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Chancellor's (Lauson) Papers:

ECONOMIC FINANCE COUNCIL MEETINGS 1987

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RECEIVED IN PRIVATE OFFICE - 5 OCT 1987

ACKO.....

THE PRIME MINISTER

37

5 October 1987

Dear Romsiem Pelons.

I was deeply perturbed by the recent report by the Court of Auditors on the Community's food aid programme. The horror stories the Court described from the early '80s prove yet again how right you and we were to make reform in this area a priority of the United Kingdom Presidency last year. I understand, however, that the new Food Aid Regulation we then secured lasts only one year. I am sure you agree with me that it would be utterly irresponsible if the improved system were put at risk at a time when famine again threatens in both Airica and Asia. The reform must be made permanent; and I hope that the Regulation can be extended into future years without substantial discussion or delay.

But I am much concerned as well by the wider issue, raised by the Court's report, of waste in food stocks held in intervention stores. I recognise that, under the regulations, this is primarily a responsibility of the member states concerned. But I suspect that it is a problem that is growing in scale. Certainly it is one that can only harm the Community's reputation.

I would be interested to know whether the Commission suspect that there now are significant amounts in store in sub-standard condition. If so, I think there would be strong arguments for extending the current arrangement to enable the Commission to make spot checks on the quality of intervention stocks on a scale sufficient to root out any malpractice.

where Commission inspectors identify sub-standard stocks they should be empowered to require disposal and disallowance of associated FEOGA expenditure.

The long-term answer must of course lie in drastically reducing total intervention stocks. This underlines the importance of introducing effective stabilisers. I welcome the Commission's latest proposals on this. But I am convinced that in the meanwhile we need to act quickly and decisively to identify and dispose of any food stocks held in intervention that are unfit for human consumption. I would strongly support a Commission initiative to this effect.

Jours sievely Dayaushaliter

Monsieur Jacques Delors



FROM: J M G TAYLOR

DATE: 12 October 1987

PS/PAYMASTER GENERAL

Mr Byatt
Mr Peretz
Mr Scholar
Mr Spackman
Mr Turnbull
Mr Crabbie
Mr R I G Allen
Mr S J Davies
Mr S Matthews
Mr Mortimer
Mr M Parkinson

Mr Tyrie

Mr Bostock - UKREP

COMMISSION OF THE EC: ANNUAL ECONOMIC REPORT

The Chancellor has seen Mr Byatt's minute and enclosure of 7 October.

- 2. He has commented that there is no way he can agree a report which calls for concerted fiscal expansion. He <u>could</u> agree, if pushed, to one calling for concerted fiscal expansion by those Member States suffering from inadequate growth. Nor can he agree to the reference to indirect tax harmonisation (paragraph 1.5 of the paper). There may be other specific points of this kind, and he would be grateful if the Paymaster General would go through the draft report with this in mind.
- 3. Finally, he has commented that the last paragraph on page 5 of the UK report is ludicrous there is no foreseeable prospect of nominal GDP growing more slowly than intended and must be deleted.

Al

J M G TAYLOR

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Long Borrey Sp. Los Dominho a Sent LT P Tackfor (Bank)
EAN COMMUNITIES (Spore) forme Brussels, 16 october 1987 Brussels, 16 October 1987

THE COUNCIL

8938/87

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DRS 51

SUBMISSION OF TEXTS

from : Working Party on Economic Questions (Establishment and Services)

No. prev. doc. 6091/87 DRS 22 6404/87 DRS 28

Nos Cion props: 4334/81 DRS 3 (COM(80) 893 final)

8864/82 DRS 43 (COM(82) 44; final)

4969/86 DRS 11 (SEC(86) 250)

Subject: Amended proposal for a Council Directive on the prospectus to be published when transferable securities are offered to the public

The version of the text annexed hereto takes account of discussions in the Working Party on Economic Questions (Establishment and Services) on 1 and 2 October 1987. Amendments to the last text circulated (6404/87 DRS 28) are indicated by underlining.

Delegations' views are given in footnotes. The passages in square brackets are still under discussion.

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TEXT OF THE DIRECTIVE AS IT STANDS FOLLOWING DISCUSSIONS IN THE WORKING PARTY ON 27 AND 28 APRIL 1987

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Articles 54(3)(g) and 100 thereof,

Having regard to the proposal from the Commission, (x)

Having regard to the Opinion of the European Parliament, (xx)

Having regard to the Opinion of the Economic and Social Committee, (xxx)

Whereas investment in transferable securities, like any other form of investment, involves risks; whereas the protection of investors requires that they be put in a position to make a correct assessment of such risks so as to be able to take investment decisions in full knowledge of the facts:

Whereas the provision of full, appropriate information concerning transferable securities and the issuers of such securities promotes the protection of investors by enabling them to evaluate the risks undertaken and to take decisions on their own responsibility;

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⁽x) OJ No C 226, 31. 8.1982, p. 4. (xx) OJ No C 125, 17. 5.1982, p. 176. (xxx) OJ No C 310, 30.11.1981, p. 50.

Whereas, moreover, such information represents an effective means of reinforcing confidence in transferable securities and thus contributes to the correct functioning of transferable securities markets and to the encouragement of their development;

Whereas it is accordingly appropriate to establish a genuine information policy relating to transferable securities at Community level; whereas such an information policy, by virtue of the safeguards that it provides to investors and its impact on the correct functioning of transferable securities markets, is capable of promoting the interpenetration of national transferable securities markets and thus contributing to the creation of a genuine European capital market;

Whereas Council Directive 80/390/EEC of 17 March 1980 co-ordinating the requirements for the drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing (xxxx) represents an important step in the implementation of such an information policy at Community level; whereas that Directive co-ordinates the information to be published when securities are admitted to stock exchange listing concerning the particulars of the securities offered and the issuers of such securities, so as to enable investors to make an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the issuer and of the rights attaching to such securities:

Whereas such an information policy also requires that when transferable securities are offered for subscription or sale to the public, whether or not they are subsequently admitted to stock exchange listing, similar

(xxxx) OJ No L 100, 17.4. 1980, p. 1.

8938/87 (ANNEX) information should be made available to investors in the form of a prospectus; whereas co-ordination of the contents of that prospectus is also required in order to achieve equivalence of the safeguards available to investors in the various Member States and to encourage the interpenetration of national transferable securities markets; whereas such co-ordination is all the more necessary in view of the fact that the public offer prospectus can also be used, in accordance with the conditions laid down by Council Directive 80/390/EEC, as stock exchange listing particulars if it contains information equivalent to that required by that Directive; whereas it is therefore appropriate to simplify the task of issuers which subsequently apply for the admission of their securities to a Community stock exchange, and to ensure that the contents of the public offer prospectus are equivalent to that of the listing particulars in all the Member States;

Whereas such co-ordination must apply to transferable securities independently of the legal status of the issuing undertaking; whereas accordingly, insofar as this Directive applies to entities to which no reference is made in the second paragraph of Article 58 of the Treaty and goes beyond the scope of Article 54(3)(g), it must be based also on Article 100;

Whereas it is neither possible nor appropriate at the present stage to have a common definition of "offer to the public";

Whereas such an information policy also requires that when transferable securities are offered for the first time to the public in a Member State, whether by, or on behalf of, the issuer or by a third party, a prospectus must be made available to investors; whereas when the public offer is of transferable securities which are to be admitted to official listing on a

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stock exchange, information similar to that required by Directive 80/390/EEC adapted to the circumstances of the public offer should be supplied; whereas for public offers of transferable securities that are not to be admitted to official stock-exchange listing less detailed information can be required so as not unduly to burden small and medium-sized issuers; whereas for public offers of securities that are to be admitted to official stock-exchange listing the degree of co-ordination achieved is such that a prospectus approved by the competent authorities of a Member State can be used for public offers of the same securities in another Member State on the basis of mutual recognition;

Whereas when transferable securities are offered in respect of take-over bids the information that must be available to shareholders will be harmonized under a company law Directive which the Commission intends to propose; whereas the provisions of such a Directive will be better suited to the particular nature of the transactions in question; whereas, therefore, it is appropriate to exclude such transactions from the scope of this Directive,)

HAS ADOPTED THIS DIRECTIVE: (1)

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⁽xxxxx) The presmble will be examined as soon as the enacting terms have been finalized.

⁽¹⁾ The German delegation entered a general reservation on the Directive.

The Irish delegation expressed doubts regarding the Directive.

SECTION I

General provisions

Article 1

- 1. This Directive shall apply to transferable securities which are offered to the public for the first time in a Member State. (2)
- 2. Where an offer to the public is for part only of the transferable securities from a single issue, the Member States need not require that another prospectus be published if the other part is subsequently offered to the public.

Article 2

This Directive shall not apply:

 (a) where transferable securities are offered in individual denominations of at least [40 000] ECU (3);

⁽²⁾ The Belgian, Italian and Luxembourg delegations entered provisional reservations on the words "for the first time", which they would be ready to withdraw if there were agreement on Article 6.

⁽³⁾ The German and United Kingdom delegations entered provisional reservations, which they would be ready to withdraw if there were agreement on the treatment of international issues.

