PO-CH/NL/0142
PART A

Part . A .

CONFIDENTIAL

(Circulate under cover and notify REGISTRY of movement)

Begins : 5/1/87.

Ends : 3/7/87.

PO -CH /NL/0142

PART A

Chancellor's (Lawson) Papers:

ECONOMIC FINANCE COUNCIL
MEETINGS 1987

Disposal Directions : 25 Years

[signature]

25/8/95

PO -CH /NL/0142

PART A

3/4

Debbie – ① to note details

② then diary folder

T.

MINISTERIE VAN
FINANCIEN

1000 BRUSSEL, January 5th 1987
Wetstraat 12-14 Tel. : 02/233.81.11

DE MINISTER VAN FINANCIEN

O. ref. : ME.lw/87.001

Mr. Nigel LAWSON
Chancellor of the Exchequer

Parliament Street
LONDON S W 1 P - 3 AG
UNITED KINGDOM

CH/EXCHEQUER
REC. 13 JAN 1987
ACTION MR LAVELLE 13/1
COPIES TO EST, MST
SIR P. MIDDLETON
SIR G. LITTLER
MR MORTIMER
MR CRABBIE

cc Mrs Lawson

C

You are lunching in St. Albans on Fri 3 April & have your Advice Centres on Sat 4 April. Shall I ask Caroline to move the latter? yes pl.

Will you both attend? pl ask Mrs L.

D 14/1

Dear Collegue,

Informal Meeting for EEC-Ministers for Finance/Economics, April 87. Governor

I am pleased to invite you to the next informal meeting of the European Community Finance Ministers which will be held on Friday, Saturday and Sunday, April 3-4-5 1987 at the "La Réserve" Hotel at Knokke on the Belgian coast.

Guests will be expected to arrive on the evening of Friday April 3rd. Reception and buffet-dinner will start at 19.00.
The conference itself will take place on Saturday April 4th.
On Sunday April 5th there will be an opportunity to sightsee Bruges before the meeting ends with lunch.

As with previous informal meetings, the Finance/Economics Minister of each member State is invited to be accompanied by the President of his Central Bank and by a senior official from his ministry.
Wives of Ministers and of Central Bank Representatives are also cordially invited to attend the meeting. Arrangements are being made to provide ladies with a special programme on Saturday April 4th.

I would be grateful if you would kindly let me know by February 10th the names of all members from your delegation including ladies and possibly security personnel.

Looking forward to welcoming you at Knokke, I remain

with best regards,

Mark Eyskens.

MACSHARRY, RAYMOND TD MEP

Fianna Fail Deputy and Honorary Treasurer.

Born Sligo 1948. Educated Summerhill College, Sligo. Member of Sligo County Council since 1967 and of Northern Western Health board since 1971. Deputy since 1969 for Sligo/Leitrim. Opposition front bench spokesman on the Office of Public Works 1973-75. Member, Committee of Public Accounts 1969-77. He was nominated as a Minister of State at the Department of the Public Service in December 1977, in recognition of his outstanding poll in the general election of June 1977. A loyal supporter of Mr Haughey, he was Minister for Agriculture from 1979-81 where he proved his ability.

A relatively competent Minister of Finance in 1982, he came unstuck when he was found to have bugged a meeting with an anti-Haughey deputy. Resigned from the front-bench. Mr Haughey's most loyal supporter in the leadership contests of 1982 and 1983, he is now regarded as a rising candidate for the succession to Mr Haughey. A hawk on Anglo-Irish relations, but argued for abstention on the Anglo-Irish Agreement, 1985.

Married Elaine Neilan. Three sons, three daughters.

Hotel La Réserve

France
Council
June

11 May – Report from Cttee on comms & cap markets

15 June – [illegible] Belgian presidency [illegible] Council Belgian [illegible]

Future role of Commission [illegible] dossier [illegible] for [illegible] Oct.

Banquet department - Elizabetlaan 160 - 8300 Knokke-Heist - ☎ (050) 61.06.06 - Telex 81.657

Art 67 of the Treaty

Hotel La Réserve

Japan

Liberalisation of capital movements

$ assignment

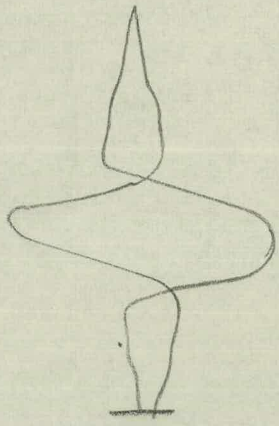
too many languages

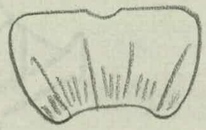
Jan

opinion

refuse

France





UK
Germany
Lux
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Ireland Denmark
Ireland Belgium

Sp
Port
Greece

Italy
Irel

La Communauté des petits

Luxembourg
Lichtenstein
Andorra
Monaco
Iceland

Hotel La Réserve

Importance of $ (a.i. of Plaza strn of mtgs)

Debts:
~~The Hrt~~
Harmonisation of
banking law etc
wh 1992.

dau 86

(will) Introduce safeguard

? ring fences

? loans for weak sisters?

By 1992 addn all pos/neg reqts

Banquet department - Elizabetlaan 160 - 8300 Knokke-Heist - ☎ (050) 61.06.06 - Telex 81.657

Hotel La Rēserve

$ < BMS

[illegible] [illegible]

[illegible] [illegible]

[illegible]

Japan < trade

[illegible]

[illegible]

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[illegible] capital

[illegible] prerequisite

No [illegible]

No [illegible] facilities [illegible]

ANNEX B4:
MEMORANDUM FROM
FRENCH MEMBERS OF
MONETARY CTTEE.

ANNEX B4

MONETARY COMMITTEE

OF THE EUROPEAN COMMUNITIES

Brussels, 10 February 1987

MEMORANDUM FROM THE FRENCH MEMBERS OF THE MONETARY COMMITTEE

The Communiqué of the Ministers and Central Bank Governors of the Member States of the EEC emphasized the desire of the monetary authorities to pursue the coordination of the policies which are necessary for the maintenance and the consolidation of monetary stability, for the control of inflation and for economic growth in Europe, and which will contribute to greater stability of the exchange rates between the major international currencies. To this end the Ministers requested the Monetary Committee and the Committee of Central Bank Governors to examine measures to strenghten the operating mechanisms of the European Monetary System.

I. **IN THE ABSENCE OF A COMMON ATTITUDE TOWARDS THE MAJOR THIRD CURRENCIES THE MECHANISM WILL REMAIN VERY VULNERABLE TO EXTERNAL SHOCKS**

The problem of the vulnerability of the present European exchange rate mechanism in the face of violent and disorderly external shocks is not of recent origin; it was one of the large reefs on which the earlier mechanism known as the "snake" struck, and was to that extent at the origin of the creation of the European Monetary System which sought, by its innovatory features, to avoid . the re-emergence of crises of that type.

Must it be concluded from recent events that we have to admit defeat in this area? To say this would be to go too far: what the recent crisis did was to reveal very clearly both the strong points and the limitations which characterize the way EMS has developed over recent years.

The benefits of the system are evident when one considers that economic policies are now convergent to a large degree, at least as far as their objectives are concerned, even if this is not yet fully true of their results.

This constitutes a fundamental and most welcome development which can be attributed to the working of the EMS; it should have led to a very substantial improvement in the strength of the system.

This strength is in fact inadequate, as is shown by

- the continuing absence, in spite of the attempts made at Gleneagles, of any real agreement on the zone within which the exchange value of the US dollar, against the main European currencies, could be considered appropriate;

- when the dollar falls sharply, currency positions seem to be changed predominantly in favour of the German mark; this is likely to be harmful to the cohesion of Community currencies among themselves.

The persistence of these disequilibria gives cause for concern about the future; paradoxically, this is all the more true in a context in which convergence has made great progress while the freedom for capital to circulate has been greatly extended.

It is therefore essential that the Monetary Committee devote its attention to these issues.

For their part, the French members of the Committee consider that a lasting solution to these disorders could be sought by the establishment at world level of a flexible system based on reference zones for the main currencies.

They consider, however, that, even in the absence of a framework of this type, substantial progress can be made as of now in the international monetary environment, in particular by the use of indicators reflecting the interactions between economies, and that this progress can be of decisive importance for the future of the exchange rate mechanism.

They recognize, of course, that this progress can only be achieved in a context of international cooperation, the attainment of which will depend, amongst other things, on the attitude of the major extra-European partners. They nevertheless consider that, if the effort to build a monetary structure for Europe is not to collapse, it is essential that the countries participating in the exchange rate agreement should strive to come to a common position.

Given this approach, the Ministers and Governors could at regular intervals conduct assessments of the appropriate levels of the US dollar and of the Yen on the following basis.

1. The appropriate areas within which the exchange rates should lie ought to be specified in a realistic way, that is, in line with the fundamental features of the economies and with their likely development. It would not be a question of using purely normative objectives as a basis.

2. These appropriate areas would be subject to periodic re-examination in order to take account of changes in the basic variables, but also to measure their impact and their position in relation to the markets' expectations. If necessary the reference points would be changed, or appropriate joint action would be envisaged.

3. This exercice would concern the Yen as well as the US dollar, in order to protect the commercial interests of Europe and to ensure that those interests are taken into account in the dialogue with these large countries.

It is quite clear that success in such an exercise, even if it seems modest by comparison with a more institutionalized system, requires an unequivocal commitment to cooperation at the highest political level, which is the only level having the authority to involve sovereign countries therein.

. Cooperation is necessary between the countries participating in the exchange rate agreement, who must accept the constraints on their domestic policies. No country within Europe is independent of the others at the present time and events have proved this.

. Cooperation is necessary among the European countries, the USA and Japan. If the action undertaken by the countries participating in the exchange rate mechanism is to be effective and lasting, there must at the very least be a substantive dialogue with the two other partners. It is impossible to envisage a stabilization of the US dollar without the agreement or even the participation of the USA, for example.

It would be desirable to consider whether an arrangement as pragmatic as this one would not have to be reinforced by more precise arrangements in the matter of the intervention practices of the European Central Banks. The fact is that in certain situations the simple operation of the present intra-European arrangements could turn out to be insufficient in an operation affecting third currencies; this was recently shown to be true when an essential degree of coordination was lacking.

In this connection, the following ideas would be studied.

. It would be made compulsory for the decision to intervene to be taken on a concerted basis by the central banks as soon the intervention thresholds were approached, the decision inevitably taking account of the situation in the markets.

. The central banks would discuss among themselves, in the light of the situation on the markets, whether to make public the concerted intervention and the degree of attention which should be drawn to it.

. As to the intervention,

*when US dollars or Yen are purchased, no difficulties arise for the European Central Banks since the purchases are made against their own currencies. There may on the other hand be difficulties for the US Federal Reserve. It would be desirable, in this connection, to strengthen the network of swaps which link the Federal Reserve Bank of New York, the European Central Banks and the Bank of Japan. This would put the US Federal Reserve in a position to take part in purchases of US dollars against European currencies or Yen on a scale appropriate to the present size of the markets.

*In a different scenario, in the event of sales of US dollars or Yen, it could happen that all the central banks, apart from the Federal Reserve, would not have sufficient foreign currency. They would then, if the need arose, procure the resources necessary for sales of US dollars against their own currencies through the swap network mentioned above. It could, moreover, be envisaged that the present mechanisms of the European Monetary System would be strengthened in order to be able to deal with such a situation.

II. THE INTERNAL WORKING OF THE SYSTEM MUST ALSO BE IMPROVED

While the European Monetary System, as put into practice in recent years, has not permitted the implementation of a common policy towards third currencies, it has been no more successful in avoiding the reef of asymetry by which the burden of adjustment and settlement in cash falls automatically on the countries whose currencies are weakest. This discipline has a value; but it is inadequate and it in fact conceals the lack of an effective common procedure for examining the coherence and the compatibility of economic policies with each other.

The exchange rate mechanism is a very integrated arrangement on the monetary level; what is required, therefore, is a high degree of coordination of economic policies.

Two approaches are possible:

1. **Rethinking the divergence indicator**

This mechanism was invented with the aim of providing an indicator which would sound the alarm when necessary and would serve to trigger action. It had two advantages: it was to give advance warning of situations which were likely to give rise to tension at a later stage, and it rightly emphasized that the disequilibrium could also be produced by the currency located at the top of the band, and not in all cases from the currency located at the bottom.

Unfortunately, experience has not been good, partly for technical reasons related to the construction of the indicator and to the weights of the currencies in the ECU.

It would certainly be useful to mount a study of the possibility of adopting some other mechanism which would provide an indicator of divergence when this is a potential source of tension while meeting more fully the objectives which are sought.

2. **Strengthening surveillance over the compatibility and coherence of economic policies by the use of economic indicators**

This approach is complementary to the previous one. The judgement as to whether a disequilibrium exists which must be corrected would be less crude since it would be based on a simplified set of indicators of the main magnitudes and in particular of those which explain the interactions between economies.

This approach would have a double advantage as far as the Community is concerned:

. it would ensure coherence with the surveillance excercise at world level which was set up after the Tokyo Summit;

. and it would enable examinations of the coordination and the convergence of economic policies to escape from the confines of monetary policy alone and to extend to a concern with performance in terms of economic growth and with budgetary policy. It is widely known that the progress achieved in these areas has been much less substantial within the E.E.C.

The French members of the Monetary Committee have already proposed that there should be a periodic discussion of these indicators in the ECO/FIN Council or in the Monetary Committee. They now repeat this proposal and would like the Alternates to discuss the way in which it could be carried out.

3. Reinforcing the resources available for intervention

The corollary of such a system of enhanced surveillance would be to reinforce the resources available to member countries for intervention, so that they can deal with exchange rate crises, particularly when fundamentals do not justify a realignment, but the measures taken by the states whose currencies are subject to tension are clearly insufficient to ensure that the fluctuation margins are respected.

The following approaches to such an idea could be explored, while keeping in mind two essential objectives: to establish confidence in the determination of the central banks at a time when the freedom of capital movements has led to a very large increase in the amount of intervention which will be necessary; and to avoid any relaxation of discipline by the introduction of mechanisms which are too permissive.

a) Improving the characteristics of the public ECU, and in particular its acceptability, which should be raised to 100 %.

b) Studying the extension of the period of the swaps with FECOM and, perhaps, an increase in their amount beyond 20 % of holdings of gold and US dollars.

c) strengthening the Community financing mechanisms.

Intra-marginal intervention, which was exceptional in the past, is now a part of regular practice. It would therefore be natural to extend the Very Short-Term Financing arrangements to cover such intervention. In order not to weaken the disciplinary effect of the system as a whole, a ceiling could be set on this use of the arrangements. If this proposal is not acceptable, a reinforcement of the mechanism established in 1985 for the mobilization of ECUs could be studied.

The Medium-Term Financial Assistance and the Community Loan facility would be amalgamated, as the Commission has suggested. The sums available would be increased but their conditionality would be maintained, or strengthened.

*

*   *

In so far as convergence continues to be evident, it would be consistent with the logic of the European Monetary System for Central banks to intervene within the margins and to retain among their assets a certain percentage of the currencies of their partners which they thus acquire. Progress in that direction is crucial if the external vulnerability of the system is to be reduced.

* *

*

In this perspective, a favourable view should be taken of the development of the private ECU. Therefore, no impediment should be allowed to hold back its development, and the central banks should continue to be encouraged to hold and to use it.

III. REALIGNMENT PROCEDURES ARE NOT ENTIRELY SATISFACTORY

1. During a realignment procedure it is necessary to avoid making the content of the discussions public. There is in fact a risk that expectations which have not in fact been realised will be reported favourably; or that a groundless sense of disagreement will be created which might jeopardize the subsequent success of the operation.

2. Economic arguments were very largely absent from the most recent discussions. This was perhaps attributable to the nature of the events which led to the realignment, which were largely extraneous to the system. Such a development is nevertheless regrettable.

One solution which could be envisaged for this would be for the Commission to provide the Ministers and the Monetary Committee with a document giving its analysis, its comments and the realignment scenarios which seem to it to have the best economic and financial basis.

3. Experience has shown that agri-monetary considerations are not absent from the discussions, and the thoughts which lie behind them, at realignment exercises, even when the realignment in prospect is small. This may be regretted, but the appropriate conclusions must be drawn. Although it is not the exclusive prerogative of the Monetary Committee to discuss these questions - and still less to decide upon them - it may be appropriate to ask what would be the advantages and disadvantages of increasing the "franchises" which apply to Monetary Compensatory Amounts and of limiting their field of application when they are not strictly necessary.

* *
*

The implementation of a common policy towards third currencies would constitute the first step towards a gradual attribution to the Community of intervention policy, the execution of which could in time be entrusted to the EMCF. Such a solution would constitute the natural point of transition to the second phase of the EMS.

ANNEX C2: INTERIM/DEVELOPMENT CTTEE BRIEFING

INFORMAL ECOFIN 3-5 APR

ANNEX C2

INTERIM/DEVELOPMENT COMMITTEE BRIEFING

NO	TITLE
1.	WEO
2.	SDR allocations
3.	Indicators in surveillance
4.	Implementation of debt strategy, with annexes on (i) conditionality and (ii) implementation of IBRD growth orientated programmes
5.	IMF arrears and burden sharing
5(a)	Compensatory financing facility
6.	Ninth Quota Review (background)
7.	Sustaining growth in developing countries: (a) Poverty impact of structural adjustment and development programmes (b) Agriculture (c) Resource transfers
8.	Environment, growth and development
9.	Trade
9(a)	Commodities
10.	IBRD issues including GCI, IDA and MIGA
11.	Problem countries: Argentina, Brazil, Egypt, Mexico, Nigeria, Yugoslavia, Zambia.
12.	Fund and Bank statistics: loans outstanding, programmes in place, commitments, repayments schedules, interest rates, reserves.

Ch

Sir G L shd have copies of these with him. You will have a set for Washington

AK

14/890

NB
The Belgian hosts will not want to make it easy for such a meeting to take place
DWK

INFORMAL ECOFIN, 4 APRIL

ANNEX D

COMMUNITY FINANCING: TRILATERAL MEETING WITH BALLADUR AND STOLTENBURG

UK objective

To obtain French and German agreement that there must in future be effective control of Community expenditure, and that all three countries should work together during future financing review to achieve this aim.

Points to make

General

- Important that we should **work together** in discussions on Community financing. I am sure our officials must keep in close contact **in run-up to June European Council** so that we can get substantive discussion off on right foot.

- Not satisfied with Commission's report. Welcome **parts** of approach, but **basically flawed** by being based on **unacceptable premise** that Community needs increased own resources to function.

Expenditure control - especially DNO

- Essential that **effective expenditure controls** should be introduced so that in future **own resources ceiling should stick.**

- Commission have made some useful proposals for modest reform of DNO. But **need to go further**. For example, would be useful to look at **voting arrangements** to see if there is a way of introducing **effective blocking mechanism for low-spending minority.**

- Hope you can **agree in principle** to this approach. Suggest that we **ask officials** to meet to sort out practical details on strengthening hands of moderates. Understand there have already been some **useful exploratory talks.** Also important to work together to make improvements to **budget management** procedure.

- One unacceptable aspect of Commission approach is suggestion that expenditure resulting from **SEA** should be **exempt from maximum rate requirements.** Also very unhappy about proposals for **structural funds** - both their proposed doubling and their re-orientation, which could have **serious effect on level of UK's receipts.** Also do not see how Commission proposals would fulfil SEA aim of aid for **declining industrial regions.** Must be a danger they will provoke a **North-South divide.** Hope France and Germany will be able to support UK in opposing these changes. Understand officials are to discuss problems towards end of April.

New own resources system

- Commission's proposals on **new own resources system and correction mechanism** far too complicated. Repeats unacceptable assumption about total level of own resources. UK also considers that proposed correction system will leave us substantially **worse off than Fontainebleau - quite unacceptable.**

- We shall not be seeking to make abatement factor in negotiations, but **shall defend position if attacked.**

CAP budget stabilisers

- Some further improvement in budgetary control of agricultural expenditure will be an essential element of ex novo negotiations. In interests of all major contributors to control this major area of EC spending.

- Most positive idea in Commission's papers is concept of introducing **automatic budget stabilisers** into each CAP regime to consider where pressure for expenditure arises and how best controlled. Officials should exchange ideas before June European Council. Given progress already made on milk and beef, sensible to concentrate now on cereals and oilseeds.

- Commission may take line that existing mechanisms (quotas, coresponsibility levies, guaranteed quantities etc) sufficient. Clearly untenable given expenditure record. But may be possible to secure significant improvement by suggesting only modest changes.

- **Oils and fats levy** not good example of budget stabiliser: little better than a punitive tax on poorest section of society and likely to exacerbate trade relations with USA and other exporting countries.

- Additionally may be some scope for technical improvements to **financial guideline** itself. But guideline cannot control expenditure, unless action also taken on individual CAP regimes.

1987 budget

- Also need to consider the short term. Important that we all continue to make clear that can be **no question of additional money this year.** Community must make necessary economies.

- Realistically, major source of savings on scale required is **move from advances to reimbursements for agricultural guarantee spending.** This anyway justified on grounds of improved financial control. Alternative is for Community to **run out of money completely** by autumn with negative effects on structure of CAP.

BACKGROUND

General

The Commission papers on reform of the Community's financial arrangements are now being discussed in COREPER, with a view to presenting an interim report to the Foreign Affairs Council at the end of April. The May ECOFIN may also look at the dossier. The FAC will then prepare the subject for the June European Council. Serious negotiations will not start until after then.

2. We would not expect the Commission proposals to survive long once the serious negotiations begin. There are, however, germs of a number of ideas which we would like to see developed further, most notably on the need for reform of the CAP and for genuine controls on other budgetary expenditure.

3. Mr Lavelle's talks with his opposite numbers last week indicated fairly good prospects for pursuing with both the French and Germans ideas for better control of DNO, especially on some of the more minor technical ideas on improving budget management we have identified. When the question of more fundamental reforms was broached, they again seemed sympathetic, but were also more inclined to think that our specific proposals were too ambitious, at least to the extent that they would involve Treaty amendment. They were both, however, clearly well disposed to continuing discussions. It would be helpful to have general endorsement of a search for techniques to strengthen the hands of the moderates.

4. Both countries should have little difficulty in supporting our views on the unacceptability of the Commission's proposals on the structural funds. German receipts from the funds are minimal, and their primary concern in the past has been to stop the Commission interfering in how they spend and account for the small sums they do get. [NOT FOR USE, AS WE DO NOT KNOW IF THE GERMANS HAVE DISCUSSED THEIR IDEAS WITH THE FRENCH. The Germans have been floating ideas of their own for reform which would almost certainly leave the UK better off than the Commission's ideas. These would

involve dividing member states into three broad economic categories, which would have assigned to them 50 per cent, 30 per cent and 20 per cent of the total receipts, with 50 per cent going to the countries in the poorest category, and 20 per cent to those in the richest. The UK would be in the middle category, but would expect to get a high proportion of its assigned 30 per cent. Officials in the sponsor departments intend to discuss these further with Dr Rambow, the German official responsible, at the end of April.] The French are likely to join us in opposing increased geographical concentration for the Social Fund and agricultural guidance. Their attitude to the ERDF is more equivocal; their receipts from it are very low and they may be prepared to write them off as the price of achieving other things of more importance. They too will be coming to London for talks with DTI etc at the end of April.

New own resources system

5. Neither France nor Germany has given much indication of their attitude to the revised financing and correction system. The Germans' main reported concern is to get an improved compensation system for themselves. We have not pressed the issue because showing interest in it would be inconsistent with our attitude that no increase in own resources is required. It seems, anyway, unlikely to survive much detailed discussion.

Agriculture

6. Although both the French and the Germans tend to give priority to meeting the demand for agricultural expenditure which is classified as 'obligatory' in EC budget terms, both their Finance Ministries have expressed interest in the ideas of further official discussions on CAP budget stabilisers.

7. Work is continuing within Whitehall on compiling a list of options for stabilisers. In the absence of an authorised list the following could be drawn on as examples:

milk accepting continuance of quotas which should be linked to EC consumption levels. Quotas 'suspended' in December 1986 decisions should be turned into definitive reductions as soon as possible. Measures to reduce intervention intake should be continued and (if necessary) developed.

<u>cereals</u> proposed reduction in intervention period to 4 months should be adopted preferably subject to ceiling on volumes of intervention. Intervention price could be adjusted in year to take account of volume of production and scope for exports at reasonable cost.

<u>oilseeds</u> current maximum guaranteed quantities should be developed as suggested by the Commission. To avoid budget overruns caused by exchange rate movements (production aids currently linked to world price in $) consideration could be given to making fixed rate payments per tonne or per hectare.

8. The Commission's proposals involve serious weakening of CAP financial guideline including incorporation of 'base drift'. Some improvements could be suggested in operation: eg obliging the Commission to make price proposals '**consistent with**' the guideline rather than just 'in the light of' it.

<u>1987 budget</u>

9. In 1987, the Community is facing a potential deficit of some 4 billion ecus (2.5 becus agricultural overrun and 1.5 becus shortfall on traditional own resources). The major sources of savings available in 1987 is to end the agricultural advances system and reimburse member states for payments they have actually made. This allows a more rigorous control of expenditure and should yield a one-off saving of 3-5 billion ecus.

10. The French are known to be unhappy about such a measure. Balladur told the Prime Minister that he was concerned about it as a device to get through 1987, and that he saw a risk that, if funds were not available, the Commission would simply decide not to reimburse certain expenditure, leaving national budgets to pay.

The Germans are reported not yet to have taken a view on the question.

11. The Commission are also anxious to introduce an oils and fats tax, which would produce 2 billion ecus in a full year and 500 mecus in 1987. The French are strong supporters. The Commission call the proposed tax a stabilisation measure, but in our view it is nothing but a revenue raising device. We are opposed to it on the grounds that it is regressive and likely to provoke new international conflict, with the US. The Germans appear to share our view that it is not acceptable as a revenue raising device, being nothing more than a large and infinitely expandable loophole in the own resources system.

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

M Jacques Delors
President of the Commission of the
European Communities
Rue de la Loi 200
B-1049 Brussels

17 March 1987

Dear Jacques

I mentioned to you last autumn that I was contemplating the repeal of the Exchange Control Act 1947. As I explained to you then, the Act has until now remained on our statute book in a state of suspension even though exchange controls were abolished in 1979. It is a thoroughly outmoded and inappropriate piece of legislation, ill-suited to modern conditions. We have absolutely no intention of re-activating the Act to re-introduce exchange controls in the UK. But for as long as the Act remains in existence the markets will never be able completely to discount the possibility. Repeal of the Act would be consistent with your drive to achieve further liberalisation of capital controls in the Community, which has my whole-hearted support.

I have now decided to proceed to repeal the Act. I intend to announce my intention publicly in my Buget speech this afternoon.

One of the questions I have had to consider carefully was where repeal of the Act would leave the UK in respect of our obligations under the Council Directive of 21 March 1972 on regulating international capital flows. I am conscious of the fact that this directive is currently under review and that the Commission intend shortly to make a proposal for a new directive to replace it. The UK will be participating constructively in the process of agreeing a new directive when the Commission proposal is ready and will take immediate steps to bring it into effect once it is agreed.

Meanwhile I can assure you that, should circumstances require it, we would be able to take appropriate measures according to the directive in force.

All good wishes,
Yours ever
Nigel

NIGEL LAWSON

INFORMAL ECOFIN 3-5 APRIL

CONFIDENTIAL

ANNEX B

STRENGTHENING THE EMS

Purpose of the Discussion

That this is on the agenda reflects two factors:

- the permanent itch of the Commission and some countries to be seen to be making EMS progress;
- particular dissatisfactions over the January realignment and events leading up to it.

UK Objectives

- To steer future work in sensible directions.
- To avoid discussion of sterling and the EMS (although it is unlikely that there will be pressure because most of the Community colleagues are persuaded that nothing can happen before the next UK election).

Documents

- The main document is the report by the Chairman of the Monetary Committee (ANNEX B-1), touching on all but one of the individual subjects listed below.
- The report of the Central Bank Governors (ANNEX B-2) is confined to a narrower field, and entirely consistent.
- The Commission paper submitted very late (ANNEX B-3) is written in the usual exhortatory and abstract style; in substance it is fairly close to the Monetary Committee, but it also has a typical nonsense section on the ecu.
- The French paper (ANNEX B-4) submitted to the Monetary Committee is worth a glance for their ideas, some of which were watered down in Monetary Committee debate.

CONFIDENTIAL

Background

It may be helpful to list the main bones of contention which have emerged in complaint and argument about the January realignment:

- political dramatisation (the Chancellor complained about this at the time; officials of most other countries have done so since);
- prior failure (or slowness) to use relative interest rate adjustment;
- lack of coordination/coherence of approach to the problem of differential impact of the dollar fall;
- technical arguments over intra-marginal intervention.

Main Points / Points to Make

The following notes follow the sequence of headings in the report of the Monetary Committee Chairman.

Policy towards Dollar and Yen

- Agree it could be useful for the Monetary Committee to discuss developments regularly; and for the Community to do its best to coordinate its own actions, and to exert what influence it can on the US and Japan.
- But to aim for "zones de reference" is premature.

Convergence

- Agree convergence in right direction desirable: emphasis on getting fiscal deficits under control is also right.

Coordination of Medium-term Policies

- Yes, but should rest on good and sustained MTFS-type policies of individual countries.

- Monetary Committee proposes to develop surveillance and use indicators for it - <u>not</u> rigid or mechanistic.

The Exchange Rate Mechanism

- The divergence indicator is not well-designed and not effective: doubtful if it can be made very useful but no objection to proposed technical study.
- Perhaps the most interesting question, especially in relation to the last realignment, is whether members should use interest rates more actively, and rely less on 'sterilised' intervention, to fend off pressures they believe to be short-term. (We have concluded that we would want to do so as members of the ERM).
- Another interesting point is that the value of massive 'sterilised' intervention is beginning to be regarded with much less confidence than it used to be.
- On intra-marginal intervention and other rules, the UK interest is in preserving flexibility and choice (not likely to be seriously challenged).
- The French proposal for cross-holdings of currencies of partners, and their use in intervention, is resisted by the Bundesbank - on the ground that it could interfere with domestic monetary management. Further discussion would be interesting and it would be a pity if it were choked off by the Bundesbank. With sterling in the ERM we would want to continue to hold DM, and we would not object to others holding sterling and using it subject to reasonable consultation.

We support

- On other pleas for extra financing facilities to finance intervention, the UK can be fairly neutral but would want to discourage more, or new kinds of, Community loans; the point can be made that the case for more finance is weak if it is accepted that intervention is less effective and therefore interest rates must be used more.

Realignment Procedures

- Reaffirm benefit of de-dramatising.
- Endorse three related, practical comments by the Monetary Committee:
  - avoid public statements before final agreement;
  - avoid Ministerial meetings if at all possible, aiming for Monetary Committee agreement to be cleared with Ministers by telephone;
  - therefore do not constrain representatives by excessively rigid negotiating instructions.

Liberalisation

- See separate brief at Annex A.

Jazzing up the Ecu

This is not mentioned in the Monetary Committee Report, but only by the Commission paper. It is an old favourite of theirs - and also of Belgium, who have recently introduced a 50ecu (gold) and 5ecu (silver) coin. Of the four Commission ideas, the first three are not very sensible, at least for now: ecu creation, an ecu money market and a new text defining the ecu. The fourth, that Germany and Spain should recognise the private ecu in law fully, as we and others do, is sensible.

ANNEX B1: REPORT BY CHAIRMAN OF MONETARY CTTEE ON STRENGTHENING THE EMS

ANNEX B1

REPORT BY THE CHAIRMAN OF THE MONETARY COMMITTEE ON STRENGTHENING THE EMS TO THE INFORMAL MEETING OF THE FINANCE MINISTERS AT KNOKKE ON THE 5TH APRIL 1987

FOLLOWING THE LAST REALIGNMENT COMMUNIQUE AND IN RESPONSE TO A MEMORANDUM PRESENTED BY THE FRENCH MEMBERS OF THE MONETARY COMMITTEE AND TO A LETTER FROM THE CHAIRMAN OF THE ECOFIN COUNCIL. THE MONETARY COMMITTEE HAS AT ITS TWO MOST RECENT MEETINGS EXAMINED WAYS OF STRENGTHENING THE EMS. IT HAS BECOME CLEAR THAT MANY OF THE ISSDES RAISED WILL HAVE TO BE STUDIED IN GREATER DEPTH. THIS REPORT. PRESENTED BY THE CHAIRMAN ON HIS OWN RESPONSIBILITY. THEREFORE GIVES AN INTERIM VIEW OF THE IDEAS WHICH ARE DEVELOPING IN THE MONETARY COMMITTEE.

INTRODUCTION

1. CONVERGENCE OF ECONOMIC PERFORMANCE WITHIN THE EUROPEAN MONETARY SYSTEM HAS IMPROVED IN THE LAST TWO YEARS. DESPITE THE PERSISTENCE OF DIFFERENCES BETWEEN COUNTRIES. HOWEVER. THE SYSTEM HAS CONTINUED TO BE SUBJECT TO TENSION. THE EMS HAS HAD TO FACE A NEW SET OF PROBLEMS IN THE RECENT PERIOD BECAUSE

- THERE HAS BEEN GROWING INNOVATION IN AND INTERNATIONALIZATION OF THE CAPITAL MARKETS..
- THERE HAS BEEN A REVERSAL OF THE VIEW TAKEN OF THE US DOLLAR ON THE WORLD MARKETS..
- THESE TWO FACTORS COINCIDED WITH THE FIRST EFFECTS OF THE POLITICAL DECISION. IN RESPECT OF TWO MEMBER COUNTRIES. TO MOVE AWAY FROM EXCHANGE CONTROLS. AND NOT TO REINTRODUCE THEM IN TIMES OF CRISIS.

2. THESE DEVELOPMENTS OCCURRED AT A TIME WHEN THE MARKETS. INFLUENCED BY THEIR EXPERIENCE OVER A NUMBER OF YEARS, HAD NOT YET FULLY TAKEN ACCOUNT OF THE CONSEQUENCES FOR EMS EXCHANGE RATE RELATIONSHIPS OF INCREASED CONVERGENCE, AND OF POLICIES PURSUED BY MEMBER COUNTRIES. IN THESE CIRCUMSTANCES THE EMS HAS BECOME SOMEWHAT MORE VULNERABLE.

GREATER FREEDOM OF CAPITAL MOVEMENTS WILL CERTAINLY PLACE HEAVIER DEMANDS ON THE SYSTEM IN THE FUTURE. WE HAVE TO CONSIDER WHETHER WHAT IS NEEDED IS A SET OF CHANGES TO THE RULES OF THE SYSTEM, A CHANGE IN THE BEHAVIOUR BY THE MEMBER COUNTRIES, OR A MIXTURE OF THE TWO.

THE COORDINATION OF POLICIES TOWARDS THE USA AND JAPAN

3. RECENT EXPERIENCE HAS SHOWN HOW IMPORTANT DEVELOPMENTS IN THE WIDER EXCHANGE RATE SITUATION CAN BE FOR THE EMS. THE MONETARY COMMITTEE WILL THEREFORE REGULARLY REVIEW THE LEVELS OF THE EXCHANGE RATES OF THE US DOLLAR AND THE YEN IN THE LIGHT OF THE GENERAL STANCE OF ECONOMIC POLICY.

4. WHATEVER THE FORM TAKEN BY INTERNATIONAL COOPERATION IN THE FUTURE, THE COMMUNITY COUNTRIES MUST THROUGH THEIR COMBINED EFFORTS BRING THEIR INFLUENCE TO BEAR, AS FAR AS POSSIBLE, ON THE ECONOMIC DISEQUILIBRIA OF THE USA AND JAPAN.

5. THE LOUVRE AGREEMENT MARKS AN IMPORTANT POINT ON THE WAY TO THE CLOSER INTERNATIONAL COORDINATION OF ECONOMIC POLICY. SINCE THE AGREEMENT, THE CAPITAL REFLOWS WHICH WERE RATHER HESITANT AFTER THE LAST EMS REALIGNMENT HAVE BECOME MUCH STRONGER.

6. PROPOSALS FOR THE USE OF REFERENCE ZONES FOR THE EXCHANGE RATE RELATIONSHIPS BETWEEN EUROPE, THE USA AND JAPAN REPRESENT, IN THE VIEW OF SOME MEMBERS OF THE COMMITTEE, ONE POSSIBLE RESPONSE TO THE PROBLEM OF MANAGING THE INTERNATIONAL MONETARY SYSTEM. THIS ISSUE, ON WHICH THERE ARE DIFFERING VIEWS, WILL BE DISCUSSED FURTHER BY THE MONETARY COMMITTEE.

7. INTERVENTION AND INTEREST RATES ARE IMPORTANT INSTRUMENTS FOR THE EXTERNAL RELATIONS OF THE EMS. THEIR USE SHOULD BE MORE CLOSELY COORDINATED BETWEEN MEMBER COUNTRIES, WITHOUT IMPAIRING THEIR ABILITY TO PURSUE STABILITY-ORIENTED MONETARY POLICIES. HOWEVER, IT IS ALSO IMPORTANT THAT THE USA AND JAPAN COOPERATE TO THE NECESSARY DEGREE IN THIS PROCESS.

THE NEED TO PERSEVERE WITH EFFORTS FOR CONVERGENCE

8. THE HIGHER DEGREE OF CONVERGENCE OF ECONOMIC RESULTS IN THE COMMUNITY WAS PARTLY THE RESULT OF FAVOURABLE EXTERNAL FACTORS IN 1986. IN 1987 IT WILL BE MORE DEPENDENT ON DOMESTIC EFFORTS. THE MONETARY COMMITTEE HAS AGAIN EMPHASIZED THE URGENCY OF CORRECTING POLICY DEFICIENCIES, PARTICULARLY IN THE AREA OF PUBLIC FINANCE. THE EXCESSIVE BUDGET DEFICITS PREVAILING IN SOME COUNTRIES SHOULD BE REDUCED TO A LEVEL WHICH CAN BE SUSTAINED OVER A LONG PERIOD. IT IS IMPORTANT THAT RELIABLE AND UNMISTAKABLE SIGNS OF A CORRECTION EXTENDING OVER SEVERAL YEARS SHOULD BECOME EVIDENT SOON. A SATISFACTORY DEGREE OF CONVERGENCE IS THE NECESSARY FOUNDATION FOR THE STABILITY OF EXCHANGE RATES IN THE EMS.

