages of a significant and lasting recovery in growth.

542. Workers and their trade unions must be prepared to accept the necessary reduction in nominal incomes. In fact, instead of running the risk of a gradual reduction in real incomes they would maintain their purchasing power in spite of an additional reduction in average working time. As far as civil servants are concerned, given the precarious situation in Europe, smaller increases in their nominal salaries are essential if they are to ultimately maintain their purchasing power.

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1 After lowering the taxes on company profits

Lastly, the reduction and reorganization of working hours, which must go hand-in-hand with negotiations on working conditions, should make it possible to create overall some 3 million extra jobs in three years as we shall see in Chapter 8.

There is good reason to hope that a proposal which safeguards purchasing power and brings a gradual reduction in the number of unemployed, provided it is drawn up at the highest Community level, will receive broad support from public opinion, especially when it is understood that there are only two alternatives to market forces, which are often unsatisfactory when it comes to incomes: namely, collective responsibility or monetary restraint.

543. Companies and their representatives are particularly poorly equipped to give commitments on behalf of their shareholders at Community level. It is therefore essential that they should do so at national level in one crucial area: the rapid development of new forms of organization of working hours and in particular the freedom of workers to choose their working hours, so as to increase the number of jobs without placing a heavier burden on industry. The lowering of taxes on company profits should make allowance for this where appropriate.

Apart from that, we must rely primarily on the change of climate which will undoubtedly accompany the new surge of growth to enable companies to derive full benefit from the new investment opportunities which the improvement in their profit margins will bring. All the proposals set out in Chapters 6 and 7 are designed, moreover, to give companies what they lack most, namely confidence in the future.

544. How is this creative compromise to be drawn up? This is not the place to decide on such matters.

What chance have these proposals of being accepted? It is not the task of this report to answer that question. It all depends on the degree of public understanding of the real problems and of the solutions required. This is why it is essential that, at the same time as the debates which will be held in the European Parliament, all the media should play their part in informing the public.

The public will then understand that, if a government refuses to join in the necessary compromise, this would be tantamount, in economic terms, to working against the development of its own country and, in political terms, to working for the opposition. Trade unions may also reject the compromise but by so doing they would be opting for more unemployment and a continuing decline in purchasing power. Companies may also choose not to take advantage, but then it will be a long time before they get such a good opportunity again ...

55. <u>The momentum of recovery and the EMS</u>

In order to give an informed opinion on this programme it is necessary to take into account its inherent momentum, which can develop not only at international level but also at national and Community level.

The special feature of this programme is that it provides a framework for a medium-term development which is conducive to the smooth functioning of the EMS, which at the present time is as essential as it is precarious:

- essential, because there has never been a time in the last fifty years when international financial instability, as reflected in the differences between inflation rates, interest rates and exchange rates, has had such an influence on growth and employment, in particular via the new forms of protectionism.

- precarious, for the simple reason that the EMS is a house built on weak foundations (that explains the failure of the transition to the second phase in 1981), but above all because of the instability and divergence of national policies. National policies are not the result of chance: faltering growth leads to rising unemployment which leads in turn to criticism of governments, of whatever complexion. This is why since the recession of the 1980s virtually every election in nearly every country in Europe has led to a change in the majority ... but to what end, if not to change the economic policy? Consequently, instead of the peaceful convergence required for financial stability and economic expansion, the European Community has witnessed a Brownian movement of economic policies which merely further aggravates the problems of growth and employment, spreading uncertainty and discouraging investment.

But this vicious circle need not continue. It is the product of our own behaviour which is itself the product of our errors.

Let us begin by injecting a little more growth, employment and stability. We have seen that this is possible. Then everyone will appreciate that his overall interest coincides more and more closely with that of his partners: all the proposals in this report, in particular the financial proposals[1], are aimed at generalizing the benefits of convergence.

There are those who complain that the EMS has put the cart before the horse. Admittedly seven parity realignments in four years is a lot. Exchange rate stability should not precede but follow economic stabilization and convergence. Indeed it is this concept which distinguishes the EMS from the 'snake', although it has remained almost entirely in the realm of theory.

If this criticism is justified then the scope of this proposed programme is even greater: the medium-term policy of growth and stability of which it will form the basis provides the framework essential to the permanence and strengthening of the EMS. It should thus be made easier for the United Kingdom to join and at the same time its membership would be decisive in paving the way for the wider use of the ECU and opening up at last a constructive dialogue with the United States.

Until Europe has established its monetary identity even the concept of dialogue will remain a mere pious hope. Even though the countries of the Community hold one-third of the world's foreign exchange reserves and half of its gold reserves, in monetary terms they form nothing but a non-Europe, squandering their most precious assets. The Bank for International Settlements stated in its latest report that the surest way to avoid the recovery being short-lived would be a lowering of American interest rates, but non-Europe has a great deal to answer for. It is failing to use the resources at its disposal to create a second major monetary axis at world level which would partially replace the Bretton Woods system.

Consequently it is vital that an immediate start should be made on stimulating growth as proposed above. This will soon lead to the natural momentum of growth taking over. The strengthening of the EMS and the recognition of the ECU as a fully-fledged currency by the monetary institutions, being

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1 The experts on the MacDougall committee also took the view that, in order to have a significant impact on the convergence of national policies, the Community budget should be raised from under 1% of GNP to around 2.5%

used on the markets and being held by financial institutions and central banks outside Europe: all this will be a natural process; at the same time a new seam of growth will have been tapped in Europe.

All the parts of this programme form a coherent whole because every aspect has been covered. It does not attempt to impose disciplines in the form of extra constraints but, on the contrary, to set up machinery for cooperation such that all the partners have everything to gain if they choose to participate and everything to lose if they prefer to ignore it. Furthermore, it can be adapted and reversed at any time except in one respect: under no circumstances must the Community squander its borrowing capacity, because it is not renewable.

CHAPTER 6

CREATING A EUROPEAN AREA FOR INDUSTRY AND RESEARCH

There is no such thing as European industry. When we say it is the second largest in the world, we are not calculating on a comparable basis. An industry's identity is determined by the content of its market. Even though Europe has established a customs union, it has not yet created a real market for industry. A good number of European firms operate at the world market level. There are practically none for whom the European market is a homogeneous industrial base.

There is no such thing as European research. The Ten still have the second largest research and development potential in the world. The word 'still' is used advisedly, because increasingly this potential is being 'sterilised' in universities, laboratories and research centres deprived of the necessary resources for research. If this state of affairs continues, a growing proportion of research workers will be condemned to become curators of museums of science and technology.

Those are the facts. They are so formidable, that, at this stage, prescribing a solution is of secondary importance. The main thing is to examine the reality of this rather 'uncommon' market.[1]

61 The 'uncommon' video-recorder market

611. In 1981, the European market for video-recorders was around 30% of the world market and twice that of Japan. It was growing at the rate of 20% a year, i.e. more rapidly than the United States' market. However, European productions of video-recorders was no more than 5%. Understandably, the three major home electronics companies decided, at the end of 1980, to combine their efforts: TELEFUNKEN in GERMANY, THOMSON in FRANCE and THORN in the UNITED KINGDOM (the 'three T's'). However, for their venture to get off the ground they needed to join forces with the owner of the technology, the Japanese firm JVC. The French Government refused. TELEFUNKEN's losses accumulated. In mid-1982 an alternative solution emerged. Max GRUNDIG, the founder of the firm bearing his name, agreed to sell his shares to THOMSON. This opened the possibility of a joint venture between THOMSON and PHILIPS. This time it was the Federal German Monopolies Commission (BUNDESKARTELLAMT) which refused on the grounds

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[1] See annex 6.

that THOMSON would then acquire a dominant position in Germany. Last act: THOMSON bought TELEFUNKEN: The 'three T's' are now only two plus their Japanese partner. In the process, Europe has lost yet another opportunity for its firms to unite and our video-recorder industry has wasted three years. Three years! A fleeting instant in the timescale of the public administrations which prosper from procrastination, but, an eternity for this forward-looking industry.

612. Why these obstacles and wasted time? Had the three T's operated in the Japanese or American markets, they would have been in a real 'common market'. We shall see below (paragraph 62) that there is practically no common European market for public contracts. Here we are talking about popular consumer products and yet, as we have seen, the European market is still far from common: it is a kind of economic equivalent of feudalism. This is because, in most front-line sectors, national administrations have so much say that, 25 years after the Treaty of Rome, no new transnational European group has been set up. Those which do exist already existed in 1958 (PHILIPS, SHELL, UNILEVER). Joint ventures between FIAT-CITROEN, DUNLOP-PIRELLI, AGFA-GEVAERT, UNIDATA (CII-SIEMENS-PHILIPS) all failed. One reason is that the legal statute for a European company, which has been on the Community's agenda for 20 years, has still not materialized. In 1983, if two complementary firms wish to join forces, one in France and the other in Germany, they have no option but to set up a new joint company, which must be either German, complying with German law, or French, subject to French law. This situation is just as restrictive for evolving small and medium-sized undertakings as it is dangerous for the major established companies because, in the first case, the French would feel swallowed up and in the second the Germans would appear to be dominated.

An American firm is American first and Texan second; no one knows TOYOTA's or SONY's province of origin, but everyone knows that - free to act on their domestic markets - these firms have used them as a springboard to conquer the world market, while European firms get tied up in knots in their own back yard: Europe of the 1980's is no more than a common market for industry than were in France under the Ancien Regime or in the Germany of the Zollverein.

The two exceptions - Airbus and the Ariane launcher - merely confirm the rule.

613. One need only walk into a shop selling household goods to realize what this is costing us: most of the traditional 'white goods' are made in Europe,

but the newer 'brown goods' are almost all imported. That much less growth. That many more unemployed. Unfortunately this situation, which is plain from the goods on sale, reflects not a stable balance but the beginning of the supremacy of our foreign suppliers and the decadence of European manufacture.

Once public opinion has understood this, the solutions will come automatically: the rules of competition will be fixed at Community level. It seems strange that a flight from Paris to Athens or from London to Rome should cost almost as much as flying from New York to Paris or to London. This is largely due to the absence of an 'integrated' European air space which allows third country airlines, in particular American airlines, to operate intra-European routes as international flights, without offering any similar concessions in their own vast internal network; they can recoup on intra-European routes losses made within the United States. Similarly a telephone call from London to Paris is much more expensive than a call from London to Edinburgh.

