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EUROPEAN COUNCIL, BRUSSELS
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ECONOMIC AND SOCIAL SITUATION
Brief By HM Treasury

OBJECTIVE

1. To secure endorsement of the need for sound macro-economic policies in the Community.

POINTS TO MAKE

2. Our individual Governments have many worries in common. They are well displayed in the Commission paper:

- Unemployment, especially of young people, made worse by rapid expansion of the working population in some countries.
- Inflation, both in its economic and social effects and in the painfulness and difficulty of the process of reducing it.
- Prospects for activity and output, better than the past very poor year, but still at best modest and at worst fragile.
- External worries, interest rates, trade threats, uncertainty of oil prices.

3. As a Community, we share a further dimension of concern. The performances and policies of individual members have been and continue to be extremely uneven. The Commission paper points to some of the contrasts. It rightly suggests that they deny us the convergence without which we cannot enjoy the confidence of stable monetary relations or exploit our potential collective economic strength.

4. The roots of most of these problems lie in the past. We must not repeat mistakes of the past which have contributed to them. This means recognising and accepting, with determination, that there is no route to healthy, sustainable growth of our economies through a rapid burst of expansion. It means focussing on policies and measures which will maintain pressure against inflation and stimulate productive and lasting developments.

5. The Commission paper, with its areas of suggested Community and individual action, points to elements of the strategy which needs to be adopted against this background. Broadly agree, but with some differences of emphasis:

- reduction of inflation must be the priority, as a necessary condition for improved competitiveness and the creation of higher levels of employment on a durable basis. Even those of our countries which, by current European standards, have relatively modest or falling levels of inflation cannot afford major relaxations. Those whose rates of inflation are still very high need to give particular priority to this problem. Rates of inflation in the United States and Japan are well below the Community average;
- public sector borrowing needs to be restrained. For the Community as a whole, it rose as a proportion of GDP during 1981, in part explained by the unavoidable effects of recession. But there are prospects of further rises in some of our countries in 1982, even as the pressure of recession and its effects begins to ease a little, and this has worrying implications for the Community as a whole, not least because it is potentially destabilising. Attention needs to be focussed on this problem both in the interests of controlling inflation and in the interests of providing scope for a recovery of our productive industries;
- investment is critically important. Applaud some points in the Commission paper: continued focus on energy saving which should not be relaxed under the influence of recent

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moderation of oil prices; emphasis on productive capital investment; and the emphasis on small businesses and innovative developments which can be particularly valuable in providing new areas of employment and in meeting the challenges of changing technology;

- external relations: as discussed separately, need for continuing dialogue with other leading countries, especially about the impact on the world at large, including the Community, of their trade performances and their mixes of fiscal and monetary policies. The main task of achieving sustainable and harmonious development within the Community lies in the convergence of our own individual policies and performance; but it is right to point to developments outside which could be disruptive.

6. Finally, unemployment. This remains our greatest social problem, in all our countries. Most Member countries have packages of schemes designed to alleviate the worst aspects of unemployment, and concentrating on the provision of training and job opportunities for young people. The United Kingdom is among them, and tribute is due to the Commission and the arrangements we have collectively made for assistance from the Regional and Social Funds in this context. But general reduction in unemployment must stem from genuine recovery of output growth which follows from lower inflation and lower interest rates.

7. This is not a comfortable message, not a recipe for immediate political popularity. But the different strengths and weaknesses of different national economies throughout the world, and within the Community, demonstrate that it is right. Joint understanding and acceptance of this message within the Community could perhaps fortify each individual Member in the difficult task of pursuing it.

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A : Defensive paragraphs on unemployment

BACKGROUND B: Commission Report on Economic & Social Situation.

8. The status of the Commission's paper is that of a background note. Last December the European Council approved guidelines for economic policy in the Community for 1982 and it is too soon to reconsider those.