THE COORDINATION OF THE MEDIUM-TERM COURSE OF ECONOMIC POLICY IN THE EMS

9. EMS MANAGEMENT HAS SO FAR BEEN ESSENTIALLY A MATTER OF DEALING WITH TENSIONS OF A SHORT-TERM NATURE. THESE CAN, HOWEVER, BE COUNTERED MORE EFFECTIVELY IF THERE IS A MEDIUM-TERM COORDINATION OF THE COURSE OF ECONOMIC POLICY, IN ORDER TO RECOGNIZE INCOMPATIBILITIES AT AN EARLIER STAGE.

10. THE MONETARY COMMITTEE HAS STUDIED THE ROLE OF MACROECONOMIC INDICATORS IN SOME DEPTH. THIS DISCUSSION IS CLOSELY RELATED TO THE DEBATE GOING ON IN THE WIDER INTERNATIONAL SETTING OF THE WORLD ECONOMIC SUMMIT.

11. SURVEILLANCE BASED ON MACROECONOMIC INDICATORS COULD BE PARTICULARLY USEFUL AT THE LEVEL OF THE COMMUNITY. IN THE VIEW OF THE MONETARY COMMITTEE, THREE ASPECTS ARE OF PARTICULAR IMPORTANCE

- MEMBERS WOULD REPORT THEIR OBJECTIVES OR EXPECTATIONS FOR THE MAIN MACROECONOMIC VARIABLES AND THE MONETARY AND BUDGETARY POLICIES CONSIDERED CONSISTENT WITH THEM.,
- THE PROJECTIONS WOULD BE CHECKED FOR COMPATIBILITY BETWEEN COUNTRIES.,

- ACTUAL PERFORMANCE WOULD BE COMPARED AGAINST THE PROJECTIONS.. SIGNIFICANT DEPARTURES FROM THE PROJECTIONS WOULD GIVE RISE TO AN EXAMINATION OF THE SITUATION.

12. THE MONETARY COMMITTEE WILL TAKE FULL ADVANTAGE OF SURVEILLANCE OF THIS TYPE THROUGH ITS INTERNAL WORKING ARRANGEMENTS. BUT IT WAS STRESSED THAT AN INDICATOR SYSTEM SHOULD NOT WORK IN A RIGID QR MECHANISTIC WAY.

STRENGTHENING THE FUNCTIONING OF THE EXCHANGE RATE MECHANISM

13. IN RESPONSE TO A NUMBER OF SUGGESTIONS AND IN PARTICULAR TO THOSE IN THE MEMORANDUM FROM THE FRENCH MEMBERS. THE COMMITTEE EXAMINED A NUMBER OF POINTS RELATING TO THE WAY THE EXCHANGE RATE MECHANISM WORKS. IT WISHES NEVERTHELESS TO MAKE CLEAR THAT SOME OF THESE POINTS BELONG PRIMARILY TO THE COMPETENCE OF THE CENTRAL BANKS. AND WILL BE EXAMINED IN GREATER DETAIL BY THE COMMITTEE OF CENTRAL BANK GOVERNORS.

A) THE DIVERGENCE INDICATOR

14. THE DIVERGENCE INDICATOR HAS LOST SOME OF ITS SIGNIFICANCE AS A RESULT OF THE WIDESPREAD USE OF INTRA-MARGINAL INTERVENTION IN RECENT YEARS. IT IS REGARDED BY THE COMMITTEE AS A USEFUL BUT NOT AS A PRIVILEGED INDICATOR. THE POSITIONS OF CURRENCIES WITHIN THE EMS-BAND CAN BE RELIABLY EVALUATED ONLY IF ONE TAKES ACCOUNT AT THE SAME TIME OF THE EXTENT OF INTERVENTION AND OF INTEREST RATE DIFFERENTIALS. FOR THESE REASONS GREATER AUTOMATICITY OF ACTION LINKED TO THE DIVERGENCE THRESHOLD IS NOT DESIRABLE SINCE IT MIGHT LEAD TO WRONG DECISIONS AND INCREASE THE INSTABILITY OF THE SYSTEM. THE COMMITTEE WILL EXAMINE SOME OF THE TECHNICAL DEFECTS OF THIS INDICATOR IN GREATER DETAIL. ALONGSIDE THE IDEA OF REDUCING THE DIVERGENCE THRESHOLD.

B) CLOSER MONETARY POLICY COOPERATION

15. RECENT EXPERIENCE HAS SHOWN THAT CLOSE COOPERATION IN THE FIELD OF MONETARY POLICY IS EXTREMELY IMPORTANT,

PARTICULARLY AT TIMES OF TENSION IN THE EMS. WITHOUT NEGLECTING DOMESTIC TARGETS. THE AIM SHOULD BE TO ENSURE THAT SPECULATION ON AN EMS PARITY CHANGE WILL BE COSTLY AND RISKY AND. IF IT OCCURS. WILL NOT BE REWARDING. IT CAN BE MADE COSTLY BY THE DETERMINED USE OF INTEREST RATES., IT CAN BE MADE RISKY BY THE FULL USE OF THE PERMITTED FLUCTUATION MARGIN.. AND IT WILL NOT BE REWARDING IF REALIGNMENTS ARE SMALL AND INFREQUENT.

C THE ROLE OF INTERVENTION

16. AS REGARDS INTERVENTION IN GENERAL IT WAS CONSIDERED THAT AN APPROPRIATE BALANCE SHOULD BE RESPECTED BETWEEN ADJUSTMENT AND.FINANCING.. THIS BALANCE WILL DETERMINE THE OVERALL COURSE OF THE SYSTEM. ONE SHOULD NOT IGNORE THE FACT THAT INTERVENTION HAS GROWN SUBSTANTIALLY IN RECENT YEARS. ALL MEMBERS WISHED NOT TO WEAKEN THE PRESENT DISCIPLINARY EFFECT OF THE EMS.

IT WAS POINTED OUT, HOWEVER, THAT THERE MAY BE A CASE FOR THE EARLIER COORDINATION OF INTERVENTION IN SITUATIONS IN WHICH FUNDAMENTALS ARE JUDGED TO BE GOOD AND CAPITAL FLOWS APPEAR TO BE REVERSIBLE. MORE SPECIFICALLY, IT WAS NOTED THAT INTRA-MARGINAL INTERVENTION HAS INCREASED SUBSTANTIALLY IN RECENT YEARS AND THAT IN THE VIEW OF SOME MEMBERS IT HAS PROVED USEFUL IN DEALING WITH EXTERNAL SHOCKS. IT MAY GIVE A RESPITE DURING WHICH POLICY CAN BE CHANGED. IT WAS FELT, HOWEVER, BY THESE MEMBERS THAT ITS USE HAD NOT ALWAYS BEEN ADEQUATELY COORDINATED IN THE PAST.

LARGE AND PROLONGED INTERVENTION CAN, ON THE OTHER HAND, ENCOURAGE OPERATORS TO BELIEVE THAT THERE WILL BE A REALIGNMENT, AND THUS BE COUNTER-PRODUCTIVE. FOR THESE REASONS, MANY MEMBERS ATTACH GREATER IMPORTANCE TO THE ACTIVE USE OF INTEREST RATES AND MORE FLEXIBLE USE OF THE EXISTING EMS EXCHANGE RATE MARGINS.

17. THE FINANCING OF INTERVENTION WITHIN THE EMS IS PRIMARILY A MATTER FOR THE CENTRAL BANK GOVERNORS AND IS REGULATED BY THE CENTRAL BANK AGREEMENT OF THE 13TH MARCH 1979. HAVING RECEIVED A NUMBER OF PROPOSALS RELATING TO THIS MATTER IN THE FRENCH MEMORANDUM, THE COMMITTEE DISCUSSED THE FOLLOWING POINTS.

- THE AVAILABILITY, WITHIN STATED LIMITS, OF THE VERY SHORT TERM FINANCING FACILITY (VSTF) TO COVER INTRA-MARGINAL INTERVENTION, IN SITUATIONS IN WHICH THE CENTRAL BANKS ARE AGREED THAT THIS WOULD BE IN THE INTERESTS OF THE SYSTEM , IN ORDER TO ALLOW MORE SPEEDY ACTION. THERE ARE IMPORTANT DIFFERENCES OF VIEW WITHIN THE COMMITTEE ON THIS QUESTION, PARTICULARLY IN THE LIGHT OF THE DIFFICULTIES WHICH COULD ARISE FOR MONETARY CONTROL IN COUNTRIES WHOSE CURRENCIES ARE USED. IN CONTRAST TO OBLIGATORY INTERVENTION FINANCED BY THE VSTF, INTRA-MARGINAL INTERVENTION DOES NOT NORMALLY HAVE AN IMPACT ON BANK LIQUIDITY IN THE COUNTRY WHOSE CURRENCY IS USED AS AN INTERVENTION MEDIUM. THIS MAKES IT EASIER FOR THE CENTRAL BANK OF THAT COUNTRY TO GIVE ITS PERMISSION FOR SUCH INTERVENTION. UNDER THESE ARRANGEMENTS

INTRA-MARGINAL INTERVENTION HAS BECOME VERY LARGE. A CHANGE IN THE FINANCING OF INTRA-MARGINAL INTERVENTION MIGHT LEAD CENTRAL BANKS TO GIVE THEIR AUTHORIZATION LESS READILY AND THUS REDUCE THE SCOPE FOR INTERVENTION BY THEIR PARTNERS.

- GREATER USE OF EMS CURRENCIES AS AN INTERVENTION MEDIUM AND THE HOLDING OF THESE CURRENCIES IN NATIONAL RESERVES. THIS WOULD EXPRESS COMMUNITY SOLIDARITY. IT COULD, HOWEVER, AGAIN RAISE PROBLEMS OF MONETARY CONTROL, AND IT WAS STRESSED THAT THE WIDER USE OF NATIONAL CURRENCIES HAS IMPLICATIONS WHICH GO BEYOND THE EMS AND TOUCH THE DEVELOPMENT OF THE WORLD MONETARY SYSTEM., THEY THEREFORE CALL FOR FURTHER EXAMINATION.

- AN INCREASE OF THE ECU ACCEPTANCE LIMIT TO 100 0/0. THE COMMITTEE SUGGESTED THAT THIS ISSUE SHOULD BE EXPLORED FURTHER.

D) CREDIT FACILITIES

18. IT WAS ARGUED BY SOME MEMBERS THAT GREATER FREEDOM OF CAPITAL MOVEMENTS WOULD NECESSITATE AN ADAPTATION OF THE COMMUNITY CREDIT FACILITIES. THE FRENCH MEMORANDUM ARGUED FOR AN INCREASE IN THE AMOUNTS AVAILABLE. THERE WAS SOME SUPPORT FOR THE IDEA OF MAKING THE COMMUNITY LOAN FACILITY AVAILABLE, PROBABLY ON A STAND-BY BASIS AND FOR A RELATIVELY SHORT MATURITY, TO COUNTRIES EXPERIENCING

TRANSITIONAL DIFFICULTIES WHEN THEY MOVE TOWARDS FREEDOM OF CAPITAL MOVEMENTS. HOWEVER, OTHER MEMBERS WERE STRONGLY OF THE VIEW THAT IF FUNDAMENTAL POLICIES ARE CORRECT AND THE INSTRUMENTS OF MONETARY POLICY ARE APPLIED IN A TIMELY FASHION NO PARTICULAR DIFFICULTIES ARE TO BE EXPECTED FROM CAPITAL LIBERALIZATION. THEY ALSO STRESSED THAT THE MARKETS AT PRESENT OFFER EMS COUNTRIES AMPLE SOURCES OF CREDIT. THE EXISTING COMMUNITY CREDIT FACILITIES, EXPECIALLY THOSE OF A MEDIUM TERM NATURE, HAVE THE HIGHLY SPECIFIC ROLE OF SUPPORTING BALANCE OF PAYMENTS ADJUSTMENT. THE WHOLE ISSUE OF CREDIT FACILITIES HAS TO BE SEEN IN THE CONTEXT OF THE OTHER POINTS IN THIS REPORT AND REQUIRES FURTHER STUDY BY THE COMMITTEE.

REALIGNMENT PROCEDURE

19. THE MONETARY COMMITTEE IS OF THE VIEW THAT THERE IS NO SUCH THING AS A TECHNICAL REALIGNMENT. EXPERIENCE HAS SHOWN THAT EVEN SMALL GENERAL CHANGES OF CENTRAL RATES CAN RAISE ISSUES OF POLITICAL CONTROVERSY ~~IMPORTANCE.~~ NO TECHNICAL CHANGES NEED TO BE MADE TO THE PRESENT PROCEDURE, BUT IT IS DESIRABLE TO DE-DRAMATIZE REALIGNMENTS AS FAR AS POSSIBLE. THE USUAL PRACTICE SHOULD BE FOR THE DECISION TO BE PREPARED BY THE MONETARY COMMITTEE, AND GIVEN THE APPROV AL OF MINISTERS BY TELEPHONE, WHENEVER POSSIBLE. PUBLIC STATEMENTS SHOULD BE AVOIDED. A MINISTERIAL MEETING SHOULD BE CALLED ONLY IF NEEDED. SINCE CENTRAL RATE CHANGES ARE DECISIONS TAKEN BY MUTUAL AGREEMENT IT IS OF CONSIDERABLE I.MPORTANCE FOR THE SUCESSFUL CONDUCT OF REALIGNMENTS THAT NEGOTIATING MANDATES GIVEN TO MEMBERS OF THE MONETARY COMMITTEE SHOULD NOT BE TOO NARROWLY DRAWN.

THE FULL LIBERALIZATION OF CAPITAL MOVEMENS - AN ELEMENT IN THE STRENGHTENING OF THE EMS

20. THE COMPLETE LIBERALIZATION OF CAPITAL MOVEMENTS IS A CONSTITUENT ELEMENT OF THE COMMON MARKET. FURTHER. FINANCIAL INNOVATION AND THE VERY RAPID GROWTH OF FINANCIAL TRANSACTIONS ARE ALREADY MAKING CAPITAL CONTROLS LESS EFFECTIVE. MANY COMPLEX ISSUES ARISE IN CONNECTION WITH THE FREEDOM OF CAPITAL MOVEMENTS AND THE COMMITTEE IS STILL AT AN EARLY STAGE IN ITS DISCUSSION ON THIS TOPIC.

21. WHILE THE FULL LIBERALIZATION OF CAPITAL TRANSACTIONS CAN INCREASE THE DANGER OF SPECULATIVE CAPITAL MOVEMENTS. IT ALSO BRINGS TO BEAR SUBSTANTIAL PRESSURE FOR A HIGHER DEGREE OF CONVERGENCE AND THUS STRENGHTENS THE EMS IN THE MEDIUM-TERM. THE LIBERALIZATION PROCESS THUS PUTS INCREASED DEMANDS ON THE EMS FOR COOPERATION, PARTICULARLY IN MONETARY POLICY.

22. ATTENTION WILL HAVE TO BE GIVEN TO THE ROLE OF THE SAFEGUARD CLAUSES. AND TO THE CREDIT FACILITIES. AS MENTIONED IN PARAGRAPH 18.

23. IT IS DIFFICULT TO SEPARATE THE FREEDOM OF CAPITAL MOVEMENTS FROM THE QUESTION OF THE LIBERALIZATION OF FINANCIAL SERVICES. THE COMMISSION HAS MADE A NUMBER OF SUGGESTIONS RELATING TQ THE PROVISION OF FINANCIAL S ERVICES WITHIN THE SINGLE COMMUNITY MARKET AND THE COMMITTEE WILL GIVE ATTENTION TO SOME ASPECTS OF THESE IN THE NEAR FUTURE. IT WILL IN PARTICULAR EXAMINE TO WHAT EXTENT HARMON IZAT ION OF NATIONAL REGULATIONS IS NECESSARY. NOTABLY IN THE FISCAL AND SUPERVISORY AREAS.

ANNEX 83: STRENGTHENING THE EMS

COMMISSION
OF THE
EUROPEAN COMMUNITIES

The President

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19 March 1987
II/118/87-EN
(Orig. EN)

Note to the President of the Council

Subject : STRENGTHENING THE E.M.S.

[illegible]

1. INTRODUCTION.

In sharp contrast to the previous three to four years, the EMS started to experience considerable strains and difficulties shortly after the Ootmarsum realignment. Success during that earlier phase was at least partially due to :

(i) a consensus based on convergence towards the lowest inflation rate ;
(ii) a relatively favourable external environment ; and
(iii) limited capital mobility.

Fundamental changes have occured in each of these areas. The System must be adapted and strengthened to face the challenges of a second phase.

1.1. Convergence.

When national inflation rates diverged significantly, the objective -progressively shared by all- of converging towards the best performance provided an implicit and clear rule of behaviour which has proved an effective tool for the coordination of monetary policies and, through them, of other policies. Realignments have been necessary in this adjustment period, but they were not in themselves a source of divergence. They were the result of common negotiated decisions, normally accompanied by other policy measures aimed at reducing the disequilibria at the origin of the divergence. They were often smaller than the underlying inflation differentials.

[illegible]

In these circumstances, a sufficient degree of symmetry, at least from a political point of view, has been ensured by the willingness of the best performers to see their currencies revalued, while the disciplinary constraint has been upheld by the willingness of the weaker performers to see their real exchange rates appreciate.

1.2. External environment.

For a period, potential tensions within the System were mitigated by the strong appreciation of the Dollar to an unrealistically high level. When the Dollar started to decline, disruptions were for a time limited because of both the degree of convergence that had been achieved and the fact that the Dollar remained overvalued for a long period. As it now approaches a more appropriate level and there are clear risks of overshooting, there is a growing need to arrive at a common and explicit view on the implications that further falls will have on the System and, therefore, on the required policy reactions. That was the case at Gleneagles.

With increasing capital mobility and a more international interdependance, resisting external shocks will, in the future, require a closer degree of coordination of monetary policies than has been the case so far. As the same risk is not attached to all currencies, at least over the medium-term, this must be reflected in a coordinated discretional response rather than the same automatic reactions.

1.3. Capital mobility.

Relatively low capital mobility played a significant role both internally and in insulating the System from external shocks. Internal inconsistencies between national policies can co-exist with exchange rate stability when capital mobility is limited, as domestic interest rates are shielded, at least temporarily. When capital mobility is high, interest rate differentials are of more immediate concern to the management of the System .

A number of measures have been taken to liberalize capital movements, especially in Denmark, France and Italy. These policy measures are part of an overall process of financial market integration which is being powerfully driven forward by factors like innovation as well as by specific policy initiatives. Careful management of the liberalization process will be necessary during the transition period that is now being experienced. ?

1.4. The January realignment.

The severe difficulties over the period leading up to the January realignment are clear confirmation that the underlying situation has now changed. Despite improved fundamentals, the realignment was characterised by a progressive build-up of tensions, which were

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mainly countered through massive intervention, until a point that they were judged unbearable. The use of other policy instruments was delayed because of indecision over who should act and in which way. The result was that the potential given by the use of the fluctuation band was not used and that early speculation paid off. Finally, it was not until after the realignment that interest rate differentials were corrected. It is possible that, if these changes had been made in a more timely way, they might have prevented the realignment.

1.5. <u>The need to strengthen the EMS</u>.

The system has played a significant role in pulling inflation down in all countries towards the level in the least inflationary Member, and in encouraging budgetary discipline. A relatively favourable external environment contributed to the success, while the existence of exchange controls in some countries made the adjustment smoother. But we are now at an important crossroads. Convergence must be managed from now on in a more symmetric manner. This does not mean either a departure from the fundamental objective of monetary stability, or an institutional change. It will require, however, a strengthening of the EMS. Furthermore, faced with serious external shocks and the challenge of increasing capital mobility, the System will be put under strain. The only response compatible with the spirit of the System and with the objective of establishing the internal single market, is to enhance cooperation and surveillance, rather than to increase the flexibility of exchange rates (1). ?

Realising that more fundamental reforms are necessary in a longer term perspective, it is now essential to add to the <u>resiliency</u> of the System by building on the experience gained so far. It should be ensured that the System reacts to tensions more promptly and by using a balance of instruments ; we must particularly look at the management of interest rate differentials and the methodology of intervention.

Any modifications must ensure that the System continues to be directed towards its fundamental objective of internal and external monetary stability, and that existing powers in this field are respected. This implies that :

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(1) It must be noted that the progress made in convergence already has provided for greater flexibility since annual inflation differentials are now smaller than the width of the band, whereas in 1979-82 they were almost three time as large as the narrow band.

- the fundamental "checks and balances" must be preserved ;

- its disciplinary constraint should not be relaxed ;

- in a context of continued and improving convergence, realignments should become smaller and less frequent;

- monetary policy coordination, particularly the management of interest rate differentials, and consistent policy-mixes should be the key to the stability of the parity grid ;

- its solidarity mechanisms and practices must be reinforced.

In keeping with these principles, any proposed changes in the EMS will be in harmony not only with Article 102 A of the Single Act, but also with the general objectives of the establishment of the internal single market and of strengthening economic cohesion.

2. POLICY COORDINATION AND SURVEILLANCE.

2.1. The divergence indicator.

The divergence indicator, which was intended to add symmetry to the System, has not been used, partly because of technical insufficiencies in its construction and partly because of the extent of unilateral intra-marginal intervention. Improvements to the methodology of intervention are suggested below. The technical imperfections of the divergence indicator could also be corrected and/or the threshold could be lowered. It may be appropriate to make the threshold the subject of periodic consultations which would determine the appropriate level on the basis of the prevailing conditions. In any case, as long as convergence continues, the signals given by the divergence indicator are more relevant.

Crossing a given threshold of divergence (say +/- 60 %) for a certain time would then trigger a Community consultation procedure to agree on what measures of monetary policy may be necessary to rectify the situation and maintain the cohesion of the parity grid. Immediate attention should be focused on interest rate differentials but, in some cases, especially to deal with longer term tensions, it would be necessary to consider other elements of economic policy, including a realignment.

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2.2. A battery of indicators.

Indicators can help to make the surveillance process more concrete especially by providing a detailed view on the consistency of objectives and by strengthening policy coordination.

It is also important to ensure the consistency of policy targets and instruments, if the System is to become more resilient. Indicators can assist in achieving agreement on the instruments to be used, by whom and on the relative weights to be given to these various instruments : interventions - sterilised or unsterilised - domestic monetary market actions, and other measures.

The recent "Louvre agreement" confirms that progress is being made at the international level in coordination, and the use of indicators at an international level should help parallel developments within the Community. Progress at the Community level would also facilitate negotiations in the international system. The indicators developed within the EMS need not be the same as those developed at the international level, although both sets should of course be consistent and complementary.

The Community battery of indicators must take account of the special circumstances of the EMS. The indicators should both focus discussion on the coordination needs within the System, and be directed at helping to find a common view of the position of the EMS vis-à-vis the exterior. This does not yet imply defining a target zone or reference range for the ECU vis-à-vis the Dollar and Yen, which would not be realistic or significant in the absence of an agreement with the monetary authorities competent for those two currencies. But external shocks have the capacity to cause tensions in the System both directly and indirectly. The direct effect is the result of the different structures of the economies. The indirect effect is produced by funds flowing first into one of the currencies - so far the DM - which may make investors in other Member countries question their portfolio choice. In either circumstance the System cannot be indifferent.

3. INTEREST RATES.

Interest rate differentials should always have been the key to maintaining the stability of the parity grid in the short-term. Increased convergence is a necessary but not a sufficient condition for discouraging speculation. Furthermore, the trend towards increased liberalization and innovation increases the magnitude of capital flows and their impact, implying that monetary policies must take more account than previously of EMS

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constraints on domestic policies and of the repercussions of external policies on domestic conditions.

3.1. Monitoring of domestic money markets.

As the segmentation of markets is eroded, it becomes more necessary that domestic money market conditions are intensely monitored in much the same way as the exchange markets. This suggests that the means for sharing information about market conditions and about policy intentions and actions should be developed to parallel the mechanisms that already exist for these purposes in the exchange markets.

This will allow a better coherence between actions and intentions on each of the markets facilitating decisions of when and in which circumstances actions in one should be allowed to affect the other. Unsterilised foreign exchange market interventions have a direct effect on domestic market conditions. They will also permit a more coordinated approach to the management of interest rate differentials.

3.2. Interest rate differentials.

As long as national economic policies are not fully compatible within the EMS, or expectations are affected by different degrees of credibility in the various policy-mixes, the required consistency with the exchange rate commitments has to be supported by monetary policy as far as possible. The differences in breadth and depth of national money markets can also give rise to the need for interest rate differentials, particularly in the face of external shocks caused by large movements of third currencies.

4. INTERVENTION METHODS.

Against a background of increased policy coordination and surveillance, the exchange rate management and especially intervention methods can be improved. The aims would be :

(i) to use more fully the flexibility afforded by the fluctuation bands ;
(ii) to coordinate better intra-marginal interventions ;
(iii) to diversify the currencies used, including the ECU ;
(iv) to allow Community financing in some circumstances ;
(v) and to improve the conduct of intervention in third currencies.

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4.1. Use of the Fluctuation Band.

Currencies have often tended to limit their bilateral fluctuations on the assumption that early action prevents larger interventions later. However, the practice has given rise to circumstances that have allowed speculators to profit. A fuller use should be made of the fluctuation bands, especially if this is is done in a cooperative way, rather than as a lever for obtaining policy changes from the authorities of the currency at the other extreme.

Another method of reducing speculation would be to make progress towards achieving a System in which the fluctuation margin is not the only point of common resistence. If at times the full weight of the System was used to defend intermediate points, speculators would be considerably more reluctant to test the margins. This would entail a more coordinated use of intramarginal intervention.

4.2. Coordination of intra-marginal intervention.

In the past, intra-marginal interventions have been undertaken mainly in strong ERM currencies (mostly DM) or in Dollars. The strong currency authorities (in particular the Bundesbank) have generally been prepared to see their currencies used in this way. The working-balances provisions of the agreement have thereby progressively been disregarded. Although the strong currency countries have not in the past intervened intramarginally to buy weak ERM currencies, some of their Dollar purchases can be interpreted as being partly a form of intra-marginal intervention.

In the case of interventions in Community currencies, a strong argument has been that the total size of interventions will be smaller if intervention is undertaken early rather than if the weak currency is allowed to fall to its margin. If this is indeed the case, the total costs are smaller. The weaker currency loses less reserves, and the stronger has to support a smaller potential disruption to its domestic money market.

There seems to be little reason why these implicit decisions should not be made explicit so that the intervention could be better coordinated and, at least in some cases, financed by Community mechanisms.

./.

4.3. Currency diversification and use of ECU.

Recently intra-marginal interventions have taken place almost exclusively in DM. The use of the DM will still be appropriate in most circumstances, but use of other ERM currencies may also prove helpful in particular situations.

Larger use of the ECU for intervention purposes should be considered. Such development could be useful, depending on the actual circumstances, in :

- positioning the EMS against the Dollar. Indeed selling or buying $ against a single EMS ccurrency only affects a bilateral exchange rate relationship and involves a single EMS central bank. Interventions in the ECU by any EMS central bank would move the System as a whole against the Dollar.

- managing the position of an EMS currency in the band, especially when it occupies an extreme position (either high or low) in the fluctuation band and recourse to the Dollar is not warranted. This would also increase the number of usable intervention currencies, now largely limited to the sole DM.

- increasing the interest of market operators in using the ECU, thereby limiting the potential for tensions in the EMS induced by bilateral currency flows.

An exchange market for the private ECU exists already and is relatively deep, although there are improvements which could be envisaged (see below). The spreads quoted are normal. Use of the ECU, especially in the cases suggested above, could be less disruptive of EMS cohesion than use of other Community currencies or the Dollar.

4.4. Financing of intra-marginal intervention.

In the past, the cost of maintaining the cohesion of the parity grid by intra-marginal intervention in Community currencies has tended to fall on the weak currency countries. While divergences were large, and average inflation high, this was no doubt appropriate. As intra-marginal intervention comes to be seen more as a common policy instrument and less as a unilateral instrument, the question arises of how to share the burden of intra-marginal intervention.

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One approach would be to allow Community financing of intra-marginal interventions by weak countries in certain circumstances. Alternatively, strong currency countries would be expected to hold ECUs or national currencies acquired in such interventions.

Central banks of weak currencies could obtain Community financing for intra-marginal interventions, for example, through an extension of the existing mobilization mechanism that was set up in 1985.The volume of credit available could be increased, the participation of partner countries and the arrangements for drawing Community currencies improved, and the option of partial settlement in official ECUs considered.

It would be possible to put quantitative and duration limits on the amounts of ECU or other Community currencies that are acquired by the central banks of stronger currencies engaging in intra-marginal intervention. There would be a right to exchange the acquired currencies for reserve assets after a certain period, or after a certain limit had been reached. Alternatively the right could be exercised in the case of need. In addition, there could be a right of exchange if the central bank of the currency concerned has positive balances of the currency of the intervening bank.

4.5. <u>Link with the divergence indicator</u>.

If an improved divergence indicator was already being used in the surveillance process, it could also be used in the management of Community financing for intra-marginal intervention. There could, for example, be a presumption that such financing should continue to be available, subject to the policy discussion which would have already been triggered, when the currency in question is beyond the agreed threshold.

To the extent that unilateraly decided interventions are discouraged by not being eligible for Community financing, the signals from the exchange market give a more true indication of underlying conditions and hence enhance the divergence indicator's role in the surveillance process.

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5. ECU MATTERS.

There is considerable scope for strengthening the role of the ECU as a reserve asset. This in itself could be expected to improve the stability of the parity grid, especially in the face of external shocks. Within the System, the ECU could become a major currency for intervention. To these ends, several improvements could be envisaged :

5.1. ECU creation.

The development of the ECU is held back both by the two-year time limit put on its existence and by the method of determining the amount of ECUs to be created every three months. The process of ECU creation could be made less precarious by at least extending the period of the "swaps" or even making it "permanent". Also the amount of ECU created could be determined by a discretionary decision followed by a rule, more or less automatic, rather than being dependent on the price of gold and the US Dollar exchange rate.

5.2. ECU money market.

The development of an ECU money market could be encouraged by creating short-term quality debt instruments, i.e. ECU denominated "Treasury bills". Indeed in order to be able to use the ECU in interventions, the build-up of ECU reserves must be facilitated.

5.3. A reference text for the ECU.

A more wide-ranging legal text concerning the ECU and its use would facilitate its use in international commercial transactions and strengthen its legal foundations. A text of this form would prevent the proliferation of ECU-quasi-money and thus add an element of stability to the ECU market.

5.4. Full recognition.

The ECU should be recognized in Germany and in Spain.

ANNEX A2: IMPLICATIONS OF FULL LIBERALISATION OF CAPITAL MOVEMENTS IN THE COMMUNITY

RECU PAR 32 2 2337114 TRESOR 32 2 2337114 27.03.87 11:07 27.03.87 10:14

COMMISSION
OF THE
EUROPEAN COMMUNITIES

The President

200 RUE DE LA LOI
1049 BRUSSELS
TEL (02) 235 11 11

19 March 1987
II/112/87-EN
(Orig. FR)

Note to the President of the Council

Subject : **IMPLICATIONS OF THE FULL LIBERALIZATION OF CAPITAL MOVEMENTS IN THE COMMUNITY**

In May 1986 the Commission presented the Council with a programme for the full liberalization of capital movements. Since then a first stage in applying this programme has been accomplished. Certain safeguard regimes have been withdrawn or made more restrictive (France, Italy). A Directive liberalizing the last operations necessary for the genuine inter-linkage of the financial markets has been adopted and entered into force on 28 February 1987.

The Commission has undertaken to promote a study of the various implications of the full liberalization of capital movements before proposing the corresponding Directive to the Council. This study is under way, notably within the Committee of Governors and the Monetary Committee. The Commission's provisional conclusion is that liberalization could be accomplished, at least in a majority of Member States, even before the deadline of 31 December 1992 set by the Single Act for completing the internal market. The purpose of this paper is to identify the conditions for the venture to succeed.

I. The liberalization of capital movements in the Community concerns all the Member States and is part of a general process

a) The objectives which underlie the liberalization programme concern all the Member States. The realization of an internal market having its full financial dimension is now an objective which the Community has set itself. The liberalization of capital movements will help improve the allocation of savings resources and can be expected to produce additional growth in the Community, from which all the member countries will benefit. In short, it aims to reinforce and consolidate the convergence of economic policies, which, though remarkable, could still now be seen to be reversible.

The interdependence of the economies means that no Member State can remain indifferent to the process which is taking shape. The countries primarily involved are undoubtedly those participating in the EMS exchange rate mechanism which consider that they still have a significant margin of autonomy in the conduct of their monetary policies. But the liberal countries will have to reckon with the opportunity given to their residents of access to currencies which have so far been unavailable. The countries which still have strict exchange controls will have to define, in terms of a timetable, their relative priorities with regard to the liberalization of their exchange rules and their participation in the EMS.

b) It will be necessary to carry through a development which is already well under way. Exchange controls have on the whole become appreciably more liberal in the last two years. The decisions taken by Spain, notwithstanding the provisions of the Treaty of Accession, are very encouraging.

The distance which still remains to be covered should not be overestimated: the operations in question are financial loans in domestic currency, transactions in money market securities and the opening of accounts in foreign currencies. Financial innovation is known to be blurring the traditional distinction between the short-term and long-term sections of the financial markets. For some countries the issue of the repeal of the safeguard clauses from which they benefit - and which is already written into the timetable - comes on top of the implications of the second stage of liberalization and obstructs their calm consideration of it.

II The completion of the liberalization of capital movements will open a new phase in the development of the EMS and monetary cooperation.

a) The first period of the EMS has been one of painful and successful convergence towards a model of monetary stability consistently provided by Germany. One of its instruments has been exchange rate discipline, relaxed from time to time by moderate realignments and somewhat facilitated by the existence of exchange controls.

This first phase is coming to an end and the realignment of 12 January 1987 probably marks its completion. The new level of exchange liberalization reached in the Community, together with the increasingly general use of indirect methods of monetary control have made the foreign exchanges more volatile and more sensitive to the relative financial data, in particular interest rate differentials. Convergence is becoming more demanding, since it must now aim to ensure the coherent management of public finances and the pursuit of monetary stability; it is also becoming less straightforward since the exemplary behaviour of the principal partner is becoming more general. It follows that when there are strains within the EMS, the methods of adjustment are proving less simple and that it will no longer be possible to evade the difficult question of sharing the burden of adjustment.

b) The EMS is going to have to face a challenge when capital movements are liberalized of the same nature as the one it would have faced as a result of sterling's accession : how to manage the triangle of incompatibilities which results from the coexistence of exchange rate stability and the free movement of capital, with the relative autonomy of monetary policies of certain member countries.

There are two rival schools of thought as to how to resolve this overdetermination in the long term. Either reliance is placed on common adherence to the same objective of monetary stability and on the formation of a "stable block" within the EMS to generate a process of spontaneous coordination of monetary policies (subject to a degree of flexibility in the management of the System to react to unexpected shocks); or the choice of a more institutional solution is recommended, with a collectivisation of the fundamental monetary choices in the Community (preferably accompanied by more scope for resorting to the mechanisms of financial solidarity in order to defend the stability of exchange rates in the event of transitory strains).

Whatever the respective merits of these two approaches, the issue at stake in the new phase of the EMS is more immediate. It is to define a method of managing a transitional stage characterized by the greater freedom of capital movements, the juxtaposition of convergent and coherent monetary policies whose credibility is however still widely dissimilar, and strict application of the EMS. It would be unrealistic to think that realignments will not be necessary from time to time. But the completion of the internal market implies, and this is how it differs from a free trade area, a rational stability of exchange rates, - and for all the Member States.

The cost and the constraints of this transitional period - notably in terms of growth rates, of volatility and level of interest rates, and of volume and financing of interventions - are liable to prove excessive for some Member States if behaviour in terms of adjustment, coordination and EMS solidarity is not cooperative. In particular there must be agreement : in seeking at Community level a rate of economic growth which makes the best use of the growth potential while respecting the priority of monetary stability; in attaining the highest degree of liberalization of capital movements, while revising a rigorous system of safeguard clauses; in reinforcing and widening the purposes of the Community's monetary and financial instruments.

It will be essential to strengthen the methods of coordinating monetary policies. For example coordination must cover the definition of an objective of monetary stability acceptable to all; the use of the existing elements of flexibility in the EMS designed to frustrate speculation; the management of interest rate levels and differentials which is consistent with the defence of the EMS parity grid and the desired exchange rate relationships with third currencies.

III The full liberalization of capital movements will reveal the variety of obstacles which will also have to be removed in order to attain a high degree of financial integration

a) The liberalization of capital movements is clearly a necessary but not a sufficient condition for financial integration. Financial integration presupposes: the effective freedom to provide financial services, for which the movement of capital is often only the support; no discriminatory treatment connected with the location of placements; conditions of competition between suppliers of services unbiased by non-economic considerations (tax evasion). This means that financial integration will not necessarily keep pace with the liberalization of capital movements, even if liberalization only fully makes sense in the perspective of financial integration.

b) Although it is in principle directly applicable, the exercise of the freedom to provide financial services presupposes a degree of harmonization in national legislation in the fields of banking, insurance and the organization of financial markets. It is sufficient to recall here the approach of the White Paper, adopted by the European Council in 1985. The White Paper forgoes - in the interests of realism - the harmonization of financial products, and instead advocates seeking a sufficient degree of harmonization - sometimes a little awkwardly termed "minimal" - of the supervisory rules, so that, in accordance with the principle of mutual recognition, the country in which the service is supplied must be satisfied with the supervision of the authorities in the supplier's country of origin. The harmonization sought does not at all mean alignment on the most flexible supervisory rules. What is desired is, on the contrary, to use the most relevant rules notably in the face of renewed banking risks. A recent judgement by the Court of Justice recognized that the wish to protect savings and the users of financial services may result in the freedom to provide services being legitimately subordinated to authorization procedures where harmonization is insufficient.