However, it is in the financial field that the most still needs to be done to develop a European services industry: the compartmentalization of the Community's financial market is such that approximately two-thirds of the Member States' external long-term financial transactions take place outside the Community's financial circuits and in 1981 loans issued by the Community countries to their partners barely exceeded 20% of those issued by third countries[1].

This situation impedes growth and contributes to unemployment in a less obvious but just as serious manner as the situation in the field of electronics for mass consumption: the major financial institutions tend to favour large rather than small-scale concerns, they prefer the old to the new, the past and the retrograde to the future and progress.

62 The railways of the year 2000

621. In the 19th century, when the railways were invented, the Europeans did not think of creating a 'Common Market', but they did realize that it would be a mistake not to adopt the same rail gauge. As everyone knows, apart from Russia and Spain, they all built their railways to the same specification. Likewise their postal and telegraphic systems.

[1] Communication from the Commission to the Council on financial integration, op. cit.

After all, if we were expected nowadays to change trains at every frontier, we would consider this to be absurd, costly and intolerable. In fact, harassment of this kind is on the increase within the Common Market, but it is not widely realized because in general it is done so hypocritically and deceptively that the consumer is taken in and the taxpayer pays without realizing.

Take colour television. The system is not the same in Germany (PAL) as it is in France (SECAM). So a French factory cannot sell its French television sets in Cologne, just as German sets are not suitable for Strasbourg. Thinking to protect himself, everyone in fact penalises himself. Instead of providing an asset for industry, the commercial area remains fragmented. Each factory, geared only to national markets, produces smaller quantities at higher cost. It is the consumer who pays the difference and the Japanese who reap the benefit: in 1981, all European factories which were still working showed losses while all the Japanese factories made considerable profits.

The President of the European Parliament has had to have two telephones installed in his car: one which links up only with Belgium and a second which complies with the specifications of the neighbouring countries. At a time when the space age is just beginning, the PTT and the Bundespost are pursuing separate technical and industrial policies. Each lays down its own standards, chooses its national champion and pursues a 'closed shop' policy to the point where it is much less difficult for a European telephone manufacturer to sell his equipment in Latin America or Asia than it is on the other side of the Rhine, the Alps, or the Channel! This anomaly explains another: because of the restrictions within the internal market, European concerns are often obliged to give priority to links outside the Community (e.g. Philips - ATT).

These are just a few examples to illustrate a virtually generalized phenomenon which is extremely significant for the European economy: the Common Market is genuinely 'common', more or less, for ordinary products - shoes, glass or mutton - that people buy everyday. The situation is radically different, however, when it comes to products purchased by the state and the other public administrations. These products, which often involve advanced technologies - in particular armaments - and where consequently a deregulation and an extension of competition would be most useful, are treated as special products, reserved in each country to the 'purveyors to the Royal Court', that is, the state. Efforts to deregulate national markets have met with so little success that the Commission stated in

February 1983 that, since the Council had been unable to reach unanimous agreement, it was necessary to start again from scratch, making it clear that even where common procedures exist 'they are often not correctly applied'.

One example illustrates all that has been said: in the field of high-speed rail transport, French and German research has been carried out independently: France has developed its own TGV (HST) system while Germany has gone for a monorail system with electro-magnetic levitation. There is a serious risk that the trains of the year 2000 - and worst of all, the high-speed trains - will have to stop at national frontiers because the specifications of the neighbouring country's rail systems are incompatible. Even now, trains travelling from Paris to Amsterdam have to change voltage three times!

622. This aspect of Non-Europe is one of the most costly. First of all in financial terms. Public contracts account for approximately 15% of Community GNP, including purchases of military and space equipment of about 400,000 million ECU. Let us assume that the average additional cost is around 10%. This seems a modest estimate given the amount of technical and economic progress which might well have been achieved over the last 15 years if all public contracts had been deregulated when intra-Community customs duties were abolished in 1968. At least 40,000 million ECU are thus levied pointlessly from the taxpayer and wasted each year.

To enable these taxpayers to appreciate the extent to which they are exploited by their national administrations, we should add the cost of the queues of lorries waiting at customs posts! The total cost of passing intra-Community frontiers can be estimated at around 12,000 m ECU a year[1]. This makes a total of around 50,000 million ECU, i.e. 2% of GNP, or:

- for an average family of 4 an amount of 800 ECU per year, or the equivalent of a week's income,
- 15% of personal income tax (EEC 11.5% of GNP in 1980),
- two-thirds of the tax on company profits (2.7% of GDP in 1980),
- twice the Community budget

[1]The report by the Commission to the Council (COM(83) 80 final).

So, when you travel by train, lift the telephone or pay your electricity bill, you are like the peasants of the Middle Ages who had to pay a tithe to their lord. What is this tithe? It is one of the costs of 'Non-Europe'. More precisely, every worker in the Common Market works on average one week per year to pay for the customs and associated services, as well as the industrial undertakings which have the privilege of being 'purveyors to the Royal Court'. As for the other firms, virtually all of the tax they have to pay on profits - which restricts their investment, so desperately needed by Europe - goes to finance disguised handouts to their competitors who have the privilege to be 'purveyors to the Royal Court'.

This additional cost of the order of 2% of GNP is also the equivalent of more than one-third of the deficit shown by public administrations in Europe. We are therefore right to assume that 'reasons of state' do not constitute an adequate explanation. There is also on the part of the administrations the desire to protect and extend their powers by playing Father Christmas: the closing off of public contracts is one of the most effective forms of non-tariff protectionism.

623. That is not all. If one examines the same phenomenon from an economic viewpoint, one finds that, far from strengthening the 'national champions' on which it bestows its privileges, the state ends up by enfeebling them. As this industrial protectionism becomes an increasingly taboo subject it has to be hidden in research and development (R & D) policies. Admittedly, this is nothing new. All developed countries try indirectly to help their industries by financing part of their industrial research. What is really serious is that within Europe the sectionalisation of industry reinforces the sectionalisation of research, bringing with it ever increasing waste and inefficiencies (see above no. 63). Too bad for the research workers; too bad for Europe's scientific elite. Of all social categories they are the most important for our future and as a group they are among those who suffer most as a result of 'Non-Europe'. An undertaking which ran its affairs in the way the European countries make use of their R and D potential would provoke justifiable rebellion amongst its personnel.

While in the short term and on a sector-by-sector basis this policy may be understood in the light of national traditions, globally and in the medium-term the products of the people and those of the 'Court' are one and the same. When the 'Court' overprotects its suppliers, they become less efficient and the products of the people suffer the consequences, with the result that ultimately the people are taxed twice, as taxpayers and as consumers. At the same time, growth is slowed down and unemployment increased.

624. This is why Community action in this field must begin by improving the information provided to consumers. This policy of increasing public awareness runs counter to the ideology which advocates transposing national industrial policies to European level together with the compartmentalization of public contracts which that implies. This is likely to multiply all the failings of national administrations. It is not concern shown by administrations that will reawaken industry in Europe, but the spur of competition.

Competition in the field of public contracts, however, raises the problem of standards. It is essential that a Community body should be given the task of laying down European standards which should gradually replace national standards. In fact it is the very 'officialese' of these administrations which acts as the best protection for these 'purveyors to the Court'.

The first responsibility of a Standards Agency should be to study all the major public contracts and to pass on its comments to consumers and competitors. It should also seek the views of the professional associations of the Community to ensure that European standards, promote international trade by remaining consistent with international standards.

This task is an extremely difficult one. Defining common standards naturally means choosing the best. In other words strengthening the strongest, forcing the weakest firms to adapt their specifications late in the day to those of their most advanced competitors. For certain countries it means the risk of having to bow to the successes of the others. In order to accomplish this task the Community has to be able to redeploy its budgetary resources in order to exercise its powers of compensation in a large number of areas. One way of providing the necessary compensation would be to earmark a part of the available financial resources to generate growth (see Chapter 5) through a programme of public works with a high technological content involving most Community countries (Chapter 7).

In any event it is now more important than ever to deregulate European public contracts, since the United States and Japan are considering the possibility of an agreement on the mutual deregulation of public contracts in all fields except the most sensitive military areas. Such an agreement would force the European countries either to follow suit or to be relegated to the second rank in the international industrial scene. The Community has perhaps no more than five years to establish a common market for public contracts. This illustrates the significance of the proposal submitted by the Commission to the European Council of Stuttgart in June 1983 for the creation of a European Telecommunications Agency.

625. The European countries should now pool their resources, or at least establish federal-type links between certain major public services whose role will be crucial to the strategy for making up ground in the field of technology; the examples in Table 10 show how important this is. There is an urgent need to set up European agencies, not just for telecommunciations but also bio-technology, deep-sea mining and new forms of transport. The aim is not to extend the public sector, nor to increase the intervention by public authorities in these sectors, but to rationalize, harmonize and thereby to lessen the amount of state intervention, which is badly organized.

It is therefore necessary to define the remit of these European agencies, namely: to establish networks and standards so as to avoid incompatibilities of the PAL-SECAM type; to ensure the homogeneity and transparency of Europe; to encourage innovation in industry, place orders, strengthen competition by lending it a Community dimension and to ensure reciprocity with third countries.

These public agencies would not be expected to take over the productive function, which should continue to be carried out by firms operating in a climate of competition. The creation of a genuinely common market in the public sector is an essential precondition for the maintenance of competition; the compart-mentalization of national markets merely places suppliers in a monopoly-type situation, which ultimately will make them uncompetitive.

We have fallen behind dramatically in the essential areas of public purchasing, industrial restructuring and the promotion of technology on a European scale. This must be a matter of absolute priority for governments and Community institutions. Such is the urgency of the need to make up lost ground that, in this case, we should waive the rules governing unanimous decision. The solution is to be found by allowing those states that are hesitant to abstain and in financing arrange-ments which call only in part on the Community budget.

