

CONFIDENTIAL

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT
EHG (L2) (80)3 COPY NO. 1

18 NOVEMBER 1980

EUROPEAN COUNCIL, LUXEMBOURG

1/2 DECEMBER 1980

ECONOMIC AND SOCIAL SITUATION IN THE COMMUNITY

Brief by HM Treasury

OBJECTIVE

1. To emphasise that UK policies are in line with agreed Community formula, and to avoid specific commitments on measures to alleviate unemployment.

POINTS TO MAKE

2. (i) Inflation now slowing down in most countries. Gap between UK rate and average EC rate has narrowed sharply in recent months.

(ii) Output declining or at best stationary in all the main economies. EC recession has been more synchronised with that in the US than once expected. Partly because inflation better contained, present recession likely to be shallower than in 1974-75. But recovery could be slow.

(iii) UK economic policies are part of Community-wide strategy to cut inflation and restore conditions for sustained growth.

(iv) Rise in unemployment disturbing. But should avoid commitments to specific measures which would add to industrial costs and risk raising expectations that there is a short-term solution.

CONFIDENTIAL

CONFIDENTIAL

BACKGROUND (All Information useable)

References

A: COM(80)596 Annual Economic Report 1980-81

3. The slowdown in Community economies has been much more synchronised with that in the US than once expected. In the second quarter, GNP in the EC fell at an annual rate of over 5 per cent (9.6 per cent in the US). Among the larger members, the falls ranged from 1.1 per cent in France to over 6 per cent in the UK; In Germany and Italy there were declines of $3\frac{1}{2}$ -4 per cent. Overall, though, output is expected to weaken less than after the 1973-74 oil shock despite an equivalent terms of trade loss. Investors and consumers have generally been under less financial pressure. Total growth in 1980-81 could be almost 2 per cent compared with less than $\frac{1}{2}$ per cent in 1974-75. Even so, growth in the EC is expected to be lower next year than this.

4. The average rate of inflation in the Community peaked at almost 14 per cent in July, little short of the level reached in 1974. But the recent upsurge owed more than the earlier one to specific policies aimed at achieving faster adjustment (eg abandonment of price controls, adjustment of tax structures and rapid pass through to consumers of higher oil prices). Wages on the other hand have risen much less sharply than in 1974, although experience has varied widely between countries. As a result, the divergence between the lowest and highest inflators has increased a lot. The gap between Germany and Italy is now some 15 per cent. But UK

CONFIDENTIAL

inflation has recently been moving towards the middle of the EC range, occupied by France and Denmark (where inflation is still rising). Since May, the differential between the UK rate and the EC average has narrowed from almost 9 per cent to around 2½ per cent.

5. The Commission forecasts that unemployment in the EC could rise to 3 million by the end of 1981 (almost 7 per cent of the civilian labour force compared with 5.6 per cent in 1979). On the same definition, UK unemployment is expected to rise from 5.3 per cent in 1979 to over 8 per cent in 1981. There have been discussions at Community level between employers and unions on various forms of work sharing. This sort of consultative process is acceptable. Practical agreements between the two sides of industry are far better than specific commitments by the Council which risk raising expectations that something can be done imminently.

6. Most Community Governments, like the UK, are seeking to stabilize or cut public sector deficits, reduce money supply growth and strengthen medium-term economic potential. This approach is endorsed in the Commission's Annual Economic Report which notes that "on the basis of the present outlook the policy mix should be strong in efforts to reduce inflation, save on oil imports, and pursue other needed structural changes ..."

CONFIDENTIAL

CONFIDENTIAL

7. Governments have been unwilling to force the pace in reducing interest rates. In a number of member states the scope for doing so is limited by domestic and/or external financing difficulties. Real interest rates are as a result very high in Denmark, Belgium and the Netherlands. Even in Germany, where money supply is growing at the bottom of the target range, rates have remained high because of the instability of capital flows following the renewed increase in US rates. And in Italy, discount rate was raised in September after the fall of Sig. Cossiga's government. In the Community as a whole, monetary expansion (M3) is now for the first time in a decade nearing the trend of the 1960's of a little over 10 per cent a year.