It remains that, in the field of banking at least, the Commission considers that the Directives which have already been adopted, those which it has presented to the Council and those which it has announced, form a body of texts sufficient to ensure the effective freedom to provide services.

c) The Commission intends to propose a redrafting of the scope of liberalization obligations in relation to financial operations; in addition to the foreign exchange authorization, liberalization should cover everything which could impede the conclusion and execution of transactions. In a recent judgement, the Court of Justice even seemed, in the name of the principle of the freedom of capital movements, to condemn certain forms of administrative and possibly tax treatment which discriminated between national and Community placements.

d) The dangers should not be underestimated of placements and financial activities being moved to other locations as a result of differences in the tax system of the Member States, although these differences affect just as much the location of the production of goods and services. They could exacerbate the effects of the normal diversification of portfolios and even in some cases take the form of "inverse transfers", hardly consistent with the optimum allocation of financial resources. These problems can be solved by harmonizing tax systems. In the meantime, the Member States are authorized under Community law "to take all requisite measures to prevent infringements of their laws and regulations" but provided that these controls do not render illusory the right to engage in liberalized capital movements.

IV The liberalization of capital movements must not run counter to the cohesion of the Community

This gives rise to three essential questions:

a) Because Member States do not start from the same situations, is there a need for supporting and transitional measures?

In the majority of the Member States the liberalization of capital movements will be complete before the 1992 deadline. Does it have to be complete by the same date in the new Member States? This is not definite, especially if it is remembered that for them the implications are particularly significant. In particular they will have to modernize their financial systems - this could be helped by the Community's structural instruments -, rearrange their systems of financing the public sector, reconsider the return on and the taxation of savings,etc.

The Commission has already announced its plan to broaden the scope of the instruments providing medium-term balance of payments assistance. In the past they have always been activated to assist member countries which, at a time of balance of payments crisis, have introduced or tightened exchange controls. Their use could be envisaged to support a State which, although its external situation was precarious, undertook to proceed along the path of liberalization. An appropriate form of conditionality would have to be worked out.

b) Because of the greater fluidity of the monetary environment of each of the Member States, should the system of safeguard clauses be amended?

Discussions in the Committees have shown the advantage there would be in a Member State being able temporarily to prevent short-term capital movements from entering or leaving the country in a situation in which they seriously disrupted the regulation of bank liquidity, but without there being any significant divergence in economic fundamentals.

It has been argued that this need could be met by the safeguard clause of Article 73 of the Treaty, authorized by the Commission, after consulting the Monetary Committee. But this clause does not really meet the same need, because it refers to disturbances in the functioning of the capital markets. A broad interpretation could give grounds for the accusation that a procedure was being circumvented. The Commission would therefore prefer to incorporate a specific safeguard clause, relating to monetary operations, in the future Directive.

c) In a financial market that is becoming global, is the financial identity of the Community an illusion?

There is broad agreement on the idea of liberalization "erga omnes". Nevertheless it will be necessary to update the 1972 Directive on regulating international capital flows since it will no longer be possible to activate the instruments of control to which it refers within the Community except by virtue of a safeguard clause, whereas today their use is discretionary. When updating the Directive, the Commission would also suggest examining the advisability of providing for the possible concerted application of this Directive in the event of exceptionally large capital movements to or from third countries; this would moreover be in line with the explanatory memorandum to the Directive, which was drafted before the EMS existed.

The financial identity of the Community will be based on the juxtaposition of the liberalization of capital movements and the free provision of services, the exercise of which is subject to legislative harmonization which will apply only to the States of the Community. Third countries will have to negotiate with the Community a regime for supplying financial services, for which it will be able to determine the conditions of reciprocity and the degree of liberality. The Commission considers however that the lack of coordination demonstrated in Member States' negotiations on the establishment of the branches of foreign financial institutions may lead to unbalanced concessions to the advantage of third countries.

CONCLUSION

a) Notwithstanding the additional comments which may be made by the Ministers, the Monetary Committee and the Committee of Governors envisage finalizing their reports for the informal ECO/FIN of September. Between now and then the Commission envisages, independantly from work on strengthening the EMS, continuing its examination of the following points in particular : advisability of subdividing the second phase, recommended by certain Member States for reasons of taxation; exact scope of the liberalizaton obligations; safeguard clauses; modifications to financial instruments. After the ECO/FIN of September the Commission intends to present the Council with the corresponding proposed Directives or Decisions, having made a progress report to Parliament at its request.

b) At this stage of the discussions the Commission is in a position to make three observations:

- The implications of full liberalization are multiple and major; but none of them represents an insurmountable obtacle;

- full liberalization now corresponds to an obligation of the Treaty. It means carrying through an irreversible process, even if its pace differs from one member country to another. It will be a challenge to the stability of the EMS, but also an opportunity to strengthen it;

- lastly, and perhaps most importantly, there is no precondition for the liberalization of capital movements. On the other hand, it will have a powerful stimulatory effect on the adoption of the accompanying measures necessary for it to lead to the completion of the internal financial market.

ANNEX A3: RESTRICTIONS IMPOSED BY MEMBER STATES

INFORMAL ECOFIN 3-5 APRIL

ANNEX A3

LIBERALISATION OF CAPITAL MOVEMENTS: RESTRICTIONS IMPOSED BY MEMBER STATES

1. Community legislation on liberalisation of capital movements, to implement Article 67 of the Treaty is enshrined in the 1960 capital movements Directive, as amended by Directives of 1962, 1985 (accompanyiny the Directive on UCITS) and 1986 (implemented 28 February 1987).

2. For liberalisation purposes, Community legislation divides transactions as follows:

(a) those subject to unconditional liberalisation, (unless covered by a specific derogation);
(b) those in effect subject to voluntary liberalisation. This includes a category of transactions which member states are supposed to liberalise unless liberalisation could be an obstacle to their economic policy objectives, and a category for which there are no liberalisation obligations.

3. In broad terms, unconditional liberalisation (2(a)) applies to direct investments, new issues of securities, most operations in securities, investment in real estate, commercial credits (where residents participate), and most personal capital movements. The main transactions to which voluntary liberalisation (2(b)) applies relate to short term capital eg Treasury bills and bank deposits.

4. Information on individual member states is given below. This is taken largely from a Commission paper of November 1986 prepared for the Monetary Committee.

GREECE

5. On 2(a) above, Greece currently has a derogation under Article 108(3) of the Treaty of Rome, agreed as part of the Community Loan package in November 1985 to help Greece with balance of payments problems. The derogation covers direct investments, investments in real estate, and some personal capital movements (which may be made subject to prior authorisation), and some operations in securities (which may be prohibited or made subject to prior authorisation). It is intended to last until November 1988.

6. Greece also maintains some restrictions on transactions under 2(b) involving in some cases prohibition and in others need for authorisation.

7. Greece is likely to be cautious about full liberalisation, stressing the need for step by step progress depending on other factors such as convergence and supporting the availability of safeguard provisions and support facilities. At the November 1986 ECOFIN, when the 1986 Directive was adopted, Greece made a statement for the Council minutes stressing the dangers of free movement of capital for the weaker economies and currencies, and the need for better co-ordination of economic policies.

SPAIN

8. On 2(a), Spain has a derogation under the Accession Treaty, covering direct investment, investments in real estate, and some operations in securities. This derogation lasts until 1988 - 1990 (depending on the type of transaction). Further, Spain does not have to implement the 1986 Directive until 1989 - 1990 (depending on the type of transaction).

9. Spain also maintains some restrictions on transactions under 2(b) mainly involving need for authorisation.

10. Spain seems to be moderately enthusiastic about liberalisation. According to the Commission's November paper, some of Spain's recent liberalisation measures on portfolio investment have gone beyond those necessary to comply with the Accesssion Treaty. At the October ECOFIN, when it was tacitly agreed that Spain and Portugal could delay implementation of the 1986 Directive, Solchaga said that for Spain this delay was not a matter of practice but of principle.

FRANCE

11. On 2(a), France's balance of payments derogation under Article 108(3) of the Treaty of Rome was rescinded by the Commission in June 1986. This was made possible because of liberalisation measures taken at the end of 1985 (in respect of direct investments) and in May 1986 (notably in respect of acquisition of foreign securities - the ending of the devise titre system, immovable investments abroad, and certain personal capital movements).

12. France still maintains some restrictions on transactions under 2(b) mainly involving need for authorisation or use of approved intermediaries. According to the Commission's November paper, France has, during 1986, taken measures towards liberalised exchange controls in respect of some commercial and financial operations of enterprises, and some transactions by residents. French residents, though, remain unable to hold foreign currency bank deposits.

13. Thus France is at the moment fairly enthusiastic about liberalisation. However discussion in the Monetary Committee suggests that they would want to move gradually (with the next stage perhaps full liberalisation for companies) and with the possibility of safeguard provisions.

IRELAND

14. On 2(a), Ireland still has a balance of payments derogation under Article 108(3) of the Treaty of Rome, covering some operations in securities, to last until end 1987.

15. On 2(b), Ireland also maintains some restrictions on transactions under 2(b) involving mainly need for authorisation (which for some transactions may only be given in certain circumstances).

16. Like Greece, Ireland is likely to be fairly cautious about full liberalisation.

ITALY

17. On 2(a), Italy still has a balance of payments derogation under Article 108(3) of the Treaty of Rome, to last till end 1987. In broad terms, this derogation permits the imposition of non interest bearing bank deposits for residents investment in real estate abroad (15%), and for acquisition of foreign securities (15%). The Commission have recently tightened up this derogation (the deposit percentages used to be somewhat higher) in line with Italian moves to relax some of their restrictions on capital movements.

18. On 2(b), Italy still maintains some restrictions on transactions including some prohibitions as well as requirements for authorisation.

19. Despite their recent moves towards it, Italy is likely to be cautious about full liberalisation of capital movements. At the November ECOFIN when the 1986 Directive was adopted, Italy made a statement for the Council minutes, about the possible destabilising effects of free capital movements on the EMS, and on the need for co-ordination of economic policies and policies on financial markets and instruments, and for measures to help with balance of payments and other problems which might arise.

PORTUGAL

20. Portugal has a derogation under the Accession Treaty, covering direct investment, investment in real estate, personal capital movements over a certain amount , and some operations in securities. These provisions last until up till 1992 (depending on the type of transaction). Further, Portugal does not have to implement the 1986 Directive until 1990 - 1992 (depending on the type of transaction).

21. Portugal also maintains some restrictions on transactions under 2(b) mainly involving need for authorisation.

22. Portugal may also be fairly cautious about full liberalisation.

OTHER MEMBER STATES

23. None of the other member states has a derogation of any sort on transactions under 2(a). Nor on the whole do they maintain restrictions under 2(b), although:

(a) according to the Commission's November paper, Denmark still has prior authorisation provisions on some transactions. However, Denmark is regarded as being substantially liberalised.

(b) Germany still has restrictions on certain transactions in ecus. (At the last informal ECOFIN, Stoltenberg said that Germany would consider full recognition of the private ecu if there was progress on liberalisation of capital movements, but nothing concrete has happened on this.)

(c) Belgium operates a dual exchange market, which separates purchases and sales of currencies for investment purposes from commercial flows. The 1986 Directive has in principle tightened up on this: for all transactions subject to unconditional liberalisation, the exchange rates applied "must not show any appreciable and lasting differences from those ruling for payments relating to current transactions".

23. All these countries are likely to support moves towards full liberalisation. Belgium is likely to be the most cautious of the group: when the new initiative was discussed at ECOFIN in June 1986, Eyskens mentioned the difficulties which full liberalisation would cause for some member states, and linked it with completion of the EMS.

cc Mr Monck
Mr Waller
Miss Barber

Mr Burgner

In view of the Chancellor's previous comments, you may wish to consider whether Airbus needs raising

A W Kelly 25/3

FROM: JANET BARBER
DATE: 25 MARCH 1987

MR KELLY
MR SHERIDAN
MR DOLPHIN

cc PS/Chancellor 12/2
Sir Geoffrey Littler
Mr Lavelle
Mr Evans
Mr Peretz
Mr Mountfield
Mrs Lomax
Ms Sinclair
Mr Walsh
Mr Mortimer
Mr Crabbie
Ms Life
Miss Wright
Ms French C&E
Mr Beales - UKREP

INFORMAL ECOFIN 3-5 APRIL

The Chancellor will attend this meeting accompanied by Sir Geoffrey Littler. The Governor of the Bank of England will also be there.

2. The agenda is as follows (see the attached letter from Mr Eyskens):

1. a first exchange of views on the implications of complete liberalisation of capital movements in the Community;

2. strengthening of the EMS;

3. preparation for the meetings of the Interim and Development Committees.

3. I would be grateful if Mr Kelly could provide a brief covering items 1 and 2, in consultation with Sir Geoffrey Littler. Discussion will be on the basis of a Monetary Committee chairman's report, which we should get in draft for comment in the next day or two, and which should be circulated in final form early next week. There will also be a report from the Bank Governors' Committee, and I am trying to get a draft of this from the Bank of England. Further, there is likely to be a paper from the Commission, which Eyskens has asked for, and which will be sent to him in the first instance rather than direct to member states. UKREP are trying to get an unofficial copy, and I will circulate this if and when we get it.

4. Item 3 should be fully covered by the briefing for the spring meetings, and I would be grateful if Mr Sheridan could confirm that the Chancellor will have this in good time for ECOFIN. The ECOFIN briefing itself will include:

(a) a copy of the Presidency statement (which was agreed at the Monetary Committee yesterday, and will be circulated in final form in the next few days);
(b) a table listing the contents of the spring meetings briefing;

(c) a copy of the standard set of statistics for the Community, US and Japan which we normally give to the Chancellor on these occasions. I would be grateful if Mr Dolphin could supply these.

5. As this is an informal meeting, there is an opportunity for the Chancellor to raise issues with other finance ministers or with the Commission (M. Delors usually attends). I would be grateful if copy recipients would let me know if there is anything that they would like the Chancellor to pursue at this meeting, or if there is anything which others might raise with him. On the latter, I would be grateful if Ms French would confirm that we need not include anything on tax approximation - there was no hint at yesterday's Monetary Committee that the Presidency were going to raise this, although the Commission just might do so if their report is nearly finished.

6. We have been asked to submit the briefing by close on Wednesday 1 April, so if possible contributions should reach me by close on Tuesday 31 March. The standard format is attached. Many thanks for your help.

Janet Barber

JANET BARBER
EC1

FAX

FROM

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Cher Collègue,

Je me réfère à mes lettres des 5 janvier et 19 février 1987 à propos du Conseil ECOFIN informel des 3-4-5 avril 1987.

Je vous suggère que le samedi matin 4 avril, nos discussions portent sur les points suivants :

1° Un premier échange de vues sur les implications d'une libéralisation complète des mouvements de capitaux dans la C.E.E. ;

2° La question de renforcement du S.M.E. Le Comité des Gouverneurs des Banques Centrales et le Comité Monétaire feront rapport au Conseil suite au mandat qui leur a été donné lors du dernier réalignement des monnaies (12-1-1987). Ces rapports vous seront transmis par vos titulaires à ces comités.

Après le déjeuner, je propose d'examiner la question de la préparation des réunions de WASHINGTON du Comité Intérimaire et du Comité de Développement et en particulier, l'adoption du projet de discours qu'en tant que Président du Conseil je prononcerai devant le Comité Intérimaire du 9 avril .

Il est bien entendu qu'un point "divers" est prévu au cas où l'un ou l'autre ministre souhaiterait aborder tel ou tel problème particulier.

Dans l'attente de notre prochaine réunion, je vous prie de recevoir mes meilleures salutations.

M. EYSKENS
Président du Conseil.

ECOFIN BRIEFING: STRUCTURE OF BRIEFS

General note: be as brief as possible, and try to get objectives and line to take/point to make on first page.

UK OBJECTIVES

These should be stated in a short paragraph. It should be made clear whether the Minister is required to intervene, or whether he will just be participating in a general discussion.

POINTS TO MAKE/LINE TO TAKE

(i) Line to take is appropriate when a proposal is being discussed, and when the Minister is asked to intervene.

(ii) Points to make are for discussion documents where no operational decisions will be reached.

(iii) Line to take/points to make should not include editorial comment except where absolutely essential and square bracketed; they should be set out in skeleton speaking note form, so that the Minister can read from them without further editing.

(iv) Points to make should be interesting i.e not only simple restatements of UK policy where that is well known. It should be remembered that a Minister is limited in the number of points he can make e.g three.

(v) Short Q/A defensive material should be included only if necessary e.g where the Minister will have to argue out a particular point.

BACKGROUND NOTE

Where possible, this should be confined to two sides.

BRIEF

ECOFIN, MARCH 12

SUBJECT

Relevant document:

UK objectives
[If any]

Line to take/Points to make

Defensive briefing
[if necessary]

Background.

RECD FAX 32 2 2337114 SOR 32 2 2337114 26.03.87 14:40 26.03.87 13:41

EYSKENS TELEX 25/3

FAX

FROM

Ch X, Suggest will need to make clear exactly where each country stands on this — not just general views but for now proposals, what restrictions on capital movements are still imposed, & how effective they are.

(PS)

MINISTRY OF FINANCE
Treasury - Brussels

Avenue des Arts, 30
1040 Bruxelles

Group III: 02.233.7114
Telex:
Telephone: 02.233.
Fax Operator: 02.233.

To: Mr N. LAWSON, Chancellor of the Exchequer, LONDON
For the attention of:
Fax n°: 00-44-1-8392082
From: Mr. M. EYSKENS, Minister of Finance, BRUSSELS
Total n° of pages: Including this page.
Date: 25.03.1987

If you have not received all the pages including this cover page or find that any of them are illegible, please call the Fax operator at the above address as soon as possible

Dear Colleague,

X I refer to my letters of January 5 and February 19, 1987 concerning the informal ECO-FIN Council of April 3, 4 and 5, 1987.

I suggest that, on saturday morning April 4, our discussions focus on the following points :

X 1° A first exchange of views on the implications of a complete liberalization of the capital movements in the E.E.C. ;

2° Strengthening the E.M.S. The Committee of the Governors of the Central Banks and the Monetary Committee will report to the Council according to the mandate they were given during the last monetary realignment (12-1-1987). These reports will be delivered to you by your representatives to these Committees.

After the lunch, I suggest to discuss the preparation of the WASHINGTON Interim and Development Committee meetings and in particular, the adoption of the draft speech I intend to deliver as President of the Council at the Interim Committee of April 9.

It is understood that an item "other business" is scheduled should a minister like to discuss a particular problem.

Looking forward to see you at our next meeting,

Yours sincerely,

M. EYSKENS.
Chairman of the Council.

CH/EXCHEQUER
REC. 27 MAR 1987
ACTION SIR G. LITTLER 27/3
COPIES TO EST, MST
SIR P. MIDDLETON
MR LAVELLE
MR H. P. EVANS

INFORMAL ECOFIN 3-5 APRIL
AGENDA

FAX
FROM

MINISTRY OF FINANCE
Treasury - Brussels

avenue des Arts, 30
1040 Bruxelles

Group III: 02.233.7114
Telex:
Telephone: 02.233.
Fax Operator: 02.233.

To:
For the attention of:
Fax n°:
From:
Total n° of pages: Including this page.
Date:

If you have not received all the pages including this cover page or find that any of them are illegible, please call the Fax operator at the above address as soon as possible

Cher Collègue,

Je me réfère à mes lettres des 5 janvier et 19 février 1987 à propos du Conseil ECOFIN informel des 3-4-5 avril 1987.

Je vous suggère que le samedi matin 4 avril, nos discussions portent sur les points suivants :

1° Un premier échange de vues sur les implications d'une libéralisation complète des mouvements de capitaux dans la C.E.E. ;

2° La question de renforcement du S.M.E. Le Comité des Gouverneurs des Banques Centrales et le Comité Monétaire feront rapport au Conseil suite au mandat qui leur a été donné lors du dernier réalignement des monnaies (12-1-1987). Ces rapports vous seront transmis par vos titulaires à ces comités.

Après le déjeuner, je propose d'examiner la question de la préparation des réunions de WASHINGTON du Comité Intérimaire et du Comité de Développement et en particulier, l'adoption du projet de discours qu'en tant que Président du Conseil je prononcerai devant le Comité Intérimaire du 9 avril .

Il est bien entendu qu'un point "divers" est prévu au cas où l'un ou l'autre ministre souhaiterait aborder tel ou tel problème particulier.

Dans l'attente de notre prochaine réunion, je vous prie de recevoir mes meilleures salutations.

M. EYSKENS
Président du Conseil.

26/3/87. cc M-S Lawson

MINISTERE DES
FINANCES

1000 BRUXELLES, le 19.2.87

Rue de la Loi 12-14 Tél. : 02/233.81.11

LE MINISTRE DES FINANCES

N. réf. : A1/JK/MCS/1A

V. réf. :

Mr. Nigel LAWSON
Chancellor of the Exchequer
Parliament Street
LONDON S W 1 P - 3 AG
UNITED KINGDOM

Dear Collegue,

I want to informe you on some organisational aspects of the informal Ecofin meeting scheduled for April 3, 4 and 5, 1987.

I wish to make clear that not only your spouse and the spouse of the Centrale Bank Representative, but also the spouse of the senior official accompanying you, is cordially invited.

As mentioned in my letter of January 5, the meeting will be held at hotel "La Réserve" in Knokke at the Belgian coast, where you can be reached via phone number 050/61.06.06 and telex number 81.667.

The guests are expected to arrive on Friday, April 3 from 7 p.m. The informal buffet-dinner will start at 8.30 p.m. The meeting itself will take place on Saturday April 4,at 9 a.m. and is expected to end around 5 p.m. During the day the spouses have the opportunity to visit the City of Gand (Gent). In the evening, guests will be transported to Bruges for a concert and a dinner in the gothic conference room of City Hall (dress : lounge suit). On Sunday there will be opportunity to sightsee Bruges. A more detailed program is enclosed.

The most convenient airport for arrival is Ostend airport. If you use a private aircraft I would recommend this airport since it is only 25 minutes by car from Knokke. It is also close to Bruges, where the meeting will end on Sunday after lunch. If you travel with a regular airline you will arrive at Brussels international airport. The transport to Knokke will take another 1 1/4 hour.

Guests arriving by plane will be welcomed at the airport and arrangements will be made to take them by car to the hotel. Guests travelling by car will be welcomed at the Belgian boarder and than accompanied to Knokke. The Belgian Ministry of Finance will take care of transportation during the weekend.

./..

CH/EXCHEQUER	
REC.	26 FEB 1987 26/2
ACTION	MR LAVELLE
COPIES TO	EST MST
	SIR P. MIDDLETON
	SIR G. LITTLER
	MR MORTIMER
	MR CRABBIE
	GOVERNOR B/E

Of course the Belgian government will take the necessary security precautions. In case you wish special security measures to be taken, please do not hesitate to contact my assistant, Mr. J. Keustermans.

I would be grateful if you would forward this practical information to the other members of your delegation. Would you please be so kind to return the enclosed question forms within two weeks.

Looking forward to welcoming you at Knokke, I remain

with best regards,

Mark Eyskens.

PROGRAMME

P R O G R A M

Informal ECOFIN on 3, 4 and 5 April 1987
Knokke, Belgium

(You should arrive at the hotel about 6.30pm)

Friday, April 3, 1987

7 p.m.	:	Reception by the Minister of Finance and Mrs. Eyskens at hotel 'La Réserve'
8.30 - 10.00 p.m.	:	Informal buffet-diner in the restaurant of hotel 'La Réserve'

Saturday, April 4, 1987

8.00 - 8.45 a.m.	:	Breakfast in the restaurant of hotel 'La Réserve'
9.00 - 12.00 a.m.	:	Conference in hotel 'La Réserve'
12.00 - 12.30 p.m.	:	Visit to the wall paintings of Magritte in the Casino of Knokke (Apéritif)
12.30 - 2.30 p.m.	:	Working lunch in the restaurant of hotel 'La Réserve
2.30 - 5.00 p.m.	:	Conference in hotel 'La Réserve'
5.00 - 6.15 p.m.	:	Break
6.15 p.m.	:	Departure for Bruges
7.00 p.m.	:	Arrival in Bruges
7.00 - 8.00 p.m.	:	Concert in the 'Provinciehuis'
8.00 p.m.	:	Dinner in City Hall
10.30 p.m.	:	Departure for hotel 'La Réserve'

You will go straight to the Airport (11.00pm take-off)

Sunday, April 5, 1987

7.30 - 9.00 a.m.	:	Breakfast in the restaurant of hotel 'La Réserve'
8.30 a.m.	:	Catholic service in hotel 'La Réserve'
9.00 a.m.	:	Departure for Bruges
9.40 a.m.	:	Arrival in Bruges
9.40 a.m.	:	Sightseeing
12.30 p.m.	:	Lunch in the 'Groot Seminarie'
14.30 p.m.	:	Departure from Bruges

LADIES PROGRAM

8.00 - 9.15 a.m.	:	Breakfast in the restaurant of hotel 'La Réserve'
9.15 a.m.	:	Departure for Gent
10.15 a.m.	:	Arrival in Gent
10.15 - 1.00 p.m.	:	Visit of Gent (the world famous painting of the Van Eyck Brothers 'the Adoration of the Mystic Lamb', the'Gravensteen' castle, the Guild halls at the 'Graslei' and City Hall
1.00 - 2.30 p.m.	:	Lunch
2.30 - 4.15 p.m.	:	Second part of the visit of Gent as well as a visit to the well-known collection of silverware in the medieval castle of Laarne
4.15 p.m.	:	Departure for hotel 'La Réserve'

****

ANNEX B2: PRELIM'Y REPORT BY CHAIRMAN OF CTTEE OF GOVERNORS

DRAFT
UNOFFICIAL COPY

ANNEX B2

Committee of Governors of the
Central Banks of the Member States
of the European Economic Community

26th March 1987

PRELIMINARY REPORT
BY THE CHAIRMAN OF THE COMMITTEE OF GOVERNORS
ON THE STRENGTHENING OF THE OPERATING MECHANISMS OF THE EMS

Since the ECOFIN Council meeting of 9th February 1987, the Committee of Governors has begun consideration of the issues raised by the last realignment of EMS central rates and of the monetary policy implications of the liberalisation of capital movements within the Community.

A. ISSUES RAISED BY THE LAST REALIGNMENT

The Governors are of the view that, in evaluating the last realignment, account should be taken of the fact that it was largely determined by factors unrelated to economic fundamentals. They also noted that there had been an excessive dramatisation of the event before and during the realignment negotiations.

1. Realignment procedure

The Governors consider that the existing realignment procedure is, in itself, broadly satisfactory and that it provides the flexibility necessary to de-dramatise realignments. Some of the problems experienced in January could be avoided by stricter discipline over public statements and discussions.

The Governors discussed the possibility of entrusting the conduct of "small" realignments to a technical committee: in their view such an approach does not seem to offer any real advantage. Indeed, while recognising that it might allow more timely decisions, thereby limiting the size of capital movements, the Governors consider that such a move would raise a number of problems. In particular:

(i) It would be difficult to identify the type of realignment to be made subject to such a procedure.

(ii) There would be a risk of giving the market the impression that small realignments are of minor importance.

(iii) There would be complications with regard to the agri-monetary implications of these realignment decisions.

The Governors also stressed that all realignments should normally be accompanied by supportive economic policy measures to strengthen convergence.

2. Functioning of the operating mechanisms of the EMS

A number of reasons led the market to reassess the sustainability of intra-EMS exchange rate relationships after the comprehensive realignment of April 1986, despite improved convergence. The weakness of the US dollar had been a major influence in this regard. The impact of external factors was reinforced by political and economic developments in individual EMS countries as well as by some remaining disparities in their economic policies and performances, in a context of progressive liberalisation of capital movements and increasing sophistication of market participants. Markets also had a perception that there was a lack of co-ordination by EEC member states in approaching the emerging tensions. These various factors gave rise to heavy capital movements in the period running up to the realignment.

The Governors agree on the necessity for continued progress towards convergence of economic fundamentals. They stress that the strains that might stem from increased capital mobility should normally be dealt with without resorting to realignments. They recognise that interventions alone cannot be sufficient to counter exchange rate pressures, and that they should be accompanied by measures to make speculation more costly and risky.

To achieve these objectives, various issues are being examined by the Governors. In particular:

(i) how to bring about a more flexible use of all instruments available for defending the system's cohesion in the short term, i.e. more timely adjustments of interest rate differentials; wider use of existing exchange rate margins within the band; and closer co-operation in conducting interventions;

(ii) how to strengthen the monitoring and joint evaluation of short-term developments in the system, with a view to agreeing on prompter and more closely co-ordinated action;

(iii) how to achieve greater co-ordination of exchange rate policies of the EMS countries vis-à-vis the United States and Japan.

B. MONETARY POLICY IMPLICATIONS OF LIBERALISATION

The Committee of Governors has also started to look into the broader implications of global liberalisation of capital movements for monetary policy and exchange rate management. The process of integration of EEC capital markets is already under way, although the points of departure for this process differ from country to country. The Governors reiterate their support for the programme of liberalisation; they stress that while liberalisation will not change the nature of the difficulties of managing the system, it will reinforce the external constraint in exchange and interest rate management.

Liberalisation increases financial interdependence, potentially enlarges short-term capital movements, and entails a reduction in the autonomy of national monetary policies. In principle, it is not possible to combine complete freedom of capital movements and fixed exchange rates with autonomous national monetary policies.

There are also a number of technical problems that need to be examined in this context, relating notably to the effects of liberalisation on:

(i) the identification and management of monetary targets and the transmission mechanism of monetary policy;

(ii) the harmonisation of regulations affecting financial markets (e.g prudential controls, tax treatment of financial assets).

Beyond these technical problems, it is clear that the liberalisation process must be accompanied by closer co-ordination of monetary policies. Otherwise, there is the risk that larger capital movements might entail strains and possibly force a relaxation of the exchange rate mechanism to cope with market pressures.

Strengthened monetary co-ordination must be placed in the context of achieving a maximum degree of domestic price stability and of extending the exchange rate mechanism of the EMS to the other EEC members. Such co-ordination, however, will be ultimately ineffectual if not supported by greater convergence of overall economic developments and policies (especially fiscal policies) in member states and by enhanced efforts to reduce structural disparities.

The Committee of Governors will also examine whether the existing financing mechanisms are adequate to forestall speculation and to meet the likely needs of the system in the new environment of free capital movements.

In conclusion, the Governors underline that their examination of the functioning of the EMS and of the implications of liberalisation is at a preliminary stage. They will keep these issues under active consideration in the coming months.

FAX
FROM

MINISTRY OF FINANCE
Treasury - Brussels

avenue des Arts, 30
1040 Bruxelles

Group III: 02.233.7114
Telex:
Telephone: 02.233.
Fax Operator: 02.233.

To: Mr. N. LAWSON, Chancellor of the Exchequer - LONDON
For the attention of:
Fax n°: 00-44-1-8392082
From: Mr M. EYSKENS, Minister of Finance, BRUSSELS
Total n° of pages: 19 **including this page.**

Date: 26.03.1987

If you have not received all the pages including this cover page or find that any of them are illegible, please call the Fax operator at the above address as soon as possible

Re Briefing

Our memorandum is clearer than the 2nd of these 2 papers. But I am also interested in the statistics of the 2nd of the first.

Dear Colleague,

Please find herewith the President Jacques DELORS-letter and a working paper reflecting the Commission's point of view on strenghtening the E.M.S. and liberalizing movements of capital.

Yours sincerely,

M. EYSKENS
Chairman of the Council.

CH/EXCHEQUER	
REC.	27 MAR 1987
ACTION	Sir G Littler
COPIES TO	EST MST
	Sir P Middleton
	Sir T Burns
	Mr Cassell

Mr Lavelle
Mr H Evans
Mr Peretz
Mr AJC Edwards
Mr C W Kelly Ms H Goodman

COMMISSION
DES COMMUNAUTÉS
EUROPÉENNES

576

Rome le 25 mars 1987

Monsieur le Ministre,

Par lettre du 10 février dernier, vous m'avez indiqué qu'à la suite de l'échange de vues qui eut lieu lors du déjeuner du dernier Conseil ECOFIN, vous souhaitiez disposer d'une note de réflexion de la Commission portant sur le renforcement du SME et sur la libération des mouvements de capitaux.

Vous trouverez ci-joint deux documents de travail qui répondront, je l'espère, à votre attente.

J'envoie copie de cette lettre et des deux notes au Président du Comité des Gouverneurs et au Président du Comité monétaire.

Veuillez agréer, Monsieur le Ministre, l'assurance de ma très haute considération.

Jacques DELORS

Monsieur Mark EYSKENS
Ministre des Finances
12, Rue de la Loi

1000 BRUXELLES

ps3/4K

1. Alex - [illegible]

UNCLASSIFIED

2. 6/F 2/4 (b)

FROM: A W KUCZYS
DATE: 30 March 1987

SIR G LITTLER

cc PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Lavelle
Mr H P Evans
Mr Peretz
Mr A Edwards (o/r)
Mr C Kelly

INFORMAL ECOFIN: 3-5 APRIL 1987

The Chancellor has seen Mr Eyskens' letter of 26 March enclosing Commission papers on strengthening the EMS and on liberalising capital movements. He has commented that our immediate interest is clearly in the second of these papers (liberalising capital movements). But he is also interested in Sections 2 and 4 of the first paper. (Section 2 deals with policy co-ordination and surveillance, and Section 4 with intervention methods.)

AWK

A W KUCZYS

ANNEX A1:
LIBERALISATION OF
CAPITAL MOVEMENTS

3889/025

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INFORMAL ECOFIN 3-5 APRIL

ANNEX A1

LIBERALISATION OF CAPITAL MOVEMENTS

Documents

The main paper is the Commission note to the President of the Council II/112/87-EN (attached). There are also references to this subject in the reports by the Chairmen of the Monetary Committee and of the Central Bank Governors.

UK objectives

(1) To encourage further removal of exchange controls as quickly as possible in those Members States which still have them.

(2) To do this without encouraging the Commission in the belief that it will then be necessary to have a procedure to set up a ring fence against capital movements between the Community and the outside world.

(3) To avoid any adverse Commission reaction to the repeal of the Exchange Control Act.

Points to make

(1) Continued movement towards full liberalisation of capital movements in the Community as quickly as possible is highly desirable.

(2) Important this should cover not just formal arrangements but also informal and other barriers to free flow of transactions across frontiers.

(3) Encouraged by Commission view that full liberalisation should be possible, at least for the majority of Member States, before deadline of 1992 set for completion of internal market.

(4) Agree that full liberalisation of capital movements could increase the danger of speculative capital movements. But do not see that as an argument for ring fencing the Community, rather as helpful pressure for more convergence within Community and greater co-operation, particularly on monetary policy, thus strengthening EMS.

Position of other countries

All Member States are signed up in principle to the idea of full liberalisation. But there are different degrees of enthusiasm. The virtuous, without capital controls, apart from ourselves, are Germany, the Netherlands and, for all important purposes Denmark and Belgium. The French have abolished a major part of their controls in the last eighteen months and the Italians have also made some progress. Both seem to want to do more. Spain has a derogation under their Treaty of Accession, but seems fairly keen to dismantle controls as quickly as possible as part of becoming a more substantial economic power. The Irish (who have a derogation under the safeguard clause), the Greeks (who have a derogation as part of the assistance package agreed under the Community Loan Mechanism) and the Portguese (who have a derogation under their Treaty of Accession) are among the laggards. The Irish, of course, have a special problem because of their relationship to sterling.

Even for the virtuous, or would-be virtuous, there is a substantial difference between agreement in principle and agreement in detail. A number will need considerable encouragement if there is not to be back-sliding, the first signs of which have already become apparent.

Background

The Commission paper is a progress report on the programme initiated by President Delors in May 1986 as part of the completion of the internal market. The first, and relatively modest stage was the capital movements directive agreed last autumn, which came into effect at the end of February. This increased the range of capital

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transactions subject to the liberalisation obligation unless covered by a derogation under the safeguard clauses of the Treaty of Rome or, for Spain and Portugal, by specific derogations under their Treaty of Accession. Discussion of the directive coincided with a considerable relaxation of existing controls in France and, to a lesser extent, Italy. It has gone hand in hand with a toughening of the Commission attiude towards the use of safeguard clauses.

2. The next stage in the programme is a second, more substantial directive intended to complete the progress of liberalisation. The Commission intend to make proposals after the informal ECOFIN in September. What has been happening in the interim has been some mind clearing discussion in the Monetary Committee and in the Committee of Central Bank Governors about the implications.

3. No immediate points for decision arise. The objective of putting the subject on the agenda now is to tell Finance Ministers what has been happening so far and to give the process a further shove.

4. At this stage, what is said in the Commission paper is all fairly generalised. But there are two points of which you should be aware.

5. First, it is clear that, despite lip service to what they call liberalisation "erga omnes", some in the Commission see the need for a procedure by which liberalisation within the Community would be accompanied by a procedure allowing the erection of a ring fence against the outside world in times of difficulty. This is clearly unacceptable, as well as impractical.

6. Second, a particular Commission pre-occupation is with the idea of finding some way of providing financial assistance to the weaker Member States as encouragement to make quicker progress towards capital liberalisation than they would otherwise wish. This is potentially expensive, if use is made of budgetary mechanisms. It ought also to be unnecessary. Nor, if the thought is that dismantling controls makes pressure on exchange rates through capital movements more likely, is it necessarily helpful to encourage

the states concerned to respond by increasing intervention rather than by making interest rate or other adjustments.

7. We do not recommend that you raise the question of the repeal of our own Exchange Control Act unless others do. But it might be courteous to have a brief word about it in the margins with President Delors, who has not yet replied to your letter.* At some stage we will have to tackle the question of amending the 1972 Directive to remove the obligation to maintain statutory powers to re-impose exchange controls. But the right time for that will be when the Commission put forward their own proposals for the revision of the directive.