Table 10

Some examples of Europe's technological decline

1. Share of the world market in electrical and electronic equipment (excl. intra-Community trade)

(%)	1978	1981
JAPAN	22.9	26.8
USA	22.6	23.9
EEC	29.8	22.9

2. Production

(Number)	Developed robots (1981)	Manufacturing centres (1980)
JAPAN	11.000	5.231
USA	8.130	2.129
EEC	4.017[1]	1.459[2]

[1]Four major countries

[2]Europe

2. Turnover of world's twelve biggest producers in 1980

('000, million $)	Integrated circuits	EDP (management and production)
USA	4.6	35.6
JAPAN	0.8	1.7
EEC	0.4	4.3

Source: See Annex No. 3

63. How to reinvigorate Community research

631. At a time when the third industrial revolution is dramatically changing working conditions both in services and in industry, the state of scientific and technical research in the Community is characterized by two essential features: on the one hand, the financial resources of the EEC countries taken as a whole are far superior to those of Japan but, on the other hand, by refusing to join forces and persisting with their go-it-alone policy in R & D, they are merely accentuating their collective weakness.

R & D expenditure in the Community is still close to that of the United States and about twice as high as Japan's but spreading our resources thinly leads to a dissipation of effort. This produces a situation where Germany, for instance, employs four times fewer researchers than Japan in the machine-tool industry where traditionally it has a dominant position, and France six times fewer researchers and engineers in the transport field, despite the fact that is in this area that its best export performance is achieved[1].

Whereas 64% of Community expenditure is earmarked for agriculture, the overall Community research budget (600 m ECU in 1982) is around 2.5% of the general Community budget and 2% of the total public expenditure on research in the Member States.

This explains the increasing number of bankruptcies. For instance, in the communications industries (informatics, electronics), Europe's balance of trade, which was in balance in 1975, was $5,000 million in deficit in 1981 and close to $10,000 million in deficit in 1982.

This trend is so distressing to those who are aware of it, that increasing numbers of European undertakings are abandoning their traditional discretion to voice their views publicly. At the end of 1982, a dozen of the largest data processing companies took an intiative which led to the ESPRIT project[2] (see below 633). Their testimony which is particularly insistent, is set out in Annex 4. It stresses that 4 million jobs are at risk from now until 1990. In April 1983, 17 of the major transnational European companies which have

[1] See table on page 7 of Telesis.

[2] Strategic European programme for research and development in information technologies

participated in a 'European initiative' project, revealed that, according to the latest Japanese analysis, out of 37 major sectors of technological progress the United States are in a very good position in 31, Japan in 9 and Europe in only 2 (electronics switchgear and software)[1].

Finally, the famous American consultancy firm McKINSEY, recently submitted a report to the Commission containing the following estimate of the number of jobs at stake by 1990 in the European information technology (IT) industry:

- 2 million new jobs if IT develops in Europe as in the United States,

- 2 million jobs lost (out of the existing 5 million) if the IT industry in the Community continues to weaken and become dependent on other countries following the present trend.

In all, therefore, 4 million jobs are at stake: 4 million jobs in about ten years! It is worth reflecting on these figures: they have been calculated on a micro-economic basis and do not appear in the overall projections used in Chapters 2 and 5. Measured against the disaster which is destroying the core of European industry's future, the dramatic situations in the textile, chemical and steel-making sectors seem no more than passing incidents. The moment has come to remind ourselves that the list of countries which, more than a century ago, proved capable of building railways is still, with few exceptions, the list of the developed countries ....

Chapter 3 showed the impotence of the Member States in the macro-economic sphere. Similarly, in the industrial and technological fields, the Member States are becoming less able to maintain their situation and finding it even more difficult to improve the effectiveness of their R & D network. If R & D continues to be organized at national level it will become less and less competitive. But here too combined European action has a multiplier effect. Proof of this is seen in the remarkable performances achieved in areas where the research is sufficiently remote from national conflicts of interest for it to be easily run on a cooperative basis by the scientists themselves. This is notably the case for CERN (Centre of Nuclear Research) and JET (Joint European Torus).

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[1] Telesis report, op. cit.

632. Of course, there is still time for Europe to awaken. The Japanese example shows that in a few years significant results can be achieved, provided a specific large-scale policy is implemented, particularly in the field of micro-electronics. Development in this area started around 1975 on both sides of the Pacific, first as a result of the American military space programmes and then from civil R & D programmes initiated by the MITI in Japan. Private companies then took up the initiative to exploit the spin-off effects of these various programmes.

The ESPRIT programme is a useful first step in this direction. First of all it has the right objective: to create a new technological base for the next generation. The idea is not to copy what already exists but to pave the way for a forward leap in information technologies. Secondly, it has the right method: provided the administrators do not make the system too bureaucratic it should work, because the programmes are drawn up by the firms and institutes responsible for carrying them out. But this is only the beginning: the 15 pilot projects launched in 1983 amount to 20 million ECU, i.e. 200 times less than IBM's net annual profit of $4,000 million.

It is essential to address this problem on a completely different scale as soon as possible, but without creating in the process new administrations which would take responsibility for defining the 'right' sectors to be in, to choose the 'right' firms to be given Community subsidies. Competitiveness does not just happen, it has to be acquired.

633. The two principles for recovery in this area are as follows:

- the Community R & D budget must be gradually increased on the basis of a ten year programme, by the end of which it ought to have reached about half the current level of public spending on R & D in the Member States, i.e. $20,000 million or 0.7% of the Ten's GNP (assuming a growth rate of 2%, GNP will increase by around 22% in 10 years).

- this would enable any joint venture of European firms to have its research programmes part-financed by Community funds, on the understanding that the industrialists would continue to be solely responsible for the implementation of the programmes. In return, the results of the research (patents) should be made available, with the Community reserving the right to allow any other European industrialist not party to the joint venture to take advantage of them. One example is the joint laboratory that has just been set up by three data-processing firms, Britain's ICL, Germany's SIEMENS and France's CII-HONEYWELL BULL.

It would not be realistic to exclude European companies cooperating with American or Japanese partners from these ventures. A firm does not have to answer for the nationality of its partner. If the Community does not want a firm such as CII to associate with HONEYWELL BULL, all it has to do is to establish a fiscal and financial system which makes it advantageous for such a firm to associate with a European partner.

In return, the Community should demand from its major partners (United States, Japan) complete reciprocity in all fields: public purchasing, investment, standards etc.

634. The world seems increasingly to be divided into the innovative economies, which advance by creating new attractive activities, and the economies of 'adjustments', which decline as they protect the threatened old preserves. The Member States, acting in isolation, are being forced increasingly to pursue the second type of policy.

If the European Community is to join the first category, it has to reconcile the need for a large market with national interests and to this end gradually extend its field of activity, especially in the industrial technologies and R & D.

It will need to use all the budgetary and financial resources at its disposal (Regional Fund, Social Fund, EIB) to compensate countries which derive less benefit from the joint industrial and R & D effort, while avoiding lapsing back into the system of national contributions which would be a retrograde step in the construction of Europe. In the same way, the common trade policy can contribute to a general improvement if it is extended to include export assistance, licence agreements and so on.

Except for the defence of Europe there is perhaps no aspect more essential to its future than the formulation of a positive policy for the creation of common base for industry and research.

CHAPTER 7

A EUROPEAN 'MARSHALL PLAN' FOR ENERGY AND REGIONAL POLICY

This heading may be somewhat surprising. The idea of a new MARSHALL plan is open to a number of serious objections. Consequently, before outlining the plan of action which we propose here, it is important to define our motives.

71 - Explanatory Statement

711 - Three lessons of the MARSHALL plan

Between 1948 and 1952 the nations of Europe, drained by the war effort, received a substantial amount of aid from the United States (approximately 10,000 million dollars per annum at 1983 values), which made a major contribution to the rebuilding of their economies. This is not the place to expatiate on the complex mechanisms of the MARSHALL plan. The main task is to highlight the three lessons which it has taught us.

American aid was granted on the express condition that its exchange value should not be used to finance the budgets of the European countries concerned, but should go into new investment. This condition appeared particularly rigorous on the war-stricken peoples of Europe eager for consumer goods. But, in the last analysis, the American demands were undoubtedly to the benefit of Europe, especially since the investment programmes had to be accompanied by an unprecedented cooperative effort within Europe. This led to the creation of the European Payments Union (EPU) and the OECD, which were subsequently to facilitate the start of the movement towards European integration.

Finally, the generosity of the Americans (approximately 1% of GDP per annum) worked to the advantage of donor and beneficiaries alike: although its initial objective was essentially political, America indirectly benefited from Europe's economic progress.

The priority given to investment over consumption, the joint organization of the investment schemes and the exploitation of economic interdependence as a way of forging a common interest between the rich countries and the poor countries: such are the three lessons to be learned today from the MARSHALL plan. It is not hard to see that they are of particular relevance to the situation in Europe. Not only in matters of energy. The proposals which follow show this because they are not confined to the energy sector. Nevertheless this sector has high priority.

712 - Three reasons for a MARSHALL energy plan

These are as follows: the future and the medium-term growth of the European economy depend as much as ever on energy investments; it is in Europe's interest to stimulate such investments not just in its own territory, but also in those countries with which it maintains special relations, especially the ACP States; the revitalization of investment activity within the EEC must be planned first and foremost on a regional basis, since certain protectionist forces must be combated as a matter of urgency.

The EEC imports a substantial proportion of its energy supplies. What would the consequences be if in 1985 the price of oil was brought back to the 1981 price of 28 or 29 dollars a barrel? The International Energy Agency notes[1] that: 'In future the total oil requirements of the OECD countries and the developing countries together would probably be far in excess of the quantities available on the world oil market. ... Such an imbalance between supply and demand would in all likelihood result in further price increases and might well be instrumental in provoking fresh upheavals on the market, triggering massive and sudden price increases'.

In other words, maintaining the price of oil at its present level is enough to reduce investment in conventional and new forms of energy and in energy saving schemes so drastically that it could easily result in a third oil shock towards the end of the 1980s. This takes no account of what would happen if, say, some missile were to sink a vessel in the Ormuz Straits. Another oil shock similar to those which followed the Yom Kippur War and the revolution in Iran would leave Europe with several more million unemployed. All of which points to the fact that Europe should at all times give the utmost priority to increasing its energy investments. However, to re-employ the phraseology which we saw fit to use in Chapter 5, the Community's approach to the energy question is one of childish irresponsibility and reckless levity since in the 1980s it is proposing to devote on average a mere 2.2 % of GDP to its energy investments (1.6% in 1980), whereas the projections of Japan and

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1 World energy prospects: OECD/IEA, December 1982

the United States are 3% and 4% of GDP respectively. This lapse must be remedied as a matter of urgency.