8. Unlike the US and Japan, the EC's current account balance has deteriorated since 1978 not only because of higher oil prices but also because of worsening in the real trade balance. In 1979, the Community accounted for less than one-third of the OECD deficit of \$38 billion; in 1980 and 1981 its share of the forecast OECD deficits of \$80 billion and \$50 billion respectively is expected to be more than one-half. The German deficit could reach \$15 billion this year and may be as high as \$10 billion next. The French deficit, now running at a very high level, is unlikely to come down much over the next few months and the Italian deficit continues to deteriorate. In some of the smaller members, notably Denmark and Ireland, deficits represent a very high proportion of GNP.

CONFIDENTIAL

9. The deutschemark was until recently very weak within the EMS, especially against the French Franc. This may partly have reflected the much greater scale of the overall German balance of payments deficit. But it may also have stemmed from differences in the way the deficits are being financed. Germany has so far relied, with only limited success, on attracting inflows through the market. France, by contrast, has greatly expanded its programme of public sector borrowing abroad. In Germany there have been recent measures to restrict capital outflows and France is attempting to slow down inflows.

10. Inflation and recession in the Community is affecting agriculture as well as industry. Some members (Italy and Ireland) take the view that agriculture is suffering relatively more than other sectors and proposals on CAP reform, price constraint and so on should be modified to take account of falling real income amongst European farmers. In fact virtually all sectors of the European economies are under pressure, but the response to these pressures varies - with industry more likely to shed labour and close down capacity compared with agriculture. So a simple comparison of the course of incomes in the two sectors is not necessarily a valid guide to how the two are faring. Agriculture does however benefit from protected markets, in contrast to industry which has to face world competition. If the protection provided to agriculture is further strengthened this can be only at the expense of more exposed sectors.

H M TREASURY

13 November 1980

CONFIDENTIAL

CONFIDENTIAL

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

EHG(L2)80)3 Addendum 3

COPY NO

28 November 1980

EUROPEAN COUNCIL, LUXEMBOURG

1-2 DECEMBER 1980

ECONOMIC AND SOCIAL SITUATION IN THE COMMUNITY

Brief by H M Treasury

OBJECTIVE

1. To ensure that unacceptable language in the Commission Communication - COM(80)76 Final circulated as EHG(L2)(80)3 Addendum - does not become incorporated in the Presidency conclusions.

POINTS TO MAKE

2. (i) Reference in para 9 EMS to "extension to member states not yet taking part" could imply that UK is the obstacle to second institutional phase of EMS. Key issue is that neither France nor Germany ready to legislate for definitive transfer of part of their reserves, to including gold, to EMF.

(ii) Reference in para 10 to role of Community in recycling could be interpreted as readiness to assist non-Member countries. Majority of countries oppose use of Community loan mechanism for relending outside Community.

(iii) References to "deflation" in paras 11-12 are clumsy. Maintenance of tight policies is agreed in the Community. What should be avoided is action specifically to reduce external deficits, by countries who can finance them.

CONFIDENTIAL

BACKGROUND

Reference: Commission Communication on the Economic and Social Situation in the Community - COM(80)756 final.

3. The Commission's paper is generally satisfactory and uncontroversial but certain passages are badly phrased and should not be used as a basis for the language of the Prisidency Conclusions.

4. Paragraph 9 on the EMS is generally acceptable but there is a risk that the reference to "extension to those member states not yet taking part" may be used outside the Council as a basis for hinting that failure to move to the second institutional phase of the EMS is the fault of the UK. In fact neither France nor Germany are anywhere near ready to legislate for a definitive transfer of part of their reserves (including gold) to a European Monetary Fund, which is a key issue in the second phase as hitherto envisaged.

5. Paragraph 10 talks of the Community taking a more active part in recycling capital shortly after a reference to the Third World and paragraph 9 refers to adjusting the Community loan mechanism to assist countries (not Member countries) in balance of payments difficulties. This suggests that the Community might borrow in order to relend to LDCs. The majority of Community countries have hitherto been opposed to making the loan mechanism a kind of Community IMF. The possibility of ad hoc use of the loan mechanism to help a non-Member in some particular case is not wholly excluded but the majority view

CONFIDENTIAL

has been that we should not suggest publicly that the loan mechanism was for any purpose other than relending to members. Some other country (eg Germany) may take this point, when we could support them. The communique drafting ought not to imply that the Community is opening shop as a loan intermediary.

