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Report

drawn up on behalf of the Temporary Special Committee on European Economic Recovery

on the 'PLAN FOR EUROPEAN ECONOMIC RECOVERY'

PART B: EXPLANATORY STATEMENT

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INTRODUCTION : ORIGINS OF PARLIAMENT'S INITIATIVE

The draft resolution and action plan drawn up by the Special and Temporary Committee on European Economic Recovery is the result of several months of work, involving several Parliamentary Committees and benefiting from the assistance of outside experts, most notably Messrs ALBERT and BALL.

On 30 September 1982 the enlarged Bureau asked five committee chairmen to draw up a proposal for preparing a report on European Economic Recovery, following an initiative taken by Sir Fred CATHERWOOD, chairman of the Committee on External Economic Relations.This decision of the Bureau was presented to the plenary session on 12 October 1982.

The group of committee chairmen, know as the Economic Recovery Group, was enlarged and chaired by Vice-Président NIKOLAOU and was composed of :

Sir Fred CATHERWOOD, Chairman of the Committee on External Economic Relations, Mr Jacques MOREAU, Chairman of the Committee on Economic and Monetary Affairs, Mrs Hanna WALZ, Chairman of the Committee on Energy and Research, Mr Pancrazio DE PASQUALE, Chairman of the Committee on Regional Policy and Regional Planning, Mr Michel PONIATOWSKI, Chairman of the Committee on Development and Cooperation and Mr Efstratios PAPAEFSTRATIOU, Chairman of the Committee on Social Affairs and Employment.

On 12 January 1983 the Group decided to appoint Mr Michel ALBERT, former "Commissaire au plan" and Professor James BALL, Director of the London Business School to draft a report. The Group also asked Dr Johannes WITTEVEEN, Professor Luigi SPAVENTA and Dr Ulf LANTZKE to contribute on specific points (monetary affairs, regional policy and energy respectively). The experts consulted widely with ministers, central bank officials, economic and monetary experts, officials in the Member States and officials of international organisations. The report, signed by Messrs ALBERT/BALL, was finalised on 30 June 1983 and presented to Parliament and the press during the July part-session in Strasbourg.

The recovery plan of the Special Committee

On 6 July 1983 the Bureau decided to submit to plenary, in accordance with Rule 91, a motion for a resolution to create a temporary special committee of 39 members, including members of the six committees concerned, with a bureau composed of the six committee chairmen, charged with drafting a report on European economic revival. It was amended in order to allow the inclusion of members of the Committee on Agriculture, making a total of 42 members, and adopted on 15 September 1983.

The committee held its constituent meeting on 26 October 1983. It elected Mr MOREAU as chairman, Mr DELEAU as vice-chairman and Mr HERMAN as rapporteur.

The committee organised hearings on the ALBERT-BALL report and on other proposals for economic recovery with Mr THORN, President of the Commission; Mr ORTOLI and Mr DAVIGNON, Vice-Presidents of the Commission; Mr ALBERT; Mr DREW, assistant to Mr BALL; Mr CEYRAC, President of the Economic and Social Committee; Professor WITTEVEEN, former Director of the IMF; Mr CARLI, President of UNICE; Mr DEBUNNE, President of ETUC; Mr DELORS, President-in-Office of the Council; Mr LE PORTZ, President of the European Investment Bank; Messrs HENDERSON and HIGGINS, OECD; Mr LANTZKE, International Energy Agency and Mr Pierre URI.

On the basis of these hearings and the detailed discussions on the working documents and draft report presented by the rapporteur, the committee adopted the draft resolution and recovery plan on 1 March 1984.

A. OBSERVATIONS ON THE ALBERT/BALL DIAGNOSIS OF THE PRESENT CRISIS

1. Any solution to the problems currently facing the Community must be based on an accurate diagnosis of the cause of the relative decline of the Community vis-a-vis the other industrialized countries of the world. Agreement on the diagnosis ought to lead to agreement on the cure. On the latter, however, Mr Albert and Professor Ball are not entirely at one.

2. Although the ideas put forward by Mr Albert have an attractive air of brilliance and lucidity, it is generally felt that they are meant to be illustrative rather than comprehensive. Without claiming to present an in-depth analysis of the problems - it would take volumes - our committee has nonetheless endeavoured to broaden the scope of the survey by briefly assessing the outcome of the economic policies pursued in a number of industrialized countries outside the Community and by questioning a dozen or so experts on most of the points at issue.

3. The main themes of the Albert/Ball diagnosis may be summarized as follows:
   (a) Europe has sacrificed the future to the present by choosing to consume rather than invest. Despite zero growth, the fruits of growth have continued to be distributed. Real wages have increased faster than productivity, with the result that company profits and, consequently, investment have suffered. This has been exacerbated by the fact that fiscal and parafiscal charges, on top of wages, are the highest in the world and have for ten years been rising more rapidly than anywhere else.

   Furthermore, public investment expenditure has been cut back in favour of consumption and social welfare expenditure, which has continued to increase twice as fast as overall wealth. In 1982, public authority expenditure amounted to 50.8% of Community GDP, as opposed to 35% in the USA and 34.8% in Japan.

(b) The reaction of the Community Member States to this crisis has been one of 'every man for himself'. Instead of trying to work together to find collective 'European' solutions to the problems, the governments have preferred to adopt a competitive rather than a cooperative stance, so that numerous meetings are spent in acrimonious negotiations over relatively insignificant sums of money (it must be remembered that the total Community budget is less than 1% of Community GDP and less than 2% of the sum of national public expenditure), leaving no time or even willingness to consider the wider issue of cooperating to compete efficiently on the world market and pull us out of the recession.

(c) It is not possible for any Member State to 'go it alone' and attempt to pursue an isolated reflationary policy whilst its partners are either deflating or adopting a 'wait and see' approach. The economies of the Community are undeniably interlinked and any action must therefore be a common action. Up to now, there has been no joint response to the crisis. Such common policies as have been adopted have been piecemeal and insignificant.

(d) Hence, the outlook for the immediate future is not encouraging. The problem of unemployment will become even more acute and the divergencies between the economies of the Member States will become more marked. In order to be able to benefit from membership of a strong Community, each country must first put its own house in order by controlling inflation and public sector finances.

4. There have been no serious differences of opinion within our committee on the above diagnosis. Moreover, with the exception of Mr Debunne, none of the experts heard took issue with the Albert/Ball analysis, at least as far as its diagnostic section is concerned.

5. Even so, there were differences of emphasis. Some experts felt that inflation and monetary instability were chiefly to blame for the crisis. Others singled out the loss of ground in technological development and the compartmentalization of the markets. Others again attached particular

importance to the lower return on investment consequent upon the escalation of wage costs, heavier taxation and the expansion of social welfare provisions. There was, however, unanimity on two points: insufficient investment and an insufficient European 'presence'.

6. Three problems are scarcely touched upon in the 'diagnosis' and deserve to be looked at a little more fully:

(a) <u>The international environment</u>

7. The European economy is more susceptible to external influences than either the American or the Japanese economy. Consequently, events in the rest of the world have a more pronounced impact on growth and employment rates in Europe than anywhere else. Monetary instability, the indebtedness of the Third World, high interest rates and increases in the prices of oil and raw materials all tend to obstruct productive activity or to blunt the impact of the economic policies pursued.

8. Although Europe's political power and influence on the international scene are incommensurate with its economic importance, by strengthening political cooperation between the Member States it could do more, with Japan and the United States, to coordinate budgetary, monetary and trade policies with a view to achieving greater stability and predictability.

9. This is why our committee believed it necessary to include an entire chapter on international cooperation in its recovery plan.

(b) <u>Demographic pressures and labour force behaviour must also be taken into consideration</u>

10. The rapid rate of increase in the working population - far more rapid than the expansion of the population as a whole - has been and will continue to be a major influence on the level of unemployment. Each year, about a million extra jobs would have to be created to maintain employment at existing levels.

11. Two factors can be identified as being the most important influences on labour inflow: the baby-boom effect and female labour force participation. The behaviour of inflows into working age population represents of course only half the story. The total demographic impact on labour markets will be the combined effect of inflows and outflows.

12. Table 1 shows for the ten Community countries the potential working population and the particularly problematical 'youth' population up to 1995. It can be seen that in all countries the population of working age will increase up to 1985. For the folloiwng five years the position is more diversified but in three of the four largest Member States (France, Italy and the United Kingdom) the potential workforce will continue to increase. In the period 1990-1995, the potential working population shows a decline in all countries except Ireland and Denmark. For the 'youth' population, the recent decline in the birth rate will be felt in all countries, except Ireland, by 1990.

13. While it is relatively easy to be assertive about the size of demographic pressures during the decade ahead (aside from migratory movements), it is much more difficult to forecast labour force behaviour. Future school enrolment is uncertain, partly because there may be a growing trend to combine schooling with gainful work. Future retirement trends are also difficult to predict owing to the effects of voluntary or compulsory early retirement schemes. But even more unpredictable appears to be the future labour force participation of women. If anything, it must be assumed that past trends of rising female labour force participation will continue. In fact, during a recent OECD High Level Conference on the Role of Women in the Economy, OECD governments agreed to seek to improve the employment chances of women regardless of prevailing labour market conditions.

14. Table 2 shows the results for 6 Community countries for which national forecasts of labour force growth are available. A deceleration of labour force growth in the late 1980s will occur in most countries but labour force participation is still expected to exert a positive influence on labour force growth. By far the most important contribution to future labour force growth will be, as in the past, the rise in working age population. Nevertheless, for the OECD area as a whole, no dramatic reduction of supply side pressure on the labour market is to be expected in the 1980s. The future development of individual working time will also be relevant to unemployment. In fact, the forecast relative strong growth of the labour force may be misleading in the sense that many newcomers to the labour market will be looking for less than full-time or less than full-year-round jobs. However,

Table 1

Demographic Trends in the Community

Projections of the potential working population and the "youth" population

	D	F	I	NL	B	L	UK	IRL	DK	GR
% population aged 15-64										
1980	66.3	64.0	64.7	66.4	65.6	68.0	64.3	57.9	64.8	63.9
1985	70.6	66.6	66.8	68.7	67.9	69.9	66.4	58.5	66.0	64.9
1990	70.3	67.0	67.3	69.2	67.6	69.7	66.9	60.6	66.7	64.7
1995	68.9	66.5	66.4	68.6	66.9	68.5	66.5	62.3	67.0	63.3
% population aged 15-24										
1980	15.5	15.9	15.2	17.2	16.0	15.1	15.8	17.2	15.0	15.1
1985	16.5	15.5	15.6	17.1	15.4	14.3	16.6	17.6	15.2	15.2
1990	14.0	15.0	15.0	15.4	14.0	12.7	15.3	18.6	14.6	14.6
1995	10.8	13.8	13.3	12.8	12.6	11.3	13.0	18.2	13.2	13.4

Source: Demographic Indicators of Countries: Estimates and projections as assessed in 1980. United Nations 1982 no reliable forecast of the working time dimension of labour supply is available. Part-time jobs for married women, for instance, may be a significant development in some countries, but in others there is evidence that with rising educational attainments women are increasingly seeking full-time jobs. Individual working time is one of the crucial variables which may be affected by policy to balance future labour markets.