We would admit that this situation is partly attributable to Europe's relative shortage of oil and coal and to the fact that the development of nuclear energy is being held up for political reasons. But that is all the more reason why the Community should embark on what would represent the most original aspect of the new MARSHALL plan: a programme of action to boost energy investment in those countries with which it maintains special relations: the countries of Africa, the Caribbean and the Pacific which are signatories of the Lomé Conventions and know as the ACP States, the Mediterranean countries and, above all, perhaps, the two countries which have applied for Community membership, Spain and Portugal. That such a programme would be to the advantage of both sides is quite obvious. The Community has everything to gain from the further economic development of these countries, since it will be able to increase its exports to them. However, their expansion is impeded by their external deficits, for which the high cost of oil imports is much to blame. Hence, it would be greatly to their advantage to invest in oil and in energy in general. Furthermore, these countries would greatly benefit from the recovery of growth within the Community, which would be short-lived unless energy investments were substantially increased.

Lastly, if Europe is to be able to open up its markets on a sufficiently large scale to imports from these countries, it is essential that it should consolidate and improve its measures in the regional development field. The Community is often tempted to close its frontiers to products from the less developed countries in order to protect its most backward regions. Just as these regions have tended to dictate its agricultural policy in relation to the Mediterranean countries and the applicant countries, so too have they influenced its policy line on the traditional industries, especially textiles, which were once concentrated in prosperous areas but are today in decline.

713 - Three objections and the appropriate responses

While the need to increase energy investment and improve regional policy in Europe is not in dispute, the idea of making additional sacrifices for the benefit of third countries, and for developing countries in particular, is opposed, and opposed all the more vehemently since Community financing is the form of assistance proposed.

The first objection is that, with a recession, large-scale unemployment and deficits of every description in Europe, it is simply not the time to deprive ourselves, even partially, of the benefits of a fall in oil prices by making over to third countries a share of the proceeds of the oil levy.

The mainspring of this objection, however, is opposition to the very principle of the oil levy. The only argument worthy of consideration here is that the fall in oil prices is having an anti-inflationary effect. But with oil at 2 ECU a barrel, that effect is 0.1%, which is negligible. It bears no comparison with the new wave of inflation which a third oil shock would assuredly bring in its wake.

The second objection is that, while a 'MARSHALL plan' would perhaps have been desirable when the Third World countries still had margins, today further loans would simply not be repaid. To this objection there are two replies. In the first place, the breathtaking rise in the indebtedness of the Third World since 1974 is primarily attributable to the fact that bank loans have been granted without conditions and their proceeds consumed instead of being invested. Those pitfalls would have to be avoided. Secondly, the 'energy' loans proposed for the purpose of investment in the third countries would not necessarily be granted to States but perhaps to oil companies (and mining companies), whose main advantage would be the political guarantee which only the Community can extend to them.

This brings us to the third objection. Why go through the Community? Why don't the Member States, which, after all, have an interest in such investment, do it? The first answer is that the Member States simply do nothing: only 1% of oil investments are made in the developing countries which are not members of OPEC, which account for roughly 15% of global reserves. The second answer is that the rigorous conditions to which the financing of the new MARSHALL plan would have to be subject cannot be negotiated in a bilateral context: any State which tried would quickly be suspected of neo-colonialism. The Community would make far more progress, because thanks to the success of the first two Lomé Conventions, it has gained sufficient trust as a partner in schemes of joint development that it would be able to negotiate effectively, especially within a collective framework.

72 - Plan of action

The three reasons outlined in the foregoing paragraphs suggest that it would be appropriate to introduce three types of scheme. Loans with interest subsidies or joint financing would be the main component of all three. Detailed studies are necessary to establish the order of priorities and suitable time-scales.

721 - In the Community, the energy policy to be pursued has recently been outlined in the 5-year programme which the Commission proposes to finance by a tax on the consumption of energy[1]. This is not the place to summarize the programme. We shall merely stress its importance and make three observations.

First, the projections made in Chapter 6 suggest that the proposed increase in Community appropriations is necessary to reduce the excessive duplication of work by the Member States and to allow a more efficient allocation of resources.

Secondly, the new resources available to the Community should be used to promote cooperation between European enterprises to enable them to master new techniques, such as the exploitation of deep gas deposits and of heavy oils, and to turn this to good account by developing new European resources (oil from the Adriatic, for example).

Thirdly, as soon as the fall in oil prices reduces the profitability of investments in the energy-dependent economies, incentives become necessary. In this regard, Japan has set an admirable example. After reducing its energy consumption, as a share of GDP, by 20% between 1970 and 1980, Japan adopted the measures needed to obtain a further 20% reduction between 1980 and 1990. The Community should use its resources to achieve savings of a similar order of magnitude, particularly within the framework of its demonstration programme, and continue to reduce its dependence on imported energy (see Graph 4).

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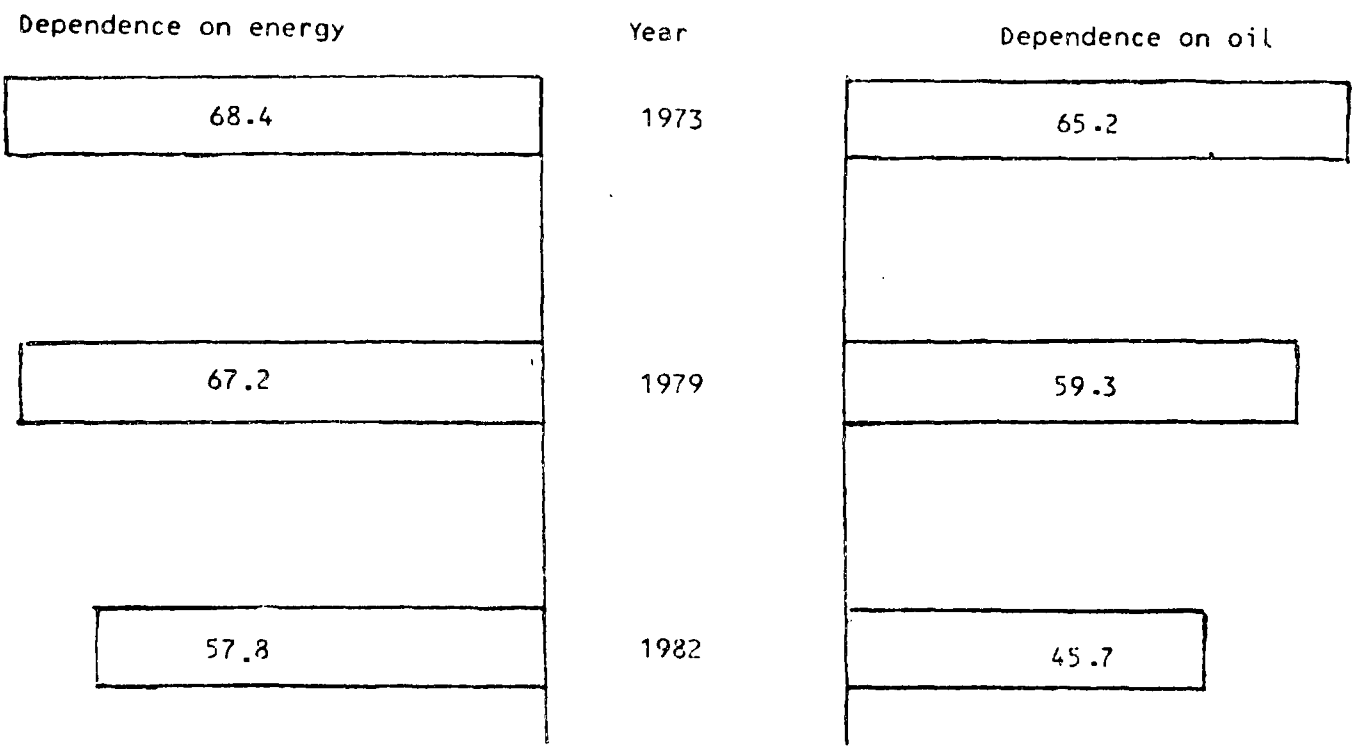
[1] Com (83) 315 final

Graph 4

COMMUNITY (excluding UK)

Dependence on imported energy and oil[1]



[1] Percentage relationship between net energy (or oil) imports and gross domestic energy (+ bunkering) consumption

Source: EC Commission

722 - Third countries with special links with the Community

The MARSHALL plan technique for promoting investments in energy and mining projects in these countries would have two advantages for the Community. In the first place, anything that fosters the development of our partners and, in particular, the development of their energy and mining output, would make an increasingly valuable contribution to growth, stability and employment in Europe. Secondly, the financing proposed should be made conditional on tied exports of equipment and services which would help to bring additional growth to the Ten.

It was with these considerations in mind that, under the presidency of Mr MACNAMARA, the World Bank had planned the creation of a specialized subsidiary to finance energy investments in the developing countries. Since this plan came to nothing, the renegotiation of the Lomé Convention, which is due to begin in September 1983, offers a suitable opportunity for instituting a pilot project of cooperation between the Europeans and their partners in Africa, the Caribbean and the Pacific.

The present deadlock results in part from the excessive demands made by some developing countries on the oil companies and, above all, from the lack of security for foreign investments in most of those countries. Hence the need for international guarantees. The Community is particularly well placed to organize such guarantees in that it is preparing the new negotiations in a global context of autonomous development for the countries concerned.

The most important projects on which the greatest progress has been made apparently relate to the liquefaction and transport of gas produced in Nigeria, 95% of which is currently burnt off; exploitation of the Inga dam on the Zaire river by industries which are major energy consumers; and the exploitation of newly discovered coalfields in Botswana. The cost of these projects is in excess of 10,000 million dollars.

723 - The Community's regional policy should be thoroughly revised, for three reasons.