- (b) where transferable securities are offered to persons in the context of their trades or professions;
- (c) where transferable securities are offered to a restricted circle of persons;
- (a) to units issued by collective investment undertakings other than of the closed-ended type;
 - (b) to transferable securities issued by a State or by one of a State's regional or local authorities or by public international bodies of which one or more Member States are members:
 - (c) to transferable securities offered in connection with a take-over bid;
 - (d) (deleted)
 - (e) to shares allotted free of charge to the holders of shares;
 - (f) to shares or transferable securities equivalent to shares offered in exchange for shares in the same company if the offer of such new securities does not involve any increase in the company's issued share capital;
 - (g) to transferable securities offered to employees by their employer:

⁽⁴⁾ The United Kingdom delegation entered a provisional reservation and would prefer the words "... trade, activity or profession" in the English version.

- (h) to transferable securities resulting from the conversion of convertible debt securities or from the exercise of the rights conferred by warrants or to shares offered in exchange for exchangeable debt securities, provided that a prospectus was published when the convertible or exchangeable debt securities or the warrants were offered to the public;
- (i) to transferable securities issued by non-profit-making bodies with a view to their obtaining the means necessary to achieve their disinterested objectives;
- (j) to debt securities and other transferable securities equivalent to debt securities issued by companies and other legal persons which are nationals of a Member State and which:
 - in carrying on their business, benefit from State monopolies,

and

- are set up or governed by a special law or pursuant to such a law or the borrowings of which are unconditionally and irrevocably guaranteed by a Member State or one of a Member State's regional or local authorities;
- (k) to shares or transferable securities equivalent to shares the holder of which is eligible to avail himself of the services rendered by

bodies such as "building societies", "Crédits populaires", or "Genossenschaftsbanken".

[(1)] (5)

(ANNEX)

Article 3

For the purposes of this Directive:

- (a) "collective investment undertakings other than of the closed-ended type" shall mean unit trusts and investment companies;
 - the object of which is the collective investment of capital provided by the public, and which operate on the principle of risk spreading, and
 - the units of which are, at the holder's request, repurchased or redeemed, directly or indirectly, out of the assets of those undertakings. Action taken by such undertakings to ensure that the stock exchange value of their units does not significantly vary from their net asset value shall be regarded as equivalent to such repurchase or redemption;
 - (b) "units of a collective investment undertaking" shall mean transferable securities issued by a collective investment undertaking representing the rights of the participants in such an undertaking over its assets;

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⁽⁵⁾ The German and Luxembourg delegations wanted Eurobonds to be mentioned so that they would be excluded from the scope of the Directive.

- (c) "issuers" shall mean companies and other legal persons and any undertakings the transferable securities of which are offered to the public;
- (d) deleted
- (e) "credit institution" shall mean an undertaking the business of which is to receive deposits or other repayable funds from the public and to grant credits for its own account, including credit institutions such as referred to in Article 2 of Directive 77/780/EEC;
- (f) "transferable securities" shall mean shares in companies and negotiable securities equivalent to shares in companies, debt securities having a maturity of at least one year and other negotiable securities equivalent to <u>such</u> debt securities, and any other negotiable security giving the right to acquire any such transferable securities by subscription or exchange;
- (g) [Eurobonds/[equities] which:
 - are intended to be underwritten and distributed by a syndicate composed of credit institutions or other financial institutions, at least two of which are incorporated in different States;
 - are offered solely or principally in one or more States other than that in which the issuer has his registered office;
 - may only be subscribed for or initially purchased through a credit institution or other financial institution. (6)

⁽⁶⁾ Under discussion.

Article 4

The Member States shall ensure that any offer of transferable securities to the public within their territories is subject to the publication of a prospectus by the person making the public offer.

Article 4a (formerly Article 7)

The Member States may provide for partial or complete exemption from the obligation to publish a prospectus where the transferable securities being offered are debt securities or other evidence of indebtedness equivalent to debt securities issued in a continuous or repeated manner by credit institutions or other financial institutions equivalent to credit institutions which regularly publish their annual accounts and which, within the Community, are set up or governed by a special law or pursuant to such a law, or are subject to public supervision intended to protect savings.

SECTION 11

Contents of the prospectus for transferable securities for which admission to official stock-exchange listing is to be sought

Article 5

1. Where a public offer relates to transferable securities which at the time of the offer are the subject of an application for admission to official listing on a stock exchange [situated or operating within [the

same) (a) (7) Member State) (8), the contents of the prospectus and the procedures for scrutinizing and distributing it shall, subject to adaptations appropriate to the circumstances of the offer, be determined in accordance with Articles 4, 5, 6(3)(a), (c) and (g), 7 to 9, 11, 13, 14, 16 to 20 and 23 of Directive 80/390/EEC. Articles 6, 8, 10 and 13 of this Directive shall not apply.

Article 5(1), second subparagraph

⁽⁷⁾ The choice between [same] and [a] will affect the scope of mutual recognition as set out in Article 14a (p. 24).

⁽⁸⁾ Proposal by the Chair to suppress the words between [] in order to separate the question of the content of the prospectus from the question of determination of the competent authority (Article 14a) p. 22.

⁽⁹⁾ The United Kingdom delegation entered a provisional reservation on the deletion of the reference to Article 10 of Directive 80/390/EEC.

The Chairman proposed reintroducing a provision contained in the amended Commission proposal (see Article 20(3), 8866/82, page 17):

[&]quot;Where the terms of the issue are not finalized until the last moment, the issue prospectus may omit information as to those terms. In such cases, it shall indicate how that information will be given. Such information must be published before the date referred to in Article 11."

⁽¹⁰⁾ The French delegation has asked for a global reference to Directive 80/390/EEC all dispositions being applicable "mutatis mutandis".

- 2. However, where the transferable securities referred to in paragraph 1 are international debt securities, the Member States need not require that the public offer prospectus be scrutinized. In such cases Articles 8(1) of this Directive shall apply.
- 3. In the event of a public offer of international debt securities, the Member States may allow the omission of certain information from the prospectus or its inclusion in summary form, provided that such information is not significant for the investors concerned by the offer.

SECTION III

Contents of the prospectus for transferable securities for which admission to official stock-exchange listing is not to be sought

Article 6 (11)

the time of the offer are not the subject of an application for admission to official listing on a stock exchange (situated or operating within the same Member State) (xxxxxx), the prospectus must contain the information which, according to the particular nature of the issuer and of the transferable securities offered to the public, is necessary to enable investors (12) to make an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the issuer and of the rights attaching to the transferable securities.

⁽¹¹⁾ The German delegation entered a general reservation.

⁽xxxxxx) see footnote 8, p. 12 above.
(12) The United Kingdom delegation asked for the reinsertion of the words "... and their investment advisers" or, if no agreement is reached on this addition, to delete the words "to enable investors".

- 2. (13) Without prejudice to (14) the obligation referred to in paragraph 1, the prospectus shall, subject to the possibilities for exemption provided for in Articles 4a and 8, contain in as easily analysable and comprehensible a form as possible, at least the information listed in (a) to (g) below: (15)
 - (a) those responsible for the prospectus (names, functions and declarations by them that to the best of their knowledge (16) the information contained in the prospectus is in accordance with the facts and that the prospectus makes no omission likely to affect its import);
 - (b) the offer to the public and the transferable securities being offered (nature of the securities being offered, the amount and purpose of the issue, the number of securities issued and the rights attaching to them; the income tax withheld at source; the period during which the offer is open; the date on which entitlement to dividends or interest arises; the persons underwriting or guaranteeing the offer; any restrictions on the free negotiability of the securities being offered and the markets on which they may be negotiated; the establishments serving as paying agents; if known the price at which the securities are offered and the method of payment, otherwise, if national rules so provide, the procedure and timetable for fixing the price if it is not known when the prospectus is being drawn up; the procedure for the exercise of any right of pre-emption and the methods of and time limits for delivery of the securities);

⁽¹³⁾ The German and Irish delegations entered reservations on paragraph 2 as a whole, which they wanted to see reduced to only the words appearing after points (a) to (g), with the parts between brackets deleted.

⁽¹⁴⁾ The German and Irish delegations wanted to substitute "In order to comply with" for "Without prejudice to".