Table 2

Labour force growth in selected Community countries

Average annual rates of growth

	Historical data	Projections	
	1970-1980	1980-1985	1985-1990
Belgium	1.0	0.6	0.2
Denmark	0.8	0.7	0.7
France	0.8	1.0	0.6
Germany	0.0	0.3	0.0
Netherlands	0.9	1.2	1.1
United Kingdom	0.5	0.7	:

Sources: Labour Force Statistics, OECD, Paris; Demographic Trends 1950-1990, OECD, Paris, 1979; and national participation rate projections

15. It should be pointed out that the above country projections were calculated by the OECD in 1979. More recently (June 1983) the European Commission has attempted to project the global Community participation rate and the consequent unemployment rate in the coming decade. Its latest forecasts predict a reduction in the participation rate from 66.4% of the population of working age in 1982 to 65.5% in 1984, the lowest rate ever registered since 1953. This will fall further to 65.1% in 1985, followed by a small progressive increase of about 0.1% per year from 1986 to 1990, when the 1984 level will be reached again.

The above projections, taken together with the current economic forecasts, imply that unemployment will fall by 1990 to 10.6% of the working population, against a predicted 11.3% for 1984.

Even in the unlikely event that productivity and employment trends returned, from 1985 onwards, to those of 1953-1962 (productivity growth of 4.4% p.a. and employment growth of 0.6% p.a.), together with a stabilization of the participation rate at 65%, there would still be an unemployment rate of 8.2% in 1990[1].

[1] See PE 87.925, pages 9 to 11

16. In the light of the foregoing, one conclusion is inescapable: the measures adopted or to be adopted to cut back the supply of manpower and relieve the strain on the labour market have to be reversible. After 1990, and particularly after 1995, demographic trends will change direction and influence the labour market in such a way that the supply of labour could once again be instrumental in curbing growth.

(c) The level of wage costs

17. Mr Albert and Mr Ball assert that the high level of wage costs and, above all, resistance to cuts in wage costs have been clearly instrumental in increasing unemployment.

18. Not surprisingly, the trade union organizations dispute this assertion. Moreover, it was apparent from the discussion of solutions within our committee that, although they had no quarrel with the Albert/Ball diagnosis as a whole, several members had doubts about the Commission's proposals on wage restraint.

19. Many statistical data have been used to support the arguments of those who disagree on this issue.

20. It is necessary here to clear up the confusion which frequently arises when economists come to assess the relationship between wage costs, employment and productivity.

21. Most of the statistics provided by the Commission are based on the concept of unit labour costs. If, however, the purpose is to assess the impact of labour costs on employment, the concept is misleading.

22. As the rise in wage costs prompts undertakings to rationalize, or forces the closure of marginal undertakings through bankruptcy, the productivity of the labour factor, measured by sector, tends to improve. Unit labour costs do not rise, and they may even fall, each time there is an increase in the level of unemployment. Using sector productivity as the accepted yardstick for increasing wage costs could, if the argument was taken to its extreme, utlimately justify wage increases which would force all the undertakings of a given sector out of business, except for the most efficient.

23. The method used by Mr Albert and Mr Ball, which consists of measuring the discrepancy between the growth of per capita real wages and the growth of GDP in volume per person employed, is certainly more acceptable.

24. This method is illustrated by the following table:

Discrepancy between per capita real wages and per capita real GDP	European Community	USA	Japan
Average 1961-1970	100	100	100
1973	106.4	103.3	100.7
1975	114	106.5	107.2
1978	112	105.4	104.2
1980	113	106.8	98.7
1983	116.8	109.2	97.9

25. The flexibility which has permitted a downward movement of real wage costs in the USA, Japan, Austria and Switzerland and the contrasting rigidity which has prevailed in Belgium, France and Italy would seem to lend credence to Albert and Ball's arguments.

26. It is also striking that the rise in unemployment has been arrested in almost all countries in which it has been possible to freeze or reduce real wage costs first. No one would dispute that many other factors have a bearing on the explanation of unemployment. Just as lack of competitiveness may equally result from draconian fiscal measures, a total loss of entrepreneurial drive or weak financial structures, so a rise in unemployment may also result from a change in the working population or a lack of occupational or geographical mobility.

27. It seems certain that increases in real wages in Europe since 1973 have encouraged entrepreneurs to invest in more capital intensive production methods thereby increasing productivity while permanently destroying jobs. In the US, on the other hand, in six of the last ten years real wages have actually fallen in response to market pressures so that the incentive for US entrepreneurs to replace labour with capital has been considerably less. The availability of an ever-growing labour force in the United States, combined with less restrictive labour legislation and less attractive social security benefits than exist in Europe, has created a flexible labour market in which even nominal wages can move downwards in response to market conditions. Such a situation has also encouraged the development of a large and growing service sector (66% of employment as against 55% in the Community) based on the employment of unskilled labour at relatively low wages.

The net effect of these structural differences in the labour markets of the Community and the United States has been that since 1973 the US has created 20 million new jobs while in Europe there are 3 million fewer jobs than ten years ago.

B. THE LESSONS TO BE LEARNED FROM THIRD COUNTRIES

28. All the countries of the world, and the industrialized countries in particular, have been affected by the collapse of the international monetary system set up at Bretton Woods and by the two consecutive oil shocks.

29. Although the degree of openness, and hence vulnerability to external pressures, varies from one country to another, and although political situations and economic structures are rarely comparable from one continent to another, the committee found it instructive to study the broad lines of the adjustment strategies pursued by governments and the results achieved, especially in terms of growth and employment.

30. In the interests of brevity, we limited the scope of this study to those countries which have achieved, or appear to have achieved, above-average employment levels. These are:

- Switzerland
- Sweden
- Austria
- Japan
- the USA
- Taiwan
- South Korea

Switzerland

The economic policy of Switzerland during recent years has shown a remarkable degree of adaptability and constancy in following certain basic aims.

1. Monetary policy aims at keeping inflation low and reducing as far as possible exchange rate fluctuations by observing a monetarist rule for money expansion. Monetary policy was restrictive in 1980-1981 and was relaxed in 1982, resulting in lower interest rates to a greater extent that was occuring internationally.

2. Budgetary policy aims at medium-term equilibrium of the finances of the Confederation. Budget deficits were reduced strongly by 1982, permitting a cautious expansionary fiscal policy in 1983 (increase of public spending of about 0.8% of GNP).

   Decreased external demand and an appreciation of the exchange rate due to low inflation resulted in a fall of exports in 1982 and 1983.

   Switzerland's economic success until today can be attributed to the following factors: Fiscal (budgetary) and monetary policies have been characterised by a great degree of stability, and the control of inflation has been pursued steadily and permanently, due in great part to the high degree of autonomy and the prestige of the Swiss National Bank. This creates a favourable economic climate and generates favourable expectations on economic prospects, that center around future prospective stability. This again makes the efforts of the government towards stability easier to attain. Switzerland seems to be a classic case of positive "self fulfilling prophecies" and a virtuous economic cycle.

   Switzerland has been able also to adapt quite fast to the new economic situation. The government has promoted measures of adaptation but did not try to substitute for private initiative. Swiss products remained relatively competitive, although the SF appreciated considerably.

This is due to the special climate existing in the Swiss labour market that is characterised by moderate demands from the trade unions and the labour force in general, as well as an important margin of manoeuver due to the existence of foreign workers. Wage demands and settlements were moderate, so that one could speak of the existence of voluntary incomes policy, while productivity growth remained relatively high, so that Swiss products remained in many cases competitive even taking into account the appreciation of the SF.

Unemployment remained low also due to measures to reduce the foreign working force in Switzerland.

Adaptation was further facilitated by the incentives given to encourage industrial redeployment to more capital and higher technology sectors, as well as incentives to encourage research and professional training.[1]

Sweden

The Swedish economy is also an open economy where exports and imports play a significant part in GNP and consumption, the export share in output reaching 28.7% for the period 1977-79. The public sector's revenue share in GDP had increased to 50.8% during the same period and the average tax rate, which has doubled over the last twenty five years, was probably the highest in the world.

A high priority has always been attached to the full employment target. Swedish economic policy after the war combined this long-run aim with trying to control cyclical fluctuations by combining selective and general measures. Selectivity has also been a characteristic feature of monetary policy, as the authorities have attempted to influence not only the total volume of credits, but also its distribution. Though the openness of the economy has naturally affected the room for manoeuvre, balance of payments problems have only on a few occasions led to a change in the orientation of policies. Also, the Swedish authorities, unlike the other Scandinavian countries, have not applied incomes policies in a formal sense, although centralised bargaining and close cooperation between the government and the labour market parties have frequently produced results which in the other Scandinavian countries were achieved through more formal arrangements.

[1] The statistics noted here are taken from OECD's economic studies, Switzerland May 1983.

In Sweden changes in primary reserves and reserve requirements have been the principal instruments in regulating overall credit supply. Over time, interest rate variations have become more frequent, but various selective measures favouring priority sectors have also gained in importance.

During the period 1974-80 Sweden followed a policy of general demand stimulus, employment suppporting measures and selective policies in favour of weak industries. Labour market measures were most extensively used and by 1977-78 4 to 4.5% of the labour force was enrolled in public relief work and training schemes, with an additional 2 to 2.5% estimated to have been "under-employed" within the private sector. This resulted in relatively high growth rates and virtually full employment but also in a marked deterioration in international competitiveness, reflecting some acceleration in nominal wage increases, a sharp decline in productivity gains, and an effective appreciation of the exchange rate due to the "hard currency option" initially adopted by the authorities. Real wages moved in line with the virtually flat trend in real rational income and nominal wage increases were comparatively moderate. Nevertheless, since the moderation was partly due to compensatory income tax reductions, which, in turn, were financed by higher payroll taxes, wage costs rose considerably faster than earnings and the improvement in international competitiveness achievec during 1970-74 was quickly eliminated. When economic policy became more restrictive in 1977, output fell by 2.5% and due to a simultaneous depreciation and reductions in social charges and payroll taxes, the deterioration in competitiveness was sharply reversed. However, there have recently been indications of growing social unrest, pointing to suppressed inflationary pressures and the risk of a renewed widening of imbalances.