The first reason is that since the crisis, regional problems have taken on an altogether different dimension. Income differentials have ceased to narrow (see Table 11). The increase in unemployment has been no less severe in the 'strong' regions than in the 'weak' regions; which, moreover have

Table 11

Per capita GDP = differences between Member States (EEC-10)

(variation coefficient)[1]

1961-1970	1971-1980	1961	1963	1970	1973	1980	1982	1983[2]
15.4	13.8	17.7	16.0	13.4	13.0	14.1	14.5	14.9

[1] Variation coefficient = standard deviation divided by mean. Data based on purchasing power parities.

[2] Forecast.

Source: European Economy

lost the safety-value of migration and often find themselves facing a return flow of labour.

In the face of these mounting difficulties, the results obtained by the European Regional Fund are disappointing. About 8,000 million ECU have been spent in eight years. 85% of this sum has been used to reimburse the Member States on the basis of predetermined quotas, instead of topping up national aid in accordance with the common regional policy objectives.

This dissipation of funds, this pretence, is even more unacceptable today in that the severity of regional problems is increasingly determined by national conditions. In the Member States where they are most acute, these problems tend to exacerbate the discrepancies in inflation and economic growth rates. This is particularly evident in two of the new member countries - Ireland and Greece.

For all these reasons, it would seem necessary to adjust the reduction in corporation tax according to how investments are distributed regionally and to earmark a third or a quarter of the supplementary investment programme discussed in Chapter 5 for a new Community regional policy - a policy which is genuinely new, since it would also apply fully to the two applicant countries of the Iberian Peninsula.

Within the Community of Ten, there are two priorities. The first is to concentrate ERDF aid in a small number of regions, particularly in Ireland and Greece, which are experiencing the most serious structural difficulties and to finance integrated development programmes so as to enhance the combined impact of Community and national resources. To this end, a small number of pilot regions should be chosen - some could be regions of older industry which are now in decline but have made special efforts to promote vocational training - for the development of new activities linked, for example, to the application of the information technologies discussed in Chapter 6.

Finally, the Community would not only meet its commitments, but also serve its own long-term interests by making a special effort to assist Spain and Portugal, thereby vindicating the idea of a 'European MARSHALL Plan'. These two countries must now be regarded as the new Mezzogiorno of the Community. The latter has a duty to ease their accession by making generous investments, adapted to their specific needs and granted on sufficiently flexible terms so that they could even be used to promote, inter alia, vocational training programmes.

724 - Further points

At what pace could the investment proposed in this chapter and the preceding one be effectively carried out? Would this pace be rapid enough? Would the geographical and sectoral redistribution measures envisaged suffice to obtain in the short term initial extra growth of around 1% per annum? While we are convinced that the general approach and the principle guidelines of this report provide a broadly accurate reply to the questions put by the European Parliament, we nonetheless lack the time and the means necessary to quantify our proposals.

That is why we have been very careful in Chapter 5 and the following chapters not to put forward detailed proposals as to how the relevant funds should be apportioned. Only through in-depth studies and political negotiations could this general sketch be transformed into a truly detailed programme.

Such studies would probably show that, had we not been anxious to keep our analysis and proposals as simple as possible and to concentrate on lines of action for a small number of priorities, we would also have had to demonstrate the benefits to Europe of undertaking a number of large-scale public investment programmes. Since the beginning of the crisis, such programmes have greatly declined. True, Europe is in the main well equipped with roads, schools and hospitals, but the renewal of much of our infrastructure is now necessary. Moreover, the economic growth of the EEC would be further stimulated by the completion of certain major projects such as the Channel Tunnel or the Straits of Messina Bridge and, above all by the implementation of new high technology programmes, notably in transport and telecommunications and in the environmental protection sector.

CHAPTER 8

GROWTH IN EMPLOYMENT THROUGH FLEXIBILITY OF LABOUR

81 - Unemployment in Europe is caused by inflexibility

This is clearly shown in Graph 5, which compares the relationship between GNP in volume and productivity in the EEC, the United States and Japan over a long period (1961 - 1983).

811 - A radical difference in structures

It can be readily understood that, if the productivity of an economy - expressed in terms of GNP in volume per person employed - increases at the same rate as overall GNP no new jobs will be created whatever the overall growth rate.

On the other hand, if overall productivity continues to develop at a slower rate than GNP, jobs will be created regardless of the GNP growth rate. This is roughly what is happening in Japan, where straight line R which denotes the relationship between growth and productivity is virtually parallel to, but below, the bisecting line (45^{o}).

In the United States the relationship between growth and productivity is even more favourable to employment: not only is straight line R below the 45^{o} line, but its gradient is only half the latter's. This means that jobs will be created even if growth rates are very low and the number of people in work will rise very steeply as growth accelerates. This explains why, as we saw in Chapter 1, the number of persons employed in the United States rose by 15 million in 1973-1983, while in Europe it fell by 3 million.

The striking feature of the EEC graph is that straight line R crosses the bisecting line at a point corresponding to approximately 3.2% growth in volume. This observation is central to the thesis of this report; <u>it shows that there is a radical and apparently little-known difference between the structures of the European economy and those of the United States and Japan, namely that below a growth rate of the order of 3%, employment falls[1], while in the other OECD countries it increases even if growth is under 1%</u>. Whereas in the United States an economic growth rate of the order of 1-2% is sufficient to increase the number of persons employed by 1% per year, on the basis of past experience the Community would require growth rates of the order of 6-7% to achieve the same increase of 1% in the number of people employed!

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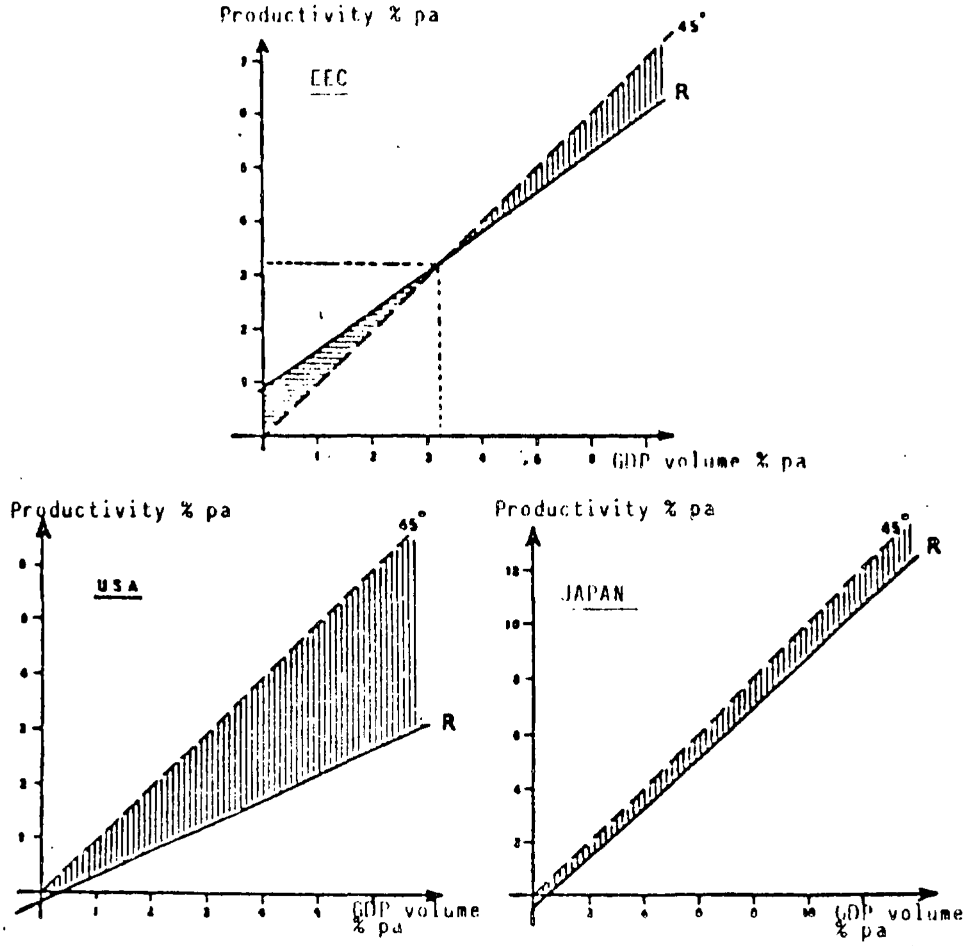
[1] The situation in Germany is even more serious: from 1965 - 1983 GNP increased by 61% or 2.7% on average, while the number of people employed fell by 1.6 million.

Graph 5

RELATIONSHIP BETWEEN GDP VOLUME* AND PRODUCTIVITY



R = Regression on basis of annual values 1961 - 1983

* GDP volume = productivity x employment (as index)

Productivity = GDP volume per person in employment

[vertical hatching]: NUMBER OF JOBS INCREASES { in USA and Japan irrespective of growth rate / in EEC at growth rate > 3.2%

[horizontal hatching]: NUMBER OF JOBS FALLS IN EEC AT GROWTH RATE < 3.2%

812 - Average working hours must be reduced

Given this historical relationship, it is absolutely impossible, in the years to come, to resolve the problem of employment in Europe solely by means of a recovery in growth and investment. Growth rates of 6 - 7% per annum for an extended period seem to be beyond us in the present situation.

What should we do to avoid increasing unemployment during the 1980s?[1]

We must of course improve growth conditions! An extra 1% growth would increase our room for manoeuvre (see Chapter 5). But the historical relationship between growth and job creation, which is so unfavourable in Europe, must also be improved[2]. This calls for flexibility on the labour market, flexibility as regards incomes (relative costs of capital and labour) and flexibility as regards the length of working hours provided that this does not have a cost effect.

Hence, whether we like it or not, we are forced to concur with the Commission's view[3] that if Europe is to avoid a steadily worsening unemployment situation it is essential to reduce the average number of working hours.

A Euro-barometer poll carried out in the ten countries of the Community in 1983 clearly shows that public opinion is aware of this fact: of those questioned about the likely trend in unemployment in the event of an economic upturn, 66% replied that this alone would not resolve the problem of unemployment. Among those who were better informed, the percentage was higher: more than 75% of those who had continued their education beyond the age of 20 shared this view.

