

UNCLASSIFIED
SAVING TELEGRAM

FROM BONN
FRAME ECONOMIC

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UKDel OECD, UKMis Geneva, all Consulates-General
in the Federal Republic, Washington, Tokyo, Vienna

FEDERAL GERMAN ECONOMY

Summary

1. The problem of high unemployment continued to cast its shadow over an otherwise satisfactory economic scene and dominated economic debate in June.
2. As foreseen (Forbes-Meyler's letter of 21 June to Graham, HM Treasury), Stoltenberg, in an attempt to improve labour market conditions, introduced a package of demand side measures aimed at supporting the ailing construction sector and creating more jobs. Efforts to improve supply side conditions continued when Blüm, the Minister of Labour and other Ministers, met leading industrialists and recommended a number of measures to ease unemployment. However, towards the end of the month the Government received a sharp rebuff from the Five Wise Men who, in a special report, warned of the danger of cosmetic measures that would have no permanent effect on the labour market. They also recommended the implementation of income tax reform in one stage, arguing that it could be funded by reducing subsidies or, failing that, by a temporary increase in the financial deficit. This advice is likely to fall on deaf ears: Stoltenberg's construction package has the approval of all the coalition parties. And Stoltenberg, announcing his 1986 draft federal budget, reaffirmed that expenditure would increase by only 2.4% and that the borrowing requirement would remain at the 1985 level. Stoltenberg's position, despite the criticism of the Five Wise Men, remains unimpaired.
3. The real economy showed an overall improvement and the signs are that it is getting into higher gear after a poor first quarter. New orders were up by 3%, total output rose by 4.5% on a year earlier and capital goods by 10.5% on the same comparison. Even the ailing construction sector recorded an improvement, albeit from a low level. Unemployment clouds an otherwise positive picture.

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Detail

4. During the month the coalition parties agreed a package of recommendations aimed at supporting the construction sector (Bonn telno 648). These measures, costing around DM 8 billion, will be jointly funded by the Federal Government, Länder, Gemeinde and the European Recovery Programme. The measures involve a shortening of write-off periods for buildings from 50 to 25 years (w.e.f. 1.5.1985). This will result in tax relief amounting to DM 1 billion in 1985 and around DM 4 billion per annum thereafter. According to the Federal Ministry of Housing this should produce an increase of about 10% in commercial construction. In addition, the Federal Government plans to treble its expenditure on urban renewal from the present DM 300 million to around DM 1 billion in both 1986 and 1987. At the same time the Länder and Gemeinde have committed themselves to doubling their expenditure on urban renewal from DM 330 million to DM 660 million. ERP-funded expenditure and the Kreditanstalt für Wiederaufbau will enlarge their low interest rate pool for local authorities and also for small and medium sized businesses by around DM 6 billion. According to Bangemann, the Minister of the Economy, these measures would halve the number of unemployed in the construction sector to 100,000. But a number of commentators dispute this forecast, notably the Five Wise Men.

5. The Five Wise Men (Council of Economic Experts), who normally publish their annual economic report in the autumn, decided to issue an out of sequence report in view of growing concern about the need for special measures to combat high unemployment. They have attacked ad hoc sectoral measures, reaffirmed the need for a reduction in subsidies (they quoted Bonn's price fixing veto as an indication of the Government's willingness to tolerate high subsidies to the agricultural sector) and called on both the Federal and Land Governments to adopt a more consistent and credible policy to strengthen current growth and reduce unemployment. They added their voice to those in favour of income tax reform in one stage rather than two.

6. But the Council believe that economic growth has not weakened and will continue steadily into 1986. Real GNP growth, export and investment led, of 2.5% to 3% for both 1985 and 1986 is their