Swedish economic policy has met with mixed success. Unemployment was lower than in most industrialised countries, but this success resulted in heavy economic costs in other areas. As the OECD points out, structural disequilibria have appeared and increased recently in the Swedish economy. GDP growth increased more slowly in Sweden than in most OECD countries and in particular industrial production and productivity fell back in relation to the other OECD countries. The situation of public finance also deteriorated sharply and the external deficit, although not so important as in some other countries, is still a constraint. Swedish exports of industrial products increased much more slowly than the weighted average of the imports of the commercial partners of Sweden. This implies a serious loss of market share and of competitiveness of Swedish products.

The main reason for this loss of competitiveness and slow-down of growth seem to be the decrease of investment, as in most European countries. This is again due in great part (also according to the OECD) to a decrease of profitability of enterprises. The share of profits in value added of industry fell by 10% from the beginning of the 1960s to the end of the 1970s (1960 share: about 34%, 1980 about 23%, compared to Japan of 54% to 44%, West Germany 42% to 30%, Canada 34% to 36%, USA 26% to 24% for the same period. Except for the USA and Canada, where the profit share remained almost constant, profit shares fell in most OECD countries, but actual profit shares lie above the Swedish one). (1)

Austria

The main thrust of Austrian economic policy has been to limit unemployment and to rely on a hard currency policy plus price controls to restrain inflationary pressures. In this Austria was on the whole successful, achieving simultaneously a progressive reduction of inflation and a continued growth of employment. A necessary condition for the success of this policy mix has been the willingness of the two sides of industry to accept a gradual reduction in nominal wage claims and profit margins without having to be subjected to a prolonged period of slack.

The results achieved by Austria bear a favourable comparison with most OECD countries. Unemployment remains relatively low, although it has increased since 1979 and inflation has decreased, due in great part to a wage moderation as well as price stability. The current account is close to equilibrium due to a low propensity to import.

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(1) Sources: OECD, Economic Studies, Sweden, July 1982, OECD, Economic Outlook, No 33, July 1983, Palle Schelde Ancersen and Johny Akerholm "Scandinavia" in Andrea Boltho, ed. "The European Economy, Growth and Crisis", Oxford UP, 1982, John T. Addison, "Incomes Policy: The Recent European Experience", in J. L. Fallick, R. F. Elliott, "Incomes Policies, Inflation anc Relative Pay", George Allen and Unwin, London 1981. For a theoretical approach to the relation between employment, investment and profitability see Edmond Malinvaud "Wages and Unemployment", in Economic Journal, March 1982.

1. Fiscal Policy: Fiscal policy was restrictive until 1981 aiming at the reduction of public deficits but became more expansionary after 1981 with a view of reducing unemployment, while end of 1982 a programme to promote employment, including medium-term measures of structural adjustment, has been introduced.

2. Monetary Policy: The Austrian Central Bank is following a monetary regime not in monetary expansion but in targeting the exchange rate of the schilling. In fact, the schilling is closely following the DM, due to the importance of Germany as a commercial partner, as an export market and for tourism. Austrian interest rates also closely follow those in Germany in order to avoid an excessive capital outflow that would result in the case of significant interest rates differentials. Monetary developments (and monetary expansion) therefore closely followed the German pattern.

3. Incomes Policy: This instrument has been used constantly by Austrian economic policy and its importance has further increased due to rising unemployment. The objective is to follow wage developments in Germany, so that, in relation to the exchange rate targetting, the competitive position vis-à-vis Germany does not deteriorate. Moreover, taking into account that the Austrian inflation rate does not differ from the German one, it is clear that any difference in wages would affect profits. If wages were to rise faster than in Germany, either competitiveness would deteriorate, or profit margins would have to be compressed, which again would influence investement negatively.

4. Employment: The low unemployment rates observed during 1960-80 can be explained in part by favourable demographic developments. Active population growth during this period was 0.25% per year, as compared to an average of 1.25% for the OECD. Recently this trend has been reversed and active population growth will increase for the next 15 years, rising at about 0.75% p.a. until 1985. Unemployment could rise due to this, even if working hours are reduced, as was the case during the 1970s. But even if the reduction of working time could safeguard existing jobs it is doubtful it could increase total employment. Also, reduction of working time must be undertaken in such a way as not to worsen Austria's international competitive position.(1)

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(1) See OECD, Economic Studies, Austria February 1983, OECD Economic Outlook No 33, July 1983

Japan

Under the difficult international circumstances of the last years, the performance of the Japanese economy has been good by international standards. Progress achieved in the fight against inflation has been remarkable, with a further deceleration of all measures of price increases to the lowest rates in the OECD area. Economic growth (at about 3%) has remained higher than in any of the larger Member countries, a development accompanied by a clear improvement in the pattern of growth, with stronger domestic demand accounting for most of the rise in output. The external position has remained strong and further structural adjustment in industry has taken place.

But still the Japanese economy has also faced some problems. By historical standards economic growth has been slow and much lower than initially expected by the authorities. The steady deceleration of real GNP growth since 1980 has continued and led to a significant weakening of labour market conditions. Although contributing to supporting the economy, continuing large budget deficits have put substantial upward pressure on debt service charges. With interest payments rising rapidly and now accounting for one sixth of total Central government General Account expenditure, this trend has made the necessary reduction in the large structural fiscal deficit even harder to achieve.

1. Fiscal Policy: Fiscal Policy since 1980 has been dominated by concern about large public sector deficits and the mounting volume of public debt. Fiscal policy's room of manoeuvre was constrained by the large structural budget deficit and the official medium-term objective of eliminating the deficit financing of current expenditure.
The present macro-economic situation (very low inflation, a large and rising current account suplurs, weak domestic demand and ample private savings in relation to government financial needs) would normally call for more expansionary fiscal policy. But this policy has to be viewed against the need to reduce the budget defict over the medium term. The actual general government deficit that is around 4% of GNP is not particularly large in relation to that of other OECD economies but its structural component, about 3/4 of the total, is relatively high. In relation to GNP the stock of outstanding government debt has risen very rapidly over the last decade to well above the average of other large countries, with interest payments accounting for most of the structural deficit. Strong upward pressures on the deficit are expected to develop as from the late 1980s, as the rapid aging of the population will reduce and eventually reverse the current substantial surplus of the Social Security account. This reinforces the need for tackling the large deficit of the central government given notably the risk of putting pressure on interest rates.

2. Monetary policy: The overall supply of credit has remained relatively easy, but the authorities have refrained from reducing the official discount rate because of fears of weakening the yen. Most of the reduction in overseas rates has been reflected in a narrowing of interest rate differentials, while the decline in domestic short and long-run interest rates has been very limited. Given the marked improvement of inflationary trends and expectations, real interest rates have remained at historically high levels.

The combination of the high level of real interest rates and the relative weakness of the yen has thus created a conflict between the domestic and external objectives of monetary policy (i.e. lower interest rates would facilitate domestic expansion and a reduction of the public deficit, but would, through increased capital outflows, weaken further the yen).

3. Employment and incomes policy: Japan has achieved favourable results, having low unemployment and wage moderation combined with high productivity and competitiveness. This is largely due to the Japanese mentality and outlook. The enterprise is regarded as a "fighting unit", where great voluntary discipline prevails, and also as a community where some decisions are taken collectively, where most people are employed for life and where promotion is usually by seniority. The loyalty of the employed towards the enterprise is very strong. Economically this means that Japanese workers take fewer holidays than in the USA and Europe, to such a degree that the days taken off work amount to about one third of an employed person's entitlement. Absenteeism is also much lower. (1)

U. S. A.

The USA is the best example of a "success story" since 1980, succeeding at the same time to increase employment (the only OECD country to do so in 1983), reduce inflation and achieve high growth rates that bear favourable comparison, not only with the last three years (since 1979) but also with other periods of relative high growth. Furthermore, prospects for 1984 and 1985 remain encouraging. Still, problems remain and if the correct solutions are not applied, growth prospects may be endangered.

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(1) See OECD, Economic Surveys, Japan, July 1983, OECD, Economic Outlook, No 33, July 1983, Tominaga, Ken' ichi "Les organisations japonaises: l'histoire contre le mythe", Takamiya, Susumu "La gestion japonaise à la croisée des chemins, Ishida, Hideo "Les conditions de travail au Japon: Une comparaison avec l'Europe", dans "Le Japon mode ou modèle" Dossier R.F.G., No 27-28, septembre-octobre 1980.

1. Monetary Policy: The Fed has followed a cautious monetary policy of quantitative money expansion in order to reduce inflation rapidly, in which it succeeded. One of the main aims of this policy was to influence long-run expectations favourably.

2. Fiscal Policy: During the last years, the USA followed a policy of strong fiscal expansion that came about through important tax cuts for enterprises in order to favourably influence profitability (supply side economics) and increased expenditure, in particular for military purposes that increased the government's demand (demand side economics of a Keynesian nature). This resulted in increased economic activity, faster growth and lower unemployment, but, combined with the restrictive monetary policy to high budget deficits. This again resulted in high real interest rates, in capital inflows to the USA, resulting in dollar appreciations, some loss of competitiveness for American products and increasing trade deficits.

According to the President's Chief Economic Advisor, Prof. M. Feldstein, the solution to the public deficits problem should come through a combination of spending cuts and tax increases to be enacted now but to go into effect in 1985.

3. Incomes Policy: The American experience with incomes policy is not very positive, with incomes policies being abandoned after a certain period of application because they proved to be inefficient, the reason for this being: a) Wage and price determination is more decentralised in the USA than is the case in the European economies; b) The conventional macroeconomic instruments of government policy are dispersed among different arms of government to a greater extent than in European countries.

Still, wage moderation, coupled with rapid productivity gains in 1983, played a major part in the American recovery.

4. Productivity: In this area results achieved in the USA, up to 1982, fell below those achieved in many European countries. One explanation could be the increase in employment by the creation of about 10 million additional jobs in USA, while employment almost stagnated in Europe. In 1983 the productivity performance in the USA started increasing rapidly, while at the same time employment also increased.