6. The references to "deflation" in paragraph 11, and especially in paragraph 12, are unsatisfactory. The first sentence of paragraph 12, if ⁱⁿ the communique, could be used critics of UK Government policy. The Communication says elsewhere that monetary policy must remain tight (paragraph 8) and budgetary policy must be tight too (paragraph 12). Some would call that "deflation". What the Commission really mean is that tight policies are needed to counter inflation but if they are adequate for that purpose, should not be further tightened to reduce external deficits. Collectively, the Community has to bear a share of the counterpart of the OPEC surplus. The admonition is directed at Germany. The thought is valid, though it is undesirable to appear to be telling the Germans what to do. But it is undesirable to have general references to "rejecting deflation" like that in paragraph 12. The OECD Ministerial Communique put the point much better. "Those countries which have no difficulty in external financing should refrain from taking policy measures specially aimed at reducing current account deficits".

H M TREASURY
28 November 1980

CONFIDENTIAL

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

EHG(L2)(80)3 ADDENDUM 2

COPY NO 1

26 November 1980

EUROPEAN COUNCIL, LUXEMBOURG

1/2 DECEMBER 1980

Economic and Social Situation

Addendum by Department of Employment

UNEMPLOYMENT

Objectives

To be seen to be associated with Community concern at rising unemployment. But to focus attention on what is practical - e.g. the restructuring of Community policies to allow expanded structural funds.

Points to Make

(i) Main task is to get inflation down, and restore conditions for sustained growth. But certain groups need special help during this adjustment, especially the young and the long-term unemployed.

(ii) Community expenditure on the structural funds should make an effective contribution to alleviating unemployment especially spending in support of regions and industries, where present high levels of unemployment are concentrated.

(iii) It is important that there should be adequate room within the overall budget for these funds. This is one of the things we look to the restructuring exercise to achieve. [Brief No 5,

CONFIDENTIAL

/especially

CONFIDENTIAL

especially paragraph 6]

(iv) The UK values the help received from the European Social Fund (£135m total allocations for 1980) especially the support for the young unemployed and for training in the regions. The revised social volet proposals under the ECSC Treaty would if agreed provide aid for early retirement and short-time working in the steel industry.

BACKGROUND

Unemployment in the Community

1. Average 6.7%. Highest is Belgium 10.5% ; lowest is Germany 3.4% ; UK 7.9%. (Source : Eurostat 10 - 1980 of 14 November 1980). (Seasonally adjusted domestic figure for UK is 2.028 m or 8.4%) - Department of Employment 25.11.80.

Unemployment Measures

2. A programme of special measures was announced on 21.11.80 to help the unemployed in 1981 - 82, to cost nearly an extra £250 m over and above the £320 m originally provided for next year.

Youth Unemployment

3. Priority is being given to young people straight from school. MSC has been asked to provide 440,000 opportunities in the Youth Opportunities Programme next year, an increase of 180,000 over the current year.

4. Other measures to help the young include increases in Community Industry and the continuation of the Unified Vocational Preparation Programme.

/Adult

CONFIDENTIAL

Adult Unemployment

5. The Temporary Short-Time Working Compensation Scheme is being extended in scope; the Job Release Scheme will continue for men aged 64 and women aged 59 and for disabled men aged 60 or over. A new Community Enterprise Programme will be introduced to replace the Special Temporary Employment Programme. 25,000 places will be provided - more than twice the number at present.

European Social Fund

6. The Community contributes significantly to the Youth Opportunities Programme (£47 m this year). Provisional applications lodged with the European Commission for 1981 allowing for extensions now agreed. The UK's allocations for 1980 represent 22.7% of the Fund mainly for national programmes run by Government Departments such as the Manpower Services Commission's Youth Opportunities Programme and other schemes for young people (£71.9m) and the Training Opportunities Programme (£21m). The remaining allocations come under a variety of headings including help for disabled people, migrant workers, textile workers, and other special groups.

Shipbuilding

7. A proposal for Social Fund to provide income support for redundant workers in the shipbuilding industry is to be discussed at the Social Affairs Council on 27 November. Majority of member states are opposed for a variety of reasons including the need for budgetary restraint and to avoid too many new aids. The UK sees merit in the proposal but only if its details can be brought more into line with UK requirements. At the time of writing it seems unlikely to be approved.

/Work

CONFIDENTIAL

Work Sharing (overtime; part-time working; early retirement;
temporary work)

8. Covered in EHG (L2)(80)3 paras 2 (iv) and 5.

Department of Employment

26 November 1980

CONFIDENTIAL