*copy at end of this section of the folder DWK

AGENDA

AWK to BARBER 30/3

8/F 2/4

ps3/2K

UNCLASSIFIED

FROM: A W KUCZYS
DATE: 30 March 1987

MISS BARBER

cc PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir G Littler
Mr Lavelle
Mr H P Evans

INFORMAL ECOFIN: 3-5 APRIL 1987

The Chancellor has seen Mr Eyskens' telex of 25 March, with the agenda for the discussions on Saturday. The Chancellor has commented that, on Item 1 (liberalisation of capital movements), briefing will need to make clear exactly where each country now stands on this - not just their views, but even more important, what restrictions on capital movements they still impose, and how effective they are.

AWK

A W KUCZYS

GRS 170

Restricted

RESTRICTED
FM UKREP BRUSSELS
TO IMMEDIATE FCO
TELNO 1155
OF 011600Z APRIL 87

Z1

FRAME ECONOMIC/AGRICULTURE

1987 COMMUNITY BUDGET

1. WE UNDERSTAND IN CONFIDENCE (PLEASE PROTECT) THAT DELORS AGREED LAST NIGHT THAT THE COMMISSION SHOULD PROPOSE A SWITCH IN THE NEAR FUTURE FROM ADVANCES TO REIMBURSEMENT FOR FEOGA GUARANTEE SPENDING. DELORS, CHRISTOPHERSEN ANDRIESSEN ALSO APPEAR TO HAVE AGREED THAT SAVINGS FROM THIS CHANGE IN 1987 SHOULD BE LIMITED TO THE AMOUNT NECESSARY TO KEEP FEOGA GUARANTEE SPENDING WITHIN THE 1987 BUDGET PROVISIONS. ANY EXTRA REVENUE (EG TO COVER A SHORTFALL IN TRADITIONAL OWN RESOURCES) WOULD COME FROM AN IGA.

2. SO FAR AS WE KNOW, THE COMMISSION WILL BE ASKED TO ENDORSE THE PLAN TO PROPOSE A SWITCH FROM ADVANCES TO REIMBURSEMENTS AT ITS MEETING ON 8 APRIL.

HANNAY

YYYY
ADVANCE
RENWICK FCO
WALL FCO
LYALL-GRANT FCO
WILLIAMSON CAB
BUDD CAB
MERCER CAB
HADLEY MAFF
DICKINSON MAFF
PERRINS MAFF
LAVELLE TSY
BONNEY TSY
MORTIMER TSY
CRABBIE TSY
DONNELLY TSY
MAIN
FRAME ECONOMIC
FRAME AGRICULTURE

UCLNAN 7649

FRAME ECONOMIC | AGRICULTURE.
ECD (I)

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ADVANCES.

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AGRIMONETARY REFORM

Line to take

1. UK sees urgent need to reform agrimonetary arrangements. 1984 strong currency system has increased CAP prices by some 12.5% by effectively linking them with DM. This creates ratchet effect on expenditure (because of increased scope for green devaluations) and undermines necessary restrictive pricing policy. No reason why farmers should uniquely be isolated from all effects of exchange rates.

2. **(For use with Germans)** Recognise political sensitivities in Germany. But not sensible to insist that German price levels should apply in all Member States. Likely to be massive effect on EC expenditure (to which Germany is the major contributor) and incentive to increase production of surpluses. Surely preferable (and probably cheaper) to accept need for green DM revaluations and, if necessary, offer degressive **national** aids to German farmers.

3. **(For use with French)** Not convinced that Commission proposals go far enough in breaking strong currency link: Fear that "automatic" price cuts will be evaded. Better to **revert** to pre 1984 system (which should happen anyway if Council fails to agree) but with greater automaticity in green **revaluations** (perhaps allowing some degressive aids at national expense).

Background

4. 1984 strong currency system is due to lapse at start of 1987 milk marketing year (i.e. effectively immediately after the 1987 CAP Price Fixing settlement), unless Council decides to renew it. Commission have proposed that system should continue but that effect of artificial MCAs created after each EMS realignment should be offset by staged price

reductions in the two following years. Wide range of views on proposal: outright opposition by Germans who claim that Commission proposals breach 1979 "Gentlemen's agreement" under which no Member State can be forced to revalue its green currency (and thus reduce national farm prices) unless the effect is offset by a common price increase. (The UK was never a party to the "Gentlemen's agreement"). France, Spain and the Netherlands have expressed support for the Commission. Only UK and Greece have so far supported **reversion** to the pre 84 system. Though Belgium and Ireland could accept this as second best.

003

CONFIDENTIAL

FROM: JANET BARBER
DATE: 1 APRIL 1987

1. SIR GEOFFREY LITTLER – seen in draft

2. CHANCELLOR

INFORMAL ECOFIN 3-5 APRIL

You are attending the informal ECOFIN in Belgium this weekend. Sir Geoffrey Littler and Mr Leigh Pemberton will also be there.

2. The meeting itself begins at 9.00am on Saturday. The agenda for the meeting was set out in Mr Eyskens' recent letter (copy attached to this note), and is as follows:

(a) liberalisation of capital movements;
(b) strengthening of the EMS;
(c) preparation for the Washington meetings.

Discussions outside the meeting might cover the following:

(d) Community financing (which you could usefully discuss trilaterally with the French and Germans);
(e) agrimonetary reform;
(f) Spain's membership of G10;
(g) airbus (which you might wish to raise).

Flag A

Liberalisation of capital movements

3. A brief prepared by Mr Kelly is at Annex A1. The main discussion document is likely to be the Commission's note to the President of the Council (which Eyskens has now circulated), attached at Annex A2. Also relevant are the reports on strengthening the EMS from the chairmen of the Monetary Committee and Central Bank Governors Committee - these are at Annex B (see paragraph 6 below).

4. You asked for a note on the restrictions on capital movements still imposed by member states. This is at Annex A3.

5. Our main objectives on this topic are to encourage the further removal of exchange controls (without a ring fence against capital movements between the Community and the rest of the world), and to avoid adverse Commission reaction to our repeal of the Exchange Control Act (perhaps by having a word with Delors in the margins of the meeting).

Flag B

Strengthening the EMS

6. A brief provided by Sir Geoffrey Littler is at Annex B. The relevant documents are:

(1) the report by the chairman of the Monetary Committee (Annex B1).
(2) the report by the chairman of the Central Bank Governors Committee (Annex B2). We have been given a copy of a (probably near final) draft of this report <u>on an unofficial basis</u>, so it should not be referred to until it is officially tabled at the meeting.
(3) the Commission's note to the President of the Council (which Eyskens has now circulated) (Annex B3).
(4) a French paper presented to the Monetary Committee after the last EMS realignment (Annex B4).

7. The papers present a substantial menu of ideas, and the UK objective is to steer in favour of sensible ones and warn off the few unwelcome ones, as guidance for work by the Monetary Committee and Central Bank Governors in the coming months.

Flag C

<u>Preparation for the Washington meetings</u>
8. There is no separate briefing on this - you should refer to the briefing prepared for the meetings themselves. (The steering brief for Washington is at Flag C on this folder; Geoff will have copies of the detailed briefs with him) AJK

9. ECOFIN will have to agree the Presidency Statement to the Interim Committee. A draft is at Annex C1. We have no problems with it, (although it is too long and boring).

10. Otherwise, the meeting will be an opportunity to exchange views on the Washington agendas. We know of no special Belgian (Presidency) objectives. However, at the March ECOFIN lunch, Tietmeyer said that there would need to be a discussion about debt strategy.

11. Other supporting documents attached are:

(1) a table listing the contents of the Washington meetings briefing (Annex C2);
(2) the standard set of statistics for the Community, US and Japan (Annex C3);
(3) the Louvre Communique (Annex C4).

Flag D

<u>Trilateral with the French and Germans on Community financing</u>
12. It would be helpful for you to discuss Community financing with Balladur and Stoltenberg, and indeed during his recent visit, Balladur suggested this. A brief is at Annex D.

13. There may not be very much time at the meeting for private discussions, so, in following up Balladur's suggestion, the main objective is to make the point that there have already been trilateral discussions at official level, and to get agreement that these contacts should be maintained in the run up to the June European Council. In particular, it would be valuable for Balladur and Stoltenberg to endorse the search for techniques to strengthen the hands of the moderates and for the discussions to cover agricultural as well as non-obligatory expenditure.

Flag E

<u>Agrimonetary Reform</u>
14. There is no need for you to raise this issue, but it might

come up in bilateral contacts. A brief for use as necessary is at Annex E, including particular points to make to the French and Germans.

Spain's membership of G10

15. The Spanish minister may raise this, as suggested in his recent telephone conversation with you. (See separate folder)

Airbus

16. It might be helpful for you to raise this. Mr Waller will provide last minute up-to-date briefing ~~separately on this on Friday~~. (in separate folder, enclosed)

Programme for the conference

17. The programme circulated by the Belgians is attached at Annex F.

Personality note

18. Attached is a note on the new Irish finance minister, Mr Raymond MacSharry. (Worth a glance!)

19 Copies of this briefing go to those on the attached list.

Janet Barber

JANET BARBER
EC1

CIRCULATION

Chancellor
PS/Chancellor
Sir Geoffrey Littler
Mr Lavelle
Mr Culpin
The Governor, B/E
Mr C Budd, Cabinet Office
Mr J S Wall, FCO
Mr D Bostock, UKREP (2 copies)

Steering brief only

PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Mr P Cropper
Mr Scholar
Mr Mortimer
Mr C W Kelly
Mr Crabbie
Mr Matthews
Mr Walsh
Mr Waller
Mr Dolphin
Mr Sheridan
Miss Simpson
Mr Donnelly
Mr J Kirby - B/E
Mr Garside - Paris
Mr A C Thorpe - Bonn
Mr T P Lankester - Washington
Miss C Elmes - Rome

FROM: A W KUCZYS
DATE: 2 April 1987

CHANCELLOR

cc Mrs Lawson
Sir G Littler
Mrs Lester

TRAVEL ARRANGEMENTS THIS WEEKEND

Friday, 3 April

Cindy will drive you direct from St Albans to Northolt, where you will meet up with Sir G Littler, the Governor and Mrs Leigh-Pemberton. Your RAF flight number is ASCOT 1422, and you are due to take-off at 4.15 pm. You should land at Ostend Airport at 6.00 pm local time, where the Belgians will have cars waiting to take you to the hotel.

Saturday, 4 April

2. After dinner, the Belgians will provide cars to take you back to Ostend Airport. If you get away promptly, you should be able to take off about 11.00 pm local time, landing at 10.30 pm British time at Manston, Kent. There will be Government cars waiting to take Geoff back to London, and you to Hythe.* (It is about 30 miles, and you should allow for a drive of about 45 minutes). So the earliest you could arrive at Hythe is 11.15 pm, and it could well be getting on for midnight.

Sunday, 5 April

3. A Government car will pick you up from the hotel at 3.00 pm to take you back to No.11.

Money, etc.

4. Because you are the guest of a foreign government, you are apparently entitled to only a minimal amount of subsistence:

*and the Governor's car for him and Mrs L-P.

in envelope inside front of folder

BFR 400, which is about £6.75. This is enclosed. If you have any Belgian money from previous trips, you may want to take that with you as well. I also enclose the Customs leaflet on what you are entitled to bring back into the country. But you will not have much opportunity for shopping, and you will not be going through a Duty Free Shop, so this is probably unnecessary.

5. You should not need your passport, but it is advisable to have it with you just in case.

AWK

A W KUCZYS

CA/028

UNCLASSIFIED

FROM: A W KUCZYS
DATE: 25 June 1987

MR DYER

cc: Mr Lavelle
Mr A Edwards
Mr Crabbie
Mr Mortimer
Mr Bonney
Mr Kelly
Miss Barber
Mr Donnelly
Mr Neilson
Miss Wright

ECOFIN/JOINT COUNCIL 15 JUNE

The Chancellor has approved the draft arranged PQ attached to Miss Barber's minute of 24 June, with some small amendments (see copy attached). As you will know from Miss Barber's note, the question should be put down today for answer tomorrow.

AWK

A W KUCZYS

ECOFIN ARRANGED PQ

No.........To ask the Chancellor of the Exchequer if he will make a statement on the European Community's Economic and Finance Council's meeting, and its joint meeting with the Agriculture Council, in Luxembourg on 15 June.

DRAFT REPLY

~~These meetings were held in Luxembourg.~~ The United Kingdom was represented at the joint Council by myself and my Rt Hon Friend the Minister of Agriculture HM. I then attended the July part of the Economic and Finance Council, and ~~our~~ Permanent Representative to the European Communities represented the UK thereafter.

The joint Council discussed the Community's budgetary situation and this year's agricultural price fixing exercise. We stressed the need for the price fixing to make significant contributions to reducing the expenditure overruns anticipated for this year and next, and, more generally, to move the Community towards a more market oriented agriculture policy. We reiterated our firm opposition to the Commission's proposal for an oils and fats tax. We argued that the Community's arrangements for handling the agricultural consequences of currency realignments must be radically reformed and that the switch proposed by the Commission from advances to reimbursement of agricultural guarantee expenditure would be an essential element in solving the Community's budgetary problems in the current year. Discussion of these issues continues in the individual Councils.

The Economic and Finance Council formally adopted the reference framework for the 1988 Community budget on the basis of the common position reached at its meeting on 11 May.

The Council heard progress reports on the work being carried out by the Monetary Committee and the Committee of EC Central Bank Governors on strengthening the European Monetary System.

The Council discussed draft directives on credit and suretyship insurance, and mutual recognition of listing particulars to be issued when securities are admitted to official stock exchange listings. Both directives were referred to later Councils for further consideration.

The Council considered the Commission's formal report on the financial effects for Spain and Portugal of the Council's decision to delay reimbursement to member states of losses incurred on the disposal of butter stocks. The Council asked permanent representatives to examine the report in preparation for a substantive discussion at its July meeting.

The Council met a delegation from the European Parliament to discuss some technical amendments to a Community own resources Regulation, on which the Council had previously reached a common position. Significant progress was made towards agreement.

FT4.70

RESTRICTED

FROM: A W KUCZYS
DATE: 1 July 1987

PP

MR LAVELLE

cc PS/Paymaster General
Sir G Littler
Mr Scholar
Mr A Edwards
Mr Mortimer
Mr Crabbie
Mr Romanski
PS/Customs and Excise

INDIRECT TAX APPROXIMATION

... The Chancellor has seen the attached telegram from UKREP Brussels. He has particularly noted that Lord Cockfield wishes to make a political presentation to ECOFIN on 13 July, but wants to avoid any reaction from the Council. The Chancellor has commented:

"Impossible - or at least highly improbable".

A W KUCZYS

4. THE FULL COMMISSION WILL DISCUSS THE PRESENTATION OF THE PACKAGE TO THE COUNCIL - LORD COCKFIELD'S DRAFT COMMUNICATION PROVOKED SEVERAL ADVERSE COMMENTS. DISCUSSION WILL ALSO DEAL WITH THE QUESTION OF DEROGATIONS AND WHETHER A PRECISE TIMETABLE SHOULD BE LAID DOWN FOR IMPLEMENTING THE PROPOSALS BETWEEN NOW AND THE END OF 1992.

5. THE COCKFIELED CABINET ARE NOT SURE WHETHER IT WILL BE POSSIBLE TO SEND THE PACKAGE TO THE COMMISSION ON 1 JULY. A FAIR AMOUNT OF FOLLOW UP WORK IS REQUIRED, AND THE AGENDA FOR 1 JULY IS ALREADY PRETTY FULL. A FIRST DISCUSSION ON 8 JULY MAY THEREFORE BE MORE LIKELY. THE CLINTON DAVIS CABINET ARE EXPECTING A SECOND DISCUSSION BY CHEFS, BUT THE COCKFIELDS SAY THAT LORD COCKFIELD STILL WISHES TO MAKE A POLITICAL PRESENTATION OF THE PROPOSALS TO THE ECOFIN COUNCIL ON 13 JULY. HE WOULD NOT BE LOOKING FOR ANY REACTION FROM THE COUNCIL, INDEED HE WISHES TO AVOID IMMEDIATE NEGATIVE RESPONSES.

HANNAY

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WILMOTT C/E
LOUGHEAD DTI
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INDIRECT TAX APPROXIMATION: MEETING OF CHEFS ON 26 JUNE 1987

SUMMARY

1. DISCUSSION COMPLETED. MANY INDIVIDUAL RESERVES. TO THE FULL COMMISSION ON EITHER 1 JULY OR 8 JULY. LORD COCKFIELD STILL WISHES TO MAKE A POLITICAL PRESENTATION TO THE ECOFIN COUNCIL ON 13 JULY, BUT WOULD NOT BE LOOKING FOR ANY REACTION FROM THE COUNCIL.

Impossible – or at least highly improbable. N.

DETAIL

2. ON 26 JUNE CHEFS DE CABINET EXAMINED THE WHOLE PACKAGE OF DRAFT TAX APPROXIMATION PROPOSALS. DISCUSSION LASTED FOR MORE THAN 12 HOURS. WE HAVE BEEN TOLD IN CONFIDENCE THAT MANY INDIVIDUAL RESERVES WERE ENTERED, THE MAIN ONES COMING FROM THE FOLLOWING CABINETS:

(I) CLINTON DAVIS - FORMAL RESERVE (WHICH WILL BE MAINTAINED IN COMMISSION) ON FAILURE TO PROVIDE DEROGATION FOR ZERO RATES - NO SUPPORT FROM OTHER CABINETS:
- FURTHER STUDY NEEDED OF EFFECTS OF MINERAL OIL PROPOSALS ON TRANSPORT POLICY:

(II) RIPADI MEANA - THE RATE OF VAT ON BOOKS AND PERIODICALS SHOULD BE LOWER THAN 4 PER CENT (BUT NOT ZERO):

(III) CHEYSON - CONCERNED ABOUT WIDER EFFECTS OF MINERAL OIL PROPOSALS ON COMPETITION AND SUBSTITUTION POLICY (BUT DG XVII ARE SAID TO BE CONTENT):

(IV) ANDRIESSEN - PREFER A SPECIFIC TAX (NOT AD VALOREM) ON ''ROLL-YOUR-OWN'' TOBACCO, AND CONCERNED ABOUT EFFECT ON CIGARS:
- FURTHER STUDY NEEDED OF WINE/BEER TAX RELATIONSHIP:

(V) MARIN - DENMARK SHOULD BE ALLOWED TO MAINTAIN CURRENT HIGH LEVEL OF TAXATION OF CIGARETTES (HEALTH POLICY):

(VI) DELORS - PROPOSALS NOT COMPLETE BECAUSE DO NOT COVER ''OTHER INDIRECT TAXES'' MENTIONED IN ARTICLE 99 OF TREATY. (COMMENT: THIS IS THOUGHT TO BE A REFERENCE TO CAR REGISTRATION TAXES AND POSSIBLY A TAX ON FINANCIAL SERVICES.)

3. THE SPANISH, PORTUGUESE AND GREEK CABINETS ALL FELT THAT THE PACKAGE DID NOT TAKE SUFFICIENT ACCOUNT OF THE REQUIREMENT TO STRENGTHEN THE COMMUNITY'S ECONOMIC COHESION. THEY WILL PROBABLY RETURN TO THIS THEME IN COMMISSION. THE DANISH AND IRISH COMMISSIONERS WILL ALSO REITERATE THE SERIOUS PROBLEMS WHICH THEY WOULD FACE IF THE PROPOSALS WERE IMPLEMENTED.

(C) AT SOME POINT LORD COCKFIELD IS LIKELY TO MAKE STATEMENT ON HIS INDIRECT TAX APPROXIMATION PACKAGE - WITHOUT ANY ENSUING DEBATE. THIS WILL BE CONFIRMED NEXT WEEK.

4. BUTTER STOCK DISPOSALS. ESPER LARSEN SAID COREPER (DEPUTIES) WOULD DO ALL THE PREPARATORY WORK ON 8 JULY ON THE BASIS OF THE COMMISSION'S NEW PAPER (7124/87) AND A FORTHCOMING AGRIFIN MEETING (DATE NOT YET ANNOUNCED).

5. SECOND QUARTERLY ECONOMIC REVIEW. PREPARATORY WORK ON COMMISSION'S REPORT COM(87)297 TO BE CARRIED OUT BY COORDINATING GROUP ON 6 JULY.

6. UK'S VAT DEROGATION REQUEST. ESPER LARSEN CONFIRMED INCLUSION TO THIS ITEM IN LINE WITH FRENCH WISHES. COREPER (DEPUTIES) WILL HAVE PRIOR DISCUSSION ON THIS ALSO ON 8 JULY. I STRESSED THE IMPORTANCE THE UK ATTACHED TO THE MATTER. CASH ACCOUNTING FOR SMES WAS ONE OF THE BUDGET PROPOSALS PRESENTED TO PARLIAMENT IN MARCH. SHOULD THERE BE AN AGREEMENT, THE COUNCIL THEREFORE HAD TO BE IN A POSITION TO EXPEDITE THIS WITHOUT DELAY, OTHERWISE THE UK GOVERNMENT'S TIMETABLE WOULD BE JEOPARDISED. ESPER LARSEN TOOK NOTE.

7. INFORMAL ECOFIN IN SEPTEMBER. THE PRESIDENCY'S INTENTION IS TO MAKE A STATEMENT OVER LUNCH ON ITS IDEAS FOR THE AGENDA. NO DETAILED DISCUSSION IS EXPECTED. STRENGTHENING OF THE EMS AND PREPARATIONS FOR THE IMF AGM WERE CITED AS LIKELY TOPICS.

HANNAY

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ADVANCE
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LYALL-GRANT FCO
KERR FCO
WILLIAMSON CAB
BUDD CAB
MERCER CAB
B H KNOX C/E
COCKERELL C/E
HOWARD C/E
HADLEY MAFF
DICKINSON MAFF
PERRINS MAFF
THOMAS MAFF
PS/CHANCELLOR TSY
[illegible] TSY

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CABINET OFFICE	D T I	HM CUSTOMS & EXCISE
MR D WILLIAMSON MR JH HOLROYD MR MERCER MR CR BUDD	IMMEDIATE	MR P KENT N BH ~~KNOX~~ N COCKHEEN N HOWARD

H M TREASURY	M A F F	
PS/ CHANCELLOR SIR GEOFFREY LITTLER MR J E MORTIMER MR C D CRABBIE MR R G LAVELLE N EDWARDS N BONNEY N BARBER	PERMANENT SECRETARY N HADLEY N DICKINSON N PERRINS N THOMAS	N KIRBY B/E

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FRAME ECONOMIC

COREPER (AMBASSADORS): 2 JULY

PREPARATION FOR 13 JULY ECOFIN

SUMMARY

1. AGENDA AGREED. NO FU[illegible] DISCUSSION NEXT WEEK.

2. COREPER (DEPU[illegible]) TO PREPARE FOR BUTTER STOCKS AND UK'S VAT DEROGATION REQUEST.

DETAIL

3. ESPER LARSEN (PRESIDENCY) CONFIRMED THE AGENDA TIMETABLE AS FOLLOWS:-

(A) 1300 LUNCH, DURING WHICH THERE WILL BE A PRELIMINARY DISCUSSION ON COMMISSION'S SECOND QUARTERLY ECONOMIC REVIEW AND THE PRESIDENCY WILL STATE ITS INTENTIONS FOR INFORMAL ECOFIN AGENDA IN SEPTEMBER.

(B) 1500 FORMAL ECOFIN TO DISCUSS BUTTER STOCK DISPOSALS, SECOND QUARTERLY ECONOMIC REVIEW AND UK'S VAT DEROGATION REQUEST.

(C) AT SOME POINT LORD COCKFIELD IS LIKELY TO MAKE STATEMENT ON HIS

CP

Ch

Robert is unhappy about this, & may take the opportunity on the journey to/from lunch to try & persuade you that he does not need to come to Brussels!

JK

Overtaken!

Pickford's wife is about to have a baby, so Robert suggests Nick Towers comes with us.

Julie has provisionally booked seats on the flights mentioned, together with a later return flight as a fallback.

AWK
6/7

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

OK – since Robin Butler might come with us this time.
N.

<u>Ch</u>

Unfortunately, the RAF are fully booked next Monday. There are, however, reasonably convenient scheduled flights. Outward, we cd leave Heathrow at 10.05 arr Brussels at 12.05 (so we wd get to the building c. 12.30, with time for a short briefing before lunch). For the return, if we cd get away about 6.00 pm, there is a flight at 6.55 pm (arr. Heathrow 6.55 pm). Roger Lavelle will accompany you, with support from Customs' officials. Stephen

PTO

28

FROM: JANET BARBER
DATE: 2 JULY 1987

MR WILMOTT C&E
MR SAVAGE
MRS IMBER
MR CRASKE C&E
MR CRABTREE ODA

cc PS/Chancellor
PS/PMG
Mr Lavelle
Mr Edwards
Mr Mortimer
Mr Crabbie
Mr Bonney
Mr Matthews
Ms Sinclair
Mr Donnelly
Mr Evans
Ms Life
Ms Mould
Miss Wright
Mr Thomson - UKREP

Ch
Presumably you will now go? If so, I will book an RAF 'plane.
AWK 3/7

Yes.

ECOFIN 13 JULY

The next EC Economics and Finance Council is on 13 July in Brussels. It will begin with lunch at 13.00, and the formal Council will start at 15.00. it is not known which Minister will attend, but probably either the Chancellor or the Paymaster General.

2. The provisional agenda is as follows (see UKREP telno 2307 of 2 July):

<u>at lunch</u>

(a) second quarterly review of the economic situation - general remarks;
(b) preparation for the informal ECOFIN in September;

<u>in the formal Council</u>
(c) butter stock disposals;
(d) continuation of discussion on second quarterly review;
(e) UK's request for derogation under 6th VAT Directive (cash accounting);
(f) indirect tax approximation - statement by Lord Cockfield;

<u>in the margins</u>
(g) Inter American Development Bank - location of next annual meeting.

I would be grateful if briefs could be provided as follows: Mr Savage, a single brief to cover (a) and (d), plus the usual economic statistics covering the EC, US and Japan; Mrs Imber on (c); Mr Craske on (e); and Mr Wilmott on (f) (taking account of Mr Kuczys note of 1 July - copy attached for Mr Wilmott). Mr Crabtree has kindly offered a brief on (g).

3. Briefs should follow the standard format (attached) and should as far as possible reach Mr Mortimer (room 18/G) by close on

Wednesday 8 July, with any attachments. After 3 July, any queries or updates about the briefing should be raised with Mr Mortimer (270-4709). Please could anyone planning to attend the ECOFIN let Mr Mortimer know.

4. Many thanks for your help.

Janet Barber

JANET BARBER
EC1
HM TREASURY

ANNEX B

ECOFIN BRIEFING: STRUCTURE OF BRIEFS

General note: be as brief as possible, and try to get objectives and line to take/point to make on first page.

UK OBJECTIVES

These should be stated in a short paragraph. It should be made clear whether the Minister is required to intervene, or whether he will just be participating in a general discussion.

POINTS TO MAKE/LINE TO TAKE

(i) Line to take is appropriate when a proposal is being discussed, and when the Minister is asked to intervene.

(ii) Points to make are for discussion documents where no operational decisions will be reached.

(iii) Line to take/points to make should not include editorial comment except where absolutely essential and square bracketed; they should be set out in skeleton speaking note form, so that the Minister can read from them without further editing.

(iv) Points to make should be interesting i.e not only simple restatements of UK policy where that is well known. It should be remembered that a Minister is limited in the number of points he can make e.g three.

(v) Short Q/A defensive material should be included only if necessary e.g where the Minister will have to argue out a particular point.

BACKGROUND NOTE

Where possible, this should be confined to two sides.

BRIEF

ECOFIN, MARCH 12

SUBJECT

Relevant document:

UK objectives
[If any]

Line to take/Points to make

Defensive briefing
[if necessary]

Background.

1988 EC BUDGET + FRAME
D

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ANNEX D

INFORMAL ECOFIN, 11-13 SEPTEMBER 3/7/87.

SUBJECT: 1988 Community Budget and Reference Framework

Relevant documents: Paymaster General's minute to the Prime Minister, 27 July, 1987;
(all attached)
Prime Minister's minute to the Paymaster General, 28 July, 1987.
PS/Paymaster General's letter of 31 July, 1987 to PS/Prime Minister.

UK objective:
To avoid prejudging or prejudicing the outcome of the future financing negotiations.

Points to make: (only if the issue is raised)
The Budget Council cannot legally vote for a budget beyond the 1.4% VAT ceiling, unless there is unanimous agreement to raise the ceiling (which there is not). It should be possible to deal with the problem of the 1988 budget quickly if agreement on future financing is reached. Effective budget discipline and progress on CAP reform remain essential pre-conditions for UK agreement to any increase in Own Resources. It is premature to seek to change the 1988 reference framework before decisions have been taken in the future financing negotiations.

D

Background:
At the July ECOFIN lunch, Christophersen, for the Commission, asked how the Budget Council could set a budget for 1988 constrained by the Council's unrealistic reference framework for agricultural market support. It was agreed that the informal ECOFIN might discuss this matter further. The reference framework for 1988 is 36.6 becu, with 22.8 becu allocated for agricultural spending, but the current forecast of actual agricultural spending in 1988 is 30 becu. However, any increase in the guideline towards this figure

UNCLASSIFIED

would undermine the integrity of the guideline methodology. It would also cause the 1.4% VAT ceiling to be breached, and would inevitably compromise our position in the future financing negotiations, that there can be no increase in Own Resources until progress is made on CAP reform and budget discipline.

3. The July Budget Council, which met after the July ECOFIN, failed to agree a draft Community budget for 1988 because most Member States would not accept a budget within the 1.4% VAT ceiling and the UK, Germany and the Netherlands would not accept one which exceeded it . The Council Legal Service confirmed that the Council could not legally put forward a draft budget which exceeded the Own Resources decision unless there was unanimous agreement by Member States that the extra resources would be provided. Since the legal position is now reasonably secure, and the matter will in any case be discussed again in the Budget Council on 17 September, there is no need to intervene unless the issue is raised by others.

4. If it is necessary to address Christophersen's point, you can say that it should be possible to deal rapidly with the problems of 1988 if agreement is reached in the future financing negotiations. The UK has indicated informally that we would consider a minutes statement to this effect. There has since then been correspondence on this point between the Paymaster General and the Prime Minister. It is important that any statement that is made is not of such a kind as to prejudice the future financing negotiations, and we would have to consider carefully any proposals for a statement.

5. Another point which may be raised is the agreement of the May ECOFIN that it might be necessary to invoke the exceptional circumstances clause to deal with the budgetary problems of 1988. But this agreement was made before the June European Council agreed to consider future financing at the Copenhagen summit. Any decision on exceptional circumstances would also involve exceeding the 1.4% VAT ceiling, and we cannot agree to this in advance of the wider discussions on future financing.

COMMISSION OF THE EUROPEAN COMMUNITIES

COM(87) 297 final

Brussells, 3 July 1987

The economic outlook for 1988 and budgetary policy in the Member States

(Communication of the Commission in accordance with Article 3 of the Council Decision of 18 February 1974 on convergence)

COM(87) 297 final

FOREWORD

The Commission presents this Communication in accordance with Article 3 of the convergence decision[1].

In accordance with the thoughts presented by the Commission in the second part of its Communication of 26 February 1987, the present document is more detailed than in the past. This should ease the burden on the Annual Economic Report and facilitate the work of European Parliament and the Economic and Social Committee in the context of the preparation of their opinions in the autumn. In addition the Commission will enter into a debate with the social partners on the analysis of economic policy presented in this Communication. With a view to an effective coordination of economic and budgetary policy it is, moreover, crucial that the guidelines proposed here from the Community interest, as well as the possible conclusions of the Council, should be taken into account in national debates on economic and budgetary policy, as well as the preparation of national budgets for 1988.

As foreseen in the 1986/87 Annual Economic Report, this Communication includes an intermediate review of the application of the cooperative growth strategy for more employment. The discussion of this review could be the occasion for the Council (Economic and Financial Affairs) to reply to the invitation which was addressed to it in June 1986 by the Hague European Council.

---

[1] Council Decision on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community, of 18 February 1974 (74/120/EEC)

The economic outlook for 1988 and budgetary policy in the Member States

Contents

As a result of the rise in profitability, the relationship between the return on fixed capital and long-term real interest rates has shifted markedly in favour of productive investment, even though real interest rates still remain at a relatively high level.

Monetary policy has underpinned the stabilization process and has made available - particularly in recent years - sufficient liquidity to finance real growth. It has been supported in its stabilization task by coordination within the EMS, by the rapid adaptation of the nominal wage trend to falling inflation and by declining import prices. The Community has now achieved a degree of price stability which has not been seen for two decades. The convergence of price trends within the EMS has improved markedly.

Since 1985, exchange-rate movements have largely been responsible for a very substantial loss in the Community's cost competitiveness compared with its most important industrialized trading partners. This development increases the need for structural change, more especially since European industry has for years been losing market share, particularly in those sectors in which world demand is growing most strongly. Full use of the potential arising from the creation of the European internal market, as well as greater efforts in the field of research and development, are increasingly necessary.

Faced with a high and increasing debt burden, budgetary policy in the Community has been directed in past years towards reducing public deficits. As a result of the - sometimes painful - efforts made, successes have been achieved, although they are still insufficient in a number of countries. Despite marked progress in a few countries, the efforts made to improve the conditions of supply and demand through public finance policy have also shown only limited progress on average in the Community: the burden of taxation is scarcely showing any reduction and the share of public investment in GDP remains at a low level.

The social dialogue at Community level has developed well. The basic principles of the Community strategy have been endorsed and agreement has been reached on many important aspects of the economic and social problems arising out of the introduction of new technologies. Joint opinions to that effect given by the social partners were confirmed in the presence of the Commission and Council presidents on 7 May 1987. While, at national level, a social dialogue takes place in one form or another in all member countries, it is frequently restricted too much to specific points. In view of the increasingly difficult economic situation, it is even more important for the social dialogue to cover all major themes of the Community strategy.

The available data and forecasts up to 1988 still show no significant catching up by the less favoured countries and regions. If progress is to made in the medium-term in this area which is important for economic and social cohesion, it is important that growth in the Community should become more dynamic, that the conditions for growth in the regions concerned should become markedly more favourable, and that the Community itself should resolutely make its own contribution by tailoring and by developing its common policies, its structural funds and other financing instruments.

1. Summary and conclusions

1.1 Outlook and risks

The slowdown in growth in the Community is now confirmed. In 1987 and probably in 1988 too, gross domestic product in the Community is unlikely to increase by much more than 2% p.a. Unemployment remains at around 12%. Even if the growth rate were to pick up to 2 1/2% a year, this would not improve the entirely unsatisfactory employment outlook. The slowdown is due primarily to a less favourable international environment. The dollar's depreciation has been greater and world trade is growing more weakly than expected last autumn. The marked weakening in exports since 1986 has quickly been reflected in an appreciable reduction in the rate of growth of investment in equipment. This unfavourable trend for growth potential and employment seems set to continue in 1987 and 1988. Under these circumstances, growth in the Community is being underpinned mainly by private consumption, although its high growth rate in 1986 will gradually diminish in 1987 and 1988.

The outlook for growth and employment which is already not very favourable could deteriorate significantly if there is an additional depreciation of the dollar combined with further interest-rate rises in the United States; in addition, there is the risk of an intensification in protectionist tendencies, the problems of the seriously indebted developing countries may increase and the expansion of world trade may decelerate further.

There is broad agreement at the interntional level on this analysis and on the risks which exist. The international meetings of the past months have developed a cooperative approach to face up to them. It is important that the Community contributes here according to its means. This is in its own interest so that the priority objective of a progressive reduction in unemployment can be pursued. The slowdown in growth does not call into question the Community strategy. Indeed, it is now a question of implementing it fully and resolutely, having due regard for the changed external conditions.

1.2 Interim assessment of the cooperative growth strategy for more employment.

Considerable efforts have been made in all member countries to improve the adaptability of markets. A number of indicators show that supply conditions have improved. Compared with the 1960s and 1970s, growth has become markedly more employment-creating. The profitability of fixed capital increased sharply between 1982 and 1986. The main factors contributing to this improvement, which could however mark time in 1987 and 1988, have been the higher level of capacity utilization and the fact that real wage increases have lagged behind productivity growth for several years.

The guidelines set out for budgetary policy in the last Annual Economic Report remain broadly valid. In view of the deceleration in growth, however, they should be more speedily implemented, as provided for in point 3.3 of the last Annual Economic Report in such an eventuality. Under present circumstances, it is essential for the moderate rise in real wages, which is still necessary, to be supplemented by tax reductions and public investment (including wholly or partly privately financed infrastructure projects). It is only thus that the necessary combination of greater investment activity and an appropriate rise in private consumption will be achieved. The more dynamic growth, induced by domestic forces which would thereby come about, would also pave the way for further progress towards the medium-term consolidation of public finances, which remains necessary, but is made more difficult by weaker growth.

However obvious this approach may appear for the Community as a whole, it is difficult to implement it in practice in individual member countries. Admittedly, a number of countries have already taken steps in this direction on their own initiative or as a result of international meetings. However, there appears to be relatively little or no scope for additional measures if each Community country is analysed individually. If it were possible, however, to achieve stronger growth in the Community through closer cooperation on public finances in the framework of the Community strategy, the budgetary room for manoeuvre at national level would increase appreciably.

The public finance situation appears to be more favourable in five Community countries (Denmark, Germany, France, Luxembourg and the United Kingdom). In France and Germany, however, the deceleration in growth is already making the tax reductions planned in those countries more difficult. Furthermore, given the present forecasts for intra-Community trade, an acceleration in domestic demand in Denmark, France and the United Kingdom too would threaten their payments balances. However, if each of those five countries could, in the context of joint action, count on stronger growth in its partners, it would be possible for them to improve their own prospects for growth more quickly and thus contribute to a faster growth in Europe. Thus a continuation in the reduction of budget deficits which remains necessary in the other member countries would be facilitated. Of those countries, three (namely Spain, Italy and Portugal) are currently making a considerable contribution to Community growth. A more dynamic environment in the Community would reduce the danger that these countries will have to curb their growth in order to maintain external balance, which would in turn have negative consequences for their partner countries.