9. The Commission's latest forecast is slightly more pessimistic about output prospects than in December, but is more optimistic than we are now about the chances of reducing inflation in France and Italy. The paper puts too much emphasis on unemployment and depressed output, and not enough on the need to reduce inflation, and restore competitiveness and profits. It also tediously pursues the idea that renewed emphasis on the EMS, with a few technical changes and aspirations, could have significant effect. But it does contain some sensible suggestions (picked up in "Points to Make" above).

10. Output fell about 0.5 per cent in the Community in 1981 with the biggest falls occurring in Luxembourg, the UK, Netherlands, Belgium and Germany: however France and Ireland probably grew. This is very much in line with the Commission's forecast given to Council last March. This year the Commission is forecasting growth of one and a half per cent in the Community's GDP, with growth rates of around 2.5% for France and Denmark and about 1.5 per cent for Germany, Greece, Ireland and Italy. The UK is marked down for growth of 1.1 per cent, the Netherlands for 0.8 per cent, and Belgium and Luxembourg for negligible growth.

Unemployment rose from 6.1 per cent of the civilian labour force in 1980 to 7.9 per cent in 1981, and the Commission forecasts another one percentage point rise this year - half a per cent more pessimistic than they were in October. Unemployment is above 10 per cent in Ireland, Belgium and the UK and the Commission expects Italy and the Netherlands to reach that rate later this year.

11. Consumer price inflation peaked in April 1980, averaging 14.1 per cent in the Ten for the whole of that year and 12.5 per cent in 1981. Ireland (23 per cent) has currently taken over the lead from Greece (22½ per cent), though Italy (17 per cent) and France (14 per cent) remain high. The Commission forecasts only a modest further fall in inflation to 10.6 per cent this year with the rate

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rising only in Greece (to $24\frac{1}{2}$ per cent) and undramatic falls in Ireland, Italy and France. Earnings (compensation of employees per head) declined from 13.4 per cent in 1980 to 11.7 per cent in 1981, with a decline to an average 10 per cent forecast for 1982.

12. The Community's current account deficit fell from $\$37$ billion in 1980 to around $\$20$ billion in 1981 - about $\$10$ billion better than forecast last March - and is now forecast to halve, to $\$10$ billion, in 1982 (though we think the Commission have considerably underestimated Germany's surplus at only $\$2$ billion).

13. Interest rates are still high by historical standards, though they have fallen in most countries since last year. Real prime lending rates in mid-March were 1.7 per cent in France, $2\frac{1}{2}$ per cent in the UK, $4\frac{1}{2}$ per cent in the Netherlands, 5 per cent in Italy and $6\frac{1}{2}$ per cent in Germany. The fact that real rates are positive in a recession is an indication of firm monetary policies, though Italy and the Netherlands do not have published targets of monetary growth. The French government, having largely ignored M. Barre's target for M2 of 10 per cent in 1981, has announced a monetary target range of $12\frac{1}{2}$ to $13\frac{1}{2}$ per cent growth this year and had recorded 11.3 per cent growth by November last year. German Central Bank Money in January was well within its targetted range, though Chancellor Schmidt has recently asked the Bundesbank to permit monetary growth in the upper half of the range ($4 - 7$ per cent).

14. Fiscal policy slackened in all member states last year except the UK, when measured by governments' general borrowing requirements as a per cent of GDP; for the whole Community the figure rose from 3.6 per cent in 1980 to an estimated 5.0 per cent last year. The Commission forecasts around 5 per cent again this year, with falls in Germany, the UK, Belgium and possibly the Netherlands being offset by the slacker policies of France, Denmark and Greece. On 10 March, President Mitterrand told the French Council of Ministers that the government's deficit in the 1983 budget should not exceed 3 per cent, but it is far from clear how this can be achieved given the momentum of this year's large increase in spending.

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15. Measures to alleviate the worst aspects of unemployment in the UK are already substantial and probably greater than in other countries. For example the part of Chancellor Schmidt's new employment measures designed to combat youth unemployment will only cost around £25 million a year while the cost of the Youth Opportunities Programme/Youth Training Scheme alone was £425 million in 1981-82. The Community's European Social Fund provided £59 million towards the Y.O.P. and also gave substantial assistance to the Training Opportunities Scheme (TOPS), the Training for Skills Programme and UK training schemes for handicapped people; in all it allocated £141 million to the UK in 1981.