⁽¹⁵⁾ The United Kingdom delegation suggested, in a spirit of compromise, limiting the introductory phrase to "2. The prospectus shall contain at least the following information":

⁽¹⁶⁾ The United Kingdom delegation asked for the addition of the following words:

- (c) the issuer (name, registered office; its date of incorporation, the legislation applicable to the issuer and the issuer's legal form, its objects, indication of the register and of the entry number therein) and its capital (amount of the issued capital, the number and main particulars of the various classes of securities of which the capital consists and of any shares not representing capital, any part of the capital still to be paid up and, where appropriate, the amount of the authorized capital and the duration of the authorization; the amount of any convertible debt securities, exchangeable debt securities or debt securities with warrants and the procedures for conversion, exchange or subscription; insofar as they are known, indication of the shareholders who directly or indirectly, hold a proportion of the capital which the Member States may not fix at more than 20 [10]% or who exercise or could exercise a determining role in the management of the issuer; where appropriate, the group of undertakings to which the issuer belongs);
- (d) the issuer's principal activities (description of its principal activities, and, where appropriate, any exceptional factors which have influenced its activities; any dependence on patents, licences or contracts if these have a major influence; the principal aspects of its investment policy and the method of financing them where this information is significant; any legal proceedings having an important effect on the issuer's financial position);
- (e) the issuer's assets and liabilities, financial position and profits and losses (own accounts and, where appropriate, consolidated accounts); if the issuer prepares consolidated annual accounts only it shall include those accounts in the prospectus; if the issuer prepares both own and consolidated accounts, it shall include both in the prospectus;

however, the issuer may include only one of the two, on condition that the accounts which are not included do not provide any significant additional information; if the issuer is from a third country, its own or consolidated accounts must provide information equivalent to that prescribed by Directives 78/660/EEC and 83/349/EEC; interim accounts covering at least the first six months if more than nine months have elapsed since the end of the preceding financial year with an indication, if appropriate, that they have not been audited; if available, a table showing the sources and applications of funds over the preceding two financial years); the name of the person responsible for auditing the accounts; if that person has qualified them or refused an audit report, the fact must be stated and the reasons given;

- (f) the issuer's administration, management and supervision (names, addresses, functions; in the case of an offer to the public of shares in a limited company, remuneration paid, benefits in kind and holdings in the capital of the issuing company of the members of the issuer's administrative, and management and supervisory organs; any schemes the issuer may operate to encourage employees to acquire holdings in the issuer's own capital);
- (g) the issuer's recent development and prospects (the most significant recent trends concerning the development of the issuer's business since the end of the preceding financial year, [except in the event of a derogation granted by the competent authorities,] (17) information on the issuer's prospects for at least the current financial year) (18),

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⁽¹⁷⁾ The Belgian and German delegations entered a reservation on the words between [], any reference to authorities having been systematically excluded from Article 6.

⁽¹⁸⁾ The United Kingdom delegation asked for the deletion of (g) or for it to be made optional.

- 3. Where a public offer relates to debt securities guaranteed by one or more legal persons, the information specified in paragraph 2(c) to (g) must also be given with respect to the guarantor or guarantors. This obligation shall not apply where such debt securities are covered by the unconditional and irrevocable guarantee of a State or one of its federated States for the repayment of the loan and the payment of interest.
- 4. Where a public offer relates to convertible debt securities, exchangeable debt securities, debt securities with warrants or warrants, information must also be given with regard to the nature of the shares to which they confer entitlement and the conditions of and procedures for conversion, exchange or subscription; where the issuer of the shares is not the issuer of the debt securities the information specified in paragraph 2(c) to (g) must also be given with respect to the issuer of the shares.
- (19) [Where a public offer relates to certificates representing shares the information specified in paragraph 2 must be given in respect of the shares represented; information must also be given in accordance with Schedule C to Directive 80/390/EEC concerning the issuer of the

⁽¹⁹⁾ The Commission representatives suggested deleting paragraph 5.

certificates, pursuant to Chapter 1 thereof, and concerning the certificates being offered, pursuant to Chapter 2 thereof. Where the issuers are those referred to in Article 16(2) of Directive 80/390/EEC, the provisions of that paragraph shall apply. Where the certificates are issued by a body for the transfer of securities or by an auxiliary body set up by such bodies, the Member States may dispense with the publication of the information laid down in Chapter 1 of the abovementioned Schedule in respect of the bodies in question.]

- 6. If the period of existence of the issuer is less than any period mentioned in paragraph 2, the information need be provided only for the period of the issuer's existence.
- 7. Where certain information specified in paragraph 2 is found to be inappropriate to the issuer's sphere of activity or its legal form or to the transferable securities being offered, a prospectus giving equivalent information must be drawn up.

Article 7 (now Article 4a)

Article 8

1. The Member States or the bodies designated by them in accordance with Article 9 may authorize the omission from a prospectus of certain information prescribed by this Directive:

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⁽²⁰⁾ If paragraph 5 is maintained the German delegation called for the entry in the Council minutes, mutatis mutandis, of the same interpretative statement with regard to Schedule C as was included in the minutes of the Council meeting at which Directive 80/390/EEC was adopted.

(a) if that information is of minor importance only and is not likely to influence assessment of the issuer's assets and liabilities, financial position, profits and losses and prospects,

or

- (b) if disclosure of that information would be contrary to the public interest or seriously detrimental to the issuer, provided that, in the latter case, omission would not be likely to mislead the public with regard to facts and circumstances essential for assessment of the transferable securities.
- 2. Where the initiator of an offer is neither the issuer nor a third party acting on the latter's behalf, the Member States or the bodies designated by them may authorize omission from the prospectus of certain information which would not normally be in his possession.
- 3. [The Member States or the bodies designated by them may provide for total or partial exemption from the obligation to publish a prospectus where the information which issuers are required by law or regulation to supply is available to investors not later than the time when the offer is made, in the form of documents giving information at least equivalent to that prescribed in Article 6.]

⁽²¹⁾ Under discussion.

SECTION IV

Arrangements for distribution of the prospectus

Article 9 (22)

A prospectus must be communicated, [before its publication] [within the time laid down by the Member States] to the bodies designated for that purpose in each Member State in which the transferable securities are offered to the public for the first time.

Article 10

A prospectus must be published or made available to the public in the Member State in which an offer to the public is made in accordance with the procedures laid down by that Member State.

Article 11

A prospectus must be published or made available to the public not later than the time when an offer is made to the public. /In cases where subscription may be revoked, the Member States may allow the prospectus to be published or made available to the public after the beginning of the subscription period, provided that it is published or made available at least /Tive/ working days before the end of the period of revocation./

Article 12

All documents and publicity relating to a public offer must state that a prospectus has been published in accordance with Article 10 and indicate where members of the public can obtain it.

⁽²²⁾ The Belgian, Luxembourg and Portuguese delegations were prepared to withdraw their reservations, which were prompted by the absence of prior scrutiny, if there were no further changes to Article 6.

⁽²³⁾ Under discussion.

If the Member States authorize the dissemination of publicity before a prospectus is available, that publicity must state that a prospectus will be published and where members of the public can obtain it.

Article 13

Any material new factor or any material inaccuracy in a prospectus capable of affecting assessment of the transferable securities which arises or is noted between the publication of the prospectus and the definitive closure of a public offer must be mentioned or rectified in a supplement to the prospectus, to be published in accordance with procedures laid down by the Member States.

SECTION V

Co-operation between Member States

Article 14

The Member States shall designate the bodies, which may be the same as those designated pursuant to Article 9, which shall co-operate with each other for the purposes of the proper application of this Directive and shall use their best endeavours, within the framework of their responsibilities, to exchange all the information necessary to that end. The Member States shall inform the Commission and the other Member States of the bodies they have designated for the purposes of this Article.

The Member States shall ensure that the bodies designated have the powers required for the accomplishment of their task.

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Article 14a

(determination of the competent authority)

Where, for the same transferable securities, public offers are made simultaneously within short intervals of one another in two or more Member States and admission as provided for in Article 5 to official listing on a stock exchange situated or operating in only one Member State is applied for at the same time, the prospectus must be drawn up in that Member State pursuant to the rules laid down in this Directive and approved by the competent authorities of that State within the meaning of Article 24 of Directive 80/390/EEC.

The provisions of Directive 87/345/EEC shall apply in the case of applications for admission to official listing in two or more Member States.

MUTUAL RECOGNITION

Article 14b

nust, subject to any translation, be recognized by or deemed to comply with the laws of the other Member States in which the offer is made to the public, without being subject to any form of approval there and without those States being able to require

.../...

that additional information be included in the prospectus. Those Member States may, however, require that the prospectus include information specific to the market of the country in which the public offer is made concerning in particular the income tax system, the financial organizations retained to act as paying agents for the issuer in that country, and the way in which notices to investors are published.

- 2. The prospectus approved by the competent authorities within the meaning of Article 24a of Directive 80/390/EEC must be recognized in or deemed to comply with the laws of the other Member State in which the public offer is made, even if partial exemption or partial derogation has been granted pursuant to this Directive, provided that:
 - (a) the partial exemption or partial derogation in question is of a type that is recognized in the rules of the other Member State concerned.

and

(b) the conditions that justify the partial exemption or partial derogation also exist in the other Member State concerned.

/Even if the conditions laid down in (a) and (b) are not fulfilled, the Member State concerned may deem the prospectus approved by the competent authorities within the meaning of Article 14a to comply with its laws. 7

The issuer shall communicate to each of the bodies designated pursuant to Article 9 in each of the other Member States in which the public offer is to be made the prospectus that it intends to use in that State. That prospectus must be the same as the prospectus approved by the authority referred to in Article 14a.

4. The Member States may restrict the application of this Article to the prospectuses of issuers having their registered offices in Member States.

SECTION ...

CO-OPERATION

Article 14c

- 1. The competent authorities shall cooperate wherever necessary for the purpose of carrying out their duties and shall exchange any information required for that purpose.
- 2. Where a public offer concerning securities giving a right to participate in company capital, either immediately or at the end of the maturity period, is made in one or more Member States other than that in which the registered office of the issuer of the shares to which those securities give entitlement is situated, while that issuer's shares have already been admitted to official listing in that Member State, the competent autorities of the Member State of the offer may act only after having consulted the competent authorities of the Member State in which the registered office of the issuer of the shares in question is situated.

