

ANNEX
B

Medhurst ^{no \$ part} we had
ANNEX B ^{in / Euro.}

CONFIDENTIAL

EHG(LX)(81)2

Inflation -
G15 -
Soc. Sec.

ECONOMIC SITUATION - SPEAKING NOTE

Int. Ref.

Labour market
Monthly
report.

①

I can broadly endorse the analysis presented to us by the Commission. It gives us no grounds for complacency. All our economies, to a greater or lesser degree, are hampered by rigidities. We are not responding quickly enough to new challenges. Our labour markets suffer from many inflexibilities which stand in the way of the reduction of unemployment. Our indexation procedures impede us in the task of eliminating inflation which remains our number one priority. We are failing to shift resources from uncompetitive to competitive industries. We are all having great difficulty in controlling public expenditure and this is a prime cause of excessive interest rates. Not all our troubles can be blamed on the United States - many are of our own making. The problems are at root political and the European Council can help by giving an agreed message to public opinion.

2. But there is a positive side and the Council should call attention to that, as well as to the deficiencies in our performance. Our economies have adjusted to the second major oil shock better than they did to the first. A good deal has been done to conserve energy and diversify the use of fuels. OECD growth in the two years 1980 and 1981 seems likely to be higher on average than in 1974 and 1975, while inflation is lower. The thrust of our policies on this occasion has been right, as was confirmed by the Interim Committee of the IMF at its recent meeting in Libreville. The Interim Committee communique,

CONFIDENTIAL

said: "The Committee reaffirmed its conviction that the fight against inflation must continue to receive the highest priority." Nothing has happened since 21 May to alter that judgement and we should endorse it at today's Council.

3. Some of our economies have of course weathered the storm better than others. The fall in output on this occasion has been especially severe in the United Kingdom as a direct result of our failure until recently to curb wage inflation. This fall in output has been associated with very high unemployment.

4. Reflation is no answer to the problem of unemployment. The solution lies in structural change. Unemployment has risen from one cycle to the next since the war, while inflation also has tended to rise. If we tried to remove our unemployment problem by expanding demand, the temporary increase in output would soon be vitiated by greater inflation.

5. We can of course relieve the social stresses and other problems of unemployment by government action. Like other member states and the Community, the United Kingdom has been developing a wide range of programmes designed to meet the needs of young people and other groups hard hit by unemployment. Nearly 1 million people in the United Kingdom are benefitting from various employment training measures supported by the government at an estimated cost approaching £1 billion a year. I hope that our Social Affairs Ministers, when reviewing the Social Fund, will find ways of improving our Community policies to deal with the effects of unemployment. Since the cost of such measures is itself a burden on employment, we must ensure

CONFIDENTIAL

that this type of expenditure, at both the Community and the national level, is as cost effective as possible.

6. Interest rates throughout the world are disturbingly high and we all want to get them down. We must ensure that we are not putting too much weight on interest rates and too little on fiscal policy. This message should guide our own actions. The British government recently introduced a very tough budget in order to permit interest rates to be lowered. The same message needs to be conveyed to the United States. The reduction in their first year tax cut from 10% effective in April to 5% effective in October was an encouraging sign. We should urge the US authorities to continue these efforts to control their budget deficit. Any over-run should be corrected by fiscal action and should not be allowed to put further pressure on interest rates. We should call attention to the effects on our economies of the volatility of US interest rates. Do they really have to let interest rates take all the strain of weekly fluctuations in monetary conditions? In the United Kingdom we are doubtful about the value even of monthly figures, let alone weekly figures.

7. [As Mr Ortoli has just told us] these matters are now being studied by the Monetary Committee, the Committee of Central Bank Governors and the Finance Council. Their work will be of value to us in the preparations for Ottawa. Because the United States is responsible for the principal trading and reserve currency, they

inevitably have international responsibilities. Their policies affect us all and we must tell them so. On the other hand the basic anti-inflationary thrust of their policy deserves our full support. We do not want to see confidence weaken once again in the dollar. Equally we have a perfect right to ask them to avoid placing excessive burdens on their allies by the manner in which they implement their anti-inflation policy.

8. The European Council should consider with care the tone of voice in which this message is conveyed. In my view, we should adopt a moderate tone as befits exchanges between allies. Public lectures are far less likely to persuade the United States to take account of our interests than sustained private pressure. The representatives of the Community will be able to draw on the results of the analysis now being undertaken by Finance Ministers when discussing these matters with President Reagan in Ottawa. [If pressed to send an emissary to the United States to make representations before the Ottawa Summit. Mr Thorn and I will of course take account of the views expressed by colleagues here today in presenting the Community's case to President Reagan in Ottawa. But I do not believe that it would be advisable to send a formal message to the US authorities in advance of Ottawa. Such an approach would risk provoking the United States to take up a definitive posture before we have had a chance to talk to President Reagan himself.]