Given the improved consensus concerning the broad lines of economic policy both between member countries and between the social partners, the progress made towards price stability and improved supply conditions should make it possible in budgetary policy also to use the Community dimension to reinforce growth. If clear progress towards reducing unemployment is not made in the foreseeable future, there is a danger that the consensus reached concerning economic policy may again be called into question.

1.3 Economic policy guidelines

In 1984 and 1985, demand growth in the Community was largely export-led. In 1986, domestic demand picked up sharply, mainly because of improved terms of trade. Such favourable external influences can no longer be anticipated.

Applying the Community strategy in these conditions means that efforts must continue to be made to improve the adaptability of markets and the profitability and competitiveness of firms; but at the same time, greater priority must be given to strengthening internal demand.

The guidelines worked out at the international meetings held in recent months and which were confirmed and made more explicit at Venice in June remain fully valid. The prime task is to stabilize the exchange rates of the major international reserve currencies at roughly their current levels. This is not only a task for monetary policy but one which must also be underpinned, at a sufficient level of world activity, by a wider growth differential between Europe and Japan on the one hand and the United States on the other. The new method of multilateral surveillance should reinforce this type of international coordination.

However, the growth sought must be lasting. This rules out an ill-considered stimulation of demand, which would undermine the progress made towards stabilization. The strengthening of internal demand must therefore be accompanied by a sharp growth in investment, which at one and the same time reinforces growth potential and constitutes an important component of internal demand. The carrying out of major Community projects can itself make an important contribution here. In this respect, the first point to be mentioned is the completion of the internal market which should be accelerated. If the realization of the European internal market is regarded as irreversible, firms will quickly adjust to this in their investment plans. Further progress in this direction will be made by the carrying out of major infrastructure projects of European interest and a strengthened and targeted role for the Community's structural funds and other financing instruments.

However, these positive contributions of the Community dimension can only have their full effect if the economic policies of the Member States are adapted to the new conditions.

The scope for actively stimulating growth by monetary policy means must be regarded as largely exhausted. Already a number of central banks have had to tolerate large overruns of their money supply targets. An excessively sharp and uncontrolled expansion of liquidity could well create new inflationary expectations and dash hopes of any further fall in long-term interest rates. Furthermore, the last phase of the liberalization of capital movements, which is to begin shortly, constitutes a particular challenge for the EMS, the strengthening of which remains a further important task. In this context, increased surveillance of economic indicators could allow an improvement in economic and monetary policy coordination.

(goods and services 1986: 1.7%; 1987: 2.1% and 1988: 3.4%) will therefore essentially be due to intra-Community exports.

The slowdown in exports since 1986 has worked through rapidly into investment in equipment, the sharp pick up in which, between 1983 (2.1%) and 1985 (9.2%) had already been interrupted in 1986, and is unlikely, in either 1987 (5.3%) or 1988 (4.6%), to achieve the momentum required to lift the Community on to a satisfactory path of growth and job creation. In these circumstances, the main support for domestic demand is provided by private consumption which represents over 61% of the Community's GDP. The increase in consumption was sharply stimulated in 1986 (3.7%) by increases in disposable income resulting from the improvement in the terms of trade. These effects are fading in 1987 and will disappear in 1988 so that the growth of private consumption will probably slow down in 1987 (3.1%) and in 1988 (2.8%), but it should still be underpinned by an appreciable increase in real per capita wages (1987: 2.4% and 1988: 1.7%), by a slight dip in the household savings ratio and, to some extent, by tax cuts made in various member countries.

The outlook described above relies on two important assumptions:

- Within the Community, it assumes a return to a growth rate of about 2.5% p.a. driven essentially by domestic demand. This assumption could turn out to be rather optimistic. The dampening effects from lower exports to third countries, working with cumulative effect from country to country, could exert an additional adverse influence on the economic climate within the Community.

- Outside the Community, it assumes that the process of international adjustment takes place against a background of indifferent growth and is spread over a relatively long period, but with no major upsets. This assumption involves considerable risks. If - after the dollar's sharp devaluation - interest rate differentials and, even more importantly, lags in the growth of domestic demand, between the United States on the

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2. Economic situation and outlook

The slowdown in growth in the Community which the Commission announced in its March Communication to the Council (Economic and Financial Affairs) is being confirmed. Instead of 2.8% - as forecast in October 1986 - the Community's GDP growth rate for 1987 is now put at 2.2%; for 1988 no significant improvement seems to be in sight. Average inflation should remain low (1987: 3.2% and 1988: 3.3%) and the Community's current account surplus should fall away gradually (from 1.1% of GDP in 1986 to 0.4% of GDP in 1988). The increase in employment is expected to slow from 0.8% in 1986 to 0.5% in 1988 which is just enough to stabilize the average unemployment rate of the Community of Twelve at a level of around 12%. Even if the forecasts - at the present time - show no cumulative process towards a recession, this outlook is entirely unsatisfactory, especially since the medium term projections - assuming unchanged policies and behaviour - still indicate continuing low growth, an insufficient increase in employment and an average unemployment rate for the Twelve which is still above 10% in 1991.

Growth prospects for 1987 and 1988 have been revised downward chiefly because of the more unfavourable international environment. The dollar's average devaluation against the ECU between 1986 and 1987 is now forecast at 13.5%. It is proving thus sharper than forecast in October 1986. The growth of world trade (non-weighted world imports, excluding the Community) should slow from 3.6% in 1986 to 2.5% in 1987 but some upturn is assumed in 1988 (3.8%); given the geographical pattern of its exports, the Community's export markets are likely to develop even more unfavourably (1987: 0.8% and 1988: 2.9%); with the loss of competitiveness of European products, this should lead to a decline in the volume of the Community's exports to third countries: the volume increase forecast for total member country exports

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3.1. The key variables

3.1.1. Supply conditions

Although it is difficult to describe the improvement in supply conditions and the adaptability of markets with simple macroeconomic indicators, there are clear signs that considerable progress has been made.

The employment content of growth has increased: during the 1960s, an annual average growth rate of 4.8% was required to increase employment by 0.2%; over the period 1984-86, half that growth rate (2.4% a year) produced twice as large an increase in employment (0.4% a year), and the relationship seems to be improving even further. It is true, however, that this improvement is also partly due to the development of part-time employment. In these conditions, a certain increase in the growth rate - to 3% or 3.5% a year, if this were possible - would permit an expansion of employment of the order of 1 - 1.5% a year or more (see Graph 1.). This is in line with the objectives of the Community strategy.

The rate of return on fixed capital increased significantly between 1982 and 1986. The main contributory factors were the higher rate of capacity utilization, and the decline in real unit labour costs due to the combination of a moderate increase in real per capita labour costs (0.8% a year) and an appreciable improvement in overall productivity (1.9% a year). The forecasts show a slowdown or even an halt in this favourable trend in 1987, and probably in 1988. The main reasons for this are a decline in competitiveness on external markets, slower growth, and a more sustained expansion of real per capita labour costs (1.5% a year).

Although the rate of return on fixed capital is still well below what it was in the 1960s, and real long-term interest rates remain relatively high, the relationship between the two variables has begun to shift markedly in one hand, and Europe and Japan on the other, prove insufficient to produce credible progress in the adjustment of payments balances, the consequences could be further exchange rate movements and higher interest rates in the United States. In this situation there is a danger of a further weakening of world trade as a result of an increase in protectionist pressures and of greater problems for the heavily-indebted developing countries.

The results of the alternative technical scenarios confirm that such developments would have serious effects on growth and employment, particularly in Europe, but without significantly improving the prospects for bringing payments balances into greater equilibrium internationally. It should also be noted that, since preparation of the current forecasts, the prices of oil and of primary commodities have reached a level somewhat higher than foreseen. A further rise, although not forseeable given current information, would lead to a further weakening of growth prospects in the Community.

3. Interim assessment of the implementation of the cooperative growth strategy for more employment

When the Annual Economic Report for 1986-87 was being prepared, short-term economic forecasts for Europe showed that the developments in the European economy were moving in the direction of the objectives of the cooperative growth strategy for more employment. Progress was too slow, however, and the Report stressed both the international risks and the need to apply the Community strategy in all its aspects. By mid-1987, the hopes of last autumn appear to have been disappointed. In these circumstances, the interim assessment of the implementation of the strategy foreseen for this Communication to the Council, has assumed increased importance. Its purpose is to assess to what extent the indicators of the key variables for the strategy and in the economic policies of the Member States have progressed in line with the objectives of the Community strategy.

insufficient. Despite the efforts made in some Member States, direct taxes and social security contributions as a percentage of GDP in the Community as a whole are barely likely to decline from 1985 to 1988, while public investment appears stuck at 2.7% of GDP, compared with about 3.8% of GDP in the early 1970s. Obviously these disappointing results are closely related to the continuing preoccupying situation of public finance in most of the member countries; but obviously, too, solving public finance problems is all the more difficult and unpleasant when growth in the Community remains insufficient.

3.1.3. Convergence towards stability

The progress made in recent years towards the convergence of price trends towards more stability is likely to be confirmed in 1987 and 1988. The Community average inflation rate (1987: 3.2%; 1988: 3.3%) should be below that of the 1960s (3.7%), and the dispersion of inflation rates in the Community and within the EMS is likely to continue to narrow. This trend is the result of monetary policies geared to stability - particularly within the EMS - and of flexible adjustment of the trend of nominal incomes to a less inflationary context. As a result, the stabilizing influences of the decline in oil prices and of the appreciation of European currencies seem to have been passed through in a more permanent way into price and domestic cost trends. These positive developments create favourable conditions for strengthening the EMS and for coordinating economic and monetary policies. They create the opportunity for lasting growth in a stable environment. They are admittedly a necessary but not sufficient condition in this respect.

3.1.4. The competitiveness of European industry

Obviously, domestic stability and moderate increases in nominal unit labour costs cannot alone offset the loss of competitiveness suffered by European industry as a result of the dramatic decline in the dollar, which depreciated in relation to the ECU by about 33% between its average level

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favour of investment. The favourable reaction of investment in equipment (up 9.2% in 1985) to the acceleration of external demand in 1984 and 1985 shows that the favourable effects of the improvement in supply conditions are beginning to come through, as long as the outlook for demand is also favourable.

3.1.2. Demand conditions

Community growth was fuelled in 1984 and 1985 by external demand, and strongly supported in 1986 by the improvement in the terms of trade. This enabled growth to speed up somewhat despite the restrictive short-term effects of efforts to consolidate public budgets in most Member States. In view of the outlook for the international adjustment process, external conditions cannot be expected to remain so favourable over the next few years. In future, growth must come therefore essentially from domestic demand. However, a hasty recovery of domestic demand without proper consideration for improving supply conditions, while it would no doubt reduce the Community's external surplus more rapidly, would not lead to durable growth of a type likely to reduce unemployment in a significant and lasting way.

What is required is thus a strengthening of domestic demand in such a way as to strike a balance between the expansion of consumption on the one hand and the trend of costs and profitability on the other, making possible - even without favourable external conditions - more dynamic job-creating investment, itself a major factor in domestic demand. This can be achieved if the continuation in the moderate growth in real per capita labour costs is accompanied by sufficient growth in demand obtained, for example, by a reduction in taxes and social security contributions along with a faster development of public investment. In areas such as these, where supply and demand conditions can be dealt with simultaneously, progress so far remains

In view of the persistence of international disequilibria, the ECU/dollar exchange rate is unlikely to show any fundamental reversal over the next few years. That is why European industry must increase its competitiveness in the areas of production processes and the type of products offered. Such a policy means refusing defensive, protectionist behaviour; it will be greatly facilitated if full use is made of the economies of scale that should result from completing the large European internal market by 1992. It also implies a major effort in the field of research and innovation. In this respect, the emphasis placed in recent years on research policy, both at Community and at national level finds its full economic justification. An even stronger research policy is now needed, concentrating especially on information technology, telecommunications and biotechnology.

At structural level, a fairly high real exchange rate should not always be considered an obstacle, but rather a stimulus, to the development of industrial competitiveness based on rapid productivity gains and a range of products for which demand is increasing rapidly. The experience of the countries whose currencies have appreciated strongly in the past confirms that this is a realistic option. The development of an industrial sector with increasing productivity and international competitiveness should not conflict with a strong development of the small business sector and a satisfactory increase in employment in the economy as a whole. However, the growth rate of the economy must be sufficient, while the expansion of real per capita labour costs should be moderate, and domestic and external competition (internal market and absence of protectionism) allow relative prices to adjust as necessary. In these conditions, the services sector has a chance to develop and create more profitable jobs (see Annual Economic Report 1986-87, Chapter 3.1). In addition, experience shows that employment creation in the service sector depends to a large extent on demand arising from the industrial sector.

in 1985 and that expected for 1987. On this basis, over the same period, the average effective exchange rate of the currencies of Community countries in relation to their nine main non-Community industrialized trade partners would have appreciated by about 20%. As unit labour costs in national currency developed in much the same way in the Community and its main industrialized partners, the real exchange rate (up by 21%) has risen approximately in line with the average effective exchange rate.

These exchange rate movements undoubtedly should contribute to the international adjustment of payments balances; they indeed correct the over-valuation of the dollar since the early 1980s, and the average relative level of costs and prices in the Community is not very different today from the level observed over long periods during the 1960s and the 1970s.

However, such wide movements in such a short time create adjustment problems that are costly in terms of profits, markets and production capacity for the firms concerned. This is even more serious in certain sectors already undergoing a difficult adjustment process such as shipbuilding and steel, where output has become still less competitive in relation to the dollar area, and where employment effects are exacerbated by the fact that these sectors are often the main employers in certain regions. Accompanying measures are required to facilitate structural adjustment in these sectors, and in particular to attenuate the social and regional consequences of such adjustment.

More generally, the present decline in the price and cost competitiveness hits European industry following several years of shrinking market shares, especially in advanced technology sectors, where world demand is developing most vigorously. Nevertheless, the trend of investment in these sectors, particularly sustained since 1982, indicates the potential for improvement.

difficult to make headway, since it is a question of achieving a fair balance between economic efficiency on the one hand and the respect for workers' basic rights on the other. Detailed discussions with the social partners are thus especially desirable.

One of the most spectacular changes of trend in recent years seems to have been the change in the trend of wages and salaries (see Chapter 3.1.1.). Structural changes in wage-setting have contributed substantially here. Much less emphasis is now placed on ex post indexation of wages on prices, while the principle of setting wage increases as a function of some inflation target has been applied in several countries where the disinflation progress had (or has) still to be completed. This practice has made it easier for monetary policy to complete the stabilization process, and has reduced the cost of that process in terms of jobs. Moreover, the period of application of collective agreements is tending to lengthen. Such agreements which fix wage increases for two or even three years, as in the German and Danish metal sectors, for example, in Italy, in the Netherlands and in Spain, reduce substantially the uncertainty attached to future rates of return on investment. They can also make the task of economic policy easier by defining a reference framework, but they also place a heavier burden of responsibility on those policies: such a principle could be called into question if the rate of inflation was higher than expected, while effects on investment and employment would be adverse if growth turned out to be too weak to generate sufficient productivity gains. Structural changes in the formation of wages and the effects which they have already had on profits are an essential contribution to implementing the strategy. However, this contribution will only be fully effective if the other factors in the cooperative strategy are also applied with determination.

3.2.2. Monetary policy

The stance of monetary policy in the Member States has generally made a noticeable contribution to the aims of the strategy. Not only has the

3.2. Economic policies in the Member States[1]

3.2.1. Adaptability of markets and wage formation

Significant efforts have been made in all Member States to improve the adaptability of markets. Indeed, this is the aspect of the strategy that has been given priority in many countries.

The measures relating to markets in goods and services come under wide programmes to deregulate markets and encourage business start-ups. At the same time, changes in legislation are under way or planned in countries such as the United Kingdom, Ireland, Germany and France to reinforce competition. In the latter country price controls have been abolished, as in Denmark and Ireland, and have been relaxed in Greece and Portugal. Deregulation and liberalization of money and capital markets have been especially rapid over the past two years in the majority of countries. Restrictions on capital movements abroad have been removed in several countries, with especially rapid progress in France and Italy, where rules in this respect are now in line with Community requirements.

As expected, labour markets have received special attention from governments. To differing degrees, all the Member States have taken specific measures in favour of employment. Measures taken are intended, first, to speed up the placing of young jobseekers in employment or the reintegration of long-term jobseekers, either through financial incentives (partial or total exemption from social security charges) or through increased investment in vocational training. Moreover, in some countries, more flexible rules have been introduced on employment, in particular new types of labour contract e.g. part-time or temporary work, and sometimes also in protection from dismissal. In this area, especially, it is often

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1 This chapter is based on the reports sent to the Commission services by the Member States in accordance with point 1.10 of the Annual Economic Report for 1986-87 (COM(86)530). The reports are to be discussed in greater detail by the Economic Policy Committee.

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markets, but since the last realignment (January 1987) the participants have improved coordination of interest-rate management of their currencies, thus enhancing its role - as was desirable - in stabilizing exchange rates.

3.2.3. Public finance

In many countries, the level and rate of increase of public debt is too high, narrowly limiting the capacity of each of the countries concerned, in isolation, to reinforce the factors determining domestic growth in the face of weakening external demand. Efforts to improve supply and demand conditions have also made little headway for the Community as a whole, despite important progress in a few countries.

The share of current expenditure in GDP declined by 0.3 percentage points of GDP on average in the Community from 1984 to 1986, as a result in particular of tighter controls on public consumption. However, social security expenditure increased more than proportionally, as a result especially of the increase in "crisis expenditure". There are further possibilities for improving the conditions of supply through specific reductions in subsidies. The lack of progress on this front has been bad both for the allocation of productive resources and for the scope for a faster decline in taxes, or an increase in expenditure to reinforce growth directly. It is true that the present rather indifferent growth rate means that the structural adjustments still required will be more painful, and determined progress more difficult.

The share of public revenue and the shares of direct taxation and social security contributions in Community GDP as a whole remained more or less steady from 1984 to 1986, although there were sometimes large differences from one country to another. Some member countries, especially France, Germany and the United Kingdom, have introduced or intend to introduce tax reductions; neither in France nor in Germany, however, will the reductions suffice to reduce in 1987 the share of direct tax in GDP. Moreover, they are often associated with increases in the rate of social security

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disinflation process progressed in the countries where this was needed, and stability been preserved in the others, but the expansion of liquidity has also been adequate to prevent any constraint on real growth, in particular in the countries where the disinflation process may be considered complete. Some headroom has thus been created for real growth. Short-term, and to a lesser extent, long-term interest rates have continued to fall. Nevertheless real interest rates as measured by the spread between nominal rates and current inflation rates remain high, potentially discouraging some investment. However, after the unanticipatedly large reduction in inflation last year, it is currently difficult to judge the exact level of real interest rates actually decisive for investment, which is that measured by the expected rate of inflation. The tasks of monetary policy have also been facilitated in recent years both by the rapid adjustment of wage trends to the reduction in inflation and by the decline in oil prices and the appreciation of the European currencies.

However, some vigilance is still necessary: the liquidity ratio is increasing; money supply growth is higher than target levels, in particular in Germany, Italy, Spain and the United Kingdom. To date, these developments have not damaged stability and convergence, but risks have been taken, and the present rapid accumulation of liquidity could become a source of inflation in less favourable circumstances. Central banks remain confronted with a dilemma of avoiding an excessive and over-rapid appreciation of their currencies against the dollar, or attaining targets for the growth of monetary aggregates or credit. This dilemma would become less acute with a better internal and international policy mix. A suitable mix of policies strengthening the credibility of the international adjustment of balances of payments would be an essential factor in the stabilization of exchange markets.

Over the past two years the European monetary system has been an essential instrument for the coordination of monetary policy. Its management has been made more difficult by the instability of the dollar on the exchange

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procedures have indeed been followed in all the Member States but often to deal only with specific points. Nevertheless, it is true that more general accords, in some cases with the participation of governments, have been concluded in Portugal, the Netherlands, in Spain (for 1985 and 1986) and in Belgium. Those which provide for specific measures in favour of employment and which often include recommendations for wage agreements, without calling into question the negotiating independence of the two sides of industry, are encouraging. Real progress towards deeper and wider social dialogue, to cover all aspects of the cooperative strategy, is lacking in many member countries, however. In several countries, there is a special need for the Government to take the initiative, according to their own requirements - as, indeed, provided for in the Council Directive on stability, growth and full employment[1] - and, where necessary, the social partners as well.

3.3 Problems of economic and social cohesion in the Community

The Community is now more heterogeneous than previously. With the most recent enlargement, the employed labour force in the Community grew by one seventh, the number of inhabitants by one sixth and the number of unemployed by more than a quarter. The unemployment rate in Spain, adjusted for the effects of different methods of analysis, stood at 21.5% in 1986 with marked regional variations (ranging from around 14% in Galicia and the Balearic Islands to around 30% in Andalusia) and at 17.5% in Ireland. This compared with a Community average of 10.8%[2] (Table 17). In Portugal and Greece, national product per head of the population is around 45% below the Community average, in Ireland around 35% and in Spain about 30% (Table 16). Differences in infrastructure endowment have also become much more pronounced.

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1 Article 3 of the Council Directive on stability, growth and full employment in the Community (74/121/EEC).

2 Conventional aggregation of the national figures gives a level of 12% for the Twelve

contributions, required because of the increase in crisis expenditure and the slowing down of the base. In addition, other countries such as Spain and Greece have been led to increase the burden of taxation in order to stabilize or reduce budgetary deficits.

In some Member States, there are signs of an incipient recovery in public investment. However, this recovery is barely adequate to stabilize the share of public investment in GDP on average for the Community, a share about 1.2 percentage points lower at present than at the beginning of the 1970s (2.7% compared with 3.8%).

The headroom made available by tighter and sometimes painful control over current expenditure has thus not been or has not been able to be fully used to reinforce the determinants of growth.

3.2.4. Social dialogue

At Community level, the social dialogue between the Commission and the social partners has been fruitful. In particular, in a joint opinion issued on 6 November 1986, which was reaffirmed on the occasion of the European Council of 29 and 30 June 1987, the social partners confirmed their agreement with the basic options of the cooperative growth strategy for more employment, and requested the governments of the Member States to make greater efforts to ensure the effective application of this strategy. In another joint opinion issued on 6 March 1987, the social partners defined broad areas of agreement on economic and social problems raised by the introduction of new technologies.

These opinions were the subject of detailed discussions and confirmed during the plenary meeting of the Community "social dialogue" on 7 May 1987, which brought together at the highest level representatives of the social partners with the Commission and the presidency of the Council of Ministers. On this occasion the Council president expressed his intention of informing the European Council of the 29 and 30 June of the content of these opinions.

At national level, social dialogue between governments and the social partners does not seem to have been so fruitful. Tripartite discussion

The completion of the internal market scheduled for 1992 is an essential condition for additional productivity gains and thus the increase of productive potential. However, care must be taken to ensure that the potential for more production on the internal market is fully used and that productivity gains do not result in factors of production being made redundant but in increased output. This calls for effective implementation of the cooperative growth strategy.

The completion of the internal market creates the conditions for a greater mobility of labour and capital and a better distribution ofresources which could contribute to boosting growth in the disadvantaged regions. However, as long as there is unused capacity in the stronger regions, the economically weaker regions can often do little to offset the competitive edge available to the stronger regions through economies of scale.

A further important factor here is how the pattern of trade will evolve. The six original Member States had similar economic structures and had reached similar levels of development. As a result, with strong growth and full employment, the removal of customs barriers between them accelerated growth in trade in manufactures produced using similar technologies and similar mixes of factor inputs. The benefits of the common market accrued largely from specialization of existing industries in particular products and from the associated economies of scale.

The economic structure of the Community is now much more varied. With the completion of the internal market, a dynamic growth of trade can be expected for manufactures produced using different technologies and mixes of factor inputs. This would lead to a greater specialization at industry level. This process leads to important structural changes, which the "central regions" can probably accomplish more easily than those at the periphery.

In addition, development of the structure of the economy in the direction of new technologies and high-technology products and the tendency for the

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Experience has shown that the economic performance of backward regions and countries can be strong enough for GDP per head to catch up with the levels in the economically more advanced regions. Between 1960 and the first oil shock, for example, GDP per capita differentials between not only the original but also the present Member States of the Community narrowed appreciably (Graph 7). In 1974, this trend, which was also clearly visible at regional level, was reversed. The latest forecasts for 1987 and 1988 and the medium-term projections to 1991 do not indicate a move to greater convergence (cf. Graph 7). The reduction of disparities between the regions of the Community called for in Article 130A of the Single European Act is, therefore, not yet in sight.

It has been found in the past that not only the catching-up process in the poorer regions but also the process of restructuring in the declining industrial regions benefit a great deal from more dynamic growth in the economy as a whole.

This can probably be put down to the fact that capacity utilization in the economically stronger regions increases in line with rising demand for goods, with the result that resources in the economically weaker regions become better employed. Besides, people were moving to the economically stronger regions during periods of strong economic growth and high capacity utilization, thereby helping to absorb unemployment in disadvantaged regions where population growth was particularly high.

The structural changes of the 1960s were necessary then for growth to be so rapid. At the same time growth for its part was an essential condition such that the structural changes could take place without creating excessive economic and social strains.

It will be clear from the above that the objectives set out in Article 130 of the Single European Act, viz. the reduction of disparities between the disadvantaged regions and the rest of the Community and the restructuring of declining industrial regions, is much easier to achieve if economic growth picks up generally. At the moment, this buoyancy is lacking.

least in some disadvantaged regions (see Graph 8). This implies, in particular, a moderate development in wages as well as increases in productivity that will be made possible by structural measures for the training and qualifications of the labour force, an improvement in the business climate and an adaptation of financing arrangements.

If the aforementioned conditions are met, more of the capital that is needed for the development of the less favoured regions will flow spontaneously from the richer regions and countries provided investors can be sure that movements in the reverse direction will be possible. Therefore, under these conditions, liberalization of capital movements in the Community can play a major part in the desired development process.

However, spontaneous capital inflows are rarely sufficient to set in motion and sustain the development process. It is therefore the responsibility of the Community to organize inflows of capital to the regions and countries concerned in order to help achieve the convergence aimed at in Art. 130A. The Community is already active in this field through the EIB and through its financial instruments (NCI, ECSC, Euratom). Loans granted under these instruments amounted to some 8,500 million ECU in 1986. In this framework the Commission has proposed developing new forms of financing tailored to different needs, to respond better, for example, to the demand for risk capital to assist the start-up and development of small and medium-sized firms and for the application of new technologies.

In addition to the spontaneous and organized inflows of capital, the Community, through its structural Funds, makes available budgetary resources designed to promote catching-up and conversion processes, while softening the social consequences.

In 1986, the structural Funds (EAGGF Guidance Section, Regional Fund and Social Fund) entered into financial commitments totalling some 6,900 million ECU, bringing the volume of Community resources available for regional and structural policy purposes (structural Funds and financial instruments) to some 15,400 million ECU in all (equivalent to around 0.44 % of Community GDP). In relation to the Community economy as a whole, these corresponding industries with future potential to move to areas possessing a good transport system, an extensive communication infrastructure and a specialized workforce and affording access to universities and research institutes might reinforce the "virtuous circle" in the "centre" and lead to a widening of disparities to the detriment of the "periphery". Accompanying national and Community measures are thus needed if the backwardness in the development of the peripheral regions is not to be further accentuated. For example, the Community is countering this trend through regional measures under its STAR and VALOREN programmes.

In addition, an increased division of labour could favour particular industrial regions of economically disadvantaged Member States, very competitive in certain medium-technology sectors currently with excess capacity at Community level and intra-Community trade barriers. The completion of the common market would permit comparative advantages to be exploited and would thus represent considerable progress for these regions.

Against this background, where the implementation of the cooperative growth strategy and the completion of the internal market are creating the conditions for greater cohesion but where developments may take place that run counter to the closer convergence that is fundamental to stronger cohesion, Article 130 of the Single European Act lays down a wide-ranging approach to the attainment of improved economic and social cohesion.

If the goal of closer convergence is to be achieved, above-average growth rates are called for in the economically weaker regions, all the more so in view of the high rate of population growth in those regions (Graph 9). New private and public investment is, therefore, needed in those regions and, for this, capital will have to be mobilized.

Some of this capital can be raised in the regions and countries concerned, a key condition being that the solid foundations essential for sustainable and stable economic growth are created there. The motives for exporting capital (avoidance of tax and inflation induced losses) must be removed. The competitiveness of the regions concerned should not be called into question by too high unit labour costs, as has happened in the past at

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Added to these economic risks is the fact that the important efforts made to improve the working of the labour market and to increase the profitability of investment, and also those made in the budgetary field, risk losing their justification if they do not bear fruit in higher investment, growth and employment. Without success here, the resurgence of defensive and damaging behaviour could call into question the current consolidation of the European economies.

An orderly solution to the problems posed by the international payments imbalances depends on close co-operation between the major economic blocs. In this respect, the course set in February in the Louvre accord and confirmed at the Venice Summit is still valid. The first requirement is to achieve a stabilisation of exchange rates through close cooperation between the monetary authorities of the countries concerned: this is particularly relevant to the international management of interest-rate differentials. The stabilisation of exchange rates is necessary to allow time for the considerable adjustments which have already taken place to produce their full beneficial effects on trade flows. On the other hand, further changes in exchange rates would exacerbate the already substantial adverse effects on the growth of the European and Japanese economies, and this would run counter to the result sought. Experience shows that it is not possible to place the entire weight of balance of payments adjustments solely on exchange rate policies, and that, in order to be effective, changes in exchange rates must be accompanied by measures in other fields of economic policy contributing also to external accounts balance. A wider positive growth differential between Europe and Japan on the one hand and the United States on the other is thus necessary now. It is important for this condition to be realised at the highest level of world growth, particularly to prevent a further deterioration in the situation of the developing countries.

Given the structure of payments imbalances, contributions by the United States and Japan remain essential. In the United States, attainment of the budgetary targets will help to cut the external deficit. The resultant fall in the absorption of world saving would take the strain off world

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amounts are of little macroeconomic significance. However, since they are concentrated on the disadvantaged regions, their effect is greater. Indeed, in the case of countries like Greece, Ireland and Portugal, they would represent around 2% of GDP and 10 to 15% of the volume of gross fixed capital formation (see Table 18).

Bearing in mind the goal of harmonious development, the interest of the present twelve Member States and, of course, budgetary constraints, a new balance must be struck between the various Community policies. In this respect, the doubling in real terms from now to 1992 of the budgetary resources of the structural funds, which has been proposed by the Commission in accordance with Article 130 of the Single European Act, is of the order of magnitude likely to lead to a substantial modification in the growth conditions of the disadvantaged regions. It is desirable, however, to increase, at the same time, the efficacity of these funds by decentralisation and by targeting Community action at the most appropriate level. However, even an appreciable expansion in the Funds' activities will only have a mobilising and pump-priming effect on capital flows if it takes place against a background of economic growth in the Community as a whole and if the macroeconomic environment in the countries and regions concerned is conducive to growth.

4. Economic policy problems for 1988 and beyond.

4.1 The implementation of the cooperative strategy and the economic policy mix in present circumstances

In present circumstances it is necessary to consider the economic policy mix which would permit a significant improvement in employment prospects and which could be one factor in the solution which must be found for international adjustment problems. This is given added importance by the risks that an additional worsening of growth prospects are not negligible (cf. Chap. 2).

regulations which, while respecting fundamental social rights, satisfy both the needs of firms and the preferences of certain groups of workers; and specific measures to help the long-term unemployed back into activity and to integrate the young unemployed into the workforce.

Progress is still possible and necessary in order to increase the adaptability of the goods and capital markets and to improve the environment of firms from the points of view of taxation, financial arrangements and legal and administrative provisions. In this respect, completion of the large internal market by 1992 has a particularly important role to play and significant progress in this area, giving clear signals to the consumers and firms, would help to breathe more dynamism into the European economies. Lastly, efforts in the field of research and development should be continued if not stepped up, especially since the recent appreciation of the European currencies aggravates the problems of competitiveness in the Community economies.

The greater adaptability of markets will not, however, be able to achieve its full effects unless it is part of an environment of more dynamic growth. By raising productive potential, such adaptability increases the chances of additional demand being reflected in higher growth and more employment. In macroeconomic terms the necessary acceleration in job-creating investments is now running into two obstacles: the halt in the improvement of profitability and the slackening of demand.

Collective agreements which, as they have done in the last few years, lead to a moderate increase in real per capita wage costs lower than productivity gains remain desirable in order to improve profitability. It is true that the increases in earnings for the Community as a whole currently projected for 1987 and 1988 and which are relatively buoyant relative to the last few years, are underpinning private consumption, and therefore aggregate demand. Nevertheless, an increase in wage costs which remained moderate would increase the chances of more rapid increases in investment and employment. In this respect, the tendency which is now emerging in several Member States to conclude collective agreements for a capital markets and reduce the danger of a redistribution of budget deficits as between industrialised countries giving rise to a damaging increase in real interest rates. In Japan, the determined and effective implementation of measures such as those announced recently, which should permit an acceleration in the growth of domestic demand and an even wider opening of Japanese markets, is necessary in order to achieve a faster reduction of the current account surplus which in 1988 will probably still stand at 3.3% of GDP (compared with 4.3% in 1986).

The acceleration of growth in Europe, desirable for external reasons, is clearly just as desirable, if not more so, in order to enable the European economies once more to approach a growth path compatible with the priority objective, the reduction of unemployment. In order to do this, however, growth in Europe should not only be stronger but also more durable and hence be underpinned by a vigorous upturn in investment, and thus be more employment creating.

There is no need to redevelop here the major options of the cooperative strategy, both those which aim to improve the adaptability of markets and those which - at macroeconomic level - aim to strengthen the determinants of investment by the continuing moderate increase of real per capita wage costs and by the appropriate underpinning of demand. The experience of the last few years shows that, in a situation of stability, growth and employment performances can be improved when greater adaptability of markets and rising profitability are accompanied by a progressive acceleration in demand (see Chapter 3.1.).

The current efforts to improve the adaptability of the labour, goods and capital markets should be pursued with determination. With more specific regard to the labour market, appropriate measures in the areas already highlighted in the last Annual Economic Report[1] should continue to encourage job creation. These are in particular: reorganizing and reducing working time; a cooperative approach to defining employment protection

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1 COM(86)530, p. 116 et seq.

Within the framework of the cooperative strategy, budgetary policy has a particularly important but difficult role to play. The guidelines laid down in the last Annual Economic Report remain entirely valid: judicious choices in respect of the level and structure of taxation and expenditure will provide the room for manoeuvre enabling the private sector to expand its activity and employment and productive potential to be reinforced by public investment in both physical and in human capital. In the present situation, the question of the speed with which these guidelines should be implemented is, however, crucial. Three points must be taken into consideration.

First, the course set for budgetary policy in the Community should also form an important element of a better mix between the major economic areas, with a view to accelerating the process of adjusting payments' balances at a high level of activity. Secondly, the progressive weakening of final demand in the Community leaves it bogged down on a low growth path. Low growth increases the dangers of returning to a budgetary vicious circle, with the room for manoeuvre created by the control of current expenditure being wiped out by a weak increase in receipts. Lastly the chances of support given to nominal demand being translated into accelerated growth, productive investment and employment now seem particularly high: considerable success has been achieved in fighting inflation; the increases in profitability which have occurred in the last few years remain; the adjustments made in the structure of the productive apparatus and the greater adaptability of markets have strengthened productive potential, and growth has become more job-creating. It is on this base that progress should be built.

The necessity for a cooperative solution thus clearly seems imperative.

First, international cooperation is required, because the Community will have to provide an important component of an orderly solution to the problems posed by international payments' imbalances.

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period of more than one year could be a favourable factor, if set in a context of growth and of high enough productivity gains and if not threatened by a pick-up of inflation (cf. Chap. 3.2.1).

Monetary and budgetary policies have an important contribution to make to stronger and more employment-creating growth.

Monetary policy should continue to pursue the objective of the appropriate financing of real growth while, in the medium-term, safeguarding in a durable fashion the results achieved in fighting inflation and, in the countries where this is still necessary, improving them. In order to promote productive investment, a fall in nominal interest rates, in particular long-term rates, still seems desirable given the wide gap which exists between them and the current inflation rate. In order to be durable, however, this fall should in the main stem from a reduction in the uncertainties surrounding the capital markets. In this respect, the consolidation of inflationary expectations at a low level is still essential if the recent falls in short-term rates are to be mirrored more sharply in long-term rates than hitherto. The continuation of monetary policies geared in the medium-term to the objective of stability remains the guarantee of such consolidation. The margin available for further falls in short term interest rates is, however, now limited due to the rapid expansion of monetary aggregates (see chapter 3.2.2).

Within the EMS, the stabilization of exchange rates must remain a priority objective of monetary policies. The convergence of performances is already contributing to this. However, such stabilization presupposes close cooperation between the monetary authorities of the countries participating in the exchange rate mechanism: the basis for this should continue to be broad agreement on the short and medium-term role of monetary and exchange rate policies (see Chapter 4.2). In the long run, the advantage of stabilization would be that the process of the downward convergence of nominal interest rates within the EMS could again move ahead on a sound basis.

since the international financial and monetary environment is unstable. The strengthening of monetary cooperation within the EMS would represent an essential answer to this challenge. However, unduly divergent developments in other economic policy areas risk, given integrated and liberalized money and capital markets, either putting too much strain on monetary policies or, something which is not desirable, loosening the exchange rate discipline within the European Monetary System. One should note, however, that the more that constraints imposed by Community discipline, in respect of nominal and real convergence, exchange rates or the freedom of capital movements, are applied in a situation of dynamic growth, the more acceptable they will be.