Article 14d

1. The Member States shall ensure that all persons now or in the past employed by the authorities referred to in Article 14a are bound by the obligation of professional secrecy. This shall mean that any confidential information received in the course of their duties may not be divulged to any person or authority whatsoever except by virtue of provisions laid down by law.

../...

- 2. Paragraph 1 shall not prevent the various Member State authorities referred to in Article 14a from forwarding information as provided for in this Directive. The information thus exchanged shall be covered by the obligation of professional secrecy applying to persons employed then or previously by the authority receiving such information.
- 3. Without prejudice to cases covered by criminal law, the authorities referred to in Article 14a receiving information pursuant to Article 14b may use it only to carry out their functions or in the context of an administrative appeal or in court proceedings relating to the carrying out of those functions.

Article 14e

(Negotiations with non-member countries)

The Community may, by means of agreements with one or more non-member countries concluded pursuant to the Treaty, recognize public offer prospectuses drawn up and scrutinized in accordance with the rules of the non-member country or countries as meeting the requirements of this Directive, subject to reciprocity, provided that the rules concerned give investors protection equivalent to that afforded by this Directive, even if those rules differ from the provisions of this Directive.

SECTION VI

Contact Committee

Article 15

- The Contact Committee set up by Article 20 of Directive 79/279/EEC of 5 March 1979 co-ordinating the conditions for the admission of securities to official stock exchange listing shall also have as its function:
 - (a) to facilitate, without prejudice to Articles 169 and 170 of the Treaty, the harmonized implementation of this Directive through regular consultations on any practical problems arising from its application on which exchanges of views are deemed useful;
 - (b) to facilitate consultation between the Member States on the supplements and improvements to prospectuses which they are entitled to require or recommend at national level;
 - (c) to advise the Commission, if necessary, on any additions or amendments to be made to this Directive.
- 2. It shall not be the function of the Contact Committee to appraise the merits of decisions taken in individual cases.

SECTION VII

Final provisions

Article 16

- The Member States shall take the measures necessary for them to comply with this Directive by at the latest. They shall forthwith inform the Commission thereof.
- 2. As from the notification of this Directive the Member States shall communicate to the Commission the texts of the main laws, regulations and administrative provisions which they adopt in the field covered by this Directive.

Article 17

This Directive is addressed to the Member States.

Done at

For the Council
The President

- are distributed in more than one State (4)
- may be acquired only through a credit institution or other financial institution, provided that the public is not subjected to canvassing or to advertising compaigns (5).

⁽⁴⁾ The Belgian, Italian and Netherlands delegations entered reservations on the deletion of "solely or principally". The Belgian delegation wanted to add the concept "and expressed in a currency other than that of the State in which the issuer has its registered office".

^{(&}lt;sup>5</sup>) An interpretative statement is suggested for the Council minutes specifying what is to be understood by "canvassing" or "advertising campaigns" on the basis of particulars provided by the IPMA:

[&]quot;"Canvassing" or "advertising campaigns" within the meaning of Article 3(g), third indent, and for the sole purpose of defining "Europeans", means any offer backed up by publicity in the mass-circulation press, the use of advertisements broadcast on radio or television or any similar media or taking the form of an advertising campaign designed to attract the attention of the general public."

Meeting document No 4

WORKING PARTY ON ECONOMIC QUESTIONS (meeting on 23 and 24 November 1987)

Public offer prospectus (9634/87)

The Secretariat suggests as a compromise an amalgam of the texts for which there was most support:

Article 3(g)

- "(g) Euro-securities (1) which:
 - are intended to be distributed by a syndicate composed of credit institutions or other financial institutions $(^2)$ at least two of which have their registered offices in different States $(^3)$.

EN

⁽¹⁾ The Belgian and Netherlands delegations wanted the definition to cover only "Eurobonds".

⁽²⁾ To allay the concern expressed by the German, Irish and Luxembourg delegations on what the term "institution" covered, it was suggested that the following clarification be given in an interpretative statement in the Council minutes:

[&]quot;Credit institutions" means institutions complying with the definition in the first Directive (77/780/EEC) of 12 December 1977 on the co-ordination of legislation relating to credit institutions (OJ No L 322/77), and "other financial institutions" means institutions the principal business of which is to grant credit facilities, including guarantees, to acquire holdings or make investments, and stock-brokers to the extent that they are authorized to belong to investment syndicates.

⁽³⁾ The Belgian and Italian delegations entered reservations on the deletion of "and are covered by an investment guarantee or underwritten by the syndicate" on the grounds that giving institutions a purely distributive role without any guarantee whatsoever on their part of successful outcome constituted a lacuna in the system intended to make good the absence of full information.

- are distributed in more than one State (4)
- may be acquired only through a credit institution or other financial institution, provided that the public is not subjected to canvassing or to advertising compaigns (5).

⁽⁴⁾ The Belgian, Italian and Netherlands delegations entered reservations on the deletion of "solely or principally". The Belgian delegation wanted to add the concept "and expressed in a currency other than that of the State in which the issuer has its registered office".

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NO. 643

PØ12

21 October 198

1.h. Handant

ROPEAN COMMUNITIES

- 1802 -

Dear Prime Minister,

Thank you for your letter of 5 October about both the implementation of food aid and the quality of food stocks in the Community. I was as concerned as you are by the report of the Audit Court on the distribution of food aid by the Community over the period 1976-1985. Even if there were problems with only a very limited proportion of the total programme, they certainly justify the management reforms which were proposed by the Commission and approved by the Council during the British Presidency in December 1986.

I agree with you that it is regrettable that the new Regulation was not immediately made permanent. There were, however, a number of Member States who were rejuctant to give the Commission the necessary powers to implement this policy. I hope that with your support this problem can now be evercome which would permit the adoption of a permanent regulation. The Commission, for its part, has made the necessary proposals to that effect.

You also referred to the problem of the quality of some of the food stocks. The existing Regulations only give the Commission limited power. It is Member States and their intervention agencies who have control over the purchase of the products. The Commission may only subsequently make sample controls and if necessary, make adjustments to FEDSA-guarantee expenditure. I think that there is a case for strengthening the Commission's role so that we can assure ourselves more effectively of the ourlity and condition of stocks. The Commission is needy to make the necessary proposals.

The fundamental solution to the problem lies in preventing the growth of each a substitute of the control of the sold to intervention and in the active programs is essential. Two years ago the Commission made a firm correctment to eliminate old excess stocks. The adaptation of the mechanisms of the Common Agricultural Policy must also play its role in solving these problems. I should be most grateful for all the help that the United Kingdom Government can give the Commission in these two ereas.

Swanly gown.

The Kt. Hon. Margaret THATCHER Frime Minister 10, Downing Street LONDON SW

CHANCELLOR

FROM: A J C EDWARDS DATE: 27 October 1987

cc: Paymaster General Economic Secretary Sir P Middleton Sir G Littler o/r

Mr Byatt Mr Cassell Mr H P Evans Mrs Lomax

Mr Peretz Mr Scholar

Mr Kelly Mr Mortimer

Mr Parkinson Mr Cropper

Mr Tyrie PS/C&E

ECOFIN, 16 NOVEMBER

We would much appreciate your guidance on two points related to the 16 November ECOFIN Council.

Chy This grind at 2.00 p.m.

on 18 Ochber, + you may already

(a) with the suggestion that prime financing

is dismost it lanch at ECOFIN

have discussed the points hith Sir D Hannay. 2. Content:

(b) that you will attend?

- 2. First, we need to decide soon whether to ask for discussion of future financing. Sir David Hannay may raise the point with you tomorrow.
- The case in favour is that ECOFIN ought not to neglect 3. this dossier totally. Discussion at ECOFIN would also enable you to signal clearly to other member states the UK's firmness of purpose and our requirements from the negotiation, backed by some reminders of the contrast between the formidable budgetary burdens of some and the handsome net profits of others. could be a valuable opportunity for conditioning the thoughts of others in preparation for Copenhagen.
- The case against is simply that ECOFIN has no operational role in the negotiations. Twelve set-piece speeches on future financing could also be less than stimulating.

- 5. The correct solution, in our view, is to ask for discussion of future financing over lunch. Sir David Hannay shares this view.
- 6. The second question relates to <u>attendance</u> at the meeting. In my judgement, again shared by Sir David Hannay, it would be highly desirable, though not quite essential, for you to attend, not least for the future financing item.
- 7. The other likely items of agenda are:
 - M Delors will presumably submit formal proposals for (a) liberalisation of capital movements, (b) strengthening of the 1979 Directive which interalia requires member states to retain exchange control instruments, and (c) amalgamation of the Community Loan Mechanism and Medium Term Financial Assistance borrowing facilities, with a higher limit (Mr Peretz's submission of yesterday refers). Member states will presumably be expected to offer preliminary comment, even though the next step will probably be a remit to the Monetary Committee to consider and advise.
 - (ii) Tax Approximation

 We assume that Lord Cockfield will deliver his aborted speech and that the remit to the Economic Policy Committee will be formally confirmed.
 - (iii) 7th and 18th VAT directives

 These relate to secondhand goods and transitional derogations.
 - (iv) <u>UCITS</u>
 There may be an item about marketing in the Community of Danish mortgage bonds.