16. At a recent meeting of OECD Employment Ministers (4-5 March 1982 - the first for six years), the agreed communique stated that efforts to create jobs and lower unemployment "could only be pursued with success in the framework of a concomitant and effective combat against inflation".

17. The French franc: the recent pressure on the franc is a product of political as well as economic forces, the government's poor showing in cantonal elections this month having increased political uncertainty. Among the economic causes are a large and growing current account deficit, loss of competitiveness vis-a-vis Germany, high inflation, high wage settlements, and the momentum unleashed by this year's increase in public spending which will be very hard to rein back next year as President Mitterrand now wishes. A serious attempt to rein it back would cause major strains within the government and its constituent parties.

18. For detailed treatment of Investment and Information Technology policies see Briefs No. 21 and 18 respectively.

HM TREASURY
25 March 1982

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Annex A

1. The following paragraphs could be used defensively, if the Danish Prime Minister is insistent that Community countries must give the highest priority to the reduction of unemployment.
2. Well understand deep concern about level of unemployment and about enormous social and economic problems it creates. Have to recognise that we cannot bring it suddenly to a halt. Process is gradual. Glad to say UK policies are having some success. Rate of increase in unemployment has slowed down markedly. Other labour market indicators - overtime, short time working and unfilled vacancies - are pointing in the right direction.
3. Recent Budget shows that British Government persevering with policies designed to continue progress in reducing inflation, so as to restore a base for economic growth, improved output and increased employment.
4. Employers and trade unions in the UK must be given credit for their successes in improving productivity, making wage bargaining more responsible, and achieving better industrial relations.
5. Much certainly remains to be done. But believe the main thing is to go on striving to get at the roots of the problem. Only this will provide ultimate solution by creating real jobs. Am clear that reflation not the way to help unemployed. Would undermine progress made in reducing inflation and restoring confidence to industry and financial markets. Any short-term gain in an apparent increase in the number of jobs would not be sustained.
6. Nevertheless special measures can certainly help in the meantime. In recent Budget the British Government have expanded special employment measures, and announced a new scheme. This shows my Government's concern to help the groups worst affected, especially our young people. Perhaps we can share experience in this area.

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Annex B

COMMISSION OF THE EUROPEAN COMMUNITIES

COM(82) 141 final

Brussels, 22 March 1981

THE ECONOMIC AND SOCIAL SITUATION
OF THE COMMUNITY

(Communication from the Commission to the European Council,
Brussels, 29 and 30 March 1982)

INTRODUCTION

This communication is intended to serve as a basis for the discussions which the European Council is to have on the economic and social situation in the Community. The first part of the paper presents an assessment of the immediate prospects. The second part gives a brief summary of the economic policy guidelines demanded by those prospects. The third part sets out the Community's own contribution to that strategy. Specific action to promote employment is outlined in part four.

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1. ASSESSMENT OF THE ECONOMIC SITUATION AND THE IMMEDIATE PROSPECTS

- 1.1 The Community's economy will have been characterized in 1980-81 by negative growth (-0.5%), by a modest reduction in the rate of inflation and by a sharp increase in the rate of unemployment (approximately a third). On the whole, the fall in the balance of payments deficit has been fairly rapid, showing a reduction on average from - 1.3% of the GDP in 1980 to - 0.8% in 1981.
- 1.2 For 1982, the growth in the GDP could be of the order of 1.6% - lower than was forecast in December - and the rate of inflation could be approximately 10.5%. The burden of the current balance of payments deficit will fall to - 0.4% of the GDP. These estimates are based on the forecast of a high rate of export accompanied by replenishment of stocks, mainly cyclical in character. It is thought that the upward trend in unemployment will continue though the increase will be less sharp. Unemployment is likely to exceed 9% of the working population during the course of 1982, under the influence, particularly, of the increase in the supply of labour which is a feature of the period 80-85.
- 1.3 These prospects leave practically untouched the main fundamental problems that have faced the Community economy for a number of years.
- First, the problem of energy.
The decrease in the volume of imports of energy products - due partly to negative growth and partly to real savings - did not prevent the burden of the net bill for oil from increasing once more to 3.9% of the GDP in 1981. In spite of a relatively favourable trend in the price of oil, albeit offset by the exchange rate of the dollar, priority must still be given to easing constraints in the field of energy.
 - the trend of investments is disturbing: the Community devotes on average a little less than 20% of its GDP to investment,