This is why close budgetary cooperation is necessary. Because of the integration of European economies, the circumstances in which each Community country can pursue its own budgetary targets depend heavily on the performances of its partners. As the Commission has already stated in its Communication "The Single Act", success will depend on Member States taking account of the network of interdependence of which their own activities form part.

Alongside close cooperation in the implementation of economic policies and the activities which could be conducted through the structural funds (cf. Chap. 3.3), four other areas should be given priority: first of all, the Community should continue to speak in the appropriate forums with a single determined voice to halt any increase in protectionism and to progress towards a greater liberalization of world trade.

It is important also to increase the effective integration of the Community economies by means of transport and infrastructure policy which will permit a significant fall in unit costs while high quality and safety standards and adequate social rules are respected. This policy would help the completion of the internal market to produce its full effect and would reduce the dangers of this occuring to the detriment of regions suffering from structural underdevelopment. The next priority is to progress

Cooperation with and between the social partners, the success of the strategy requires a contribution from all parties. The successes realised at Community level deserve to be followed through at national level (cf. Chap. 3.2.4). Here it seems that fresh impetus should be given in several Member States, first by governments or, where appropriate, by the social partners themselves.

Lastly, it requires cooperation at Community level, since implementation of the growth strategy for more employment has a part to play in the attainment of the two objectives which the Community has set itself in adopting the Single European Act: the completion of the internal market by 1992 and the strengthening of its economic and social cohesion; and because close budgetary cooperation would increase the effectiveness of the policies pursued.

4.2 Prospects opened up by the Community dimension

The close link which exists between higher growth, the completion of the internal market and the strengthening of economic and social cohesion has been analysed in greater detail in Chapter 3.3. In this respect, particular importance attaches to the completion of the internal market which should be accelerated. In the document "The Single Act: A new frontier for Europe[1]" the Commission has already indicated the conditions for success of the enterprise. The main point is to concentrate efforts on a number of crucial areas and, within each area, to exploit the Community dimension so as to make the policies pursued as effective as possible.

The first requirement is to increase the coordination of economic policies. In the monetary field, the experience gained in the last few years as a result of the EMS is a precious asset. It has enabled the Community consensus on economic analysis to be strengthened, has brought together ideas on economic policy and has led to greater convergence in monetary policy and performance, particularly as regards inflation. The liberalisation of capital movements, an integral part of the completion of the large internal market, is a new challenge for the EMS, especially

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1 COM(87)100

integration and interdependence of the Community countries. For example, in many Member States, policy at national level is moving towards a progressive reduction of the State's share of GDP. But the speed with which the control of public expenditure can be converted into a reduction of the burden of taxation, instead of being used for budget consolidation, also depends on the level of growth, and therefore partly on the dynamism of the Community environment.

The public debt situation remains difficult in the Community. The public debt/GDP ratio will probably go on increasing as a Community average, but at a lower rate than up to 1985. Besides, between 1986 and 1988, the average budget deficit in the Community should fall from 5.0% of GDP to 4.4% after standing at 5.4% in 1984. The main assumption behind these forecasts is that several countries with excessive budget deficits or levels of public debt will make significant consolidation efforts : thus between 1986 and 1988, the general government deficit is projected to fall by 2.4 percentage points of GDP in Belgium, 1 point in Spain, 2.9 points in Ireland and 2 points in Italy.

In the five countries where the budgetary situation is more comfortable - Denmark, Germany, France, Luxembourg and the United Kingdom - the forecasts differ somewhat : in Denmark, Luxembourg and Germany, the effects of automatic stabilizers and the implementation of tax reforms should lead to a deterioration in the budget balance between 1986 and 1988, although still in surplus in the first two countries. In France, on the other hand, the budget deficit should fall slightly. Lastly, in the United Kingdom, despite the planned tax cuts, the general government deficit should fall by 1.2 percentage points between 1986 and 1988, owing to continued buoyant growth.

Without the objectives of budget consolidation in the medium-term being called into question, the present situation suggests the need to modify the time profile of the effects of the automatic stabilizers in such a way as to magnify their effects, by judicious use of the leeway created as current constructively and in a spirit of solidarity towards a European policy for the environment, an area in which problems have clearly become international. Environmental protection is an end in itself and cannot be an instrument of employment policy. However, it is just as important to remember that this area represents a significant potential for innovation, growth and jobs - and this also applies to export markets. Finally it is important to follow a common policy on scientific and technological development, within the framework programme submitted to the Council and concentrating on the areas where the greatest benefits from closer cooperation can be hoped for. Such a policy is particularly necessary because in some areas Europe has fallen behind technologically, and must catch up in order to improve its competitiveness.

4.3 General stance of budgetary policies

In accordance with the "convergence" decision[1], the Council's second examination each year of the economic situation must pay particular attention to budgetary problems. In its last Communication to the Council on the economic situation[2] the Commission stated its intention of intensifying the dialogue within the Council so that more account can be taken of the Community dimension in the major economic policy debates which are starting at this time of the year with a view to the adoption of government budgets in the member countries.

There is clearly an important Community dimension to national budgetary choices, even if it is often difficult to define. Given the international adjustments which still have to be made, the Community, in the coming months and even years, must rely above all on its own resources in order to reinforce growth. The need is to perceive, on the basis of the broad trends of public finances laid down at national level, a certain number of areas which can be expected to benefit from closer cooperation between the Member States as a result of the economic, financial and monetary

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1 Council Decision of 18 February 1974 on the attainment of a high degree of convergence (74/120/EEC)

2 The economic situation and economic policy coordination problems in the Community (COM (87) 77 final).

completion of the internal market and the economic and social strengthening of the Community, infrastructural investment, notably in the transport field, has an important role to play in the improvement of Europe's productive potential and the integration of its outlying regions. An ambitious infrastructure policy should increase the effectiveness of the resources allocated to this crucial area. At macroeconomic level, steady growth of public investment autonomously helps to stabilize final demand, which is an important determinant of private investment. In the current situation, a degree of flexibility in the implementation of such a policy should provide direct and welcome support for final demand.

Much of the financing of public investment, and in particular of large-scale infrastructure projects, can be left to private initiative. Nevertheless, it is the task of the public authorities, both national and Community, to create favourable conditions. The Commission will continue with the efforts outlined in its Communication on financing major Community infrastructure projects[1] and will endeavour to achieve deeper discussion on this subject with the relevant authorities as requested by the Council.

With regard to public investment, the choices and needs of each of the member countries differ somewhat. In several countries, public investment has been, or is still, very considerably affected by budget consolidation efforts. In the countries where development is lagging behind, there is a clear need to improve the infrastructure. This need is, moreover, given emphasis by the outlook for the realisation of the internal market and by the need to increase the integration of the European economies. The needs of other countries in this area may seem less pressing. However, in these countries too, projects exist which it is known will be profitable and which, if their implementation were accelerated, could currently provide appreciable support for demand alongside their effects on productive potential.

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1 Doc (86) 722 of 15 December 1986

expenditure is brought under control, so as to reinforce directly the determinants of the growth of domestic demand. This can be achieved in two ways: by accelerating reductions in the burden of taxation and parafiscal charges, as aimed at in the short or medium-term in several Member States, and by a more sustained upturn in public investment. In comparison with current forecasts, the implementation of such policies could lead in the short-term to a limited and temporary increase in the average general government deficit in the Community, as envisaged in the previous Annual Economic Report in the case of unfavourable economic developments, without calling into question the objective of medium-term budget consolidation. However, the disadvantage of a slightly less rapid reduction, or in some countries, a slightly faster increase in public deficits should be weighed against the disadvantages stemming from the persistence of low growth, in terms of its effects both on future budgetary policy room for manoeuvre and on the speed of adjustment of international payments' imbalances.

The question which arises with regard to more rapid reductions in the burden of taxation, is whether concerted action on the timing and scale of the measures envisaged in several Member States would not be likely to multiply their effects and thus increase the chances of their implementation and their success. This applies in particular to the countries still faced with substantial budget difficulties, which could also envisage accelerating the planned reductions in the burden of taxation if they could count on a more dynamic Community environment and if this did not undermine the requisite discipline with regard to current expenditure. In addition to the indirect effects on demand, the advantage of accelerating tax cuts would be the improvement of supply-side conditions, positive announcement effects, and conformity with the choices laid down by the national budgetary authorities. But in an otherwise depressed environment, the danger is that they will be insufficient to restore a growth rate of sufficient vigour for a sustained pick-up in private investment.

As part of a medium-term strategy, public investment should play a more important role. National choices in this area have in several respects a Community dimension which must be taken into account. Looking ahead to the

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In the Federal Republic of Germany economic growth this year and next will turn out weaker than during the last few years. The rate of inflation remains low. As far as the development of the public finances is concerned, the automatic stabilizers are tending, in 1987, to provide some support to domestic demand. Moreover, tax reductions amounting to 13-14 000 million DM (0.6-0.7% of GDP) will enter into force at the beginning of 1988. Despite the resulting positive impact on economic growth - which in any case is only likely to be felt with a certain lag - the budget deficit will rise somewhat further. A reform of the wage and income tax is planned for 1990 and should reduce the tax burden of households and enterprises by around 20 000 million DM (a little below 1% of GDP). This tax reform will presumably entail a further increase in the deficit.

Bearing in mind the current weakening in growth as well as the uncertainties affecting future prospects, it would be appropriate, particularly in the context of action at Community level, to consider the possibility of bringing forward the implementation of the entire tax reform or major parts of it and of increasing remunerative public investment. Efforts aimed at improving the structure of expenditure should be continued, particularly in the form of a selective reduction in subsidies and in favour of measures capable of stimulating growth. If such a policy were implemented, a temporary increase in the budget deficit need not erode confidence in the solidity of budgetary policy. On the contrary, it would facilitate a reduction in the weight now placed on monetary policy within the "policy mix".

The aims of budgetary policy in the United Kingdom, as set out within the framework of the Medium-Term Financial Strategy, have been to reduce public sector borrowing and create room for a reduction in the tax burden through strict control of public expenditure. In the 1986-87 financial year, despite a fall of more than one half in North Sea oil revenues, but because of the buoyancy of non-oil tax revenues, the public sector borrowing requirement turned out at just under 1% of GDP, well below earlier official

5. Economic policies and budget guidelines of the Member States

It can be seen from the previous chapter that the task to be fulfilled by budgetary policy in 1987 and 1988 will be difficult but very important, the main emphasis of the policy mix having to shift to public finance. A range of macroeconomic or financial constraints, which vary in nature from country, could be overcome by a balanced organization of each Member State's budgetary policy which would set in motion the synergy required. Only by the joint but carefully judged implementation of the measures outlined in Chapter 4 will a Community-scale public finance policy be able both to attain the macroeconomic objective of underpinning domestic demand and improving supply-side conditions and to create in each country the necessary environment to ensure that this action succeeds. This joint solution would make it possible (1) for the countries which have a measure of flexibility to use it without endangering their financial health, their external equilibrium or their restored price stability. (Denmark, Federal Republic of Germany, France, Luxembourg, United Kingdom), (2) for a satisfactory growth rate to be maintained in the countries which are already growing at a relatively more rapid pace (Spain, Italy, Portugal) and (3) for the member countries which have both serious budgetary problems and slow growth to be helped out of this vicious circle (Belgium, Greece, Ireland, Netherlands).

In the <u>first group of countries mentioned above</u>, economic growth will be fairly limited in 1987, with the exception of the United Kingdom, and probably in 1988, whereas the medium-term evolution of the borrowing requirement and the public debt can be considered to be satisfactory. Some temporary deterioration in the budget balance should not affect financial equilibrium; however, in Denmark, France and the United Kingdom, the authorities are mindful of the consequences for external equilibrium of an accelerated growth of domestic demand while the German authorities must consider the effect of the tax cuts already planned. It is precisely in such circumstances that these countries - of which three economies represent 60% of Community GDP - can back one another's efforts without endangering public finance equilibrium.

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cases, the target equilibria - deficit limited solely to the interest burden, i.e. a little over 2% of gross domestic product, in the case of the central government budget, and strict equilibrium for the social security accounts - involve the same effort of strict control of expenditure. The reduction in budget expenditure should be comparable to that of 1987. As for the social security schemes, the additional resources will not do away with the need to seek ways of limiting the tendency for certain of their costs to rise and in particular those of the health insurance scheme. Public finance policy will nevertheless continue, simultaneously, to encourage the emphasis of domestic demand to shift to investment, to promote research and training and to combat unemployment directly.

Within the framework of action organised at the European level, permitting an increase in French exports and an easing of the external constraint, efforts in the field of budgetary policy could be intensified thus reinforcing the competitive capacity of the French economy now that it is already underpinned by a relatively favourable development of wages costs. In these conditions, there would be the possibility of bringing forward the implementation schedule of certain public investment projects.

In Luxembourg, the return to budgetary surplus as far back as 1985 has made it possible to reconstitute the reserves of the investment funds and to envisage additional major measures to strengthen the potential for growth and to promote the diversification of economic structures. The programme of reducing taxation was begun in 1986 and is being applied in full in 1987, when the amount involved is equivalent to 2.5% of GDP : this effort does not, however, entail a budget imbalance.

In 1988, the budget should again result in a surplus sufficient to increase the resources of the investment funds to cover the additional cost of the agreed direct tax cuts and even to build up reserves for further cuts in social security contributions. As in 1987, such measures would help to compensate for the effects on domestic activity of the weakness of export demand.

In Denmark the current external deficit, which in 1986 amounted to 5.1% of GDP, has been the focus of policy preoccupations. In view of the low level

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projections. Part of the reduction in the public sector borrowing requirement since the early 1980's has been achieved through the massive expansion of the Government's privatisation programme, which is expected to raise some UKL 5 000 million (over 1% of GDP) in each of the next two years. The Government now intends in this and future years to hold the public sector borrowing requirement constant at 1% of GDP (equivalent to a general government financial deficit of 2-2 1/2% of GDP). This implies a decline in the public debt/GDP ratio over the next few years.

Despite the upward revision of expenditure plans last November, the continued buoyancy in tax revenues should allow the public sector borrowing requirement target of 1% of GDP in 1987-88 to be achieved without great difficulty especially bearing in mind that economic activity is expected to remain strong. It will be important to maintain this economic upswing in 1988 also in order to improve the employment situation. In the context of joint Community action, there would be a case for allowing the public sector borrowing requirement in 1988-89 to rise above the level set for the medium term. Strict control of public expenditure will need to be continued, but the possibility of selective additional spending on worthwhile capital projects could be explored further. It appears probable that the policy of tax reductions could be continued in 1988; the Government is committed to personal tax cuts, but could also choose to use some of the room to reduce the costs to enterprises of increasing employment, perhaps targetted more particularly at the long-term unemployed.

In <u>France</u>, the precarious foreign trade situation encourages the authorities to pursue a budgetary policy which helps to keep the growth of domestic demand within sufficiently narrow limits. Against this general background, the public finances, in 1988 as in 1987, will continue to show a marked divergence between the trend in the central government budget, where the deficit will continue to narrow despite substantial tax cuts, and that in the social security accounts, which are kept in equilibrium only at the price of a further discretionary increase in their resources. In both the Treasury deficit was to be completed in 1987, but the domestic political situation added to the difficulties of achieving the target set initially, which was to reduce the deficit to LIT 100 000 000 million, or 10% of gross domestic product[1]. After what will probably be major slippage relative to the planned projections, public finance policy in 1988 should return to the interrupted course of consolidation, by adopting a target for the deficit close to that which could not be achieved in 1987. If, in conformity with the plan, there was no increase in the pressure of taxation and social security contributions, this course of action would involve a severe curb on the expansion of operating expenditures, at both central government and regional and local authority level, and an even tighter rein on social security expenditure. This reining back of expenditure implies, in its turn, the rapid adoption of structural reforms with respect to pensions, health, unemployment compensation and local finances; these are at different stages of preparation, although none of them have yet been adopted. In addition to structural concerns - chiefly the very high debt level, still on a rising trend - which are at the root of the current efforts to restore sound public finance, the cyclical need to limit the deterioration of the external balance also means that the effort should be actively pursued in 1988. The maintenance of satisfactory economic growth in 1988 is no less an essential condition for restoring the public finances to order and for stabilising the public debt in the medium term.

In Spain, growth in both 1987 and 1988 will remain relatively more rapid than in most of the other member countries despite a slowdown in domestic demand, which has been the engine of expansion since 1985. The maintenance of an active supply side policy and the fight against inflation remain the essential preconditions for the continuation of the major effort of modernization and investment stimulated particularly by accession to the European Community.

In 1987 general government net borrowing will probably be slow to decline despite the fiscalisation of much of the fall in energy prices and the favourable yield from the newly introduced VAT. For 1988, the authorities intend, in particular, to go on improving public infrastructure and social

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1 According to the recently revised national accounts.

of private saving the main burden of adjustment has fallen mainly on budgetary policy which was tightened in stages in 1986. As a consequence the general government budget balance shifted from a deficit of 2.1% of GDP in 1985 to a surplus of 3.3% in 1986. Measures have, however, also been taken to increase the cost of credit for residential construction and for consumer spending.

A certain lowering of the budget surplus is expected for 1987 but this is in part due to a temporary loss of receipts as a result of the tax reform initiated at the beginning of the year. The government's objective is to maintain central government spending unchanged in real terms in 1988 and to keep the rise in local government expenditure within tight limits. In 1988, the budget surplus could reach 2.5% of GDP and the current external deficit may also decline to 2.5%. Given that the stance of economic policy is exclusively determined by the external constraint, some relaxation would be possible should the external environment prove more buoyant than assumed in current projections. Joint action on a Community level, implying an improvement in the current balance of payments situation, would allow budgetary policy to be applied with less rigour thus favouring an improvement in the employment situation.

The three countries (Italy, Spain, Portugal) belonging to the second group are among the most dynamic in the Community. This is a very desirable trend from the point of view of real convergence. At the same time, however, the restoration of sound public finance must remain a priority objective to which sustained and regular economic growth should actively contribute. It is therefore essential for the pace of activity not to weaken in these three countries, and this depends in particular on the Community's economic expansion remaining sufficiently strong.

In Italy, the prospects for economic growth and disinflation in 1987 and 1988 provide a favourable background for the necessary continuing restoration of sound public finance. Under the three-year plan adopted by Parliament in the autumn of 1986, a further stage towards the reduction of increasing slowly mainly because of tax reductions introduced in respect both to earnings and company profits.

In a third group of countries, budgetary consolidation remains an absolute priority and leaves scarcely any room for manoeuvre. In Belgium and Ireland, public debt is continuing to increase appreciably and interest charges exceed 10% of gross domestic product: this means that large savings must be made in other fields to halt a cumulative process of mounting debt. In the Netherlands, the public authorities must endeavour to offset the losses resulting from the sharp fall in natural gas revenues, while in Greece the overall recovery plan for the economy contains a very strict budgetary component. In this group of countries, an acceleration of growth in the other Community countries would lighten considerably the difficult task of budgetary policy.

In Belgium, where inflation has been cut to under 2% and where the current account balance in 1987 is yielding an appreciable surplus, budgetary policy cannot in the short term do much to help improve growth conditions. The Government's objective - cutting net borrowing to 7% of GDP in 1989 - adopted as part of the May 1986 programme of public finance consolidation is an essential condition for the stabilization of the public debt as a percentage of GDP and for the lasting reversal of the tendency for the relative proportion of interest on the public debt to increase; currently this proportion stands at 10% of GDP, i.e. twice or three times as high as in most of the member countries. The effects of this programme should mainly start to make themselves felt in 1987, when central government net borrowing will be cut to a level appreciably below that of 1986 in absolute terms.

In 1988, despite the low growth of tax revenue, and the additional factor that social security contributions are not being allowed to rise, general government net borrowing should still decline slightly. This improvement will probably be too small, however, to permit a relaxation in the control of expenditure if the target set for 1989 is to be achieved; thus the security benefits, but to apply greater strictness to administrative expenditure and to ensure the more efficient collection of taxes.

It must be stressed that the budgetay room for manoeuvre, of which full use has been made since 1985 consonant with the cooperative strategy, will be markedly reduced for some years to come mainly because of the predictable fall in the external surplus, and therefore in the nation's financing capacity. In view of this outlook, available resources must be allocated as efficiently as possible, assisted particularly by an appropriate mix of budgetary and monetary instruments, in order to ensure the rapid growth of private and public investment. This makes it essential to maintain a growing demand from other Community countries.

In Portugal, growth in 1987 and 1988 will remain more rapid than in most of the other Community countries, thus contributing to the real convergence of the Portuguese economy within the Community. In order to keep this development going until the start of the 1990s, it will be necessary to continue to remedy the structural inadequacies on the supply side and to make a major investment effort. However, the predictable fall in the current account surplus and the prospect of an eventual deficit position increase the need to ensure a process of gradual reduction in general government net borrowing, adopted as an objective in the medium-term national strategy (PCEDED): this is necessary for the continuous reduction of inflation in the Portuguese economy, itself an essential condition if the economy is to move closer to the European Monetary System.

Against this background, certain changes in present trends seem inevitable. General government net borrowing stands at slightly over 9% of GDP, after the reduction of some 2 percentage points of GDP observed in 1986: the reduction is roughly equivalent to the increased revenue from the tax on petroleum products; for the current year, no fall in the deficit is forecast. Priority expenditure (public investment and transfers to households) is continuing to rise appreciably while the growth rate of most other items of expenditure is more difficult to reduce. On the revenue side, the indirect tax yield is rising rapidly, but direct taxes are

.../...

Budgetary policy for 1988 must take account of the worsened situation in 1987 and will suffer the effects of the slowdown in growth. In these circumstances, attainment of the target of a public finance deficit of 7% of net national income (6.3% of GDP) which, in the Government agreement, is held to be a necessary stage on the road to faster expansion, will involve new measures on both the expenditure and the revenue side. If the authorities were completely or partly to abandon corrective measures, the deficit would widen once again.

In Greece, the public finance policy has, since October 1985, been subject to the restrictive guidelines of a stabilization plan which aims to restore conditions making for the lasting and balanced growth of the economy. The public sector borrowing requirement has been cut from 17.6% of gross domestic product in 1985 to 13.7% in 1986, and the objective is to bring it down to under 10% in 1987. The need to continue with this effort will become all the more essential in 1988, because, despite the exceptional revenue from which the budget will have benefited, the target set for 1987 will not be achieved. Despite the additional revenue which should result from the progressive widening of the effective tax base, the equilibrium sought will require redoubled strictness in the control of expenditure, including the maintenance of strict discipline on consumption and public investment, a further cut in subsidies and the elimination of the public enterprise deficit and measures which will put an end to the trend increase in the pension funds deficit.

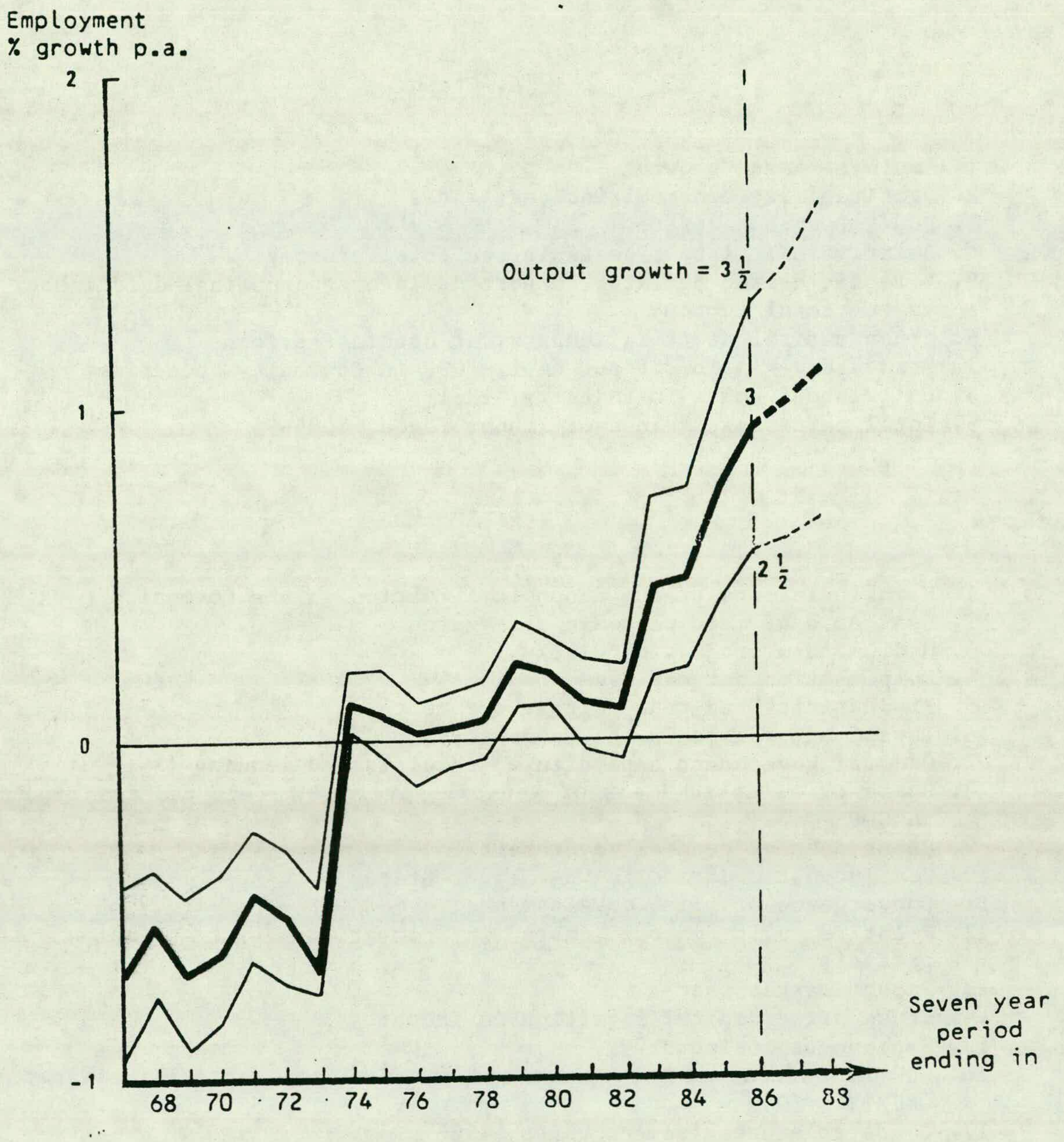
central government budget for 1988 does not offer much scope for increasing public investment or for granting tax cuts beyond those already planned.

In Ireland, budgetary policy entered an important new phase last March, when the incoming Government introduced a budget aimed at reducing the Exchequer deficit in 1987 by 2 percentage points to 9.75% of GDP. This relatively ambitious target reflects a strategy to restore balance to the public finances and thus to establish the conditions for economic growth. It is particularly important that this overall budgetary target be respected. Its achievement this year appears feasible in the light of development of the economy as foreseen in the macro-economic forecasts.

With very few options available to the Government in the near future to increase total revenue, the burden of further budgetary adjustment in 1988 must fall on public expenditure, particularly in the area of current transfers. In addition, severe pay restraint in the public service is a key condition for successfully implementing budgetary consolidation but also for securing a moderate development of real wages economy wide. In the medium term there is a need to reduce the overall tax burden and rationalise the tax system but the scope for progress in this direction in 1988 appears limited.

In the Netherlands economic policy aims to improve the competitiveness of enterprises and the potential for growth: among its most important intermediate objectives are the restoration of balance to the public finances and the stabilization, or even the reduction, of the tax burden. In 1985 and 1986 budgetary consolidation made definite progress, but in 1987 the fall in natural gas revenue is interrupting the process of restoring balance. It is leading to a deterioration in the central government borrowing requirement, though the deterioration is, indeed, limited as a result of the compensatory measures taken to increase revenue and reduce expenditure.

Graph 1: Employment and growth [1] (EUR12)



1 This graph shows the developmer: of the relationship between growth and employment which has been estimated by moving regressions for seven year periods (First period: 1961-67; last period 1982-88). A point on one of the lines indicates the increase in employment corresponding with a rate of growth of 2,5%, 3% or 3,5% according to the regression for the period in question.

Source: Commission services.

STATISTICAL ANNEX

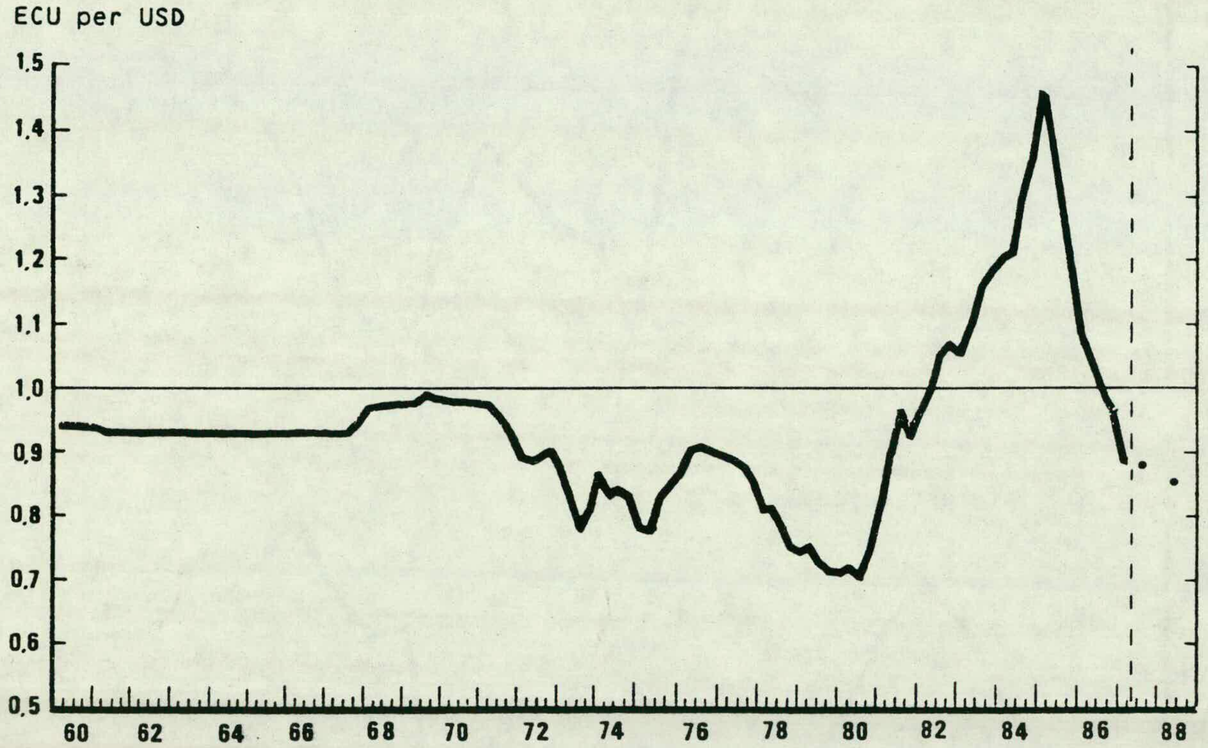
"The economic outlook for 1988 and budgetary policy in the Member States"

List of Graphs and Tables

A. Graphs

B. Tables

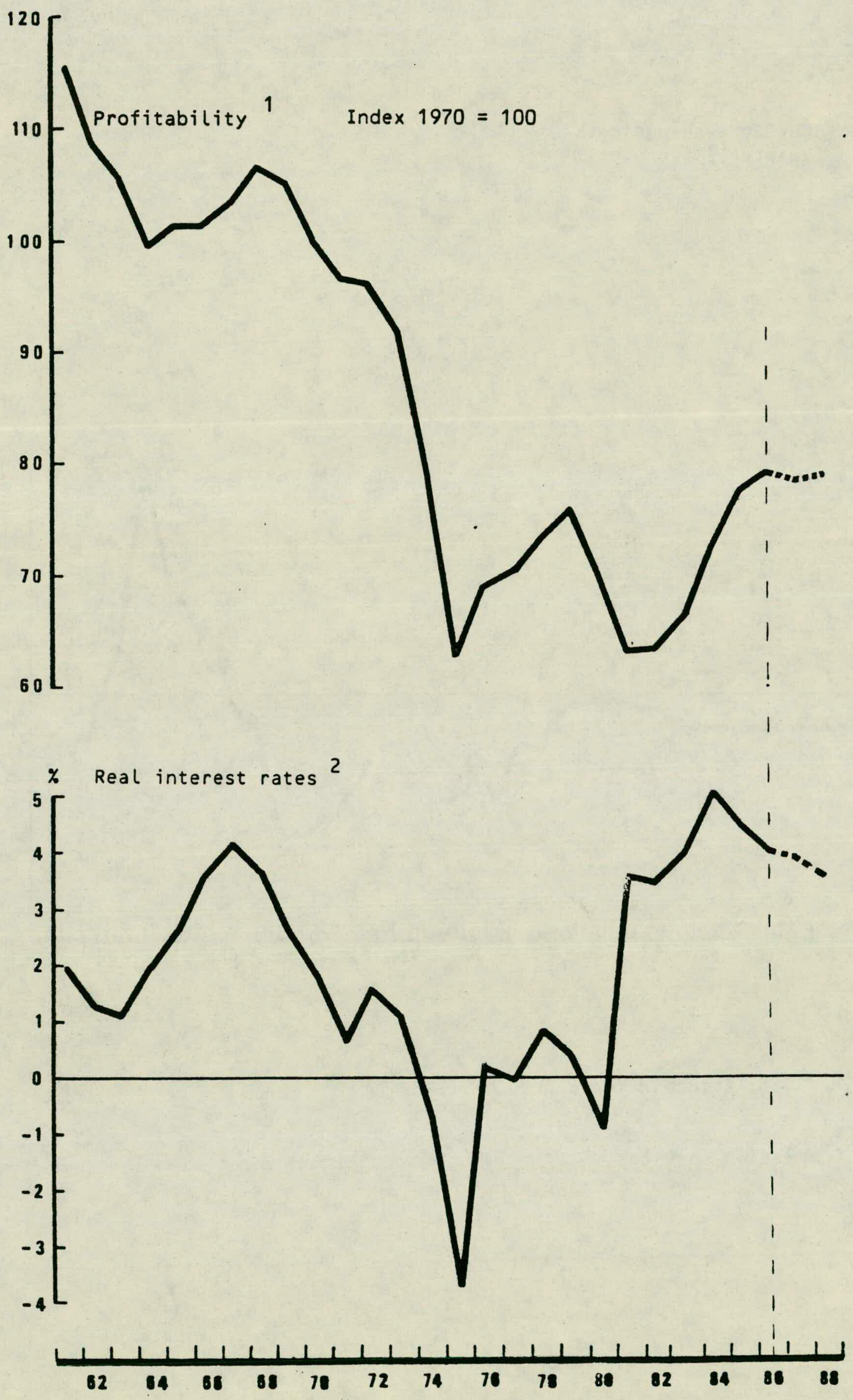
Graph 3: ECU/USD exchange rate (quarterly averages) [1]



[1] for 1987/1988: Economic forecasts, May 1987

Source: Commission services

Graph 2: Profitability and Real interest rates (EUR4)

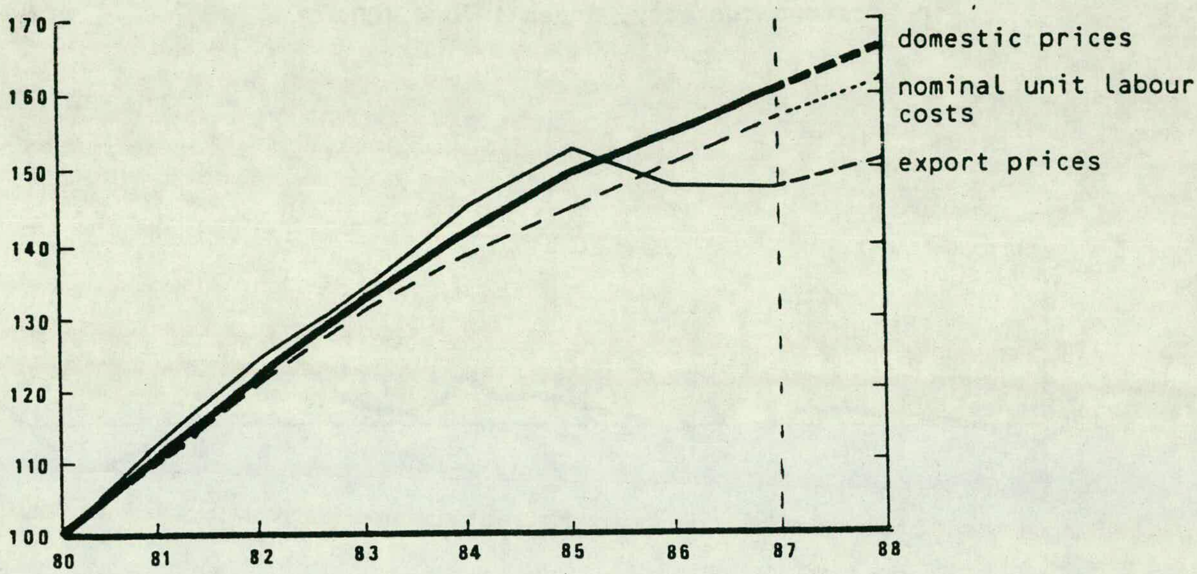


1 Net operating surplus (adjusted for the imputed income of independents) as a percentage of the net capital stock in the non-agricultural business sector (excluding housing)