8. You may feel that you should attend for item (i), and also item (ii) if you are present, as well as the future financing discussion. I would however see no problem about your leaving before items (iii) and (iv), which UKREP should be well able to handle with support from Customs and DTI.

Conclusion

- 9. I should be glad to know whether you would be content for us:
 - (i) to request a discussion of future financing over lunch, and
 - (ii) to assume provisionally that you will be attending yourself.

If the answer to (ii) is yes, we will look with the Private Office into the possibilities for an early morning military plane.

AJCE A J C EDWARDS

NFORMAL 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.

- 6. 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, Solchage 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.

ALTHOUGH MINISTERS COULD OF COURSE COMMENT IF THEY WISHED. HE EXPECTED FURTHER PROCEDURAL DECISIONS WOULD BE TAKEN ON THE PACKAGE, HOWEVER.

8. AS REGARDS THE CAPITAL LIBERALISATION PROPOSALS (WHICH THE COMMISSION REPRESENTATIVE INSISTED SHOULD BE RELABELLED 'CREATION OF A EUROPEAN FINANCIAL AREA''), ESPER LARSEN NOTED THAT AT THE INFORMAL ECOFIN IN SEPTEMBER A MANDATE HAD ALREADY BEEN GIVEN TO THE MONETARY COMMITTEE TO CONSIDER THE MACRO-ECONOMIC ASPECTS. THIS COMMITTEE WAS MEETING IN MADRID ON 30 OCTOBER AND MIGHT BE PREPARING AN ORAL OR WRITTEN REPORT FOR THE NOVEMBER ECOFIN. PROCEDURAL DECISIONS WOULD DEPEND ON WHETHER A REPORT EMERGED AND IF SO, WHAT IT CONTAINED. NONETHELESS HE EXPECTED QUESTIONS OF PROCEDURE TO BE DISCUSSED AND POSSIBLY AGREED ON FOLLOWING THE COMMISSION'S FORMAL PRESENTATION.

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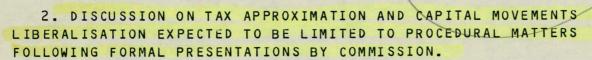
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COREPER AMBASSADORS 28 OCTOBER

PREPARATION FOR 16 NOVEMBER ECOFIN.

SUMMARY.

1. PROVISIONAL AGENDA AGREED.

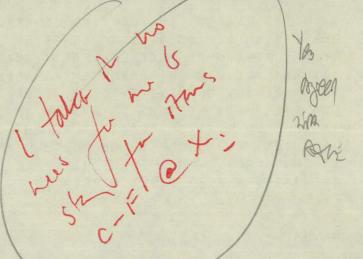


3. UK REQUEST FOR FUTURE FINANCING DISCUSSION OVER LUNCH

DETAIL.

- 4. PROVISIONAL AGENDA WAS AGREED AS FOLLOWS:
- A) LIBERALISATION OF CAPITAL MOVEMENTS.
- B) TAX APPROXIMATION (''ABOLITION OF FISCAL FRONTIERS'')
- C) SEVENTH VAT DIRECTIVE
- D) EIGHTEENTH VAT DIRECTIVE
- E) (POSSIBLY) UCITS INVESTMENT POLICIES DIRECTIVE
- F) (POSSIBLY ALSO) PROSPECTUSES DIRECTIVE
 - 5. 11.30 STARTING TIME CONFIRMED.
- 6. ESPER LARSEN (PRESIDENCY) SAID THAT GIVEN CURRENT DEVELOPMENTS, THE PRESIDENT OF THE ECOFIN COUNCIL EXPECTED THE MAJOR TOPIC DURING LUNCH TO BE THE ECONOMIC AND MONETARY SITUATION. BOSTOCK (UK) FORMALLY REQUESTED THAT FUTURE FINACNING ALSO BE DISCUSSED AT LUNCH AND STRESSED THE UK'S WISH FOR A WEIGHTY EXCHANGE ON THIS IMPORTANT SUBJECT. ESPER LARSEN NOTED THIS.
- 7. ON TAX APPROXIMATION, ESPER LARSEN THOUGHT THAT THERE WOULD BE NO SUBSTANTIVE DISCUSSION AFTER LORD COCKFIELD'S PRESENTATION

PAGE 1 RESTRICTED





Pmp

FROM: J M G TAYLOR

DATE: 30 October 1987

MR A J C EDWARDS

cc Paymaster General Economic Secretary Sir P Middleton Sir G Littler o.r. Mr Byatt Mr Cassell Mr H P Evans Mrs Lomax Mr Peretz Mr Scholar Mr Kelly Mr Mortimer Mr Parkinson Mr Cropper Mr Tyrie PS/C&E

ECOFIN, 16 NOVEMBER

The Chancellor has seen your minute of 27 October.

2. He is content both with the suggestion that future financing is discussed at lunch at ECOFIN, and that you should assume provisionally that he will attend himself.

J M G TAYLOR

Revenusion by Alosence 9 November ECOFIN. Mr Edwards suggests that your team consist of: Janathany Sir GL or Mr Revetz or Mr Kelly M Edwards.V RIG Allan Mr Bryce Knox - C+E. Who would you like to accompany you? arasids 2/11.





FROM: MRS J THORPE
DATE: 2 November 1987

PS/SIR P MIDDLETON

cc Sir G Littler
Mr A J C Edwards

MEETING OF EUROPEAN FINANCE MINISTERS: MONDAY, 16 NOVEMBER

The Chancellor will be attending the November meeting of the European Finance Ministers on Monday, 16 November. The meeting is scheduled to start at 11.30am and continue until mid-afternoon. The Chancellor will probably be accompanied by five officials.

- 2. The Chancellor would prefer to travel to and from Brussels on an RAF flight because his diary is very busy around this time and it would be very inconvenient for him to travel on a commercial flight. In addition it is always very difficult to know when the ECOFIN will finish and there is always the possibility that the Chancellor would either miss a booked commercial flight or have to hang around a long time waiting for one.
- 3. I should be grateful if you could seek Sir P Middleton's permission for the use of an RAF flight.

MRS JULIE THORPE

ulie tharpe.

Diary Secretary

Mkrep. 2920 X305 Julie THORPE Agre Wilson

From: R B SAUNDERS

Date: 3 November 1987

MRS J THORPE

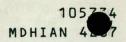
cc Mr A C S Allan

MEETING OF EUROPEAN FINANCE MINISTERS: MONDAY 16 NOVEMBER

Sir Peter Middleton has seen your minute of 2 November. He has asked when was the last time the Chancellor came back by a commercial flight.

R B SAUNDERS

Private Secretary



THAT THE FINANCIAL QUESTIONS GROUP SHOULD EXAMINE VAT AND EXCISE DUTIES ALTERNATIVELY TO ENSURE THAT PROGRESS WAS MADE ON BOTH FRONTS.

- 4. VILAR SUGGESTED THAT WHEN THE MACRO-ECONOMIC STUDY OF THE FISCAL PACKAGE HAD BEEN COMPLETED (PRESUMABLY A REFERENCE TO THE ECONOMIC POLICY COMMITTEE), WORK SHOULD BEGIN IN THE COUNCIL ON THE TAX RATE PROPOSALS. THE COMMISSION ATTACHED PARTICULAR IMPORTANCE TO THE VAT AND EXCISE DUTY RATE CONVERGENCE PROPOSAL, WHICH WAS REGARDED AS A TEST OF THE COUNCIL'S POLITICAL WILL TO MAKE PROGRESS. SWIFT ADOPTION OF THIS PROPOSAL WOULD PREVENT FURTHER DIVERGENCE OF NATIONAL TAX SYSTEMS, AND WOULD PROVIDE THE FRAMEWORK FOR MEMBER STATES' ACTION, AT THEIR OWN PACE, TO ACHIEVE THE ABOLITION OF FISCAL FRONTIERS BY 1992.
- 5. THE COMMISSION EXPECTED THE EUROPEAN PARLIAMENT AND THE ECONOMIC AND SOCIAL COMMITTEE TO GIVE TH OPINIONS BY MARCH 1988, AND HOPED THE FISCAL PACKAGE COULD THEN BE QUICKLY ADOPTED BY THE COUNCIL. CLOSE COOPERATION WOULD BE REQUIRED BETWEEN THE MEMBER STATES AND THE COMMISSION IF THE TIMETABLE ESTABLISHED IN THE SINGLE EUROPEAN ACT WERE TO BE RESPECTED.
- 6. NO DELEGATIONS REACTED TO THIS STATEMENT. MAILAND CHRISTENSEN (PRESIDENCY) CONCLUDED THAT IT WAS HELPFUL TO KNOW THE COMMISSION'S IDEAS. THESE WOULD BE REPORTED TO CAPITALS AS PART OF THE PREPARATION FOR THE ECOFIN COUNCIL ON 16 NOVEMBER. HE EXPECTED THAT THE COUNCIL WOULD HAVE AN EXCHANGE OF VIEWS AND DRAW THE APPROPRIATE PROCEDURAL CONCLUSIONS.