813 - But this reduction is likely to be no remedy at all

However, having established this fact, we must immediately make two further points: first, merely by studying Graph 6, which shows the actual average working hours in industry in the major OECD countries, we can see that there is no correlation between working hours and the unemployment rate; on the contrary, the two countries with the lowest unemployment rate, Japan and Switzerland, are those where actual working hours are also longest. Secondly, the national policies to reduce working hours that have been implemented to date have generally failed: instead of improving the employment situation they have led to a worsening of inflation and, as a result, have adversely affected industrial competitiveness and corporate investment and thus, ultimately, employment.

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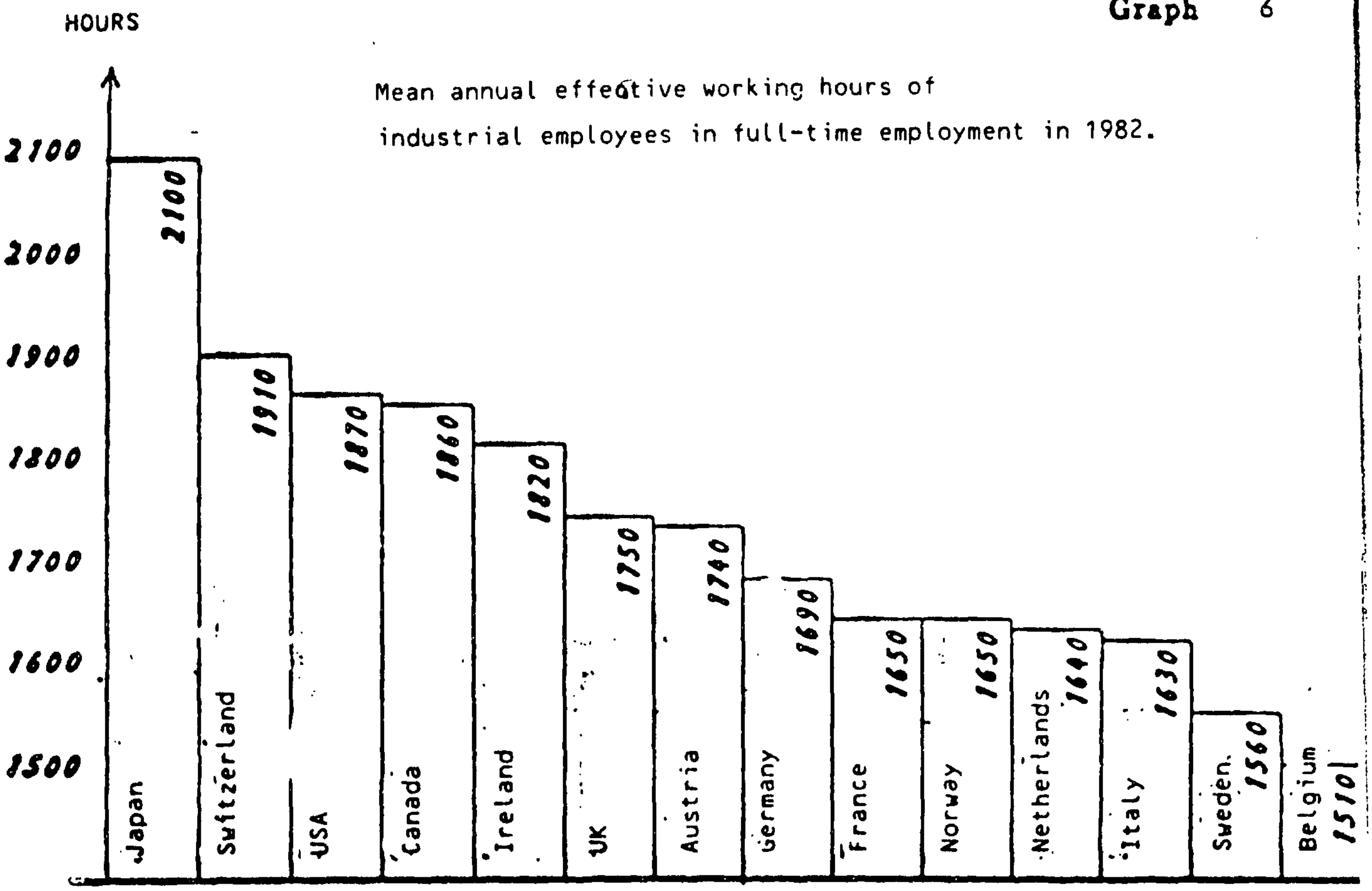
[1] One of the most recent studies by the Netherlands' Economic Institute in December 1982 projects the following unemployment rates on the basis of current trends (December 1982 = 10.5%): 1985 = 12.6%; 1990 = 15.1%.

[2] The American economy, on the other hand, can tolerate smaller increases in productivit for various reasons, chiefly because incomes adapt more flexibly to the trend in productivity (see Chapter 1, Table 1)

[3] COM(82) 809 final of 10.12.1982, Memorandum on the reduction and reorganization of working time.

Graph 6

Mean annual effective working hours of
industrial employees in full-time employment in 1982.



Source: Council of Europe. Working hours - a comparative study. Study group chaired by Mr A. DOYELLE. Strasbourg, 1983.

As a result, the European economy - much more so than its partners - has had to endure an increase in unemployment which has become a permanent feature and yet, at the same time, even the most radical policies are unable to reverse this trend. One single factor is responsible for both these phenomena: inflexibility. On the one hand, the European economy is hidebound by the compartmentalization of its markets, the inertia of its traditional activities and methods of economic organization and archaic social relations, the ossified structure of income distribution and the excessive burden of compulsory deductions. The combined effect of these factors is equivalent to a general consensus in favour of unemployment. On the other hand, any general policy which tries to speed up the natural process of reducing working hours without thereby reducing the income available for distribution further inhibits the undertakings to which it applies and thus contributes to unemployment. Justifying 'work-sharing' is easy: gaining general acceptance for 'income-sharing' is harder.

Faced with this situation, there are many who believe that the most sensible solution is to do nothing and that this is still possible despite the increase in unemployment, since unemployment is not such a burning political issue at the moment. This may be true, but we should not forget one fact. Unemployment now is less explosive but more corrosive, less revolutionary but more insidious. There is no longer the whiff of gunpowder because it has been replaced by a whiff of decay: the will of young people to work is being allowed to rot. More than one-quarter of them are condemned to unemployment (EEC average 26.4% at end March 1983 and one-third or more in Belgium, Denmark, Italy and the Netherlands).

What is needed to accompany and strengthen the recovery in economic growth is specific action to combat unemployment, but action which is dictated by the golden rule that industrial competitiveness must not be affected and which is based therefore on greater flexibility of working conditions. Although employment policies, like other social policies, should continue to be implemented primarily at national level[1], European action proper is justified in this case because the inflexibility which is at the root of unemployment and the demographic changes which make the next few years crucial are specifically European phenomena.

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[1] This is why this report does not deal with the adaptation of social security systems, although this is a general problem for Europe and one which is closely linked to the recovery of growth. Similarly, on the whole issue of the distribution of incomes and assets which basically involves national traditions and options, we felt that we should not go further than the general proposal to slow down nominal increases in salaries in the public sector, which enjoys guaranteed employment (Chapter 5). Any additional flexibility would be highly favourable to employment.

Community action should be taken at two levels: specific policies to promote youth employment and the negotiation of a European collective agreement on the organization of working hours and the freedom to choose working hours.

82 - Flexibility for youth employment

'More than 4.5 million young people under 25 are unemployed in the Community at present. This represents 40% of all unemployed workers, whereas young workers represent less than 20% of the labour force. Thus the average rate of unemploymeent for those under 25 is over 20% compared with 11% overall. Changing demographic patterns will, in most Member States, only have an impact in the 1990s.'[1]

This social drama has a decisive influence on economic growth in Europe. Europe is beginning to wake up to that fact.

The European Social Fund has just taken an important decision to allocate 75% of its resources to measures to combat youth unemployment, compared to its current level of one-third. However, this decision, which follows the line proposed by the European Parliament, must not allow us to forget the low level of social expenditure in the EEC which is around 400 times less than spending on social protection in the Member States.

In order to help young people to appreciate the value of what the Community is doing for them, certain of these measures will have to be financed wholly from the common budget. One of the most important facts in this connection is that in the 70's the percentage of young people of 20 years of age continuing with higher education was approximately 30% in the United States, 25% in Japan and only 11 to 17% in Europe. It is a fact that the young people who find employment most readily are those who have been best trained and the high level of education in the United States and Japan is undoubtedly a contributory factor in their technological advance.

Secondly, to restore the growth of the European economy, there needs to be a European market which is integrated in every sphere, including an increasing number of young people trained 'European-style'. This constitutes a potential source of jobs and growth which compels the Community to contribute to the decompartmentalization of research by setting up a number of European centres of excellence specialized in university teaching and research in the sectors of the future (information industries, bio-technologies and so on).

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[1] Communication from the Commission to the Council of 21.3.1983, COM(83) 148 final.

Furthermore, just as we proposed in Chapter 6 that the Community should give financial support to any joint ventures in the field of research and development undertaken by firms from the various Community countries, transnational study programmes between schools and universities and exchanges of students and teachers should also be considered as priorities for Community budget expenditure, since they are profitable long-term investments in the recovery of employment and growth in Europe.

The more flexible the conditions of training and education are and the more closely geared to the essential progress of the European market, the better prepared young people will be for geographical and vocational mobility and the more effectively the labour market will be able to contribute to the economic progress of the Community.

Naturally, this alone will not be sufficient. Only greater flexibility in either individual incomes or working hours will enable us to make room for young people on the required scale. But we must take care that the reduction of working hours does not bring a demobilization of those socio-professional categories who form the main motor of growth (industrial directors, management and technical staff etc.); on the contrary, these categories should be encouraged by new economic and social prospects.

83 - Flexibility of working hours

831 - The difficulty of collective methods

Not all collective methods of reducing working time are necessarily doomed to failure. As thinking on this subject has developed, there have been more and more experiments in recent times combining reduced working hours with increased productivity and a limited reduction in salaries. In the German chemicals industry, for instance, an agreement was concluded on a phased reduction of the working week (4 hours per fortnight in 1983, 4 hours per week from 1987) for salaried workers over 58. In return the trade union agreed to a cut in the overall wage increase.