5. External relations and balance of trade: The strong dollar combined with the strong US recovery led to increasing trade deficits, forecasted to exceed $ 70,000 million for 1983. Relative to the position of two years ago, in 1984 the USA will be providing its trade partners with a stimulus equivalent to more than 0.5% of the GNP of the rest of the world.

The strong dollar has generated protectionist pressures in some American sectors that suffer most from foreign competition.[1]

Taiwan

Taiwan has achieved very high growth rates during the 1970s and succeeded in withstanding the crisis relatively well. Taiwan is a case of vigorous export led growth, which was possible due to the high competitiveness of its products in some sectors.

1. Monetary Policy: Inflation is held to the low teens, but some pressures on inflation from higher energy prices till 1980 and higher wages have increased it slightly in 1982 and 1983. The main aim of the government's anti-inflation policy has been strict control of the money supply, while a moderate liberalisation of imports of manufactured goods has also helped to restrain the prices of locally produced goods. Monetary policy follows losely the monetary measures of Taiwan's main competitor, South Korea.

2. Structural Policy: Structural policy has aimed till recently to achieve a high degree of industrialisation, concentrated in some key sectors, like textiles, consumer electronics and wood products. The international competitiveness of these sectors was good, due to high productivity, high technical skill of the labour force and wage moderation. Some problems have appeared recently due to a slow-down in productivity and acceleration of wage increases.

The government is aiming at structural change of the industrial base towards more high technology industries, as electronics, precision instruments and sophisticated materials.

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(1) See John H. Pencavel "The American Experience with Incomes Policies" in J.L. Fallick and R. F. Elliott "Incomes Policies, Inflation and Relative Pay" op.cit., H. Giersch, F. Wolter "Towards an explanation of the Productivity Slowdown: An Acceleration-Deceleration Hypothesis" E.F. Denison "The Interruption of Productivity Slowdown in the USA" and A. Lindbeck "The Recent Slodown of Productivity Growth", all in Economic Journal, No 93, March 1983, Morgan Guarantee Trust" World Financial Markets, the US Trade Deficit and the Dollar" October 1983, Council of Economic Advisers (Chairman M. Feldstein), "The US in the World Economy", in Economic Impact, No 43 1983/3.

South Korea

South Korea achieved high growth rates in the period 1961-1979 and became one of the new industrialised countries.

The crisis hit the Korean economy hard (GNP fell by 6.2% in 1980) and although the situation ameliorated in 1981-83 (interest rates dropped, inflation was reduced) it has been realised that the crash of 1980 was not only due to the oil shock but to serious structural imbalances.
A change in the economic structure is necessary, because the successful policies of the 1970s had become counterproductive by the beginning of the 1980s. The government used their control of the financial system to channel credit to big businesses capable of building new plants and factories and shipping their products overseas quickly. Huge projects,such as shipyards were built in months, exports ballooned and the economy grew in one record year by 15%. But high growth was followed by increased inflation. Investment had to be paid for by subsidised loans and was therefore wasteful, while competition between the big business groups compounded the waste. Small companies, which might have been supplying them, were left to wither for lack of credit. Exporters bought supplies overseas instead, widening the country's large current overseas deficit and turning it into one of the biggest borrowers on international capital market. Foreign investment was barred from some industries and barely welcome in many others.

The problem actually seems to be a too high degree of state interventionism in the economy. The state owns some industries, including public utilities and steel. But since it gets its way with private industry, mainly by controlling the banking system, the new regime's (General Chun replacing Park as the head of State after Park's assassination) campaign to give private industry the helm in the country's development depends most on its success in freeing the banks and capital markets.

The Koreans had to launch big new industries because labour costs are increasing steadily, their manufacturing industry must increase its value adde to compete overseas and to raise incomes at home, and because of the need to have factories capable of making weapons to defend themselves against North Korea. But the problem is connected with the degree of self-sufficiency that S. Korea should aim for, related to the cost of this policy. Some industries can pay their way only if they can export as well as serving a limited home market. All industries must be at least as competitive as overseas rivals to make import substitution worth the high cost.

South Korea has no choice but to abandon its labour intensive industries due to the rising labour cost. (Although Korean labourers work the longest hours of any in the world, average earnings in manufacturing have risen by 27% per year during 1978-1981).

The policy followed in order to restructure the economy has three main aims:

1. Import liberalisation to increase the percentage of items which are not on the banned list from 77% to 90% by 1986.

2. Increase in direct foreign investment in order to attract capital and new technology.

3. Strengthening the financial and corporate section to make companies more profitable, less inclined to survive on debit and more inclined to increase their equity.

Conclusions

31. With the exception of Sweden, whose results are, by and large, the least convincing, all the countries considered have achieved the same three objectives:

(a) Control over inflation

32. While some of the countries considered, e.g. Sweden and Austria, have never experienced high rates of inflation, the others have succeeded, after various false starts, in solving the problem of escalating costs. All have pursued a relatively strict monetary policy.

(b) Flexibility of real wage costs

33. In the three Far Eastern countries considered, this flexibility has been achieved primarily by means of the variable income component which is linked to company performance. In Austria and Switzerland, it has been achieved through the maintenance of good labour relations. In the United States, it is more readily accepted than elsewhere that the labour market functions like any other market.

34. The flexibility of wage costs does not merely impinge on income levels; it also has a bearing on the spread of incomes and on the adjustment of working hours.

(c) Reorientating industrial activity towards the growth sectors

35. Whether encouraged by fiscal incentives, interest rebates or subsidies, or by the lack of opposition to the cessation or creation of productive activities, conversion and redeployment have been achieved more swiftly than elsewhere and have escaped the social or political difficulties so often encountered in the countries of the Community.

C. PROPOSED SOLUTIONS

36. Although there was relatively close agreement on the diagnosis, the debate on appropriate solutions revealed significant differences of opinion, not least between the two authors of the report 'Towards European Economic Recovery in the 1980s'.

I. THE PROPOSALS PUT FORWARD BY MR ALBERT AND MR BALL

(a) Matters on which they agree

37. The two authors acknowledge that growth must be revived in order to reduce unemployment, increase investment and its profitability, moderate wage costs, reduce public authority charges, strengthen the EMS, consolidate the common market, coordinate economic policies, reduce our dependence on external oil supplies, and elaborate a Community industrial policy.

38. They also agree that growth could not by itself eliminate unemployment within a short time span unless rates were achieved which today would be considered totally unrealistic.

(b) Mr Ball maintains that the primary task is to recreate a climate and conditions which are favourable to investment. Market forces will do the rest. Hence his insistence that priority must be given to creating monetary stability, cutting back fiscal and parafiscal levies and decompartmentalizing the national markets. He refuses to believe that measures to stimulate demand, especially public investment schemes, would have any lasting impact. He has no faith in incomes policies and price freezes, is extremely sceptical about the effectiveness of work-sharing schemes and has no enthusiasm for the idea of imposing an oil tax.

(c) Because he is aware of the difficulties and the hardships imposed by macro-economic adjustments and structural changes in the absence of growth, because he fears that these adjustments might cause widespread deflation and because he believes in the possibility of reconciling a policy of incomes restraint with a policy for expanding demand based on public investment, Mr Albert proposes that the recovery should be founded on a combination of three measures:

- action to revive investment with a view to increasing the growth rate in the Community by 1%; the additional investment needed for this purpose would be of the order of 15,000 million ECU and would be financed from Community loans. The cost of these loans would be reduced by means of interest subsidies, which in turn would be financed by a levy on oil imports,

- the creation of a European area for industry and research, and

- the formulation of a European Marshall plan for energy and research policy.

These measures would be supplemented by a special programme designed to bring greater flexibility to working conditions and working hours.

II. THE VIEWS OF THE EXPERTS

39. The response of the experts to the 'diagnosis' was one of qualified approval. With the exception of Mr Debunne and Mr Uri, they endorsed the general content of that part of the analysis on which Mr Albert and Mr Ball were in agreement.

Hearing of Mr ALBERT - 16 November 1983

1. Investment: Europe lags behind

Mr Albert pointed out that for a dozen years, consequent upon the first oil shock and the world recession, the prevailing trend in Europe had been to neglect investment in favour of both private and public consumption. Public consumption, he noted, had increased at a faster pace than private consumption thanks to the rapid expansion of the social security systems and the Welfare State.

Despite the slowdown of growth, all the European economies had preserved the traditional patterns of income growth.

Having opted for consumption and the status quo, having, in a word, refused to adapt, we now found that where investment - and especially investment in the key growth sectors - was concerned, we were in a considerably weaker position than the United States and Japan.

2. Working hours

Given the rigidities inherent in our economies and, in particular, the rigidity of certain income structures, there could be no hope of restoring full employment in Europe unless the average working week was shortened.

It was undoubtedly important to aim for as high a growth rate as possible, but encouragement should also be given to local voluntary schemes to adjust working hours, bearing in mind that it was neither desirable nor indeed practicable to impose a shorter working week in each and every sector of the European economy.

3. The general strategy

Because it carried the idea of a measure of permanence, Mr Albert preferred the word 'redressement' (recovery) to 'relance' (boost or stimulus). Relying on short-term palliatives could be no substitute for reactivating the main generators of economic activity.

It was essential, therefore, to deliver a positive psychological shock with a view to changing the direction of the European economies.

Mr Albert's recommendation to the committee was that recovery should be based not on consumption, but on investment; such investment should be managed at Community rather than at national level and concentrated on projects of common interest relating, for instance, to research and development, the growth industries, energy, and the development of the less favoured Community regions and the poor countries.

4. Conclusions

Growth in isolation was impossible and no country - not even the Federal Republic of Germany, the most powerful country in Europe - could achieve growth rates which were substantially and permanently higher than the rates achieved by its partners.

Mr Albert saw that the committee had identified the nub of the problem. The revival of growth was indeed the key issue, but this had to be achieved for the European economy as a whole. In other words, no Member State could go it alone. It was imperative that the peoples of Europe should be made aware that Europe was on the edge of catastrophe. If the European Parliament was unable to deliver the necessary salutary shock to the citizens of Europe, there would be no way of avoiding a technological collapse which would create an unemployment problem of far greater severity than that which we were experiencing today.

Hearing with Mr DREW, Assistant to Professor BALL 16.11.83

Mr DREW underlined four key observations made in the ALBERT/BALL report. The first is exchange rate stability and the importance of dialogue with the US whose deficit and high interest rates are perhaps the most serious threat to sustaining the recovery that is taking place. The second is the need to restore a proper balance between fiscal and monetary policy together with an acceptable rate of inflation. The third is about creating the right economic environment, which, if achieved, will allow the economy to take off by itself. This involves changing economic and political expectations, especially labour market expectations. The fourth point is for the Community to take the last vital steps to create a genuine internal market (see list of measures on page 55 of the ALBERT/BALL report).