whereas in Japan the corresponding rate is close on 32%. The causes of this situation are well known: the level of interest rates, low profits, uncertainties regarding demand prospects. The results are serious: investment is not contributing sufficiently to economic adjustment, either by reducing dependence in respect of energy or by strengthening competitiveness.

- inflation is still too high, at a time when the European economy is in the trough of an economic cycle. The improvement in 1982 will be insufficient and entirely relative.
- developments in the situation regarding employment are worrying. The rate of unemployment will show a further appreciable increase (15% approximately) for the ninth year in succession in spite of the gradual speeding up of recovery during 1982, which it is thought will bring a growth rate of 2.5% by the end of the year. This recovery depends, of course, very closely on the international situation (world trade, exchange rates and interest rates).

On the most optimistic assumption, recovery will be modest and there is a danger that it may not be sustained. Those responsible for policy must bear that danger in mind.

2. ECONOMIC POLICY GUIDELINES

2.1 The policies pursued by Member States must inevitably take into account the particular circumstances of their respective situations.

Having said that, the differences in policy, behaviour and performance give cause for concern in a Community based on a single market and linked, monetarily, by strong mutual commitments. Rates of inflation in 1982 are estimated to be scattered between 4.5% and 24%; extreme rates of unemployment differ by more than six points; the Netherlands has a current balance of payments surplus of 3.9% of the Gross Domestic Product, Ireland a deficit of 9.3% and expected growth rates range from 0.4% and 2.7%. In view of such contrasting situations, the risk and temptation of calling into question the Community patrimony ("acquis communautaire") may be increased.

The fact remains that since their economies are closely interdependent, and since they have to face the same, largely structural, problems and external constraints, the Member States cannot depart from a course of action adhering to the same aims and using the same means.

2.2 From the outlook detailed above, it appears that unemployment is of major concern to all the Member States. Mere maintenance of present policies offers no prospect of a renewal of growth sufficient to improve employment.

As a resurgence in overall demand can be discounted, all available room for manoeuvre in the Member States must be reserved to support investment. Since this national activity has the common aim of restoring growth and employment, it must be closely coordinated at Community level. The Commission therefore thinks it advisable to inform the Heads of State and of Government of the need for such coordinated action. The Commission feels that research into

possible courses of action should be undertaken at Community level so that their scope and the methods to be used both at national and Community level, can be defined at the next European Council.

2.3 This boost to investment might follow the following guidelines:

In the matter of budgetary policy, some Member States have no freedom at all and must therefore continue to give priority to reducing their public sector deficits. In other cases, some room for manoeuvre has been progressively acquired; it must be utilised fully on two conditions:

- . it must directly serve investment, the creation of productive employment or increased competitiveness,
- . it must not start a slide causing the Member States concerned to lose control of their budgetary development.

It is also necessary for most of our Member States to begin systematic medium-term efforts at restructuring public expenditure so as to increase the proportion of expenditure allocated in their budgets to stimulating productive activity.

2.4 Such action requires an increased effort at austerity as regards monetary policy and the growth of incomes

Monetary policy must continue to ensure tight control of national monetary aggregates so that inflation can be reduced; however, where it has been possible to acquire room for manoeuvre, monetary policy should aim for the upper end of the target area adopted for expansion of the money supply.

In any case, adjustment constraints will continue to require that the trend of costs and hence of incomes shall take into account the imperative need to be competitive and to make available the resources required for development of a modern productive base.

3. THE COMMUNITY'S CONTRIBUTION

- 3.1 The Community's contribution to the recovery of the economy and to an improvement in the employment situation can be considerable if a decision is taken at the highest level to exploit rapidly and to the full the assets which belong specifically to Europe.