Similarly, in the Benelux countries, schemes to reduce working hours increasingly involve a partial reduction in salaries, to avoid the increase in charges borne by the firms cancelling out the gains resulting from increased productivity. The '5-3 Agreements' in Belgium are a case in point (collective negotiations by sector for a 5% reduction in working time, a 3% reduction in salaries and a 3% increase in the workforce). In the Netherlands salaries in a number of sectors were de-indexed at the start of the year and in return an agreement was sought on a reduction of working hours and an increase in jobs.

In France the new 'contract of solidarity' concept introduced at the end of 1982 combines a reduction in working time with changes in the way it is organized; the resultant increases in productivity can be distributed in a manner which reconciles the interests of the firm and of its employees with an improvement in employment.

832 - The growing importance of voluntary short-time working

However, the feature common to all these experiments is their very limited scope in relation to the overall unemployment problem. In fact, they all fail - especially during a time of slow economic growth - because of the difficulties workers have in collectively accepting a partial limitation of salaries.

This is why, if we are to obtain substantial results in the employment field in the medium-term, it is indispensable that any reduction in the length of working hours should principally be a matter of free personal choice.

This free choice has so far mainly applied to the voluntary reduction of the retirement age. There are still plans for further initiatives of this kind, particularly in the FRG. But this is probably the most difficult way of fighting unemployment.

On the other hand, when a worker changes from full-time working to part-time he quite naturally accepts half the salary thus making way for another part-time worker without substantially increasing the financial burden on his firm. Now there is a deep-rooted sociological evolution affecting not only women but also, increasingly, men - particularly at the start or at the end of their careers - which is making an increasingly number of our contemporaries feel a desire to be able to choose freely the level of their income in relation to the length of their work. They wish to determine their working hours themselves.

What is more, at a time when purchasing power will inevitably progress less rapidly than it has done in the past, the development of free choice for the individual as regards working hours could constitute one of the most important new paths of social progress.

In all countries the demand for part-time work - not only from the unemployed but also from people in full-time employment - is far greater than what industry can offer. In most cases firms have little to gain directly and prefer to manage fewer full-time workers rather than a larger number of part-time workers for reasons of convenience.

But the immediate convenience of every firm must come second to the need to reduce unemployment in Europe, if only in the collective interest of industry: we have seen in Chapter 2 how unemployment encourages protectionism, harms investment and makes individuals more hostile to work. Experience also shows that in the case of part-time working, as in the case of flexible working hours, firms which make the effort to adapt their personnel management methods achieve satisfaction in the end.

In fact, the scope for part-time working in the EEC is considerable since part-time workers account for around 12% of full-time workers compared to 16 to 17% in the United States. The difference is approximately 5 million people.

If half of them were able to find work where they could voluntarily determine their hours, and we add the effect of extra growth from the stimulation of investment, it would be possible within three years to halt and then reverse the upwards unemployment curve. In fact,

- we have seen in Chapter 2 that the trend is towards an increase of 2 million unemployed from 1984 to 1986. To reverse this trend the number of jobs would have to be increased by about 3 million;

- the extra 1% growth per annum for three years calculated in Chapter 5 would make it possible to create 600,000 extra jobs;

- if, at the same time, 2.5 million new part-time jobs were offered, the objective could be attained. And if these jobs were offered primarily to young people, the youth unemployment rate could fall from over 26% to about 11%, or the Community's overall average. On the basis of 105 million existing jobs, this corresponds to a conversion to part-time jobs of less than 1% per annum[1]. Who would say that this is impossible?

It is probable that if public opinion and governments call on all firms to follow the example of those firms which are developing flexible working hours - and are satisfied with the result - they will do so because they will realize that it is in their own interest. Flexibility of working time is in fact the only way in which they will be able, on a large scale, to maintain their competitiveness while reducing unemployment, and in a manner which can be reversed at any time.

However, should persuasion not be sufficient, governments would have no lack of means of providing incentives, without transgressing competition rules. As we mentioned in Chapter 4, they could link a reduction of profit taxes to firm or industry policies directed towards reduced or flexible working hours; some administrations are thinking of reducing unemployment contributions for firms which encourage part-time working or of allowing long-term unemployed to retain part of their allowances while working part-time, which would avoid the tendency for them to become second-class citizens and unemployable. Similarly, studies of the French measures show that, if need be, financial incentives granted to full-time workers who are prepared to change over to part-time working would, after a few years, be largely offset by the reduced cost of unemployment benefits.

Part-time working is developing rapidly in Japan and especially in the United States, where it accounts for one-third of all new jobs. The fact that Europe is lagging behind in this area exemplifies the flexibility which is required in view particularly of the demographic reversal which will begin in the 1990's.

More flexibility would also create fresh scope for individual freedom and collective bargaining in the employment sector.

At present there are only two European collective agreements and they

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[1] This was the assumption on which the projection summarized in Chapter 5, Table 5 was based (average reduction in working hours up from 0.7% on the basis of current trends to 1.9% per year). Part-time employment is taken as equivalent to half-time working.

concern agricultural workers. A framework directive[1] and new European collective agreements are needed as part of the European programme for growth, stability and employment proposed in Chapter 5 to enable the rights and working conditions of part-time workers to be harmonized and improved.

This is necessary because, as the Director-General of the ILO recently wrote[2], 'full employment in the conventional sense is no longer possible. There is no long-term projection which allows of the hope of a return to this type of full employment. We must therefore show imagination, i.e. overcome the inflexibility of our ideas and remind ourselves that between 1900 and 1980 the total number of hours worked by an individual during his lifetime has fallen by half: compared to the beginning of this century we are now virtually all part-time workers ...'.

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[1] Amended Commission proposal to the Council of 17.12.1982, COM(82) 830 final

[2] Francis BLANCHARD in 'Futuribles', January 1983

CONCLUSION

It was the economic growth of the member countries that welded the foundations of European unity in the beginning. Nowadays the unifying influence at large in Europe is altogether different and it is gaining ground rapidly. This new unifying factor is decadence.

It is a vague sort of word we are not used to hearing and one whose real implications are difficult for us to grasp since the experience of our generation, to which we still implicitly hark back, has been one of rebirth and growth. Nevertheless, the facts are there.

After having surprised the world during the 1950s and 1960s by their ability to grow without inflation and to lay the foundations of the Community together, the Member States saw the tables turned during the 1970s, which brought inflationary growth followed by inflation without growth. All these mistakes have been compounded by the constant round of meetings in which our ancient nations have behaved like members of a bourgeois family fighting over an inheritance. The European Economic 'Community' has become a euphemism. The first oil shock set it on the way to becoming a non-Europe.

With the second oil shock and the advent of the 1980s came the time to pay for these mistakes. Certain countries have done so but they are beginning to discover that this necessary sacrifice is not enough to enable them, alone, to return to the path of stable growth. Others who believed that they had found a way to continue working less and earning more are now facing a severe test - made more severe by their isolation.

The game they are playing is a zero-sum game: they have had zero growth for three years from which they will never extricate themselves if they continue, each man for himself, to tend their own private gardens intensifying their mutual differences, failing to realize that they are in fact walling themselves in so that they are all prisoners. Instead of looking for a driving force which can pull them along together, they are squandering their energies on quarrels which simply serve to slow them all down.

Admittedly it was easier to embark on the building of Europe while sharing out the dividends of rapid growth than it is to continue the process when the growth in collective prosperity has ceased. But one need only look at Europe's decline in the field of information technology to realize that there are very few years left to indulge in this petty self-destructive game of every man for himself.

Tomorrow, when the Community is nothing but a poor old cripple, it will have learned too late that soft growth makes for hard societies and slow growth for run-down societies. The 'balkanization' of Europe will have carried the peoples of the ten Member States of the Community into a New Middle Ages.

Non-Europe, under-employment, non-growth, decadence, are all part of the same phenomenon, which in everyday life is reflected in growing despair and sometimes violence. Just fifty years after the election of Roosevelt and Hitler's coming to power, we need to remind people of the full significance of the recovery of growth demanded by European public opinion and the European Parliament alike.

This recovery is possible. In Europe there is a seam of growth and social progress which has barely been explored and is totally untapped. It is the 'multiplier effect of Community action' which has been described in this report.

How can it be put to work? At Community level it will take an initial impetus which is strong enough to create a psychological jolt but sufficiently controlled to avoid financial upheaval and, in particular, sufficiently understandable to command the broad support of those involved.

The proposal in Chapters 5 and 7 can be summarized in the expression three times three: 1% of extra growth each year for three years and three million extra jobs. The techniques described use investment as the means of both increasing supply and supporting demand: they aim to restore balance in public finance and in company accounts; they combine a consolidation of purchasing power with an improvement in employment.

Over the last ten years isolated attempts at revival by individual states have ended in aborted recovery followed by long recession. In this case, on the other hand, the model simulations which have been conducted demonstrate that this gentle initial stimulus at Community level - if accompanied by a sustained effort to reduce inflation - will lead, all things being equal, to a sustained revival of growth in the EEC. At the same time resources can be allocated - and above all the necessary climate created - to enable Europe to respond to the challenges in the fields of energy and technology which are threatening its future. By taking this path to recovery the Community will at last be able to establish its credentials in the monetary field with a strengthened EMS, to open serious dialogue with the United States and Japan and to play its proper role in working for the progress of the Third World countries, many of which are threatened by complete collapse.

What is needed for this project to become reality and to involve those who are committed to growth, i.e. are motivated by a desire to create, enthusiasm for action and the thrill of achievement? Basically, the answer is support from public opinion, which is still unaware that it is facing a radical choice between realization or suffering. One example among many: throughout Europe social security benefits are gradually being cut back; the public often believes that this is a result of temporary difficulties and that afterwards all will be as before; in fact it is only the beginning of a long-term retrenchment which will get progressively worse until Europe once again achieves sustained and stable growth.

Europe lacks neither the resources nor the technology to achieve a recovery in growth. What it lacks is a clear perception of its situation. But how can it perceive anything when it has no eyes? All that is left of the Community is a hotchpotch of regulations and abstractions. That is why the slightest progress on matters of practical detail is a sound investment in growth because it has a direct impact. This applies to the European passport and European driving licence, to the abolition of VAT collection at borders or to European television. All these projects should be implemented as a matter of urgency and accompanied, for example, by Community-wide postal, telephone and public transport rates.