He drew attention to the shift from traditional industry to the service sector and to the use of new technologies which means that employment opportunities of the future will be very different from those of the past. In particular, small and meoium-sized undertakings are likely to be predominant in the creation of new jobs, although it is still the large companies and the way in which they work together that will develop a European industrial base.

In addition, Mr DREW pointed to Annex 6 of the ALBERT/BALL report which calls for the creation of an Ad Hoc Industry Committee facing the European Parliament. This would enable Parliament to be informed directly of the needs of the industrial sector.

Hearing of Mr ORTOLI (Vice-President of the Commission) (16.11.1983)

1. After expressing his support for Parliament's initiative, Mr Ortoli pointed out that the solution to the employment problems depended above all on a policy for the development of productive activity.

A macroeconomic framework was needed for such a policy, in which measures to reduce inflation would play a predominant part. A climate favourable to growth could be created by monetary and budgetary policies which were mutually consistent and helped to combat inflation; in times of change, more than at any other time, short-term measures had to be directed towards overcoming structural problems.

Mr Ortoli explained that an end to the crisis depended on action of three kinds:

(a) action to establish consistency between the relevant national policies;

(b) action to ensure that Community measures took full advantage of the 'continental dimension'; and

(c) action to guarantee that the Community's influence was used to strengthen international cooperation.

2. The need for such action was now generally accepted. Nevertheless, a number of key questions still had to be answered.

In the first place, were macroeconomic policy and statutory and fiscal measures sufficient to create the necessary development structures? Or was it necessary to go further and, for instance, formulate a more directive industrial policy?

Second, how were policies to enhance competitiveness and accelerate advanced technology and to be reconciled with the need to preserve social harmony and cohesion?

Third, even if a stringent policy were pursued, would it be possible to put our budgets in order?

In answer to this last question, Mr Ortoli said that the present situation required that the following conditions be met:

- budget management had to be seen to be credible;

- the link between budgetary policy and monetary policy had to be maintained;

- since many of the benefits accruing from the restoration of budgetary stability would be eroded by the rise in interest rates, we would have to guard against the risk of a snowball effect which would increasingly get out of hand.

3. Turning to the question of the urgent need to revive investment, Mr Ortoli pointed out that the decline of investment in Europe was symptomatic of the relative decline of Europe as a whole. The lack of adequate investment, notably in the new industries, had impaired our capacity for development.

That being so, we were bound to ask whether we should expand Community borrowing operations.

Mr Ortoli thought that we should, but the investment strategy was a complex matter: it was a strategy for organizing the recovery, the success of which would determine the level of investment demand and the shape of the policy for improving competitiveness.

4. As for the question of relying heavily on interest subsidies, Mr Ortoli drew attention to the attendant problems: choice of beneficiaries, financing, the response of the market and of interest rates and, above all, the strength of demand for substantial additional loans. On this latter point, Mr Ortoli felt that there were two sectors in which there was undoubtedly some margin for manoeuvre. These were the innovating industries and small and medium-sized undertakings; there was already scope for the development of a 'European infrastructures plan'.

5. Mr Ortoli then considered the problem of the organization of work. In the light of the situation on the labour market, modern production techniques, the present organization of industry and the need to produce at really competitive prices, there was no reason why working hours should not be reduced.

6. As far as the developing countries were concerned, Mr Ortoli indicated that he was in favour of continuing to build on the achievements of Lomé. Nevertheless, he was sceptical about the Community's ability to make further significant contributions without support from elsewhere. A 'Marshall Plan for the Developing Countries' could not be implemented by Europe alone. However, in the light of the soundings that had been made on the other side of the Atlantic, the chances of a vast programme of aid being undertaken jointly by the industrialized countries seemed somewhat remote.

At the hearing on 17 January 1984 Mr CEYRAC, President of the Economic and Social Committee, said that:[1]

He was aware that there was a need for institutional reorganization of the European Communities. But economic recovery had to be seriously tackled before this was complete. He wished to comment on three areas: firstly the internal European market, secondly the investments needed and thirdly reorganization of working time. The creation of a genuine European internal market was essential for economic success. Attention would have to be given to the following points:

(a) the obstacles to a free exchange of goods would have to be entirely abolished;

(b) public markets would have to be opened up;

(c) European standards would have to be established to replace existing national standards;

(d) to achieve free competition, a legal framework for European undertakings would have to be provided;

(e) the European Monetary System would have to be strengthened. In its second phase the ECU must become a real means of payment;

(f) the financial basis for private investments would have to be created by cutbacks in the public sector. The burden on industry would have to be reduced.

Suitable areas for investment were transport, regional policy, energy-savings and the development of new sources of energy. The ACP states should also receive support in this field. Further sectors were the environment, leisure and housing. By analogy with the principle of subsidiarity, investments should be made at European level if they would be more effective there than at national level. This also applied, for example, to the research sector. The investments needed should not be made via new instruments but placed on the market by making use of existing structures. He advocated an increase in the value-added tax proportion of own-resources to 1.4% and for greater use to be made of the New Community Instrument. In its deliberations, the ESC had come out against an energy consumption tax and a tax on fats. As regards the reorganization of working time, he noted that growth alone could not solve the problem of unemployment; more specific measures would have to be taken.

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[1] See PE 88.789, 24.1.84

This, however, was largely a matter for the two sides of industry, which would have to negotiate separately in the individual sectors. Neither the state nor the Community could intervene. Progress would be achieved by a dialogue between the two sides of industry. But it must always be ensured that there was no threat to competitiveness. Greater flexibility would be necessary. Part-time work, for example, could be helpful in this respect; reversible programmes for young workers who had been employed for a long time would be conceivable. The optimum use must be made of the existing production machinery. Unlike Mr Albert, he supported the Commission proposal for reducing working time. He pointed out that there was considerable controversy about reducing weekly working time. In a final personal comment he again spoke in favour of the maximum possible flexibility when discussing the organization of working time. He believed that there was no longer any contradiction between economic and social aspects, but that these were converging.

In reply to questions from various members, Mr Ceyrac said that he was not aware of comprehensive statistics on the possible effect on prices of achieving a uniform market for 270 m European citizens but that the transfrontier costs alone had been estimated at an annual 12,000 m ECU. In accordance with the principle of subsidiarity, investments should be made at the European level if they were likely to be more successful there than at national level. The second phase of the European Monetary System must be achieved and a European Monetary Fund created. There were some hopeful developments in this direction. It would be extremely difficult to make an overall comparison of profit margins between the USA and the Community. Early retirement would be dangerous even in the short-term given the imminent shift in demographic trends. As with other social systems, there must always be provision for the system to be reversed. A general introduction of the ECU as a means of payment could lead to greater monetary stability and would therefore benefit agriculture. The rejection by the ESC of the introduction of a tax on fats had come about as the result of a very close vote with a large number of abstentions. A policy to keep wages down was necessary but very difficult to implement. The ESC had not considered the question of a tax on energy imports.

At the second hearing on 17 January 1984 Mr Wittenveen began by saying that he agreed with practically the whole analysis in the Albert-Ball report. He also agreed that investment in productive innovatory sectors of industry was the major aim in the near future. The change of mentality which this required seemed to be starting to take place. The first necessity was effective unity of the European market. The European Treaties provided a basis for this. But over the last few years a great many obstacles had been created. This applied in particular to the public sector. The uniform market would make it possible for European industry to specialize as needed. In the field of fiscal policy the question arose whether the European economy needed tax incentives. Discussions to date had revealed that a distinction should be made between the short-term and medium-term aspects. In the medium-term there was likely to be a lack of savings which would lead to a lack of disposable capital. The reason for this was that the OPEC surpluses of the past had now disappeared and been replaced by a $25,000 m deficit. The current US budget deficit was $200,000 m. Together these two factors would lead to a shortage of disposable capital throughout the world. The only conclusion to be drawn was that these deficits must be reduced. In the short-term it should be noted that there was a short-fall in demand due to the crisis. There were two schools of thought as to whether demand should be stimulated by fiscal measures, initially with the result that budget deficits would grow. At the present time the European states were reducing their deficits while the USA was actually expanding its deficit. This might be seen as a Keynesian tax incentive. But in fact it was not a genuinely Keynesian policy because it was accepting a permanent deficit which in the long-term must lead to a shortage of capital. The structural policy being pursued in Europe to reduce deficits was extremely difficult to implement. The states with a strong balance of trade had greater room for manoeuvre in this respect. It would be possible to provide short-term fiscal incentives. Investments could be made via the European Investment Bank. But whether this was a suitable instrument for investments on the scale of 15,000 m ECU was another matter. Nor was it obvious whether appropriate projects could be found in the private sector and it was specifically this sector where investments were particularly important. The idea of subsidized interest rates was attractive.

Additional investment programmes should only trigger the development and then the market must take over. There was much to be said for a tax on oil imports, not least as this would maintain the pressure to save energy. Taxes on business profits should be cut. A distinction should be made in fiscal policy between cyclical and structural elements. In structural terms, the main aim was to cut government spending. In the Third World the Community could act as an adjunct to the IDA on condition that the aid granted should be spent in the Community. There was a need for political guarantees to safeguard banking risks for projects in the Third World.

Replying to the questions raised by several members, Mr Witteveen drew particular attention to the importance of integrating the European capital market and strengthening the EMS. The latter had already achieved certain successes. Reducing wage costs was necessary to the extent that the increase in real wages stayed beneath the increase in productivity. The idea of a fluctuating oil import levy was interesting, but the revenue this would yield would not be predictable. The planned aid to investment of 15,000 m ECU, to be financed via a loan, was on the appropriate scale. But he was not sure whether the EIB was suitably equipped. He did not have concrete figures on transfers of capital from Europe to the USA. The US requirements in 1983 were $60,000 m and were likely to amount to $80,000 m in 1984. A large part of the capital required came from Europe. It would be extremely difficult to discourage such exports because the international capital markets were closely interlocked. It would be far better to make investment in Europe more attractive. It was important that there should be confidence in a stable economic and monetary policy. Although it would be useful for there to be Commission regulations on budgetary discipline in the individual Member States, these could only come about in a United States of Europe. Generally it was very important to note, as had been pointed out time and again by the European Parliament, that countless questions could only now be settled at the international level.