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COREPER (DEPUTIES): 4 NOVEMBER 1987

ABOLITION OF FISCAL FRONTIERS : PROCEDURE

SUMMARY

1. COMMISSION PRESENTS ITS IDEAS ON ORGANISATION OF WORK AND SETTING OF PRIORITIES FOR CONSIDERING THE PACKAGE OF TAX APPROXIMATION MEASURES IN THE SHORT TERM. NO REACTION FROM DELEGATIONS. ECOFIN COUNCIL ON 16 NOVEMBER WILL HAVE AN EXCHANGE OF VIEWS AND DRAW PROCEDURAL CONCLUSIONS.

DETAIL

- 2. VILAR (COMMISSION) SKETCHED THE BACKGROUND TO THE COMMISSION'S RECENT PACKAGE OF TAX APPROXIMATION PROPOSALS WHOSE OBJECTIVE WAS TO ACHIEVE THE ABOLITION OF FISCAL FRONTIERS BY THE END OF 1992. DECISIONS WERE NEEDED ON HOW TO ACHIEVE THIS OBJECTIVE, WHICH THE COMMISSION CONSIDERED HAD BEEN ACCEPTED AND RATIFIED BY THE MEMBER STATES IN THE SINGLE EUROPEAN ACT. LORD COCKFIELD WOULD MAKE A POLITICAL PRESENTATION OF THE COMMISSION'S PROPOSALS TO THE ECOFIN COUNCIL ON 16 NOVEMBER, BUT THE COMMISSION HAD ALSO REACHED ITS OWN CONCLUSIONS ABOUT HOW WORK SHOULD BE ORGANISED AND WHAT PRIORITIES SHOULD BE SET IN THE SHORTER TERM.
- 3. VILAR CALLED FOR MORE FREQUENT MEETINGS OF THE FINANCIAL QUESTIONS GROUP TO EXAMINE:
 - (I) THE TECHNICAL AMENDMENTS SUGGESTED TO THE 6TH VAT DIRECTIVE:
 - (II) THE VAT CLEARING SYSTEM:
- (III) EXISTING EXCISE DUTY STRUCTURAL PROPOSALS (ON OILS, TOBACCO AND ALCOHOLIC DRINKS).

THE COMMISSION WOULD RE-EXAMINE THE EXCISE DUTY STRUCTURAL PROPOSALS, SOME OF WHICH WERE NOW 10 YEARS OLD, AND VILAR SUGGESTED

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FROM: MARK PARKINSON

DATE: **5** November 1987

MR C KELLY (MG)

MR SAVAGE

MS FRENCH (C and E)

MR CRASKE (C and E)

MR CREASE (DTI)

MR C EVANS

cc PS/Chancellor /2/2

PS/PMG

Mr Edwards

Mr Mortimer

Mr Mercer

Mr Bonney

Mr Matthews

Ms Sinclair

Mr Donnelly Mr P Hall

Miss Wright

Mr Thomson (UKREP)

ECOFIN 16 NOVEMBER

The next EC Economics and Finance Council is on 16 November in Brussels. It will begin at 11.30am. The Chancellor intends to attend.

2. The provisional agenda is as follows (see UKREP telno 3427 attached - the prospectus directive is now off the agenda):

in the formal Council

- (a) liberalisation of capital movements (creation of a European financial area)
- (b) indirect tax approximation Lord Cockfield's proposals.
- (c) seventh VAT directive
- (d) eighteenth VAT directive
- (e) UCITs investment policies directive

at lunch

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- (f) future financing discussion
- (g) the economic and monetary situation.

3. I would be grateful if briefs could be provided as follows:

Mr Savage, the usual economic statistics covering the EC, US and Japan;

Mr Kelly on (a) and (g);

Ms French on (b);

Mr Craske on (c) and (d);

Mr Crease on (e); and Mr C Evans on (f).

- 4. Briefs should follow the standard format (attached) and should reach me by close on Wednesday 11 November, with any attachments. Please could anyone planning to attend the ECOFIN let me know.
- 5. Many thanks for your help.

M PARKINSON

Mark Parkinson

EC1

Room 20/G

HM Treasury

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COREPER AMBASSADORS 28 OCTOBER

PREPARATION FOR 16 NOVEMBER ECOFIN.

SUMMARY.

- 1. PROVISIONAL AGENDA AGREED.
- 2. DISCUSSION ON TAX APPROXIMATION AND CAPITAL MOVEMENTS LIBERALISATION EXPECTED TO BE LIMITED TO PROCEDURAL MATTERS FOLLOWING FORMAL PRESENTATIONS BY COMMISSION.
- 3. UK REQUEST FOR FUTURE FINANCING DISCUSSION OVER LUNCH "'NOTED''.

DETAIL.

- 4. PROVISIONAL AGENDA WAS AGREED AS FOLLOWS:
- A) LIBERALISATION OF CAPITAL MOVEMENTS.
- B) TAX APPROXIMATION ("'ABOLITION OF FISCAL FRONTIERS"')
- C) SEVENTH VAT DIRECTIVE
- D) EIGHTEENTH VAT DIRECTIVE
- E) (POSSIBLY) UCITS INVESTMENT POLICIES DIRECTIVE
- F) (POSSIBLY ALSO) PROSPECTUSES DIRECTIVE
 - 5. 11.30 STARTING TIME CONFIRMED.
- 6. ESPER LARSEN (PRESIDENCY) SAID THAT GIVEN CURRENT DEVELOPMENTS, THE PRESIDENT OF THE ECOFIN COUNCIL EXPECTED THE MAJOR TOPIC DURING LUNCH TO BE THE ECONOMIC AND MONETARY SITUATION. BOSTOCK (UK) FORMALLY REQUESTED THAT FUTURE FINACNING ALSO BE DISCUSSED AT LUNCH AND STRESSED THE UK'S WISH FOR A WEIGHTY EXCHANGE ON THIS IMPORTANT SUBJECT. ESPER LARSEN NOTED THIS.
- 7. ON TAX APPROXIMATION, ESPER LARSEN THOUGHT THAT THERE WOULD BE NO SUBSTANTIVE DISCUSSION AFTER LORD COCKFIELD'S PRESENTATION

PAGE 1
RESTRICTED

ALTHOUGH MINISTERS COULD OF COURSE COMMENT IF THEY WISHED. HE EXPECTED FURTHER PROCEDURAL DECISIONS WOULD BE TAKEN ON THE PACKAGE, HOWEVER.

8. AS REGARDS THE CAPITAL LIBERALISATION PROPOSALS (WHICH THE COMMISSION REPRESENTATIVE INSISTED SHOULD BE RELABELLED 'CREATION OF A EUROPEAN FINANCIAL AREA''), ESPER LARSEN NOTED THAT AT THE INFORMAL ECOFIN IN SEPTEMBER A MANDATE HAD ALREADY BEEN GIVEN TO THE MONETARY COMMITTEE TO CONSIDER THE MACRO-ECONOMIC ASPECTS. THIS COMMITTEE WAS MEETING IN MADRID ON 30 OCTOBER AND MIGHT BE PREPARING AN ORAL OR WRITTEN REPORT FOR THE NOVEMBER ECOFIN. PROCEDURAL DECISIONS WOULD DEPEND ON WHETHER A REPORT EMERGED AND IF SO, WHAT IT CONTAINED. NONETHELESS HE EXPECTED QUESTIONS OF PROCEDURE TO BE DISCUSSED AND POSSIBLY AGREED ON FOLLOWING THE COMMISSION'S FORMAL PRESENTATION.

HANNAY

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PAGE 2
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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.

ECOFIN, MARCH 12

SUBJECT

Relevant document:

UK objectives [If any]

Line to take/Points to make

Defensive briefing [if necessary]

Background.

From: Sir G.Littler Date: 5 November 1987 MRS JULIE THORPE c.c. PPS PS/Sir P.Middleton Mr Edwards ECOFIN: 16 NOVEMBER You may like to note that I shall be attending this meeting of ECOFIN, in my capacity as Monetary Committee Chairman (I shall be invited also to attend the Ministerial lunch). If the Chancellor takes a private plane I should like to travel with him please. (Geoffrey Littler)

From: Sir G.Littler
Date: 5 November 1987

MRS JULIE THORPE

c.c. PPS

PS/Sir P.Middleton

Mr Edwards

ECOFIN: 16 NOVEMBER

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(Geoffrey Littler)



1000 Bruxelles, le 5 novembre 1987. Rue, de la Loi 12 Tél.: (02) 233 81 11

REC. 9 NOV 1987 9 11

ACTION SIFG. LITTLER

COPIES MR EDWARDS

ME EVANS

MRS LOMAN

MR PERETZ

MR M. PARKINSON

M. Nigel LAWSON Chancellor of the Exchequer Parliament Street LONDON S W 1P - 3 AG Fax nº 00-44-1-8392082

Herewith an advanced copy of a note and a letter to the President of Council Palle SIMONSEN, wich will be sent to you by letter in the coming days.

Sincerely yours.

of Mr Kelly

Mark EYSKENS.

Ms Goodin



1000 Brussel, November 6, 1987 Wetstrast 12 Tel.: (02) 233 81 11

Monsieur Palle SIMONSEN
Ministre des Finances
Président du Conseil ECO-FIN
Ministère des Finances
Sig Porg
1, Shots Pladt.
1218 COPENHAGUE.K.
DANEMARK.

Sir,

The recent crash on the stock exchanges will have consequences on the world economic and monetary outlook.

I think it is important for the Eco-fin Council to have a full discussion on that matters so as to be able to make a building confidence statement.