In essence, those assets are: in market terms, the continental dimension; in economic and monetary terms, the multiplier effect of policies of convergence and the project for creating a zone of stability, that is, providing a more stable and reliable framework for economic activity; in external terms, the negotiating strength which is available to the world's leading trade partner.

- 3.2 The Commission proposes that the European Council should select three areas of action to be given priority:

a) The project for creating a zone of monetary stability through the EMS - that is, rendering the general framework of economic policy less uncertain - is absolutely vital.

Following the meeting of the European Council in November 1981 the Commission submitted proposals and the Council made the necessary arrangements to enable a resolution to be adopted at its meeting in May. The objective of the decisions will be to develop in a realistic but significant manner the system's internal strength and its ability to project itself to the outside world. In the Commission's view the aim should be:

- . to increase efforts to achieve convergence of policies and performance, necessary to ensure the stability of the EMS;
- . to place on a firm footing the instrument of financial diversification and embryonic reserve asset represented by the ECU;
- to
- ./improve the technical mechanisms of the EMS in a way which is fully compatible with the objectives of domestic monetary policies in the Member States;

- making use of increased European monetary credibility, to propose, to the Community's main partners a system of organised cooperation which would make it possible to avoid fluctuations and unjustifiable levels of exchange or interest rates.

The Commission considers that realistic action on a considerable scale is both possible and desirable at a time when the risks of divergence are increasing and where, in many areas, Europe is finding it difficult to assert itself. It assumes that the European Council will share this view.

b) The continued expansion of investment is a common objective. Its realisation depends in essence on the individual decisions of businessmen but those decisions are themselves determined by the level of competitiveness of the undertaking concerned and also of the economy, by prospects for demand and by the fiscal and regulatory framework laid down for investment. The Community is already taking action in two areas: the development of borrowing and loan mechanisms for which, as it has already stated, the Commission will shortly submit further proposals, and in the field of energy, the gradual definition of a common strategy in which investment is a crucial element.

The Commission looks to the European Council to confirm the importance it attaches to the mobilisation of Community credit to promote investment, particularly in the area of energy.

c) Exploitation of the continental dimension - completion of the internal market for goods, capital and services, development of an industrial strategy at Community level, technology and innovation policies - must now leave the realm of general discussion.

The Commission has proposed clearly - defined courses of action or specific measures in all these areas. Furthermore, signs of an active awareness of a community of interests are emerging in the specialised Councils of Ministers in the fields of industry, energy and research.

The European Council must make it clear that it considers this area to be one in which the European contribution can be the most positive.

At its meetings in June and December the European Council would take the appropriate decisions with regard to aid to investment and to exploitation of the internal market.

4. ACTION TO PROMOTE EMPLOYMENT

4.1 Concern for employment is central to the economic policy guidelines which the Commission is proposing. An improvement in the level of employment must come to a large extent from a resumption of investment and growth.

The level which unemployment has already reached and the prospect of an increase in the working population, by as much as 5 million over the period 1980-85(?), show the extent of the problem. Concerted action by the Member States is essential in order to reverse present trends.

In the previous sections, the emphasis has been placed on the role of investment, and in particular of public investment. This must help to ensure in particular that the expectations of firms regarding the trend of demand become progressively more optimistic and influence their propensity to recruit.

4.2 On the question, moreover, of specific action to promote employment, the Commission proposes that the following priorities, which it has already submitted in its document on job creation, be adopted:

- action to help young people, namely, in the course of the next 5 years, ensuring vocational training and initial work experience, for all young people under 18 years of age, under the auspices of educational institutions as part of special programmes for young people, or under contracts of employment. This priority should be reflected in the operations of the European Social Fund which should devote a considerable proportion of its resources to it.

The objective of sparing those young people the experience of unemployment must be a major commitment for the Community.