2 Long term interest rates deflated by GDP prices in the respective years (EUR4)

Source: Commission services

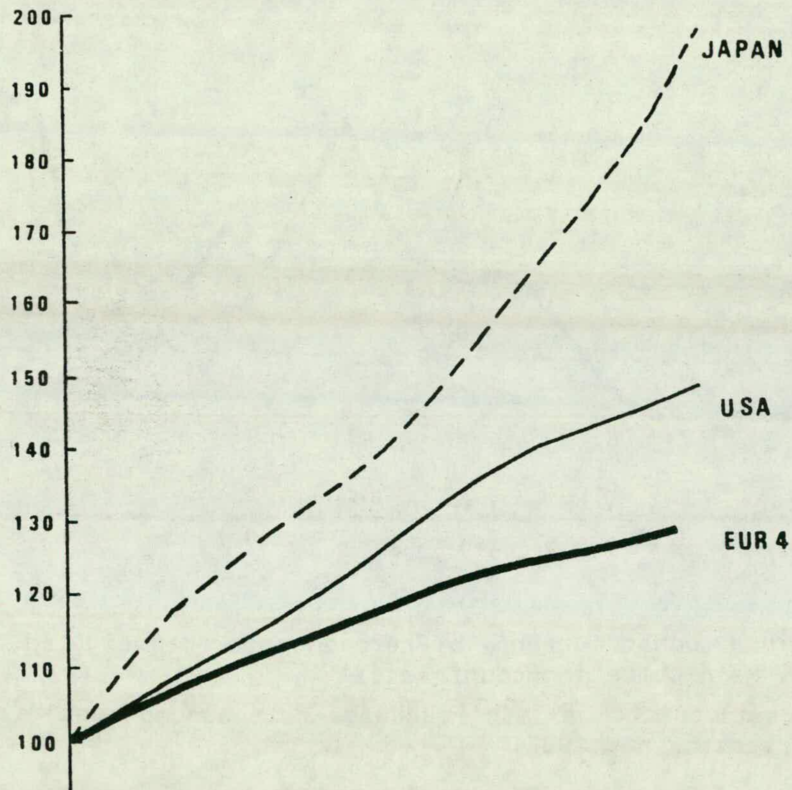
Graph 5: Domestic demand deflator, export deflator (goods and services) and nominal unit labour costs in the total economy [1] (EUR12 in national currencies, indices 1980 = 100)



[1] The series are designed to serve as indicators for domestic prices, export prices and domestic costs, respectively
For 1987/1988: economic forecasts, May 1987

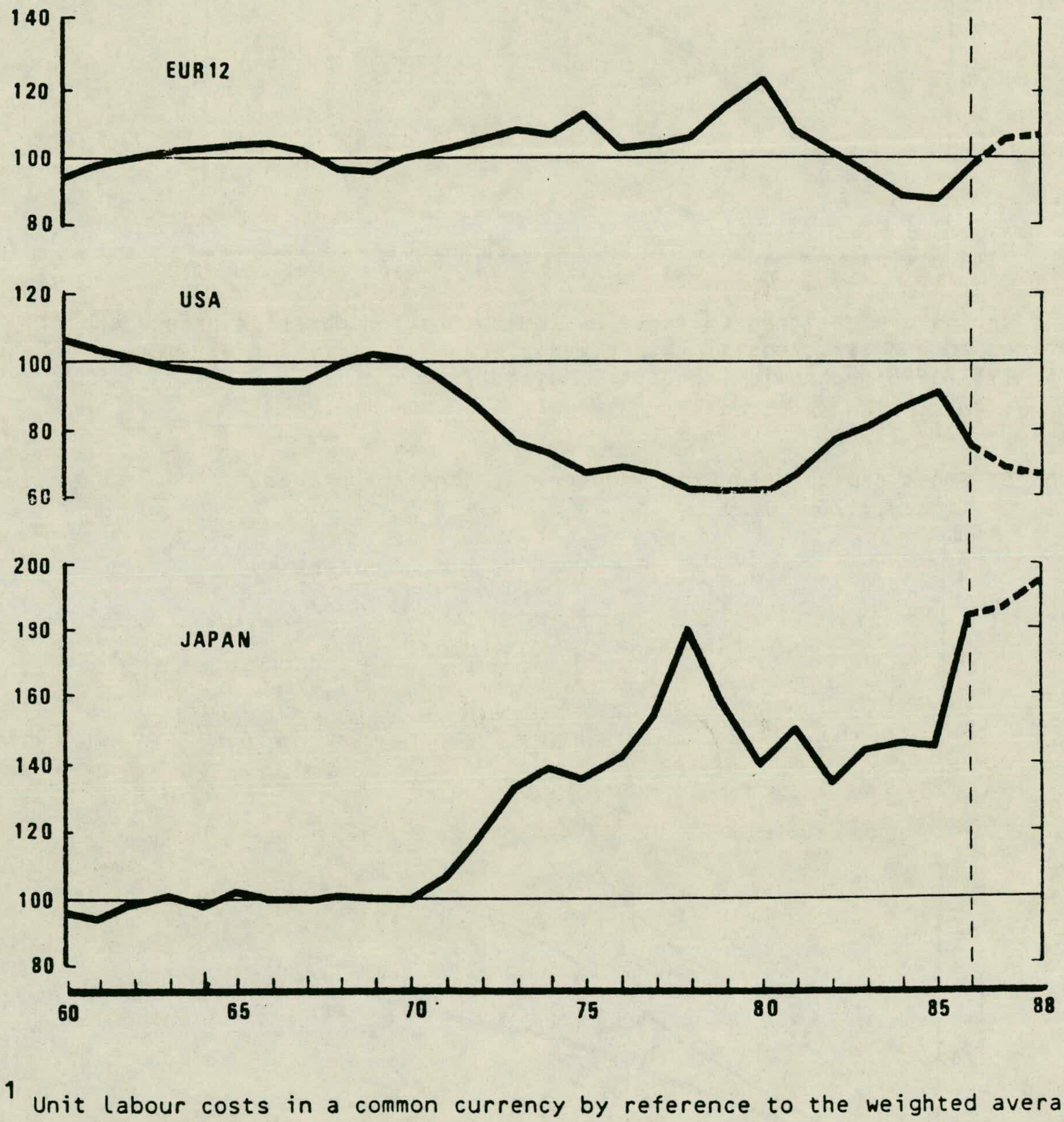
Source: Commission services

Graph 6: Gross capital stock in industry at constant prices (index 1973 = 100)



Source: Commission services, sectoral database

Graph 4: Relative unit labour costs in the total economy
(in a common currency, index 1970 = 100) [1]

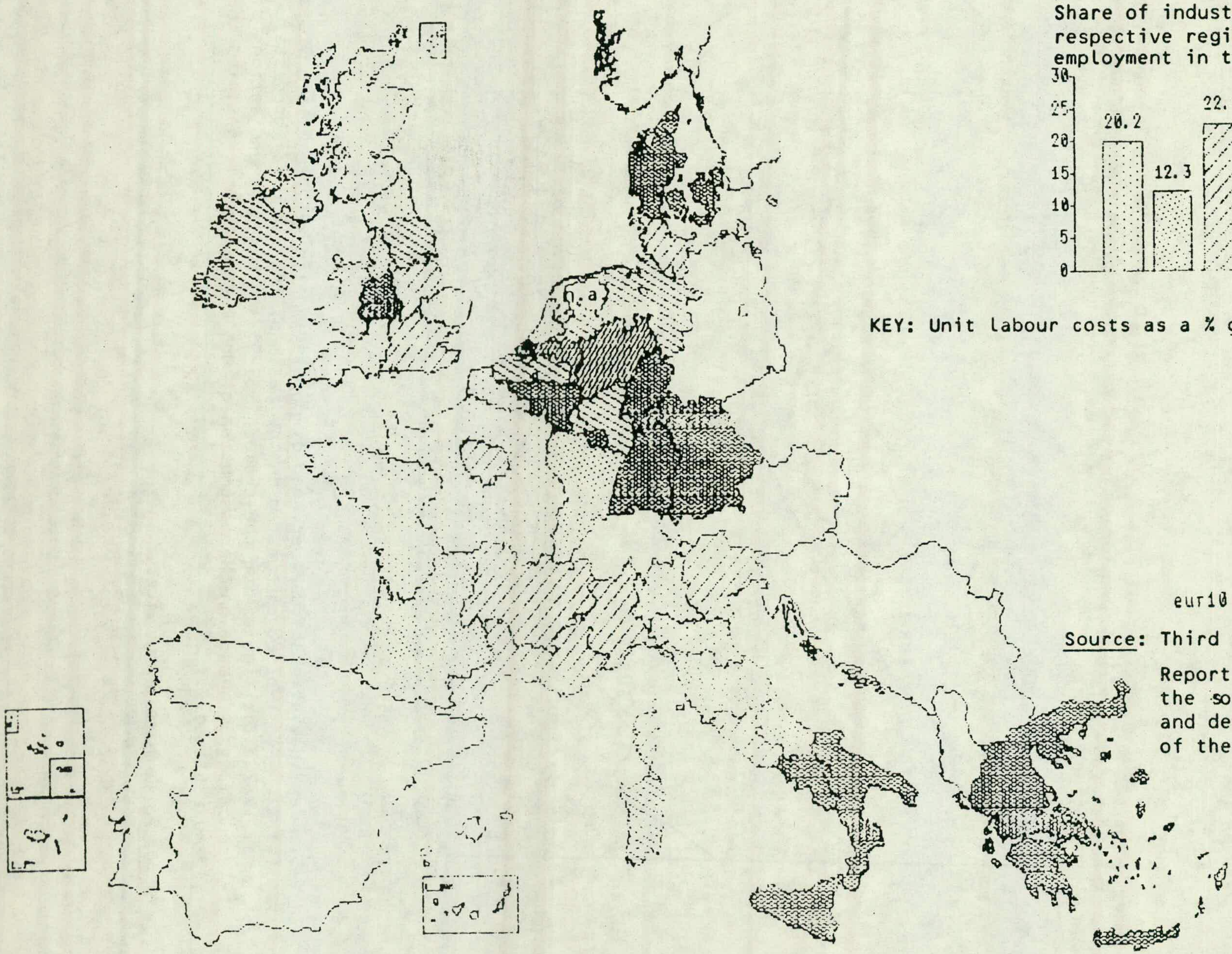


[1] Unit labour costs in a common currency by reference to the weighted average for 9 (EUR12) or 19 main competing countries.

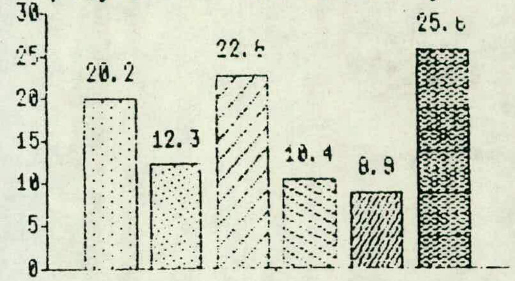
For 1987/1988 forecasts on the basis of exchange rate assumptions of the economic forecasts, May 1987

Source: Commission services

Graph 8 : Unit labour costs in industry - 1981 (EUR10)



Share of industrial employment in respective regions in total industrial employment in the Community.



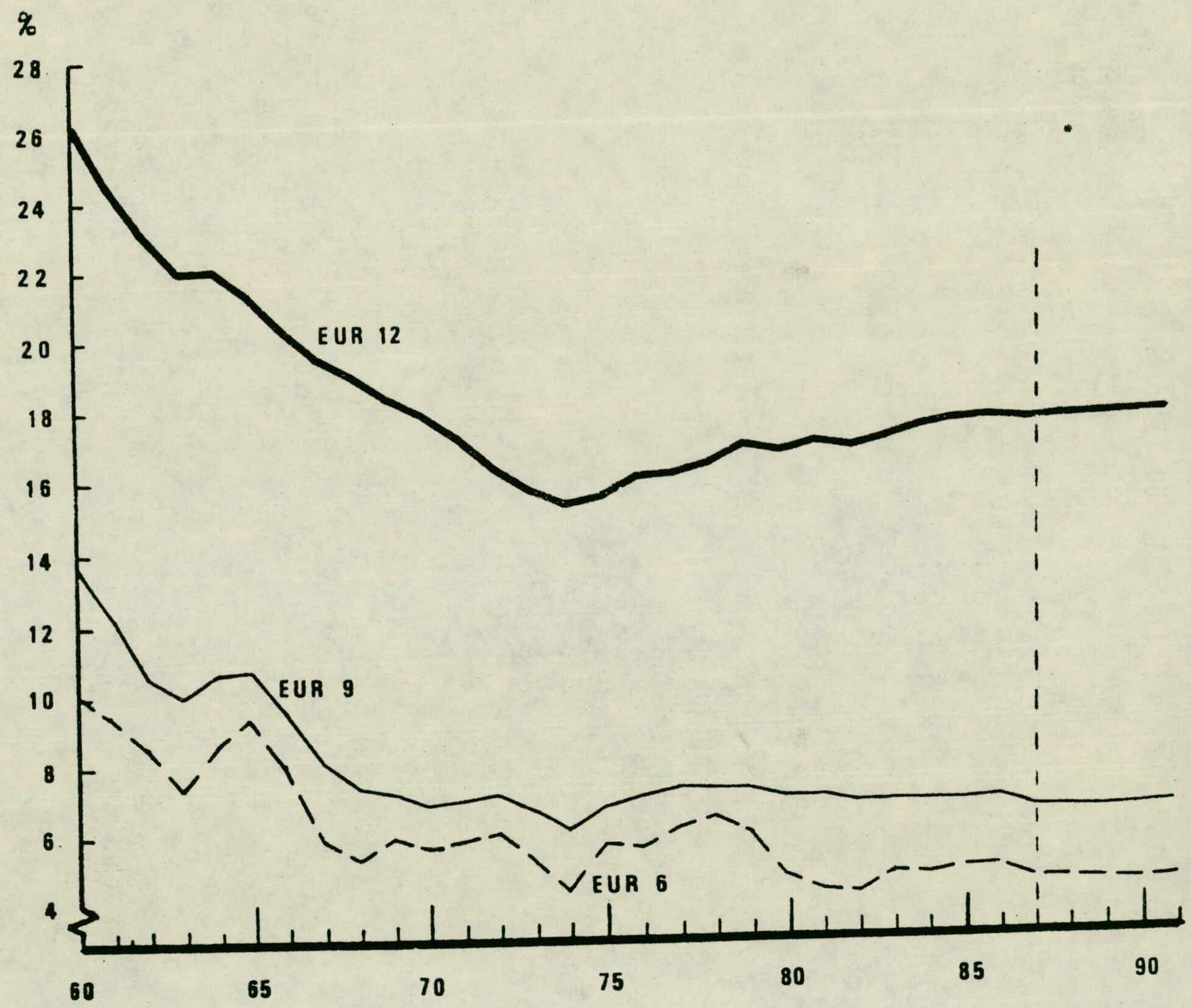
KEY: Unit labour costs as a % of the Community average

1 : < 90.3
2 : 90.3 - 95.1
3 : 95.1 - 100.0
4 : 100.0 - 104.9
5 : 104.9 - 109.7
6 : > 109.7

eur10 = 100.0

Source: Third periodic Report from the Commission on the social and economic situation and development of the Regions of the Community

Graph 7: Standard deviation of GDP per capita in Community countries[1]



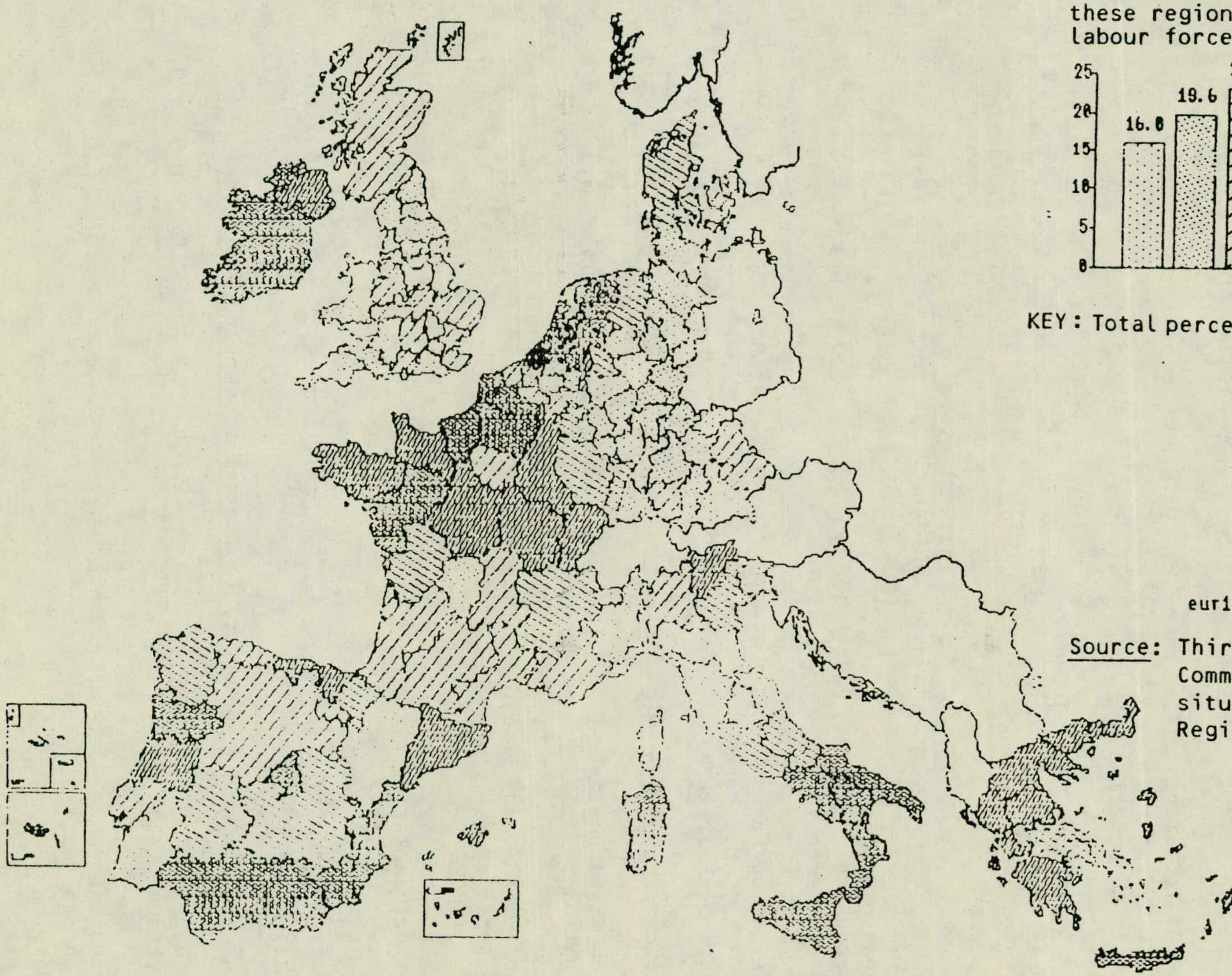
[1] Standard deviation of GDP per head of population (in PPS) in Member States (as %). For 1987-88 calculated on the basis of the Economic Forecasts, May 1987. The figures for the period 1989-91 are based on projections of economic growth made on the assumption of unchanged economic policies in Member States.

Source: Commission services.

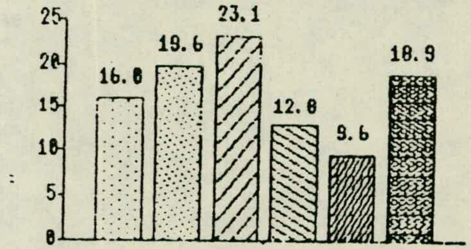
Table 1:
Main indicators of the economic situation in the Community (EUR12)

	average 1973/60	average 1981/73	1982	1983	1984	1985	1986*	1987*	1988*
a) Macroeconomic performance									
GDP at constant prices(% change p.a.)	4,8	2,0	0,6	1,5	2,4	2,5	2,5	2,2	2,3
Unemployment rate					11,7	12,1	12,0	11,8	11,8
	2,2[1]	5,1[1]	9,0[1]	10,1[1]	10,6[1]				
Rate of inflation (price deflator of private consumption % change p.a.)	4,6	12,2	10,5	8,5	7,0	5,9	3,7	3,2	3,3
Current account balance (% of GDP)	0,4	-0,5	-0,9	-0,1	-0,1	0,6	1,3	0,8	0,5
b) Indicators of demand[2] (percentage change on previous year)									
Domestic demand - Community performance	5,0	1,6	0,9	1,0	1,9	2,4	3,7	3,1	2,7
- Deviation from average of other OECD member states	-0,5	-0,6	0,9	-1,8	-3,4	-1,1	0,0	0,6	0,0
Private consumption	5,0	2,4	0,7	1,3	1,3	2,4	3,7	3,1	2,8
Gross fixed capital formation	5,5	0,1	-1,8	0,2	1,6	2,3	3,6	4,1	3,7
Exports of goods and services	8,0	4,2	1,0	2,9	7,7	4,9	1,7	2,3	3,4
- Extra-Community export market growth (goods)[9]	:	:	-3,0	5,5	11,5	2,0	-0,2	0,9	3,0
- Extra-Community exports (goods)	:	:	-2,0	-1,2	7,5	4,4	-5,9	-2,5	0,9
c) Indicators of supply conditions									
Employment (% change p.a.)	0,3	-0,1	-0,9	-0,7	0,0	0,5	0,8	0,6	0,5
Productivity (% change p.a.)	4,5	2,1	1,5	2,0	2,3	1,8	1,8	1,6	1,8

Graph 9: Total percentage change of labour force 1985-95 without migration



Share of labour force in these regions as a % of total labour force in the Community



KEY: Total percentage change 1995/85

1 :	< -0.4
2 :	-0.4 - 2.2
3 :	2.2 - 4.8
4 :	4.9 - 7.5
5 :	7.5 - 10.2
6 :	> 10.2

eur12 - 4.9

Source: Third periodic Report from the Commission on the social and economic situation and development of the Regions of the Community

TABLE 2 : THE MAIN MACRO-ECONOMIC AGGREGATES, 1972-1986, AND COMMISSION FORECASTS FOR 1987 AND 1988 (*)

A) GROSS DOMESTIC PRODUCT; REAL PERCENTAGE CHANGE ON PRECEDING YEAR (a)

	1972 - 1979	1980	1981	1982	1983	1984	1985	1986	1987 forecast of X-86	1987 forecast of V-87	1988
B (c)	3.1	4.1	-1.5	1.9	-.3	1.7	1.5	2.2	1.3	1.2	2.1
DK (c)	2.5	-.4	-.9	3.0	2.0	3.4	3.8	3.4	1.8	-.2	.5
D (c)	2.8	1.4	.2	-.6	1.5	2.7	2.6	2.5	3.2	1.5	2.0
GR (b)	4.8	1.8	-.3	-.2	.4	2.8	2.1	1.3	-.2	-.7	.6
E (c)	3.9	1.5	-.2	1.2	1.8	1.9	2.2	3.0	3.0	2.8	3.0
F (b)	3.7	1.1	.5	1.8	.7	1.5	1.1	2.4	2.5	1.5	2.4
IRL (c)	5.1	3.1	3.4	1.4	-1.9	4.2	2.0	.5	3.1	1.1	1.6
I (c)	3.2	3.9	.2	-.5	-.4	2.6	2.3	2.7	3.6	3.2	2.8
L (c)	3.0	1.4	-1.0	1.5	3.2	5.5	2.9	2.3	2.6	2.0	1.6
NL (c)	3.0	.9	-.7	-1.4	1.4	2.4	1.7	2.1	1.8	1.7	1.1
P (e)	5.2	.7	-1.5	7.8	-1.4	-2.8	4.1	4.3	3.5	3.4	3.0
UK (c)	2.3	-2.3	-1.2	1.0	3.8	2.1	3.7	2.4	2.7	3.1	2.6
EUR (c)	3.2	1.1	-.2	.6	1.5	2.4	2.5	2.5	2.8	2.2	2.3
USA (d)	3.0	-.2	1.9	-2.5	3.6	6.4	2.8	2.5	2.3	2.3	2.5
JAP (c)	4.7	4.4	3.9	2.8	3.2	5.0	4.5	2.5	2.4	2.7	3.2

(a) GROSS NATIONAL PRODUCT FOR THE USA AND JAPAN
(b) 1970 PRICES
(c) 1980 PRICES
(d) 1982 PRICES
(e) 1985 PRICES

B) IMPLICIT DEFLATOR OF PRIVATE CONSUMPTION; PERCENTAGE CHANGE ON PRECEDING YEAR

	1972 - 1979	1980	1981	1982	1983	1984	1985	1986	1987 forecast of X-86	1987 forecast of V-87	1988
B	7.4	6.4	8.0	7.3	7.5	6.2	4.8	1.3	1.5	1.5	2.0
DK	10.6	10.7	12.0	10.2	7.2	6.5	5.0	3.6	2.8	4.3	4.3
D	5.1	5.8	6.0	4.7	3.2	2.4	2.1	-.4	1.1	.8	2.0
GR	13.5	21.5	23.4	20.8	17.9	18.4	18.6	22.1	12.5	13.5	9.0
E	16.0	9.9	14.3	14.5	12.3	10.7	8.3	9.1	5.3	6.0	5.4
F	9.4	13.2	12.8	11.2	9.5	7.2	5.5	2.7	2.3	2.7	2.3
IRL	13.9	18.6	19.6	15.9	10.0	7.5	4.2	3.6	3.2	3.2	3.5
I	15.1	20.2	19.2	17.0	15.1	11.1	9.4	6.3	4.0	4.3	3.7
L	6.8	7.5	8.7	10.8	8.1	6.4	3.3	.3	1.3	1.3	2.6
NL	7.5	6.9	6.3	5.3	2.7	2.5	2.6	-.0	-1.0	-.9	1.2
P	17.5	25.0	20.0	16.7	28.6	33.3	16.7	11.7	9.0	9.5	8.0
UK	13.5	16.2	11.4	8.7	5.0	4.8	5.2	3.7	3.9	3.9	4.2
EUR	10.9	12.8	12.0	10.5	8.5	7.0	5.9	3.7	3.0	3.2	3.3
USA	6.9	10.7	9.2	5.7	3.9	3.8	3.1	2.1	3.4	3.5	3.8
JAP	9.0	7.1	4.4	2.6	1.9	2.1	2.2	.7	.2	.0	.5

C) BALANCE ON CURRENT TRANSACTIONS WITH REST OF WORLD AS PERCENTAGE OF GDP (a)

	1972 - 1979	1980	1981	1982	1983	1984	1985	1986	1987 forecast of X-86	1987 forecast of V-87	1988
B	.1	-4.5	-4.6	-3.3	-.5	-.4	.4	2.5	2.8	3.5	3.6
DK	-2.9	-3.7	-3.0	-4.3	-2.6	-3.3	-4.5	-5.1	-3.6	-3.3	-2.5
D	1.1	-1.7	-.7	.5	.6	1.1	2.2	3.9	2.1	2.8	2.0
GR	-2.5	.5	-.7	-4.4	-5.1	-4.0	-8.2	-5.4	-3.7	-4.7	-5.2
E	-1.1	-2.4	-2.7	-2.5	-1.5	1.3	1.7	1.9	3.7	.7	.3
F	-.4	-1.4	-1.4	-3.0	-1.7	-.8	-.8	-.2	.4	-.4	-.4
IRL	-6.0	-11.8	-14.7	-10.6	-7.0	-6.1	-3.2	-1.8	-1.3	-1.4	-1.2
I	-.2	-2.2	-2.2	-1.6	.3	-.6	-.9	.8	.9	.5	.1
L	18.8	19.9	23.0	35.2	38.5	38.9	42.4	41.5	30.7	39.7	38.3
NL	1.7	-1.5	2.2	3.2	3.1	4.1	4.3	2.9	2.8	1.6	1.5
P	-3.5	-5.6	-11.4	-12.4	-6.3	-1.9	1.7	3.9	4.2	1.0	-.8
UK	-1.2	1.5	2.3	1.2	.7	-.3	.8	-.3	-.6	-.8	-.7
EUR	-.1	-1.3	-.8	-.9	-.1	.1	.6	1.3	.9	.8	.5
USA	.2	.1	.2	-.3	-1.4	-2.6	-2.9	-3.4	-3.3	-3.3	-2.9
JAP	.5	-1.0	.5	.7	1.8	2.8	3.7	4.3	3.5	3.8	3.3

(a) NATIONAL ACCOUNTS BASIS. THESE FIGURES CAN DIFFER FROM THOSE PUBLISHED ON A BALANCE OF PAYMENTS BASIS.

D) NUMBER OF UNEMPLOYED AS PERCENTAGE OF THE CIVILIAN LABOUR FORCE, ANNUAL AVERAGE (a)

	1972 - 1979	1980	1981	1982	1983	1984	1985	1986	1987 forecast of X-86	1987 forecast of V-87	1988
B	5.5	9.1	11.1	13.0	14.3	14.4	13.7	12.7	13.4	12.8	12.8
DK	4.2	6.7	8.7	9.3	10.1	9.9	8.8	7.6	7.7	8.0	8.6
D	2.9	3.4	4.8	6.9	8.4	8.4	8.4	8.1	7.7	7.9	8.0
GR	-	-	4.2	5.8	7.8	8.1	7.8	7.4	8.3	8.0	8.7
E	-	-	14.4	16.2	17.7	20.6	22.0	21.5	21.5	21.3	21.3
F	3.7	6.4	7.7	8.7	8.9	10.0	11.0	11.5	10.7	11.6	12.2
IRL	7.5	8.2	10.2	12.3	14.9	16.6	17.8	18.3	18.0	18.7	18.3
I	5.5	7.2	8.0	9.7	10.9	11.9	12.9	13.0	12.8	13.0	12.6
L	.3	.7	1.0	1.3	1.6	1.8	1.6	1.4	1.2	1.3	1.2
NL	4.6	6.2	8.8	11.8	14.3	14.5	13.1	12.1	11.1	11.4	11.1
P	-	-	-	-	-	8.5	8.7	8.6	8.5	8.5	8.5
UK	3.9	6.0	9.2	10.6	11.6	11.8	12.0	12.1	12.0	11.3	10.8
EUR12	-	-	-	-	-	11.7	12.1	12.0	11.7	11.8	11.8
EUR9	4.0	5.7	7.4	9.0	10.1	10.6	11.2	11.2	10.8	11.0	10.9
USA	6.4	7.1	7.6	9.7	9.6	7.5	7.2	7.0	6.9	6.7	6.8
JAP	1.8	2.0	2.2	2.4	2.7	2.7	2.6	2.8	2.9	3.2	3.3

(a) SOEC DEFINITION; EUR9 : REGISTERED UNEMPLOYED; GR, E, P : LABOUR FORCE SAMPLE SURVEY

(*) THESE FIGURES CAN DIFFER FROM THOSE PUBLISHED IN 'ECONOMIC FORECASTS 1987-1988 APRIL/MAY 1987', BECAUSE THE NATIONAL ACCOUNTS OF SOME COUNTRIES HAVE BEEN UPDATED SINCE THEN.

Table 1: (cont.)
Main indicators of the economic situation in the Community (EUR12)

	average 1973/60	average 1981/73	1982	1983	1984	1985	1986*	1987*	1988*
		c) Indicators of supply conditions (contd.)							
Real unit labour costs[7] (Index 1973 = 100)	98,9	103,0	101,5	100,8	99,3	98,2	97,1	97,0	96,7
Profitability[3] (Index 1973 = 100)	117,9	76,7	69,2	72,4	79,3	84,8	86,3	85,6	86,0
Investment in equipment (% change p.a.)[8]	:	1,7	-1,0	2,1	5,8	9,2	4,5	5,3	4,6
Investment in construction (% change p.a.)[8]	:	-1,4	-1,9	0,3	1,2	-3,1	2,7	2,8	2,8
Competitiveness based on unit labour costs[4] (Index 1973 = 100)	94,6	101,3	92,1	86,9	80,4	79,7	88,9	96,6	97,3
		d) Economic policy indicators							
Compensation per employee - nominal	10,0	14,8	11,1	9,9	7,4	6,8	6,2	5,7	5,1
- real (deflated by the private consumption deflator)	5,1	2,3	0,5	1,3	0,3	0,9	2,4	2,4	1,7
Monetary expansion (annual average)	11,4[1]	13,7	11,3	11,2	9,5	8,5	10,3	8,7	7,5
General government borrowing (% of GDP)	-1,1[5]	-4,1[5]	-5,4	-5,2	-5,3	-5,1	-4,9	-4,6	-4,4
Gross debt of general government (% of GDP)	37,5[5]	43,4[6]	48,1	51,4	54,8	57,4	58,9	61,2	63,2

1 EUR9 (without Greece, Spain and Portugal).
2 All indicators at constant prices.
3 Estimates for EUR4.
4 Real effective exchange rates on the basis of unit labour costs: total economy.
5 EUR9 (without Greece, Ireland and Portugal); 1973 and 1981 respectively
6 EUR12 1981.
7 Compensation per employee deflated by the GDP price deflator divided by real output pe person in employment.
8 To 1985 EUR10, from 1986 EUR12.
9 Change in imports of third countries weighted by the Community's export structure.
* Estimates and Economic Forecasts of Commission services (May 1987).

Source: Eurostat and Commission services.

Table 4: Compensation per employee
(% change p.a.)

	1973/1960	1981/1973	1982	1983	1984	1985	1986*	1987*	1988*
			a) Nominal compensation per employee						
B	8,9	10,9	8,2	6,0	5,8	4,4	2,4	3,6	2,8
DK	10,7	11,4	11,9	8,2	5,3	4,8	4,3	7,0	5,2
D	9,2	7,1	4,2	3,8	3,4	3,0	3,9	3,5	3,5
GR	10,2	21,2	27,8	21,3	21,2	21,7	13,2	9,9	9,0
E	14,5	21,0	13,8	14,5	11,8	9,9	8,4	7,4	6,5
F	9,9	14,7	13,7	10,6	8,1	5,8	4,7	3,6	4,0
IRL	11,3	19,3	14,4	11,6	11,8	7,5	6,7	6,3	4,9
I	11,6	20,5	16,2	16,0	11,4	10,2	7,7	8,4	6,1
L	7,4	10,7	6,9	6,8	7,2	4,1	4,0	4,8	5,0
NL	11,4	8,7	5,8	3,2	0,4	1,3	2,4	2,0	1,9
P	12,0	24,6	20,1	16,6	18,7	19,9	18,4	12,8	11,2
UK	8,3	17,0	9,3	9,1	5,1	7,3	7,3	6,9	6,7
EUR12	10,0	14,8	11,1	9,9	7,4	6,8	6,2	5,7	5,1
			b) Deflated by private consumption prices						
B	5,1	2,9	0,9	-1,4	-0,4	- 0,3	1,1	2,1	0,8
DK	3,8	0,4	1,5	1,3	-1,1	-0,0	0,7	2,6	0,8
D	5,4	2,0	-0,5	0,6	1,0	0,9	4,3	2,7	1,5
GR	6,5	3,7	5,8	2,9	2,4	2,6	-7,3	-3,2	-0,0
E	7,3	3,1	-0,6	1,9	1,0	1,5	-0,6	1,3	1,0
F	5,1	3,2	2,3	1,0	0,8	0,4	2,0	0,9	1,7
IRL	5,0	2,3	-1,3	1,5	4,0	3,2	3,0	3,0	1,4
I	6,5	2,5	-0,0	1,0	0,0	0,8	1,3	4,0	2,4
L	4,2	2,9	-3,5	-1,2	0,7	0,7	3,7	3,4	2,3
NL	6,0	1,6	0,5	0,4	-2,0	-1,3	2,4	2,9	0,7
P	8,3	2,5	-2,0	-7,1	-8,2	0,8	6,0	3,0	3,0
UK	3,3	1,6	0,6	3,9	0,4	2,0	3,5	2,9	2,3
EUR12	5,1	2,3	0,5	1,3	0,3	0,9	2,4	2,4	1,7
			c) Deflated by GDP prices						
B	4,6	3,5	1,2	-0,4	0,5	-0,6	-2,3	0,8	1,0
DK	3,4	1,3	1,2	0,5	-0,4	-0,5	-0,6	2,0	1,3
D	4,6	2,3	-0,2	0,5	1,4	0,8	0,8	1,5	1,4
GR	5,5	4,2	2,3	1,8	0,9	3,5	-4,9	-3,0	0,4
E	6,9	3,5	-0,0	2,6	0,8	1,1	-2,6	1,0	1,1
F	4,8	3,4	1,0	1,0	0,8	-0,0	0,1	0,3	1,6
IRL	3,9	3,9	-1,1	0,3	5,2	2,4	1,5	2,3	1,3
I	5,9	2,4	-0,0	0,6	1,1	1,3	-0,3	2,3	1,9
L	2,9	3,7	-3,3	-0,9	0,8	0,7	-1,8	1,8	2,8
NL	5,0	1,7	-0,3	1,3	-1,7	-1,0	2,2	2,9	0,6
P	7,7	4,4	-1,7	-5,8	-5,1	-1,4	0,8	2,7	2,6
UK	3,0	0,9	1,5	3,8	1,0	1,4	3,5	2,3	1,7
EUR12	4,6	2,4	0,4	1,3	0,8	0,7	0,6	1,5	1,5

* Estimates and Economic Forecasts of Commission services (May 1987)

Source: Eurostat and Commission services.

Table 3: Medium term projection 1987-1991
(average annual growth rates as %)

	Historic data EUR12			Projection
	1961-70	1971-80	1981-86	1987-91
Real GDP	4,8	3,0	1,6	2,6
Private consumption	5,0	3,4	1,7	2,9
Public consumption	3,6	3,1	1,6	1,6
Gross fixed capital formation	6,0	1,5	0,2	4,2
Exports of goods and services	7,8	5,8	3,7	3,8
Imports of goods and services	8,6	5,4	2,9	4,9
GDP deflator	4,4	10,9	8,0	3,4
Price of private consumption	3,8	10,7	7,9	3,4
Total employment	0,2	0,2	-0,3	0,6
Unemployment rate 1)	2,0 4)	6,1	12,0	10,6
Real per capita wage 5)	4,6	3,2	1,0	1,7
Labour productivity 2)	4,6	2,8	1,9	1,9
Real wage cost per unit of output	0,0	0,4	-0,9	-0,2
General government net lending 3)	+0,1 4)	-3,6	-5,0	-3,0
Current balance 3)	+0,5	-1,3	+1,1	-0,7

1) As percentage of labour force, end of period.
2) Real GDP per person employed.
3) As % of nominal GDP, end of period.
4) EUR9 (excluding Greece, Spain and Portugal).
5) Deflated by the GDP deflator

Source: Commission services.