Hearing with Mr CARLI (President of UNICE) 25.1.84 (Full summary in PE 88.900)

Mr CARLI stated that UNICE is in broad agreement with the analysis of the weakness of the European economy contained in the ALBERT-BALL report. The worsening of the economic position of the Community is attributable to many factors, most notably the imbalance of the major components of national income and expenditure, such as the decline of the share of gross fixed investment; the rising share of consumption; the halving in the share of savings; the increase in the public sector and in its deficit; the rise in the share of wages; and the level of social charges. In addition, European industry is handicapped by the continued absence of a genuine internal market. These factors are confirmed in a recent UNICE study comparing European to Japanese and American competitiveness. Unlike Europe, wages in the USA have not risen faster than GDP and consequently more jobs have been created. Also, tax increases in Europe have tended to affect firms rather than individuals (ie. voters) more. All these factors have tended to undermine profitability: the current transfer of capital to the USA is due to higher profitability there rather than higher interest rates.

In UNICE's view, economic recovery in Europe will be brought about more by the creation of the right economic environment than by "pump-priming" by the state. Business activities should be promoted by measures that complement market forces. The transfer of resources to productive activity requires important modifications in the structure of public finance. They include the reduction of current expenditure, the allocation of higher priority to capital expenditure, appropriate public sector pricing policies and the modification of tax structures with a view to promoting competititveness and employment.

In parallel to such a medium-term financial strategy, other measures must be taken to increase capacity for sustained economic growth. This means, in particular, the promotion of investment. However, the ALBERT-BALL proposal for additional publicly-financed investment programmes equivalent to 1% of GNP, introduced by the "backdoor" expedient of a 150% increase in Community borrowing so as not to effect the already large national deficits, begs a number of questions: who would take up the loans? What would be the inflationary consequences? What impact would such a large loan have on international capital markets? UNICE acknowledges that increased public investment is needed in such areas as infrastructures and the development of high technology but it must be capable of being financed by economies in current payments for goods and services, including wages and salaries. UNICE believes that measures should be taken to facilitate self-financing by companies of their own private investment. This means increasing profitability. UNICE has advocated such measures as the easing of taxes on companies, provisions for the accelerated depreciation of fixed assets, tax relief on stock appreciations and exemption from taxation of such capital gains as are re-invested. The costs of such proposals could be offset by reductions in public consumption.

Other measures that would help create a better economic environment in Europe would be steps to de-regulate markets for labour, goods, services and capital; the creation of a truly common market; the strengthening of the EMS including the coordination of policy vis-à-vis the dollar and the promotion of the private use of the ECU which should be given the status of a convertible currency; the selective transfer of public R and D budgets to Community level; and the opening up of public sector contracts. Concerning the proposals to strengthen Community action in the energy field, UNICE feels that the impact of this should not be over-estimated, though it endorses the Commission's June 1983 proposal. Lastly, on the reorganisation of working time, he declared that it was not by working less than its competitors that Europe would solve its problems.

Hearing with Mr DEBUNNE 25.1.84 (Full summary in PE 88.900)

Mr DEBUNNE first issued a word of warning about comparison with the USA, pointing out that the USA differs from Europe in that it has a real common market, is a monetary superpower, possesses a high level of technology through its high military research and allows social situations that would be unacceptable in Europe.

ETUC is convinced of the need for concrete measures to stimulate economic growth again. Together with the European Trade Union Institute, they carried out a study based on the OECD "Interlink" economic model that showed that a concerted 1% increase in investment of 1% of GNP by the Community countries would create 4 million new jobs without causing a significant regression in balance of payments or budgetary deficits. He pointed out that investment in the public sector also creates jobs in the private sector both by direct spin-off and by the multiplier effect.

Currently, Community countries are engaged in a spiral of competitive cuts in wages and social security, each hoping to improve its position vis-à-vis the others but in fact leading to an overall decline in purchasing power and therefore demand in the economy. This vicious circle causes greater unemployment and greater budget deficits. It must be broken by a concerted European stimulus to the economy, boosting demand through public investment. The use of Community instruments to finance investment would be welcome. He recalled that the cost to national exchequers of keeping people unemployed is enormous, accounting for a large proportion of national budget deficits. This should also enter into any calculations about the cost of new investment: every new job created also saves public money.

The trade unions support the introduction of new technology, but it must be carefully planned in order to avoid social crises in what is already a disastrous social situation. In the short-run it is impossible to reduce unemployment without also taking measures to shorten working time per person. This should be done in a European framework, setting, for instance, an orientation direction for a 10% reduction, which would be applied flexibly to different industries. It must be coupled with measures ensuring that more workers are thereby taken on.

ETUC is not in favour of protectionism. However, they do feel that Europe must respond to the protectionism of others, notably the USA, and to unfair competition.

He supported the use of price controls as a method of combating inflation. Concerning barriers to the internal market, he supported their gradual abolition and appealed for harmonized norms at least for new technologies and products. He pointed out that the most successful post-war European economies were those in which trade unions were strong and were closely involved in all important economic decisions, such as Sweden and Austria.

Hearing with Mr LE PORTZ 26.1.84 (Full summary in PE 88.900)

Mr LE PORTZ concentrated his remarks on aspects directly linked to the European Investment Bank and the Community's lending instruments, recalling that the EIB was established by the Treaty of Rome precisely to contribute to balanced economic growth.

He felt that there are three sectors in which investment is vital for economic recovery. They are energy, to reduce Europe's dependence on imported oil; industry, to enable Europe to catch up its lag in advanced industry; and regional development to achieve a better balance of activity and employment. It so happens that it is in precisely these areas that EIB and Community lending activities are concentrated.

Investment through Community instruments is also advantageous for another reason. One of the most important consequences of the development of the common market has been the growing interdependence of national economies. This has brought many benefits but, as the ALBERT-BALL report illustrates, it means that any attempt at unilateral recovery by a Member State will run up against balance of payments constraints. It is therefore necessary to concert economic policies closely, and to have a mechanism of financial solidarity that enables weaker economies to develop their level of investment without upsetting their balance of payments or boosting inflation: this too is the role of the EIB.

Since 1977, Community borrowing and lending activities have developed enormously. The capital of the EIB was doubled twice. Together with the creation of the New Community Instrument and the EMS loans, this led to an increase in lending handled by the EIB of some 25% per year from 1977 to 1983, and this during the deepest recession Europe has known since 1930. In this respect, the EIB is already partly fulfilling what was advocated in the ALBERT-BALL report. Including balance of payments loans, some 10.6 bn ECU were transferred in 1983.

The impact of such a level of loans is important, both as transfer between Member States and in terms of the economic impact. The loans by the EIB in the energy sector (36% of its loans) from 1977 to 1983 financed projects that led to a cut of the Community's oil imports by 21%. One-third of Ireland's road, electricity, water and telecommunications investment came from EIB financing. Between 400,000 and 500,000 jobs were created by EIB investments in 1983 (with the highest number per unit of investment being in small and medium-sized undertakings).

Can EIB and Community loans be developed further? It would be difficult to increase them faster than the 25% rate of increase per annum that has been achieved over the last six years, taking into account market capacities and the need to ensure high standards of quality in projects financed. The EIB is already second only to the World Bank in the international market. Nevertheless, a continued increase at the current rate seems possible, if carried out with care.

Capital for investment is only one element in economic recovery. Other factors must also be present, such as general economic and financial equilibrium, wage rises compatible with the economic situation, a sufficient degree of self-financing by firms and an international monetary situation that does not cause excessive interest rates.

Mr HIGGINS presented their introductory remarks. They subscribe to the diagnosis of the economic situation summarized in paragraph 41 of the ALBERT-BALL report and the essentials of the analysis of Part I of the Commission's Annual Economic Report for 1983-84. Four main impediments to better economic performance can be identified:

(1) Inflation: this has reached new heights at each peak of the business cycle since the war, and is therefore not just due to the oil crises. It is recognized that in the long run inflation is not a trade-off for employment, but jeopardizes economic performance, creating unemployment.

(2) Income share: wage and non-wage labour costs have risen more rapidly than prices, leading to declining profit shares.

(3) Public expenditures and deficits: with effects on initiative, inflationary and "crowding out" effects of public sector borrowing, distortions due to the high level of taxation. In addition, public expenditure has shifted away from investment and towards transfer payments, and taxation has fallen more on the business sector (non-wage payroll costs) than on the household sector.

(4) Mobility and responsiveness in markets: European economies respond only slowly to changed circumstances due to rigidities caused by interventionism, restrictive practices, barriers to trade.

Weak private investment is a symptom of these underlying maladies, rather than a cause. They reduce expected return on investment, and investment falls.

OECD's current forecasts for Europe in 1984-85 predict a slight pickup in real growth and a continuing decline in inflation. However, unemployment will continue to rise until 1985, reaching 11%. Unit labour costs increases will level out and profit shares are likely to increase. The balance of payments surplus will grow. Government borrowing will be lower, However, a comparison with other zones of the OECD indicates that the recovery is seen as weakest in Europe.

Most European governments are already beginning to follow the necessary policy guidelines, but these must be continued consistently. Additional measures should addresss the underlying problems and not be palliatives: they are rather sceptical of the ALBERT-BALL plan (paragraph 52) to boost public investment funded by borrowing, not because it would not be a viable project in itself or that there would not be enough outlets, which there would be, but because the idea does not come to grips with fundamentals. They warned that it is necessary for policies to have a high degree of consensus if they are to work, which requires that the costs of change be shared equitably and that the "safety net" of the welfare state be maintained.

The May 1983 OECD Ministerial meeting had identified three categories of economies: strong, convalescing and weak. Although they had felt there was some room for the stronger economies to help the others by relaxing their policies, he warned that the usual mistake of governments at this point in the business cycle was to be too relaxed. On the "Interlink" economic model, he pointed out that this had been incorrectly invoked earlier in the Hearing with Mr DEBUNNE. OECD results were different from ETUC's. In any case, any model should be used with caution as they are based on the average of past economic responses which may have changed.

Mr HENDERSON stated that they were in broad agreement with the ALBERT-BALL report where it spoke of the need for a genuinely unified European market and about governments' over-emphasis on the short term in economic policy. However, they felt that the report was too pessimistic on the position of Europe in the medium-term, too optimistic about the effects of "pump-priming" and too "Colbertiste".

Hearing with Mr URI 26.1.84 (Full summary in PE 88.900)

Mr URI concentrated his remarks on challenging a number of assumptions and myths. He pointed out that private investment depends on expected volumes of sales which depends on consumption not being cut. Consumption and investment are not zero-sum trade-offs when there is unused capacity in the economy. The USA has not compressed consumption. Public investment, on the other hand, should not look at short-term profitability but at medium-term benefits to the economy. The aims of the nationalized sector in France is to do this, in the same way that Japanese companies do not go for short-term profits but make medium-term plans together with MITI.