- action designed to encourage employers to recruit more workers. Measures to provide assistance should aim to stimulate the creation of jobs that are viable in the long term, as well as a higher level of activity, while containing any inflationary pressure and avoiding any additional expenditure. It is largely for the Member States to launch schemes in these fields, in particular through the management of the contributions and other social welfare costs (?) falling on employers. The Community would support that effort by expanding Social Fund operations intended to provide aid for recruitment.
- action to help small and medium-sized firms and cooperatives, which must include aspects relating to technical assistance and infrastructure (training, access to networks supplying information on new technology and products, etc), falling basically within the province of the public authorities. The Community can contribute to such action by specific use of the resources of the Social and Regional Funds, and, in a wider context, by means of the loan instruments which it intends to allocate more extensively to small and medium-sized firms.

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TABLE I - Main economic aggregates, 1980-82

	GDP volume % change			Private consumption price deflation % change		
	1980	1981	1982	1980	1981	1982
Denmark	-0.2	-1.2	2.5	12.3	11.5	10.1
Germany	1.9	0.0	1.4	5.4	6.0	4.5
Greece	1.6	-0.2	1.2	22.2	23.5	24.0
France	1.3	0.1	2.7	13.2	13.1	13.0
Ireland	1.9	1.7	1.6	18.2	20.0	19.5
Italy	4.0	-0.8	1.5	20.3	19.2	16.5
Netherlands	0.6	-1.1	0.8	6.9	6.7	5.0
Belgium	2.4	-1.4	0.4	6.4	7.6	10.0
Luxembourg	0.4	-3.0	0.1	7.7	8.1	12.0
UK	-1.4	-1.4	1.1	15.9	11.6	10.3
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EC	1.4	-0.5	1.6	11.8	11.4	10.6
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	Unemployment rate, as % of civilian labour force (SOEC definition)			Balance of payments on current account, as% of GDP		
	1980	1981	1982	1980	1981	1982
Denmark	6.2	8.3	8.9	-3.4	-3.1	-2.9
Germany	3.4	4.8	6.6	-1.8	-1.2	0.2
Greece	(2.8)	(3.1)	(3.4)	-0.9	-4.0	-3.0
France	6.5	7.8	8.5	-1.3	-1.4	-1.4
Ireland	8.3	10.4	12.0	-8.4	-12.9	-9.3
Italy	8.0	8.9	9.7	-2.5	-2.1	-1.2
Netherlands	4.9	7.5	9.7	-1.4	2.0	3.9
Belgium	9.3	11.5	13.3	-5.2	-6.4	-3.9
Luxembourg	0.7	1.0	1.3	22.2	19.7	(20)
UK	6.9	10.5	11.8	1.4	2.2	0.7
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EC	6.1	7.9	9.1	-1.3	-0.8	-0.4
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	General government net lending (+) or borrowing (-), as % of GDP (3) (? figure not clear)			Money supply, % change (1) (2)		
	1980	1981	1982	1980	1981	1982
Denmark	-5.9	-10.7	-12.1	10.9	10.1	13.0
Germany	-3.5	-4.5	-3.6	6.2	5.0	4.9
Greece	(-3.3)	(-6.3)	(-8.2)	24.7	34.7	27.8
France	-0.4	-2.1	-3.1	9.7	12.3	(13.0)
Ireland	-12.8	-14.4	-12.3	16.9	13.6	13.6
Italy	-7.8	-10.6	-10.3	16.9	17.0	17.0
Netherlands	-3.4	-4.1	-3.7	3.6	6.3	8.8
Belgium	-9.4	-13.3	-12.0	2.7	5.1	(9.5)
Luxembourg	-1.8	-3.3	-3.0			
UK	-3.9	-2.3	-0.8	18.4	10.5	9.0
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EC	-3.6	-5.0	-4.7	11.3	10.9	(9.9)
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(1) The figures relate to the calendar year, except(words unreadable).... financial year.

(2) Year-end on year-end.

(3) Excluding loss on bonds issued at below par:
-2.9, 6.9(?) and -8.5 % respectively.

(4) Excluding private sector participation in investments, amounting to 112 million

Source: Commission departments, based on data available on 2 March 1982. The figures make provisional allowance for the effects of the parity realignment of 21 February 1982 within the EMS.