The medium term projections have been made under the assumption of unchanged policy and behaviour. The main exogenous assumptions are :

(i) starting from an average level (all origins taken together) of $16 a barrel in 1988, the price of oil imports into the Community will climb gradually to $24 a barrel in 1992;
(ii) non-EEC world demand will pick up gradually from 1987 to 1991, to increase by an average of 4,1% a year in volume terms;
(iii) real exchange rates will remain stable during the period 1989-91;
(iv) the period 1989-91 will see no marked recession in the other OECD economies nor any major debt crisis for the developing countries;
(v) after the fall in nominal interest rates forecast between 1986 and 1988 they will remain at this level in 1989-91;
(vi) the keynote of budgetary policy within the Community will continue to be the determination to cut public deficits by means of a marked reduction in current and capital public expenditure as a proportion of GDP accompanied by a stabilization or slight fall in the burden of charges.

Table 6: Investment ratios in the Community
(Gross fixed capital formation as % of GDP, at current prices)

	1970	1973	1980	1983	1984	1985	1986*	1987*	1988*
B	22,7	21,4	21,1	16,3	16,1	15,9	16,2	16,2	16,5
DK	24,7	24,8	18,8	16,0	17,0	18,5	19,2	19,2	17,9
D	25,5	23,9	22,7	20,5	20,2	19,5	19,6	19,6	19,9
GR	23,6	28,0	24,2	20,4	18,5	19,0	18,1	18,1	18,2
E	26,5	26,9	22,1	20,6	19,0	19,1	21,0	21,0	21,7
F	23,4	23,8	21,9	19,8	19,0	18,9	18,9	18,9	19,4
IRL	22,7	25,3	28,6	23,0	21,3	20,9	19,0	19,0	18,9
I	26,2	25,5	24,3	21,3	21,2	21,2	20,0	20,0	19,8
L	23,1	27,2	27,0	21,9	20,3	20,2	19,7	19,7	19,8
NL	25,9	23,1	21,0	18,2	18,5	18,6	20,4	20,4	20,8
P	23,2	26,8	28,6	29,5	23,9	21,8	22,6	22,6	23,7
UK	19,0	20,0	18,2	16,3	17,4	17,2	17,5	17,5	17,8
EUR12	23,9	23,7	21,9	19,6	19,3	19,1	18,9	19,2	19,5

* Estimates and Economic Forecasts of Commission services (May 1987).

Source: Eurostat and Commission services.

Table 5: Productivity and real unit labour costs
(% change p.a.)

	1973/1960	1981/1973	1982	1983	1984	1985	1986*	1987*	1988*
					a) Labour productivity[1]				
B	4,3	2,2	3,2	0,7	1,7	0,7	1,5	1,3	2,0
DK	3,2	1,1	2,6	2,2	2,0	1,1	1,3	-0,6	0,3
D	4,1	2,3	1,1	3,0	2,6	1,9	1,5	0,9	1,7
GR	8,2	1,6	0,6	-0,7	2,5	1,1	1,0	-0,8	0,6
E	6,3	3,7	2,2	2,6	5,0	3,2	0,9	1,0	2,3
F	4,9	2,3	1,7	1,2	2,5	1,4	2,4	1,8	2,6
IRL	4,3	3,3	1,3	0,2	5,9	4,9	2,1	1,9	1,0
I	5,7	1,9	-0,3	-0,0	2,7	1,3	1,9	2,6	1,7
L	3,0	0,6	1,8	3,5	4,9	1,4	0,3	1,2	1,1
NL	3,9	1,9	1,1	3,4	2,8	0,6	0,7	1,0	0,8
P	7,4	2,6	3,7	-4,4	-0,1	3,6	4,1	3,0	2,7
UK	2,9	1,0	2,8	5,0	0,2	2,4	1,8	2,1	1,7
EUR12	4,5	2,1	1,5	2,0	2,3	1,8	1,8	1,6	1,8
				b) Real unit labour costs[2]					
B	0,3	1,3	-2,0	-1,1	-1,2	-1,3	-3,7	-0,5	-0,9
DK	0,2	0,3	-1,3	-1,7	-2,3	-1,5	-1,8	2,6	1,0
D	0,5	0,0	-1,2	-2,5	-1,2	-1,1	-0,7	0,6	-0,3
GR	-2,5	2,5	1,7	2,5	-1,6	2,4	-5,8	-2,2	-0,2
E	0,5	-0,1	-2,2	-0,0	-4,0	-2,1	-3,4	-0,0	-1,2
F	-0,0	1,1	-0,7	-0,1	-1,6	-1,4	-2,3	-1,5	-1,0
IRL	-0,4	0,6	-2,4	0,0	-0,7	-2,4	-0,6	0,4	0,3
I	0,2	0,5	0,3	0,6	-1,6	-0,1	-2,2	-0,3	0,1
L	-0,2	3,1	-5,0	-4,3	-3,9	-0,7	-2,1	0,7	1,7
NL	1,0	-0,2	-1,3	-2,0	-4,4	-1,6	1,4	1,9	-0,1
P	0,3	1,8	-5,2	-1,5	-5,0	-4,8	-3,2	-0,3	-0,1
UK	0,2	-0,1	-1,3	-1,1	0,8	-1,0	1,6	0,2	0,1
EUR12	0,1	0,3	-1,0	-0,7	-1,5	-1,1	-1,2	-0,1	-0,3

1 Real GDP per person in total employment
2 Compensation per employee deflated by real GDP prices divided by real GDP per person in total employment
* Estimates and Economic Forecasts of Commission services (May 1987).

Source: Eurostat and Commission services.

Table 8: Share of selected items of general government receipts and expenditure in GDP

	1970-1973	1974-1980	1981	1982	1983	1984	1985	1986	1987	1988
					a) Gross fixed capital formation of general government					
B	4,4	3,7	3,7	3,4	3,0	2,6	2,2	2,0	1,7	1,7
DK	4,4	3,7	3,0	2,8	2,3	1,9	2,2	1,7	1,9	2,1
D	4,3	3,6	3,2	2,8	2,5	2,4	2,3	2,4	2,5	2,5
GR	:	:	3,9	2,9	3,4	4,2	4,4	3,6	3,9	3,9
E	2,7	2,2	2,3	3,1	2,8	3,0	2,6	2,6	2,6	2,6
F	3,7	3,3	3,0	3,3	3,1	3,1	3,0	3,0	3,0	3,0
IRL	:	5,3	5,7	5,1	4,4	3,8	3,8	3,5	3,2	2,9
I	2,6	2,9	3,3	3,5	3,6	3,5	3,6	3,4	3,3	3,2
L	4,7	6,3	6,9	6,7	5,4	4,9	4,7	4,5	4,5	4,5
NL	4,4	3,5	3,1	2,9	2,7	2,8	2,6	2,6	2,5	2,5
P	:	:	5,4	4,5	3,9	2,9	2,4	2,7	3,0	3,4
UK	4,7	3,6	1,8	1,6	2,0	2,0	2,0	2,1	2,0	1,9
EUR12	3,8[1]	3,3[1]	2,9	2,9	2,8	2,8	2,7	2,6	2,7	2,7
					b) Direct taxes					
B	12,1	16,8	18,0	19,3	18,6	19,2	19,1	18,2	18,4	18,3
DK	23,8	25,2	25,8	25,4	26,6	27,6	28,5	29,0	28,3	29,6
D	11,5	12,8	12,2	12,1	12,0	12,1	12,5	12,2	12,2	11,8
GR	3,7	4,7	4,7	5,9	5,5	6,0	5,6	6,0	6,6	6,3
E	3,7	5,2	7,2	6,8	7,9	8,3	8,3	8,4	8,4	8,6
F	6,9	7,9	8,8	9,0	9,1	9,3	9,3	9,5	9,5	9,2
IRL	:	10,9	12,9	13,3	14,0	14,9	14,8	15,6	16,3	16,4
I	5,0	7,4	11,0	12,2	13,2	12,9	13,0	12,9	13,0	13,2
L	13,0	18,2	18,0	17,9	19,4	18,2	19,8	18,4	16,7	16,3
NL	14,0	17,0	15,1	14,7	13,6	12,8	12,7	13,6	13,7	14,0
P	:	:	7,3	7,5	8,5	7,4	8,3	6,5	6,1	5,9
UK	13,3	14,2	14,2	14,7	14,3	14,7	14,8	14,1	13,8	13,4
EUR12	9,5[1]	10,9[1]	11,6	12,0	12,2	12,3	12,4	12,3	12,2	12,1
					c) Social security contributions					
B	10,8	12,3	12,7	12,7	13,2	14,0	14,7	14,1	14,5	14,4
DK	2,3	1,6	2,1	2,4	2,9	2,9	2,9	2,5	3,0	3,1
D	13,5	16,4	17,4	17,8	17,3	17,4	17,4	17,3	17,5	17,4
GR	6,6	7,8	9,1	10,3	11,0	10,8	11,5	11,8	12,2	12,1
E	7,4	10,7	13,4	13,3	13,7	13,1	13,1	12,8	12,8	12,5
F	14,8	18,2	20,2	20,9	21,5	21,8	21,8	21,4	21,4	21,4
IRL	:	4,4	4,9	5,5	5,8	5,8	5,8	5,8	5,8	5,9
I	10,8	12,1	12,6	13,5	14,0	13,5	13,6	14,0	13,9	13,9
L	10,5	14,6	15,6	14,9	14,4	13,6	13,5	13,1	13,3	13,3
NL	14,8	17,4	18,7	19,7	21,9	20,8	20,5	19,9	20,1	20,1
P	:	:	7,7	7,6	7,2	8,3	6,5	8,0	8,0	8,1
UK	5,2	6,2	6,3	6,6	6,9	7,0	6,9	6,9	7,0	7,0
EUR12	10,8[1]	13,1[1]	14,0	14,5	14,8	14,7	14,6	14,5	14,6	14,6

[1] Without Greece, Ireland and Portugal.

Source: Commission services.

Table 7: General government expenditure, receipts and lending

a) Total current receipts (% of GDP)

	1970	1973	1981	1982	1983	1984	1985	1986*	1987*	1988*
B	36,5	38,2	45,2	46,8	46,1	47,3	47,8	45,6	46,1	45,7
DK	46,2	47,3	52,9	52,0	54,4	56,7	57,4	58,7	58,4	59,6
D	38,9	42,9	45,6	46,1	45,8	46,1	46,1	45,3	45,1	44,7
GR	26,5	25,1	28,9	32,3	33,5	34,2	34,5	36,0	38,9	37,6
E	22,9	24,1	31,7	31,9	34,0	33,8	34,8	35,6	35,9	36,3
F	39,8	39,4	47,4	48,3	48,9	49,8	49,9	48,9	48,7	48,4
IRL	:	:	38,4	40,5	42,7	43,0	43,1	43,3	44,2	44,3
I	26,7	26,7	33,9	36,4	38,7	38,0	38,5	39,2	39,0	39,6
L	35,8	39,4	54,7	54,1	56,4	54,5	56,5	54,1	52,4	51,8
NL	41,1	46,4	53,8	54,2	55,6	54,7	55,0	53,8	53,1	52,9
P	:	:	30,4	30,4	33,4	31,9	29,5	33,3	33,5	33,7
UK	39,8	35,6	41,6	42,7	41,6	42,0	42,0	40,9	40,5	39,7
EUR12	35,8[1]	36,1[1]	41,8	42,9	43,5	43,7	43,9	43,5	43,3	43,1

b) Total expenditure including capital (% of GDP)

	1970	1973	1981	1982	1983	1984	1985	1986*	1987*	1988*
B	38,6	41,5	58,0	57,8	57,5	56,7	56,2	54,4	52,6	52,1
DK	42,1	42,1	59,8	61,2	61,6	60,7	59,5	55,4	56,3	57,0
D	38,7	41,7	49,3	49,4	48,4	48,1	47,2	46,6	46,8	46,8
GR	:	:	39,9	40,1	41,8	44,3	48,2	46,3	48,3	47,9
E	22,1	22,9	35,6	37,5	38,8	39,3	41,1	41,7	41,3	41,3
F	38,9	38,5	49,1	51,1	52,0	52,7	52,4	51,8	51,5	50,9
IRL	:	:	51,8	54,3	54,5	52,9	54,7	54,0	53,2	52,1
I	29,7	32,8	44,1	47,3	48,7	49,0	50,7	50,4	49,4	48,9
L	33,1	36,1	58,1	55,7	56,2	52,5	52,1	50,2	50,0	49,9
NL	42,3	45,4	59,2	61,3	62,0	61,0	60,1	59,8	59,7	58,9
P	:	:	40,9	39,5	41,0	39,6	40,1	41,7	42,5	42,8
UK	36,9	38,3	44,4	45,0	45,2	45,9	44,8	44,2	43,0	42,0
EUR12	35,5[1])	37,2[1])	46,9	48,3	48,7	48,9	49,0	48,4	48,0	47,5

c) Total net lending (+) or borrowing (-) including interest payments (% of GDP)

	1970	1973	1981	1982	1983	1984	1985	1986*	1987*	1988*
B	-2,2	-3,3	-12,8	-11,0	-11,3	-9,4	-8,4	-8,7	-6,5	-6,3
DK	4,1	5,2	-6,9	-9,1	-7,2	-4,1	-2,1	3,3	2,1	2,5
D	0,2	1,2	-3,7	-3,3	-2,5	-1,9	-1,1	-1,2	-1,7	-2,1
GR	:	:	-11,0	-7,8	-8,4	-10,1	-13,7	-10,3	-9,4	-10,3
E	0,7	1,1	-3,9	-5,6	-4,8	-5,5	-6,3	-6,0	-5,4	-5,0
F	0,9	0,9	-1,8	-2,7	-3,1	-2,9	-2,6	-2,9	-2,8	-2,5
IRL	:	:	-13,4	-13,7	-11,8	-9,9	-11,6	-10,7	-9,0	-7,8
I	-3,1	-6,1	-10,2	-10,9	-10,0	-11,1	-12,3	-11,3	-10,4	-9,3
L	2,7	3,3	-3,4	-1,6	0,2	2,0	4,4	3,9	2,4	2,0
NL	-1,2	1,0	-5,5	-7,1	-6,4	-6,3	-5,1	-6,0	-6,6	-6,0
P	:	:	-10,5	-9,2	-7,6	-7,7	-10,5	-8,5	-9,0	-9,1
UK	2,9	-2,7	-2,8	-2,3	-3,7	-3,9	-2,8	-3,2	-2,4	-2,2
EUR12	0,2[1]	-1,1[1]	-5,2	-5,4	-5,2	-5,3	-5,1	-4,9	-4,6	-4,4

d) Interest payments on the public debt (% of GDP)

	1970	1973	1981	1982	1983	1984	1985	1986*	1987*	1988*
B	3,4	3,3	7,9	9,2	9,4	9,9	10,6	10,9	10,9	11,0
DK	1,3	1,3	5,3	6,0	8,1	9,7	9,9	8,8	8,2	7,7
D	1,0	1,1	2,3	2,8	3,0	3,0	3,0	3,0	2,9	3,0
GR	:	:	3,2	2,6	3,7	4,6	5,4	5,9	6,5	6,2
E	0,6	0,6	0,8	1,0	1,3	2,0	3,5	4,1	4,2	4,3
F	1,1	0,8	2,1	2,2	2,6	2,7	2,8	2,8	2,8	2,7
IRL	:	:	7,4	9,0	9,4	9,6	10,9	10,1	10,4	10,7
I	1,5	2,2	6,2	7,3	7,7	8,2	8,1	8,5	7,7	7,3
L	1,1	1,0	0,9	1,0	1,0	1,2	1,3	1,2	1,2	1,1
NL	2,9	2,8	4,4	5,1	5,7	6,0	6,4	6,4	6,3	6,5
P	:	:	5,4	5,4	6,4	7,1	7,7	9,3	8,7	8,2
UK	3,9	3,7	5,0	5,1	4,7	4,9	5,0	4,7	4,4	4,2
EUR12	1,9[1]	1,9[1]	3,8	4,2	4,5	4,8	5,0	5,1	4,9	4,8

[1] Without Greece, Ireland and Portugal.
* Estimates and Economic Forecasts of Commission services (May 1987).

Source: Eurostat and Commission services.

Table 10: Domestic demand at constant prices in the Member States

a) Real domestic demand (incl. stocks) (% change p.a.)

	1973/1960	1981/1973	1982	1983	1984	1985	1986*	1987*	1988*
B	4,8	1,7	0,4	-2,5	1,8	1,2	3,3	1,6	1,6
DK	4,6	0,0	3,5	1,4	4,1	5,4	5,7	-1,2	-1,3
D	4,5	1,7	-2,0	2,3	1,9	1,5	3,6	2,9	2,8
GR	8,2	2,0	2,9	0,8	-0,4	5,3	-0,9	-1,4	-0,1
E	7,8	1,6	1,1	-0,1	-0,5	2,7	6,2	4,9	3,8
F	5,8	2,5	3,7	-0,4	0,6	1,9	4,0	2,0	2,4
IRL	5,4	3,5	-2,9	-4,1	1,0	-0,4	0,7	0,6	1,1
I	5,5	2,1	0,3	-0,4	4,4	3,1	3,2	4,3	3,3
L	3,9	1,9	0,4	0,5	1,7	0,8	3,9	3,3	2,2
NL	4,9	1,5	-0,9	1,5	1,4	2,2	3,2	3,0	0,9
P	7,5	2,7	3,4	-7,4	-6,6	0,5	8,2	6,1	4,4
UK	3,2	0,1	2,1	4,7	2,8	2,8	3,2	3,5	2,8
EUR12	5,0	1,6	0,9	1,0	1,9	2,4	3,7	3,1	2,7

b) Deviation from the average of the other Member States[1]

	1973/1960	1981/1973	1982	1983	1984	1985	1986*	1987*	1988*
B	-0,0	0,0	-0,2	-3,9	-0,0	-1,0	-0,3	-1,2	-0,8
DK	0,2	-1,4	3,1	-0,2	2,1	3,2	2,1	-4,1	-3,8
D	-0,4	0,1	-3,5	1,6	-0,1	-0,9	0,0	0,1	0,5
GR	3,3	0,4	2,6	-0,4	-2,5	3,0	-4,4	-4,4	-2,7
E	2,9	-0,0	0,2	-1,2	-2,3	0,5	2,5	2,0	1,4
F	1,1	0,9	3,8	-1,7	-1,6	-0,3	0,4	-1,1	-0,2
IRL	1,5	2,4	-3,8	-6,0	-1,0	-2,7	-2,8	-2,3	-1,4
I	0,7	0,5	-0,4	-1,7	2,8	1,0	-0,5	1,6	0,9
L	:	:	:	:	:	:	:	:	:
NL	0,2	-0,1	-1,2	0,4	-0,5	0,2	-0,4	0,2	-1,6
P	2,9	1,3	2,7	-8,7	-8,4	-1,7	4,4	3,1	1,9
UK	-1,9	-1,7	2,0	4,2	1,0	0,8	-0,4	0,8	0,6
EUR12[2]	-0,5	-0,6	0,9	-1,8	-3,4	-1,1	0,0	0,6	0,0

1 National index of domestic demand on the average of the indices for the other Member States (export weights).
2 Deviation from the average of the nine main OECD trading partners
* Estimates and Economic Forecasts of Commission services (May 1987).

Source: Eurostat and Commission services.

Table 9: Gross debt of general government[1]), 1973-88
(% of GDP)

	1973	1981	1982	1983	1984	1985	1986*	1987*	1988*
B[2]	63,2	88,0	95,4	105,1	111,0	117,1	120,8	124,9	128,5
DK	5,0	43,7	53,1	62,6	67,6	65,8	59,8	57,9	55,0
D	18,6	36,4	39,5	41,0	41,9	42,5	42,2	43,5	44,8
GR[3]	:	32,8	36,4	41,6	49,9	57,9	55,1	59,3	65,0
E	12,9	21,4	26,6	33,0	39,8	45,1	46,5	49,0	51,2
F	25,1	26,0	29,1	30,7	32,9	34,9	37,0	38,9	40,3
IRL	:	89,8	96,2	108,5	114,8	118,3	133,2	140,0	145,0
I	54,2	62,8	69,0	75,0	80,6	87,6	91,8	96,5	101,2
L	20,5	14,3	14,4	14,6	14,6	14,2	14,2	14,4	14,7
NL[2]	43,4	50,3	55,6	61,9	66,4	70,1	74,8	81,7	86,7
P	:	47,5	49,9	56,2	61,2	64,8	67,0	72,7	78,8
UK[4]	63,3	51,1	57,8	57,5	59,2	57,7	58,0	56,7	55,7
EUR12	37,5[5]	43,4	48,1	51,4	54,8	57,4	58,9	61,2	63,2

1 Gross monetary and financial liabilities.
2 Public administration excluding social security.
3 State.
4 Debt at market prices.
5 Without Greece, Ireland and Portugal.

* Estimates and Economic Forecasts of Commission services (May 1987). The forecasts are on the basis of unchanged policies.

Source: Eurostat and Commission services.

Table 12: Relative unit labour costs in comparison with principal trading partners
- percentage change on preceding year and index (1970 = 100)[1]

	Relative unit labour cost in national currency		Relative unit labour cost in a common currency		Effective exchange rate
	Index	Change	Index	Change	
EUR12					
1980	119,9	4,8	122,9	6,5	1.6
1981	122,4	2,1	105,3	-14,3	-16,1
1982	123,9	1,2	99,2	-5,9	-7,0
1983	127,8	3,2	93,6	-5,6	-8,5
1984	130,1	1,8	86,6	-7,5	-9,1
1985	131,4	1,0	85,8	-0,9	-1,8
1986	132,2	0,6	95,7	11,5	10,8
1987[2]	133,0	0,6	104,0	8,6	8,0
1988[2]	132,8	-0,2	104,7	0,7	0,9
USA					
1980	82,4	0,5	64,1	0,4	-0,2
1981	82,0	-0,4	72,0	12,3	12,8
1982	83,1	1,3	81,6	13,4	12,0
1983	82,3	-1,0	85,5	4,7	5,7
1984	82,2	-0,1	92,0	7,7	7,8
1985	82,8	0,7	96,5	4,8	4,0
1986	82,2	-0,7	78,2	-19,0	-18,4
1987[2]	82,6	0,4	71,3	-8,7	-9,1
1988[2]	83,4	1,0	69,5	-2,5	-3,4
Japan					
1980	100,6	-7,7	137,3	-11,4	-4,0
1981	95,1	-5,5	147,5	7,4	13,6
1982	89,7	-5,7	132,1	-10,5	-5,0
1983	87,2	-2,7	142,4	7,8	10,9
1984	84,2	-3,5	145,0	1,8	5,5
1985	80,9	-3,9	143,5	-1,0	3,0
1986	78,8	-2,6	180,1	25,5	28,8
1987[2]	76,0	-3,6	180,1	0,0	3,7
1988[2]	74,2	-2,4	184,3	2,3	4,8

[1] Unit labour cost for the total economy in national or common currency by reference to the weighted average for 9 (EUR12) or 19 main competing countries.

[2] Economic forecasts of Commission services (May 1987).

Source: Eurostat, estimates and forecasts by Commission services.

Table 11: Convergence of price developments
(Deflator of private consumption)

	1969/1960	1977/1969	1981/1977	1982	1983	1984	1985	1986*	1987*	1988*
B	3,2	7,4	5,6	7,3	7,5	6,2	4,8	1,3	1,5	2,0
DK	5,7	10,0	10,6	10,2	6,8	6,5	4,8	3,6	4,3	4,3
D	2,7	5,5	4,7	4,7	3,2	2,4	2,1	-0,4	0,8	2,0
GR	2,4	10,5	18,5	20,8	17,9	18,4	18,6	22,1	13,5	9,0
E	5,9	13,4	16,3	14,5	12,3	10,7	8,3	9,1	6,0	5,4
F	4,2	8,3	11,3	11,2	9,5	7,2	5,5	2,7	2,7	2,3
IRL	4,5	13,8	15,2	15,9	10,0	7,5	4,2	3,6	3,2	3,5
I	3,7	12,9	16,4	16,2	14,9	11,4	9,3	6,3	4,3	3,7
L	2,3	6,8	6,2	10,8	8,1	6,4	3,3	0,3	1,3	2,6
NL	4,0	8,0	5,5	5,3	2,7	2,5	2,6	-0,0	-0,9	1,2
P	2,6	13,1	21,6	22,5	25,5	29,3	19,0	11,7	9,5	8,0
UK	3,7	12,4	12,6	8,7	5,0	4,8	5,2	3,7	3,9	4,2
					Weighted average					
EUR12	3,7	9,9	11,3	10,5	8,5	7,0	5,9	3,7	3,2	3,3
EMS	3,6	0,6	9,9	9,9	8,3	6,4	5,1	2,4	2,3	2,5
					Measures of dispersion related to average[1]					
EUR12	0,9	2,5	4,7	4,6	4,7	4,6	3,9	4,1	2,7	1,8
EMS	0,8	2,2	3,9	3,4	2,8	1,9	1,7	1,9	1,5	0,8
					Measures of dispersion related to lowest[1]					
EUR12	1,4	4,7	7,4	7,7	7,6	7,0	5,2	5,8	5,1	2,8
EMS	1,5	3,6	4,8	5,5	5,1	3,8	2,5	2,6	3,1	1,5

[1] The dispersion index is an unweighted sum, disregarding signs, of each country's deviation from the respective reference value (e.g. weighted average or lowest rate).

* Estimates and Economic Forecasts of Commission services (May 1987).

Source: Eurostat and Commission services.

Table 14: Gross fixed capital formation in industry - percentage change on preceding year (in 1980 prices)[1])

	1979/1973	1985/1979	1982/1979	1985/1982
Total industry				
EUR4[2]	-0,4	1,1	-3,8	6,3
USA	5,5	1,4	-3,4	6,5
Japan	-2,1	9,7	9,2	10,2
Strong demand				
EUR4[2]	1,9	1,4	-5,5	8,9
USA	7,2	5,1	3,6	6,6
Japan	-0,8	15,8	13,0	18,6
Moderate demand				
EUR4[2]	2,1	0,8	-2,3	3,9
USA	6,4	1,5	-4,1	7,3
Japan	-1,4	8,3	7,0	9,6
Weak demand				
EUR4[2]	-5,0	0,1	-6,3	6,9
USA	3,0	-2,9	-10,0	4,8
Japan	-3,6	5,4	8,4	2,5

1 For the classification of the sectors with respect to demand growth see Table 13

2 F.R.Germany, France, Italy and United Kingdom.

Source: Commission services, sectoral database.

Table 15: Employment in industry - percentage change on preceding year[1])

	1979/1973	1985/1979	1982/1979	1985/1982
Total industry				
EUR7[2]	-1,3	-2,4	-2,6	-2,1
USA	0,9	-1,4	-3,6	0,9
Japan	-1,7	1,3	0,9	1,7
Strong demand				
EUR7[2]	-0,6	-1,5	-2,3	-0,7
USA	2,1	-0,3	-1,4	0,9
Japan	-2,0	4,9	4,3	5,4
Moderate demand				
EUR7[2]	-0,7	-2,0	-1,8	-2,1
USA	1,3	-0,5	-2,9	2,0
Japan	-0,9	0,6	0,9	0,4
Weak demand				
EUR7[2]	-2,1	-3,2	-3,6	-2,9
USA	-0,2	-3,3	-5,9	-2,0
Japan	-2,1	0,2	-0,6	0,9

1 For the classification of the sectors with respect to demand growth see Table 13

2 F.R.Germany, France, Italy, United Kingdom, Netherlands, Belgium and Denmark.

Source: Commission services, sectoral database.

Table 13: Export market shares*

	1973	1979	1980	1981	1982	1983	1984	1985	Diff. 79-73	Diff. 85-79
Total industry										
EUR10	26,80	27,04	27,25	26,65	26,61	26,03	25,21	25,60	+0,24	-1,44
USA	15,43	15,26	16,35	17,92	17,20	16,49	16,59	15,99	-0,17	+0,73
Japan	10,53	11,38	12,43	15,16	14,62	15,60	16,94	16,75	+0,85	+5,37
Strong demand										
EUR10	27,96	27,40	27,00	25,79	25,75	25,23	24,01	24,86	-0,56	-2,54
USA	17,51	18,08	19,18	20,70	20,91	20,11	20,74	19,32	+0,57	+1,24
Japan	12,36	13,06	14,18	17,34	16,53	18,54	20,62	20,20	+0,70	+7,14
Moderate demand										
EUR10	26,98	26,69	27,66	26,49	26,32	25,34	24,32	24,27	-0,29	-2,42
USA	18,65	17,66	18,26	20,42	19,12	18,21	17,95	17,87	-0,99	+0,21
Japan	9,22	10,86	12,24	14,76	13,98	15,03	16,38	16,52	+1,64	+5,66
Weak demand										
EUR10	25,53	27,23	26,86	27,89	28,12	28,29	28,46	29,16	+1,70	+1,93
USA	8,90	8,81	10,62	10,42	9,37	8,84	8,53	7,76	-0,09	-1,05
Japan	10,93	10,53	10,99	13,43	13,52	12,90	13,02	12,38	-0,40	+1,85

* defined as share of exports of a certain country or zone in total exports of all OECD countries (at current prices); excl. intra-EC trade

Source: Commission services, VOLIMEX database

Products with strong demand:
electrical equipment and electronics, information technology, automated office equipment and precision instruments, chemicals and pharmaceuticals. World demand grew at an average annual growth rate of around 6%.

Products with moderate demand:
transport equipment, food, drink and tobacco, paper pulp-, packaging and printing, rubber and plastics, industrial machinery. World demand expanded by an average of 2%-3% a year.

Products with weak demand:
steel and metal ores, metal goods, textiles, leather and clothing, construction materials and non-metallic minerals. World demand grew by some 1% a year.

The average annual growth rate has been calculated on the basis of the average for 1981/1982 compared with the average 1972/1973. (In USD at 1975 prices and exchange rates.) The classification is based on the growth rate for the area as a whole.

Table 17: Comparable unemployment rates, 1986[1]

Member State	Regional max.	Regional min.	Regional disparity[2]	National average
B	14,2	7,2	2,3	10,2
DK	7,8	5,5	0,8	6,5
D	13,2	3,3	2,4	7,1
GR	10,2	3,6	2,4	7,5
F	13,9	7,1	1,9	10,1
IRL	-	-	-	18,7
I	19,3	4,6	3,5	10,0
L	-	-	-	2,5
NL	13,2	6,5	1,2	9,8
UK	19,1	6,1	3,5	12,0
EUR10[3]	17,7	4,2	3,4	9,7
E	30,2	13,6	5,0	21,5
P	-	-	-	8,7
EUR12[3]	23,2	4,2	5,0	10,8
EUR10[4]	15,5	5,0	-	-
EUR12[4]	20,6	5,0	-	-

1 Registered regional unemployed adjusted by Sample Survey results for national differences in registration practices. These figures differ from data on the basis of statistics for registered unemployment normally used. Unemployment rates for Spain and Portugal come from national surveys.

2 Standard deviation weighted by regional shares of the labour force.

3 Max. and min. = weighted average of 10 regions with highest or lowest rates.

4 Max. and min. = weighted average of 25 regions with highest or lowest rates.

Source : "Third periodic report from the Commission on the social and economic situation and development of the regions of the Community", Eurostat and Commission services.

Table 16: Gross domestic product at current market prices and purchasing power standards per capita ; EUR12 = 100

	B	DK	D	GR	E	F	IRL	I	L	NL	P	UK	EUR12
1960	96,1	119,8	118,2	38,7	58,3	101,4	61,9	91,4	141,3	120,0	38,2	128,3	100,0
1961	96,0	120,9	116,7	40,8	61,7	101,2	62,4	94,0	138,7	116,7	38,2	125,7	100,0
1962	96,9	122,5	116,5	39,7	64,5	102,3	62,1	95,7	134,0	115,4	39,4	121,4	100,0
1963	96,9	118,0	114,5	42,1	67,1	102,2	62,4	96,8	132,5	113,9	39,9	121,3	100,0
1964	98,0	122,1	115,3	43,3	67,4	102,9	61,8	94,2	134,6	116,1	40,4	120,8	100,0
1965	97,3	122,5	116,4	45,6	68,5	103,3	60,7	93,3	131,5	116,6	42,0	118,8	100,0
1966	96,7	121,1	115,1	46,6	70,3	104,5	59,2	95,1	128,2	114,6	42,5	116,8	100,0
1967	97,2	120,6	111,5	47,2	70,5	105,5	60,2	98,4	124,7	115,9	44,4	115,9	100,0
1968	96,0	118,7	111,6	47,8	70,8	103,9	61,7	101,0	123,2	116,3	46,0	114,4	100,0
1969	97,6	119,9	113,5	49,9	72,9	105,3	62,2	99,9	128,6	116,8	44,9	110,2	100,0
1970	99,5	116,7	113,6	51,7	72,3	106,1	61,4	100,6	125,3	117,3	47,4	108,0	100,0
1971	100,1	115,9	112,7	53,7	73,2	107,9	61,2	99,1	123,6	117,5	49,5	107,5	100,0
1972	101,1	116,9	112,4	56,0	75,6	109,2	61,8	98,0	125,8	115,8	51,7	105,6	100,0
1973	101,1	114,0	110,9	56,6	76,5	108,0	60,3	98,6	128,0	113,9	54,4	107,4	100,0
1974	103,4	110,8	109,4	53,6	78,9	109,2	61,0	100,6	129,3	115,7	53,6	104,8	100,0
1975	103,0	111,3	109,6	57,1	80,1	110,4	63,0	97,7	122,7	116,3	50,3	105,7	100,0
1976	103,6	113,0	111,0	57,3	78,0	110,6	60,2	98,4	120,0	116,0	50,4	104,9	100,0
1977	101,9	112,3	112,3	57,2	78,0	111,3	62,9	97,9	119,4	115,6	51,7	104,0	100,0
1978	102,0	110,5	112,6	58,7	76,4	111,9	64,8	97,5	120,5	114,6	51,8	104,6	100,0
1979	101,2	111,0	113,9	58,4	73,8	111,9	63,9	99,1	120,2	113,3	52,6	104,1	100,0
1980	104,4	109,5	114,2	58,4	73,8	111,6	64,7	102,0	120,5	112,4	54,3	100,7	100,0
1981	103,1	108,9	114,6	57,9	73,2	111,9	66,3	103,4	119,5	111,3	54,3	99,8	100,0
1982	104,6	111,9	113,5	57,2	73,4	112,9	66,3	103,0	121,0	108,8	55,5	100,5	100,0
1983	102,9	113,3	114,1	56,4	73,3	111,8	63,7	101,8	123,2	108,5	54,9	102,8	100,0
1984	102,5	114,8	115,2	56,4	72,7	110,6	64,5	102,9	127,0	108,3	52,4	102,6	100,0
1985	101,7	116,7	116,0	56,1	72,3	109,0	63,8	103,2	127,5	107,3	52,6	103,9	100,0
1986	101,7	117,9	116,2	55,4	72,4	108,7	62,8	103,5	127,4	106,5	53,3	103,9	100,0
1987	101,1	115,2	115,7	53,8	72,6	107,8	62,4	104,6	127,3	105,7	53,7	104,9	100,0
1988	101,2	113,3	115,7	52,7	72,9	107,7	62,1	105,2	126,7	104,1	53,8	105,2	100,0

Note : The present table has been calculated with purchasing power standards which have bee revised on the basis of the 1985 survey. In addition it is based on the results c the revised national accounts for Italy (see Eurostat, National Accounts, ES 1960-1985). In comparison with prior calculations, this upward revision of th Italian GDP data leads to an increase of the Community average and therefore to decrease in the value of the index for the other Member States.

Source: Eurostat, Forecasts 1987/88 : Commission's services.

Table 18: Lending by the community's structural funds and financial instruments, 1986

Member State	Structural funds[1] (mio ECU)	Financial instruments[2] (mio ECU)	Total (mio ECU)	% GDP	% Gross fixed capital formation
B	79,8	47,0	126,8	0,11	0,70
DK	81,9	258,2	340,1	0,40	1,98
D	286,1	946,5	1232,6	0,13	0,70
GR	598,0	253,2	851,2	2,10	11,35
E	1083,2	409,2	1492,4	0,64	3,24
F	901,7	950,9	1852,6	0,26	1,38
IRL	443,1	263,0	706,1	2,84	14,59
I	1545,7	3464,1	5009,8	0,82	4,07
L	7,6	20,2	27,8	0,53	2,67
NL	126,1	184,8	310,9	0,18	0,89
P	637,4	190,3	827,7	2,78	12,58
UK	1073,6	1521,0	2594,6	0,47	2,72
Total	6864,2	8508,4	15372,6	0,44	2,31

1 Regional Fund, Social Fund, EAGGF Guidance Section: Commitments.
2 EIB, NCI: Loan agreements; Euratom, ECSC: loans paid out.

Source: Commission services.

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1. Gross domestic product (per cent changes)

	1986	1987	1988
Belgium	2¼	1¼	2
Denmark	3½	-¼	½
France	2½	1½	2½
Germany	2½	1½	2
Greece	1¼	-¾	½
Ireland	½	1	1½
Italy	2¾	3¼	2¾
Luxembourg	2¼	2	1½
Netherlands	2	1¾	1
Portugal	4¼	3½	3
Spain	3	2¾	3
UK	2½	3	2½
EC	2½	2¼	2¼
USA	2½	2¼	2½
Japan	2½	2¾	3¼

2. Prices- consumers' expenditure deflator (per cent changes)

	1986	1987	1988
Belgium	1¼	1½	2
Denmark	3½	4¼	4¼
France	2¾	2¾	2¼
Germany	-½	¾	2
Greece	22	13½	9
Ireland	3½	3¼	3½
Italy	6¼	4¼	3¾
Luxembourg	¼	1¼	2½
Netherlands	-	-1	1¼
Portugal	11¾	9½	8
Spain	9	6	5½
UK	3¾	4	4¼
EC	3½	3	3¼
USA	2	3½	3¾
Japan	¾	-	½

Source: EC Commission Forecasts, May 1987

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