On the proposed oil tax or levy, Mr URI felt that this would be useful as a source of revenue for investment and as a disincentive to waste energy. If it was to take the form of an import tax, this would contribute to solving the disequilibrium in the UK contribution to the Community, though to solve that problem by itself it would have to be a very high levy.

Mr URI insisted on the need to exploit the Community dimension. The field of research is instructive: the hoped-for joint atomic energy research foreseen in Euratom never took off as each country hoped that it would make a breakthrough. The result is that we now all buy American-designed nuclear power stations. This must not happen again: the Treaties allow possibilities for joint research if there is political will.

The US economic recovery, for the first time, is not spreading to the rest of the world. This is partly due to their high interest rates sucking much-needed capital away from Europe and the Third World, a problem with long-term consequences.

Mr URI said that the way to develop employment while cutting inflation is to concentrate on the development of what the economist, EDOUARD, calls "marginal jobs". He also called for a strengthening of the institutional framework of the Community to increase its capacity to act.

Mr URI pointed out that profitability is not the only incentive for growth and investment: the French nationalized sector had a higher than average growth in productivity, while making losses due to the holding down of their prices by inflation-fighting governments.

On taxation, he pointed out that, as it is proving difficult to cut the overall level of tax, given the large budget deficits, any suppression of a particular tax would have to be replaced by another tax. Proposals to exempt profits from taxes should bear this in mind. However, he felt that re-invested profits should be taxed less than distributed profits.

He drew attention to the myth that social security charges are a burden weighing on the whole European economy: it is true that they are lower in the USA but there military spending - equally a burden - is much higher. For several decades, the most successful economies were the Scandinavian ones, with very high levels of social security.

Hearing of Mr LANTZKE (IEA) (30.1.84) (full summary in PE 89.046)

1. Mr LANTZKE dealt with the main aspects of the Albert and Ball report, agreeing with their analysis. He dealt with the problem of the current economic recovery which was evident in the level of consumption but not yet in the level of investment: an important reason for this was the so-called 'non-Europe'. However, it was not the only reason, the other fundamental one being the lack of investment in the recent past caused in part by low profits.

There were three principal areas of action to stimulate a recovery in investments:

- the urgent need to overcome a certain passivity in Europe through the challenge of new technologies;

- the need for Europe to make a great leap forward to catch up with the United States and Japan;

- the importance of giving far greater consideration to the problem of the unified European industrial area.

There were however certainly in the Albert and Ball report areas of excessive pessimism about the possibility of a further depression in the 80s, whereas the speaker felt that there were prospects of growth, albeit limited. However, we had to get out of the vicious circle in which a weak economic situation prevented investment; the means for doing so were at hand: inflation under control, a new approach by both sides of industry, and public sector deficits which were gradually coming under control.

2. On the question of energy, Mr Lantzke said that the states of Europe had to provide clear norms and standards in this sector and pursue a policy which left room for managers to manage. He pointed to the effectiveness of energy-saving measures and measures to use Community resources.

The idea of a tax on oil imports was not very practical, he felt, since it was not justifiable in terms of a fall in world prices: this tax would simply weaken the competitive position of European industry. It was also politically difficult to find an agreement on such a tax; lastly it could create a distortion in imports of other energy products.

He was sceptical about the idea of a Marshall plan for energy for the countries of the Third World since not all of those countries had the potential to respond to the stimulus of massive investment. This was true even for many countries in the Lomé Convention.

3. Europe, Mr Lantzke concluded, had the resources and the economic and technical means to eliminate the negative effects of energy problems on its economy; it did, however, have to lay down a framework for activities in this sector and take energy problems into account in all decisions, reviewing the concepts of security of supplies, dealing with the problem of radioactive waste and, lastly, developing the energy savings policy to prevent the unlikely but not impossible eventuality of a third oil crisis.

4. Answering the questions put by certain members, Mr Lantzke pointed out that the destination of the revenue from the oil tax was influenced by political problems and that there was a danger that it would be primarily prestige projects which would be financed. Furthermore, the various European countries would tend to encourage investments which might even conflict with one another.

As regards priorities for investments in the energy sector, he took the view that the soft energy sector should be encouraged, but without harbouring any illusions that this could replace traditional sources; furthermore, what was needed was not so much major programmes to support energy savings, but much more information.

He was certain that a third oil crisis would lead to a serious depression: to prevent this, there would have to be a more effective policy on stocks.

Mr Lantzke concluded that only an excessive fall in oil prices could justify a variable levy.

Hearing of Mr Davignon (Vice-President of the Commission) (30.1.84)
(Full summary in PE 89.046)

1. The Vice-President of the Commission, Mr DAVIGNON, stressed the need to increase Europe's investment capacity in the energy sector, which was very low in comparison with Japan and the United States. The same was true for investments in manufacturing industry, which were not at present principally directed towards new products.

The difficulties in investing in Europe lay in low profitability, in the lack of a true common market, where the European dimension is a fundamental factor in profitability, in the lack of incentives for industrial cooperation in Europe, and in the ineffectiveness of regulations on intellectual property in a number of sectors.

A different problem arose in the telecommunications sector, in which the encouragement for investment would come primarily from the creation of standard norms, rather than from public investment or promotion of research. On the other hand, research and investment were essential in a sector such as transport and biotechnology. But investment in the sectors of new technology was hampered by weaknesses in the areas of information, research and regulations.

2. On financial problems, Mr Davignon spoke of the need to create stable sources of finance for multiannual programmes: the Community was not geared up to this approach.

He also maintained that Community aid took the form of subsidies to Member States rather than genuine measures aimed at achieving Community ends: to reverse this situation, programmes with well-defined priorities would have to be laid down.

3. Answering the many questions put by members, Mr DAVIGNON said that the weaker countries could benefit from a recovery in the stronger countries. He said that Europe had to maintain a certain level of production even in the less advanced sectors.

He added that to deal with the crisis we would have to ensure that the differences between the Member States did not prevent them from taking common measures. There was also a need for specific initial encouragement for a recovery in investment, because profitability in Europe was at present low; but there was no escaping the need to create more favourable market conditions.

There was then a need to identify sectors where investment was essential and to preserve development capacity, bearing in mind that simply acquiring patents did not automatically confer development capacity.

He was opposed to a tax on oil products, even a flexible one.

Replying to a specific question, Mr DAVIGNON said that permanent interest subsidies or even a minority shareholding in companies by the Community were impracticable.

Lastly, Mr Davignon pointed out that the essential prerequisites for recovery were: creation of an effective internal market and a Community industrial area, more lenient taxation on concentrations at European level, new incentives to investors, and the launching of measures in the research sector.

III. THE DEBATE IN COMMITTEE

40. The members of the committee broadly agreed on the content of the plan for European economic recovery and, in particular, on the need to consolidate the common market, strengthen the EMS, integrate the capital market and evolve appropriate industrial and research strategies. They recognized the need to avoid refuelling inflation, to bring the economic policies closer together and to pursue international consultations with Europe's partners outside the Community. Most were in favour of maintaining a generous programme of aid for the countries of the Third World, in line with the principles established by the European Parliament. As for their differences, they tended to side either with Mr Albert or Mr Ball, but were less amenable to compromise.

- Some members insisted on the need for energetic measures to revive domestic demand by means of public investment schemes financed both from Community loans and from the national budgets of those countries which had succeeded in redressing the macroeconomic imbalances. They were in favour of incomes moderation to the extent that increases in purchasing power or wages should not outstrip productivity gains. They also favoured the subsidization of interest rates as an incentive to investment in the priority sectors. Lastly, they favoured a flexible industrial policy, planned and supervised by the public authorities, an immediate and substantial reduction in working hours without any loss of purchasing power, and retention of all the benefits of the Welfare State.

- At the other extreme, there were those members who maintained that priority should be given to restoring the profitability of investment by depressing real wage costs and reducing fiscal and parafiscal charges. It was the duty of the public authorities to make every effort to stabilize exchange rates, bring down inflation, reduce the budget deficits, eliminate the barriers to freedom of movement for goods, persons and capital, and cut back welfare expenditure. Market forces could be relied upon to do the rest. They nonetheless recognized the need for a major Community programme to foster research in the new technologies.

- Between these two relatively clear-cut positions stood those who advocated a recovery programme based solely on the revival of private investment and using interest subsidies, those who favoured reviving consumption and investment growth through cuts in taxation, and those who held that priority should be given to improving our export performance through subsidized financing or the lowering of exchange rates.

IV. THE VIEWS OF THE RAPPORTEUR

41. While subscribing to almost every point in the diagnostic section of the Albert/Ball report, particularly where it discusses the macroeconomic disequilibria between investment and consumption, the substantial size of the public levies, the rigidity of the factor allocation mechanisms, the compartmentalization of the markets, the cost of social welfare provisions and the lack of solidarity and convergence at European level, your rapporteur would have been all the more pleased if the section presenting the authors' separate or agreed solutions had been equally specific and comprehensive. While this section undoubtedly addresses itself to some of the most crucial issues, it neglects many of the questions raised in the diagnosis.

Is recovery necessary and, if so, what form should it take?

If it is intended that 'recovery' should be based on a rapid and substantial increase in public investment demand - or private or public consumption demand - then we are being asked to accept a Keynesian-type policy, which certainly cannot provide a suitable remedy to the present economic situation in Europe.

The reasons for this are legion.

(a) We must first of all dismiss the idea that recovery can be achieved on a purely national basis. The policies tried by the British Government in 1976-77 and by the French Government in 1975-76 and 1981-82 did nothing but rekindle inflation and very rapidly led to balance of payments and exchange rate difficulties.
Some commentators have pointed out that these policies would nevertheless have been effective if the external constraints could have been eliminated either by abandoning fixed exchange rates or by introducing a measure of protectionism - or if they had been coordinated at European level.

However, these same commentators conveniently ignore the inflation factor, forget that the experience with floating exchange rates has not yet produced conclusive results and seem to be unaware that a return to protectionism would be a disaster for Europe.
That leaves us with the idea of a concerted and non-inflationary European recovery.

(b) Assuming that the Member States governments agreed on this type of recovery and assuming - in the absence of a single European currency - that increases in trade between the Member States were such that additional imports were exactly offset by additional exports, thus leaving their trade balances unchanged, then the imports component of GNP would be reduced from 25% to 12.5%. However, the external constraint on our economies would not disappear, and since Europe is without an international reserve currency instrument of its own, it could not afford to dispense with the mechanisms needed to redress its balance of payments in relation to the rest of the world.