This report is only one of a number of possible outlines of a common plan for growth, stability and employment. Its strength is in its reliance on the ability of the European public to understand where their current interest and their future opportunities lie, at a time when they are staking their all and when the European population is being enriched by growing numbers of better-trained young people with a desire to work.

COMMENTARY BY PROFESSOR BALL

CHAPTERS 5, 6, 7 and 8

This commentary, I should stress, is not concerned with the analytical section of our report, which as stated elsewhere, we are broadly agreed on. Nor is it concerned with the seven key observations and the policies we would jointly support in Chapter 4. However, the development of some of these policies which have been outlined by Michel ALBERT in Chapters 5 - 8 require some comment. I have studied these carefully and while appreciating the difficulties of any specific proposals believe that these are worthy of discussion and debate in arriving at a final view. I would have to say however that I have some reservations about certain details. The proposals that he advances in Chapter 5 of the Report seem to be as follows.

The Albert Proposals: Analysis

2. Real profitability is one of the key factors in the provision of future output and employment. This means that wage growth must be restrained for the foreseeable future to permit an increase in the share of profits if output can be made to rise. What is necessary is to combine an increase in the share of profits sufficient to sustain economic growth with an initial expansion in the level of demand. This requires two things. The first is that there should be some agreement and realisation at a Community level that real wage moderation is required. At the outset it is not necessary that nominal wages should fall, but simply that the real wages of those at work should not expand as overall demand, output and employment rise. The increase in the level of demand that is to accompany wage restraint is to be stimulated by additional investment in the Community of some $15bn each year for three years, which is to be allocated to investments mainly in energy and new technology.

3. These are the elements of the 'dynamic process' to which M. Albert refers.

The Albert Proposals: Commentary

4. I have several difficulties with this proposal. The first is that, even at a national level let alone at Community level, I have doubts as to the meaning and significance of any type of 'dynamic process'. I am in no way opposed at any level to general exhortations to prevent people from pricing themselves out of work as too many have done in the recent and more distant past. Changing

expectations with regard to real wages and increased flexibility in labour markets are key factors in the restoration of profitability, upon which future expansion must be soundly based. However, I doubt the reality of any 'dynamic process' which makes an expansion of overall demand dependent on wage restraint.

5. Secondly, the impact of additional borrowing on interest rates and credit markets on the scale envisaged raised a number of difficult and complex questions. The question of an oil tax raises other issues not simply connected with the funding of the Community. It is an interesting idea which has received and is receiving study in other forms, as a tax on consumption rather than imports and as a general tax on energy rather than simply on oil. I would argue that at this stage it is an interesting idea, the full ramifications of which are not clear.

6. Unlike M. Albert, I do not see the Community as such as a major source of funding for so-called European projects, either through the European Investment Bank or otherwise. This is not to say that the Community may not need additional funding to carry out some of its tasks, but rather that I see no reason why it should be a source of finance in itself. I see its role more as impresario or conductor of the orchestra.

7. Finally, it is not in general clear to me that the real problems of the Community are related to the provision of finance. Low investment in the Community has been substantially the result of supply side factors of a behavioural kind, stemming from the behaviour of both management and labour, rather than from a lack of finance as such. The real problem is not a lack of supply of finance for profitable activity within the Community. The problem in large measure has been the lack of a profitable demand for it, which stems from the impact of the factors discussed in the last section. In consequence, the provision of further Community resources must be set very explicitly against the uses to which they would be put. There may indeed be a case for more Community initiatives and funds to support them. I find it difficult, however, to justify such borrowings in terms of the Community's immediate role and needs other than along the lines of demand pump-priming through the back door.

Emploi Partiel: Reservations

8. I am sceptical about the other essential element in the package promoted by M. Albert, namely the introduction of 'l'emploi partiel'. Let me say at the outset that I have absolutely no objection to changing work practices in any way which increases the real choices between work and leisure for people, or which in a very general sense increases the flexibility of labour market behaviour.

9. I recognise the important small print in M. Albert's presentation, namely that, whatever changes take place in working practices, there should be no increases in unit labour costs. My own view, however, is that all serious changes in labour practices cost money. M. Albert is quite clear that he is not advocating work-sharing. Others are. I have no doubt that the ultimate effect of so-called work-sharing policies would be to raise unit labour costs and, in the longer run, make European industry even more uncompetitive vis-à-vis the United States, Japan and the emerging industrial world. Even if the proposal made by M. Albert were implemented, I have absolutely no empirical basis from which to conclude that the effect on European unemployment would be other than distinctly marginal.

10. We are left, however, with the need to alleviate the problems of the unemployed during the period of market adjustment. To deal with this as a social problem it is necessary to do what governments in the Community are already doing to target the particular problems of the unemployed groups, providing additional training for the young and accelerating early retirement throughout the labour force.

A European Marshall Plan

11. Finally, I refer to what M. Albert has described as a new Marshall Plan for Europe orientated towards investments in energy projects both in Europe and the Third World and towards current major projects in Europe.

12. Mr Albert in Chapter 7 has at length, and fairly, described some of the objections to such a development. The first relates to the wisdom from a European point of view in attempts to transfer resources from Europe to the third World at a time of high unemployment in Europe. Secondly there is concern as to the ability of the Third World to service new debt. Thirdly why should not Member States rather than the Community undertake such a task?

13. I have already set out my general concern as to the role of the Community as a large borrower and disburser of funds, a view which I need not repeat in detail. Apart from the possible objections to the proposed Marshall Plan as discussed by Mr Albert himself, I have a very specific concern as to how the balance of future development should be conducted not in terms of the balance between the Community and Member States but between the public and private sector.

14. Mr Albert must be right in saying that problems have arisen in the carrying out of energy investment in certain developing countries as a result of the demands placed on private investors. My response to this is not to shift the problem from private industry to either the Community or Member State level. Developing countries cannot expect investment from abroad on terms other than would apply to investments between developed countries, if such investments are to be defined as economically viable. When the investment is deemed to be economically viable, emphasis should be placed on the role of private rather than public capital.

15. As far as the balance between the Community and the Member States is concerned, one should note that, whatever the arguments are, it is not true that individual states can, or do, do nothing. The recent tax changes made in the UK budget this year, encouraging investment in the North Sea and in small and medium-sized business is a case in point.

16. Lastly, history leads me to be suspicious of large scale public investment projects such as the Channel Tunnel. Whether such developments are a good thing I cannot say. Each case must be decided on its own merit. I have already indicated my support for a serious reappraisal of the balance between public capital spending and public consumption in Member States. Care must be taken, however, to ensure that large scale uneconomic public capital projects do not crowd out the desirable and necessary recovery of investment in private sector industry.

Commentary by Mr Michel ALBERT

There are no universal and absolute truths in economic policy. It is therefore hardly surprising that two men who are as different as James BALL and myself should express differing views on several of the subjects dealt with in this report.

There were two ways in which we could approach our disagreement. The first was to gloss over them and sign a compromise text which was so watered down as to be of no interest whatever. The second, since this report is intended for a debate in the European Parliament, was to convey to that Assembly the tenor of our own discussions. We have chosen the second alternative, which has at the very least two advantages.

Firstly, there is the clarity and sincerity of our texts. Admittedly, each of us has influenced the other. For instance, my final version pays closer attention to the problems raised by incomes.
Similarly, James BALL gradually became convinced that the United Kingdom had a real interest in participating fully in the EMS. Nevertheless, our views differ on the best way of restoring European economic growth and on the urgency of that task.

These differences - and this is a second advantage - merely strengthen the credibility of our areas of agreement. The scope of these can be gauged by the importance of the demonstration contained in Chapter 3 (the impotence of the nation states) or our broadly common proposals on the strengthening of the EMS (Chapters 4 and 5), the new industrial strategy (Chapter 6) and the common energy policy (Chapter 7) which should be pursued in future.

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On which points do we differ? Mainly on three subjects:

- unemployment;
- policy towards the Third World; and
- the financial role of the Community.

Let us begin with unemployment. The opposition between us relates both to the diagnosis and to the proposed therapy.

James BALL is not convinced that the tendency for unemployment to increase will continue beyond 1984[1]. Why does he subscribe to this view when all the forecasts point in the opposite direction? Because the increase in unemployment is itself a remedy to unemployment and to the crisis: 'To the extent that one believes that real wage behaviour is likely to be moderated at least for some time by the very existence of heavy unemployment in itself, one cannot but believe that there are some corrective forces operating through the market system that will mean that the generality of unemployment forecasts into the eighties are likely to be pessimistic.' He logically concludes from this diagnosis that no further action need be taken at Community level or at national level: 'it is necessary to do what governments in the Community are already doing to target the particular problems of the unemployed groups'[2].

My view is totally different. It is based on the tables set out in Chapter 5 and on the graph in Chapter 8 which show that to increase the number of jobs in the EEC we need a growth rate in excess of 3% and a growth rate of about 6% to reduce unemployment. It seems to me improbable that such a rate can be obtained in the next few years. Above all, in my view unemployment is not to remedy but a cause of the crisis and lack of growth from which Europe is suffering[3]. Hence the set of proposals contained in Chapters 5 and 8. I express this conviction with real sadness: if these proposals are ignored, 1984 will be the twelfth consecutive year in which unemployment has increased in Europe, 1985 the thirteenth and 1986 the fourteenth ...

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[1] Chapter 4, point 44

[2] Commentary above, point 10

[3] See, in particular the three adverse effects analyzed in Chapter 2, section 222

The same type of reasoning explains the criticisms of my extremely cautious proposals concerning certain Third World countries. I was merely proposing that energy investments should be jointly financed in those countries in return for a tied export arrangement. The objection is that 'developing countries cannot expect investment from abroad on terms other than would apply to investments between developed countries'. In other words, the same method would be applied to the unemployed as to the countries of the Third World: we should do nothing and simply wait for an improvement in the financial situation and real economic adjustment to have their effect.

According to this criterion, the World Bank is at fault by distributing loans on particularly advantageous conditions to the Third World countries. This explains James BALL's criticisms of my proposals relating to the financial role of the Community. These proposals consist essentially in drawing the greatest possible benefit, while taking all the appropriate precautions, from the existing Community instruments, the most important of which, the European Investment Bank, was set up by the Treaty of Rome. However, on this point the Treaty of Rome itself is certainly not above reproach ...

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