This is why I am asking you to put on the formal agenda of the Eco-fin meeting of the 16th november 1987 this discussion on the world economic and monetary outlook.

I send you an attached short note intended to propose a few topics for discussion. This note is also sent to the President DELORS and to each Minister of the Council.

Sincerely yours,

Mark EYSKENS.



1000 Bruxelles, le 6 novembre 1987.

Rue de la Loi 12
Tél.: (02) 233 81 11

N. ref.

V. 761.

THE EUROPEAN COMMUNITY AND THE DEVELOPMENT OF

1. The Events on the stock exchange during the last weeks and the recent economic developments in the United States put heavy pressure on this country for tackling in a determined way its two-fold deficit - the public budget and the trade balance in order to give greater confidence to stock and exchange markets and to reassure the partners of the U.S.A. about the ability of the U.S. to put its house in order within a reasonable period of time.

American policies will be forced to considerably reduce public expenditure; lowering deficit spending will facilitate the reduction of the trade deficit.

Administration, in order to increase production and productivity. It is premature to predict already now the results of such a policy on the growth of the american economy. However, there is no doubt that the wiping out of both deficits will depress the consumption demand and the economic growth.

2. The new situation will require the European Economic Community working out a coherent community stand with a view to control as efficiently as possible the evolution in the financial and monetary fields as well the cyclical conditions !

In this light it seems to me very desirable that at the occasion of the EcoFin-meeting of the Minister of Finance on november 16, the Council could agree on a common declaration fixing the principles and the broad guidelines of a common economic and financial policy for the next months and years.

Such a declaration must be of such a kind that it could restore the confidence of the european public opinion in the European Community and in the E.E.C.-economic development on short and medium term.

The most important elements of such a policy declaration can be summarized as follows:

- 2.1. The reconfirmation by the Ecofin-Council of the 1992-objective and more specifically with regard to :
 - the setting up of the large integrated market of goods and services;
 - the abolition of the fiscal fourtiers and especially the harmonisation of indirect taxation;
 - the completion of the last phase of the liberalisation of capital movements.

2.2. Contribution to the economic growth

It seems evident that a policy of uncontroled deficit spending has to be precluded since this would jeopardize again the efforts made by several countries in the field of improvement of public finances.

It is however important to exercise, through a better coordination of the budgetary policies in the different countries a more positive global influence a the Community level.

So-called reflationary policies must definitely remain in conformity with a double restriction:

- public expenditure in most E.E.C.-countries cannot be increased;
- the increase of the purchasing power cannot take place in such a way that it would lead again to a stimulation of inflation or an increase of production costs, what means that one has to be very careful about real wage-increases.

In this framework three major elements have to be taken into consideration:

- a) Coordination at E.E.C.-level of several fiscal reforms
 concerning personal income tax that are envisaged or
 worked out in the different countries.

 The intention would be to achieve an harmonised timing
 in order to intensify the macro-economic effect of the
 netto-purchasing power increase.

 At the same time, it is important, at E.E.C.-level, to
 quantify that effect because more optimistic expectations could result herefrom on the consumption side and
 in this way lead to an improvement of the investment
 climate.
 - ment expenditures can be increased.

 It is obvious that weak economic growth in a number of countries is due to a sluggish consumption and an insufficient investment demand.
 - c) Consider the possibility to increase public investments at least in the countries which have the necessary budgetary room for it.

2.3. Monetary policies

What matters is to implement a sufficiently flexible monetary policy so that unnecessary limitations would be incorporated as far as the expansion of economic activity is concerned. In most member states the danger of inflation has strongly diminished.

4.

Here, 2 problems have to be considered :

a. coherence of interest rates :

It is desirable to keep the level of interest rates as low as possible given the external constraints, namely the relations vis a vis the dollar, and the necessity to promote at most the stability of the European monetary system.

A coherent interest rate policy does however not preclude that in specific circumstances interest rates might diverge between countries with strong currencies and countries with weak currencies.

b. In the present circumstances, characterized by or rather weak economic growth and a declining dollar rate, the evolution of the money stock can in no way imply a limitation on the financing needs of the economy.

2.4. Implementation of the NYBORG Agreements.

It is very important to underline that the reinforcement, of the E.M.S., as it has been worked aut in Nyborg, also appeared to be implemented in practice and that the intramarginal intervention mechanism has demonstrated its efficiency in the recent period of exchange rate instability.

2.5. Strengthening of the Louvre-agreement.

The E.E.C. has obviously to plead for a U.S. adjustment policy that however must not entail a strongly disturbant management of exchange rate depreciatic. This fundamental position, from the European side, that concurs with the spirit and even the letter of the Louvre-agreement, doesn't preclude that a further decline of the dollar during the past weeks constitutes a fact that has to be considered as irreversible for the next future.

To restore the confidence, one should strive to keep the Louvre agreement in its capacity of mechanism, embryonic structure for the international monetary system and as a framework of methods for international cooperation and surveillance in the economic and monetary fields between the major countries. It is precisely because the operators in the stock and exchange markets were of the opinion that the Louvre agreement was abandoned by its signatories, that the confidence was so heavily shaken and turned into panic.

The G-7 have to take the necessary confidence building measures in this field.

It should be reaffirmed that the stability on the exchange markets is necessarily determined by a strengthening of the international cooperation.

2.6. Strengthening of the Financial structures in Europe.

The crisis on the stock exchange, the possible deterioration of the debt problems in the developing countries, compel us to examination and possibly to a consolidation of the functioning of the financial institutions.

Two tasks have to be done :

- strengthening of the banks' and other financial institutions' own resources.

 Progress has already been achieved in this field, more specifically with regard to the improvement of the solvency obligations. But it might be desirable to make further progress in this field and eventually to look for this in the framework of European harmonisation.
- Examination of the working of the stock and financial markets, more specifically the equity-market,
 after the numerous financial innovations and deregulations.

6.

Mayby will it be possible to draw now the necessary lessons from this.

2.7. The financing of the E.E.C. : The DELORS package

It seems obvious to me that the present incertainty about the financing of the Euroepan Community strongly weakens the setting up of a E.E.C.-policy. The inefficiency of the community initiatives is also assessed by the market operators and contributes to the uncertainty and the lack of confidence. We must aim to reach a breakthrough in the financing of the European Community at the next European Council.

2.8. The European Community and the poorest developing countries.

Europe has very close economic and political ties with a.o. a number of sub-Sahara countries in Africa that are specially affected by unfavorable world economic and financial developments.

It appears that the World Bank and the I.M.F. have taken or are considering taking several initiatives in favour of the poorest developing countries. The structural adjustment facility looks particularly relevant in this respect.

The question can be asked whether the European Community as such cannot play a more active role vis-à-vis specific countries in the Third world, with whom complementary synergies can be developed in the industrial field.

The dormant demand that is potentially present in those countries has to be activated and channeled towards the supply of European products. From a European viewpoint one has to reflect on additional financing techniques, always strictly linked to conditionality that can be checked.

Mark EYSKENS.

UNCLASSIFIED



FROM: MRS J THORPE

DATE: 6 November 1987

SIR G LITTLER

CC PS/Paymaster General
Mr A J C Edwards
Mr R I G Allen
Mr Taylor
Mr B Knox - C&E

ECOFIN: MONDAY, 16 NOVEMBER

As you know the Chancellor is to attend the ECOFIN meeting on Monday, 16 November, in Brussels. He has asked you, Andrew Edwards, Richard Allen, Jonathan Taylor and Bryce Knox to accompany him.

- 2. I have arranged for an RAF plane to take the party to Abelag, near Brussels, departing from Heathrow at 7.30 am. I will let you have details of the VIP Suite in due course. The arrival time at Abelag should be 9.30 am (local time), giving you enough time to travel into Brussels for the ECOFIN meeting at 10.00 am. Continental breakfast will be available during the flight.
- 3. The Chancellor is hoping to leave the Meeting at about 4.00 pm after discussion of Lord Cockfield's proposals. The plane will be on standby at Abelag from 4.00 pm. Tea and/or drinks should be available during the flight. Mr Knox has agreed to stay on to cover the last items at the Meeting and will return by commercial flight.

MRS JULIE THORPE Diary Secretary

Rue de la Loi 12 Tél. : (02) 233 81 11



N. ref.

THE EUROPEAN COMMUNITY AND THE DEVELOPMENT OF THE WORLDECONOMY

V. ref.

1. The Events on the stock exchange during the last weeks and the recent economic developments in the United States put heavy pressure on this country for tackling in a determined way its two-fold deficit - the public budget and the trade balance in order to give greater confidence to stock and exchange markets and to reassure the partners of the U.S.A. about the ability of the U.S. to put its house in order within a reasonable period of time.

American policies will be forced to considerably reduce public expenditure; lowering deficit spending will facilitate the reduction of the trade deficit.

Greater efforts will be needed, probably by the new American Administration, in order to increase production and productivity. It is premature to predict already now the results of such a policy on the growth of the american economy. However, there is no doubt that the wiping out of both deficits will depress the consumption demand and the economic growth.

2. The new situation will require the European Economic Community working out a coherent community stand with a view to control as efficiently as possible the evolution in the financial and monetary fields as well the cyclical conditions!