(c) Let us go further and assume that the problem has been solved or else does not arise. It cannot be claimed with certainty that an increase in demand would result in a high level of sustained growth, so long as the structural impediments to growth identified in the Albert/Ball diagnosis have not been eradicated. A relaxation of budgetary or monetary discipline might produce a growth rate in real terms of the order of 2 or 3%, but the only other result would be an upturn in infation. Why?

(d) Let us suppose for a moment that there is no energy problem. Even a very modest recovery of growth would reactivate demand for oil products, but we would assume that supply could easily meet such demand and that the explosive political situation in the Middle East would for the time being have no effect on the oil-exporting capacity of the Gulf States.

Growth in Europe is impeded by two factors : the ground lost in technological development, and the structural rigidities, which both prevent the optimum allocation of the factors of production, thereby detracting from the competitiveness of European industry, and inhibit productive investment in the private sector.

(e) Much has already been said about the technology gap. We are no longer ashamed to admit the error of our ways. Indeed, the electronics and computer industries in Europe have themselves sounded the alarm. Although it would be mistaken to believe that the adoption and implementation of the Esprit programme would enable us rapidly to make up the considerable ground lost, it is frustrating and disappointing to note that, even as these lines are being penned, the Council still hesitates to give the green light for reasons of budgetary austerity. Be that as it may, any increase in demand in Europe would at present result in a disproportionate increase in imports of the growth technologies and have no positive impact on employment.
On the contrary, it would aggravate the employment situation inasmuch as the imported technology would be 'labour-saving'.

(f) As for the structural rigidities, these arise from the compartmentalization of the markets resulting from the persistence of technical (or non-tariff) barriers to trade, the high level and inflexibility of wage costs, the excessive cost of the Welfare State, and the plethora of bureaucratic rules and regulations.

(g) The rapporteur, who has read countless studies of the problems outlined above[1], has found no better resumé of the matter in hand than the conclusions reached by the Giersch and Wolter team of the Institut für Weltwirtschaft, Universität Kiel, in its article 'Towards an explanation of the productivity slowdown', published in Volume 93 of the Economic Journal (March 1983). These conclusions, which are reproduced below, are the outcome of an exhaustive and extremely well-documented study, which we would commend to the reader.
The high level of growth of the 1960s could not be sustained for the following reasons :

1. Straightforward quantitative growth was bound to fall into disrepute after it had raised general welfare in some fields and could no longer hide its deficiencies and costs in other fields; what the public legitimately demanded after a period of fast quantitative growth was a new public good called 'qualitative growth'.

[1] See bibliographical annex

2. For Europe and Japan, opportunities for the economic exploitation of technological innovations, especially those originating in the United States, were finite.

3. Export-led growth in Europe and Japan had come to an end as it was based on an overvaluation of the dollar and American resources.

4. Supplies of many materials were limited and had to become less elastic at given relative prices in the fields of energy, exhaustible resources and - for Europe - skilled manpower.

5. Accelerating inflation, due to fine tuning and the fact that declining supply elasticities were accommodated by monetary policy rather than wage policy, had to be stopped at some point by rigorous deflationary measures, which in turn inhibited growth.

(h) Elements of mutual causation which had positively affected the acceleration process turned negative.

1. While straightforward quantitative growth - with scale economies and minor changes in relative prices - had boosted investors' confidence, qualitative growth - requiring more structural adjustment in response to greater changes in relative prices - made business uncertain and pessimistic.

2. After fast productivity advance had enabled a fast increase in real wages without impairing employment opportunities, organized labour held extrapolating (or adaptive) wage expectations when the transition to qualitative growth occurred. Instead of accommodating the greater investment uncertainty, organized labour in large parts of Europe rejected taking into account the sharp deterioration of its full employment (or equilibrium) terms of trade vis-á-vis energy and the natural environment and started a fiercer struggle over the income distribution, which weakened the social consensus, induced governments to embark upon populist reform policies, strengthened protectionist attitudes, and led to more unemployment or to a lower productivity advance and possibly to both.

3. While monetary acceleration plus adaptive expectations on financial markets had kept real rates of interest in check during the 1960s and while it helped once more when it was used again to accommodate the higher level of energy prices after 1974/75, a stop of monetary acceleration was bound to raise the real rate of interest to its long run equilibrium level, perhaps with some overshooting; and a monetary deceleration to bring down inflation rates finally produced the exotic real rates of interest we had in the recent past.

(i) The article ends with the following recommendations :

'As to conditions on the labour market that would bring us back to satisfactory levels of employment, we can state : if a norm for real wage increases in the future were to be established on the basis of past trends, the measured increase of labour productivity in the base period must not only be corrected for changes in the terms of trade and in the costs of other inputs, it must also be corrected for changes in employment. The equilibrium productivity advance, i.e. the advance consistent with constant employment, must be judged to have been lower (higher) than what is actually measured if employment has fallen under the pressure of excessive wage costs (if wages have been lagging behind the growth of distributable output). If the target for the future is not constant employment but rising employment, the wage norm has to be further reduced by a margin whose size will depend upon the speed at which employment is to be increased. A level of employment which was too low for too long a time is likely to have generated wage induced capital obsolescence and a corresponding job gap. In order to close this gap a long and strong lag of real wages behind productivity advance may be necessary for sufficiently boosting profit expectations, profits, and investment. Wage restraint also has the function of accommodating the high real rates of interest which are required for raising the propensity to save and for inducing investors to change their technological bias from labour-saving to capital-saving methods of production.
An acceleration of investment in plant and equipment (promoted by lower wage costs), a better allocation of this investment, and a more efficient use of the existing stock of capital (enforced by relatively high real rates of interest) would in combination gradually close the structural job gap. By raising the medium run level of employment, this would reduce resistance against exploiting the gains from specialisation, freer trade, and faster technical progress, and pave the way for a more rapid productivity advance, faster wage increases at given levels of employment, and a renewed social consensus, perhaps with less reliance on collective action. But the process of transition may be tough, comparable to what the world experienced half a century ago. The catharsis could be facilitated by :

- an intellectual consensus on the fundamental distortions that have to be corrected,
- institutional changes in the labour market to make wage behaviour more responsive to unemployment,
- a removal of barriers to entry for new firms and entrepreneurial talents, and,
- efforts te reduce uncertainty in the relationship between governments and markets.

Measures to boost demand may be necessary should mutual confidence collapse in a critical phase, but mutual confidence and confidence in government can be best trusted to revive and to induce a sustainable expansion of effective demand, in compliance with a renewed growth of factor productivities and aggregate supply, if relative factor prices reflect relative factor scarcities.'

(j) Although, in any recovery plan, the accent must above all be placed on measures to eliminate the obstacles to growth, there is a danger that, unless those measures are sufficiently bolstered by export demand (which is at present the case in the US economic recovery, although there is no certainty that it will last) and by investment demand from the private sector, the resulting deflationary effect will be more lasting than is desirable. This is why the recovery plan must aim first to reduce the cost of capital to investors and then to ease the fiscal pressure on personal incomes and the parafiscal pressure on wage incomes, so as to increase the amount of income available for saving and consumption without pushing up production costs.
Any other recovery plan - especially one which relied on a massive expansion of public investment or public consumption - would have the disadvantage of reducing still further the already unacceptably small share of the private sector and of increasing the already excessive indebtedness of countless public authorities or, if the money stock were too large, of rekindling inflation.

(k) Why is it that, with the same growth rate in the United States and Europe, there is such a pronounced difference in their ability to create jobs?
The answer to this question is twofold.

The relative price ratio as between the labour factor and the capital factor, which has been much higher in Europe than in the United States, has prompted industry to give precedence to capital-intensive investment and labour-saving investment.

(l) This trend has been further exacerbated by a deliberate policy of subsidizing investment by reducing interest rates or awarding capital grants, with the result that GNP growth rates have been further dissociated from employment growth rates.
There can be no doubt that the reversal of the relative factor cost trend (currently taking place) and the greater emphasis now being placed on the 'quality' rather than the 'quantity' of growth will in the long run be more conducive to the creation of jobs. This is illustrated by the considerable expansion of employment in the tertiary sector in the USA.

(m) The second significant factor is the difference in the level of flexibility of the labour market and in the amount of social security available to workers. Periods of unemployment in the USA are on average six times shorter than in Europe (1 month as opposed to 6 months), and half the unemployed in America receive no benefits of any kind.
The co-existence of a high level of unemployment and a scarcity of certain kinds of labour is a very rare phenomenon in the United States. The most important reason for this is the degree of flexibility which characterizes real wages as well as working hours. It is not surprising that the most spectacular growth in employment has taken place in the service sectors, in which working hours are more flexible, part-time working is more common and the wages spread is greater than in any other sector.

(n) It is equally striking to note that the new desire for 'qualitative' growth has resulted in Europe in a substantial increase in the demand for public services (health, culture, security, leisure) and, concomitantly, an increase in the number of public officials and a rise in taxation, since many of these services are provided or sold at below-cost prices. In the United States, on the other hand, this same growth in demand is addressed to the market, which has responded flexibly and efficiently. There is no doubt that market-orientated growth of this kind will come up against fiscal and bureaucratic constraints and the poor allocation of resources which often stems from such constraints less quickly than the type of growth seen in Europe.

(o) Until the adjustments now in hand have the desired effect, the recovery of growth will not be accompanied by a cut-back in the level of unemployment. Hence the need for back-up measures.
Unless it allows of a measure of flexibility and compromise in the interests of maintaining the competitiveness of undertakings and financing investment, the principal demand of the trade union organizations in this area - an unconditional reduction in working hours - could well be as disastrous for the growth of employment as the maintenance of indexing or the increase in wages which followed the first oil shock.

(p) Although Michel Albert's proposals are plausible and reasonable, they presuppose that people in employment will accept the trade-off between income and leisure, or will be prepared to make considerable sacrifices to help those who have no employment. This is a risky assumption and we can understand why Mr Ball should express scepticism. Your rapporteur takes a less pessimistic view, but he has no faith in general formulas imposed from on high.

(q) Your rapporteur is inclined to place his trust in the effectiveness of negotiations which take place as close as possible to the shop floor. He is also in favour of fiscal or administrative incentives being made available to all undertakings which venture to test new ways of adjusting or reducing working hours, with the express proviso that such experiments do not result in an escalation of production costs.