In this light it seems to me very desirable that at the occasion of the EcoFin-meeting of the Minister of Finance on november 16, the Council could agree on a common declaration fixing the principles and the broad guidelines of a common economic and financial policy for the next months and years.

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The most important elements of such a policy declaration can be summarized as follows:

Community and in the E.E.C.-economic development on short and

- 2.1. The reconfirmation by the Ecofin-Council of the 1992-objective and more specifically with regard to:
 - the setting up of the large integrated market of goods and services;
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2.2. Contribution to the economic growth

It seems evident that a policy of uncontroled deficit spending has to be precluded since this would jeopardize again the efforts made by several countries in the field of improvement of public finances.

It is however important to exercise, through a better coordination of the budgetary policies in the different countries a more positive global influence a the Community level.

So-called reflationary policies must definitely remain in conformity with a double restriction:

- public expenditure in most E.E.C.-countries cannot be increased;
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In this framework three major elements have to be taken into consideration:

- a) Coordination at E.E.C.-level of several fiscal reforms
 concerning personal income tax that are envisaged or
 worked out in the different countries.
 The intention would be to achieve an harmonised timing
 in order to intensify the macro-economic effect of the
 netto-purchasing power increase.
 At the same time, it is important, at E.E.C.-level, to
 quantify that effect because more optimistic expectations could result herefrom on the consumption side and
 in this way lead to an improvement of the investment
 climate.
- b) Examine in which way private and more precisely investment expenditures can be increased.

 It is obvious that weak economic growth in a number
 of countries is due to a sluggish consumption and
 an insufficient investment demand.
- c) Consider the possibility to increase public investments at least in the countries which have the necessary budgetary room for it.

2.3. Monetary policies

What matters is to implement a sufficiently flexible monetary policy so that unnecessary limitations would be incorporated as far as the expansion of economic activity is concerned. In most member states the danger of inflation has strongly diminished.

Here, 2 problems have to be considered:

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It is desirable to keep the level of interest rates as low as possible given the external constraints, namely the relations vis à vis the dollar, and the necessity to promote at most the stability of the European monetary system.

A coherent interest rate policy does however not preclude that in specific circumstances interest rates might diverge between countries with strong currencies and countries with weak currencies.

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To restore the confidence, one should strive to keep the Louvre agreement in its capacity of mechanism, embryonic structure for the international monetary system and as a framework of methods for international cooperation and surveillance in the economic and monetary fields between the major countries. It is precisely because the operators in the stock and exchange markets were of the opinion that the Louvre agreement was abandoned by its signatories, that the confidence was so heavily shaken and turned into panic.

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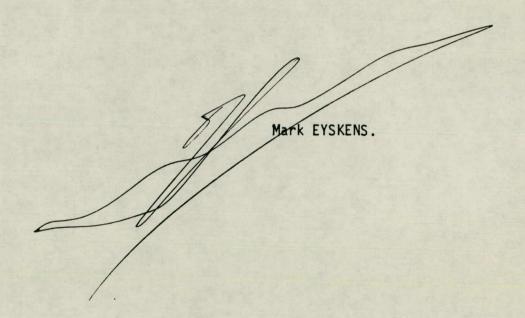
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The question can be asked whether the European Community as such cannot play a more active role vis-à-vis specific countries in the Third world, with whom complementary synergies can be developed in the industrial field.

The dormant demand that is potentially present in those countries has to be activated and channeled towards the supply of European products. From a European viewpoint one has to reflect on additional financing techniques, always strictly linked to conditionality that can be checked.



Ecofin. Experience Ch Ecofin. I have just heard from UKREP that 10.00 the Presidency now mish to start ECOFING This tollows a Belgian regulat to the "Elenumic + financial Silvation as a substimbre item. the agenda with be: () Economic + Firming Silvation (ii) Capital Liberalization; (iii) Lhow (fabore financing) i (iv) Tax approximation (v) VAT Stoff. 2. The 10.00 5 hut mems a v. emp Asparture from here (I roome you would not want to go out an Sunday night). But the first item is, frankly, likely to than into a Whinge by the smaller formines form

From: R B SAUNDERS

Date: 9 November 1987

MRS THORPE

MEETING OF EUROPEAN FINANCE MINISTERS: MONDAY 16 NOVEMBER

Following your response to my minute of 3 November, Sir Peter Middleton has now approved the use of an RAF 'plane on this occasion.

R B SAUNDERS

Private Secretary

M. Edwards, M. J. Taylor 34/2.

Please who the change is starting time and hat there is a lovered ression on The economic and monotany sitestion (for which - be kelly is busting). M. Padeins

FROM: D J Bostock

DATE: 9 November 1987

cci Mr Goulden

Mr Thomson

Mr Parkinson, HMT (by Mufax)

Mrs Eyre-Wilson

Sir D Hannay

ECOFIN 16 NOVEMBER

- My Danish opposite number says:
- (a) EcoFin will now start at 1000 hours;
 - the international economic situation will be discussed (b) in the formal session at Belgian request;
 - the Presidency have built into their plans the Chancellor's (c) wish for a lunchtime discussion of future financing.
 - the change of timetable and extra agenda item will be (d) announced at Coreper tomorrow.
 - You might like to provoke Esper Larsen to say (c) in Coreper tomorrow; there was no "preparation for EcoFin" on last week's Coreper II agenda.
 - 3. Mr Thomson might like to explore with the Commission (Dixon) how Delors is likely to (or at least will be briefed to) deal with the international economic situation.

D J Bostoek



1000 Brussel, November

Wetstraat 12 Tel.: (02) 233 81 11

O. ref. :

U. ref. .

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

Sir,

The recent crash on the stock exchanges will have consequences on the world economic and monetary outlook.

I think it is important for the Eco-fin Council to have a full discussion on that matters so as to be able to make a building confidence statement.

I am writing today to the President of the Eco-fin Council to ask him to put on the formal agenda of the Eco-fin meeting of the 16th november 1987 this discussion on the world economic and monetary outlook.

I send you an attached short note intended to propose a few topics for discussion. This note is also sent to the President DELORS and to each Minister of the Council.

Sincerely yours,

Mark EYSKENS.

- ORAL REPORT BY THE CHAIRMAN -

- 1. THE ECONOMIC POLICY COMMITTEE HAS CONDUCTED AN INITIAL EXAMINATION OF THE ECONOMIC ASPECTS OF THE HARMONIZATION OF INDIRECT TAXATION, AS PROPOSED BY THE COMMISSION. IT PLACED ITS WORK IN THE CONTEXT OF THE SINGLE EUROPEAN ACT. THE COMMITTEE TOOK NOTE OF THE WORK DONE BY THE COUNCIL'S AD-HOC GROUP ON THE ELIMINATION OF FISCAL FRONTIERS AND ITS CONSIDERATIONS HAVE TO BE SEEN AS A COMPLEMENTARY CONTRIBUTION.
- 2. THERE ARE IMPORTANT MICRO-ECONOMIC ISSUES RAISED BY FISCAL HARMONIZATION. THESE INCLUDE THE CONDITIONS FOR COMPETITION AND THE STIMULUS WHICH A GREATER OPENNESS OF MARKETS WOULD GIVE TO THE ECONOMIES OF THE COMMUNITY.
- J. THE MACRO-ECONOMIC ANALYSIS WILL COVER THE CONSEQUENCES OF FISCAL HARMONIZATION FOR MAJOR VARIABLES, SUCH AS PRICES AND TAX REVENUES. IT WAS NOTED THAT THE SCALE OF BUDGETARY ADJUSTMENT REQUIRED WILL CREATE SERIOUS FISCAL PROBLEMS FOR SOME MEMBER STATES. ANY QUANTITATIVE ASSESSMENT OF THESE EFFECTS IS HOWEVER SUBJECT TO SEVERE LIMITS, GIVEN THE RESTRICTED NATURE OF THE ANALYTICAL TOOLS AVAILABLE.
- 4. AT ITS FIRST MEETING THE COMMITTEE EMPHASIZED THE IMPORTANCE OF PROGRESS WITH THE INTERNAL MARKET AS A MEAM OF INCREASING COMPETITIVENESS WITHIN THE COMMUNITY. THE REDUCTION OF FRONTIER AND OTHER BARRIERS WOULD PLAY AN IMPORTANT ROLE AND HELP TO CREATE CONDITIONS SIMILAR TO THOSE IN LARGE UNIFIED MARKETS, SUCH AS THE US AND JAPAN.
- 5. THERE IS BROAD AGREEMENT THAT IN THE LONGER TERM THE COMPLETION OF THE INTERNAL MARKET MUST BE ACCOMPANIED BY GREATER HARMONIZATION OF INDIRECT TAXATION AND ON THE NEED FOR HAVING A TIME HORIZON FOR THIS. HOWEVER, SEVERAL ISSUES STILL HAVE TO BE RESOLVED, SUCH AS TIMING AND THE KIND OF MECHANISMS NECESSARY TO ACHIEVE HARMONIZATION OF INDIRECT TAXATION.
- 6. THE COMMITTEE REAFFIRMED THE FUNDAMENTAL ADVANTAGES OF VAT AS A NEUTRAL, BROAD-BASED CONSUMPTION TAX. THE COMMUNITY HAS, WITH GREAT EFFORT, DEVELOPED THIS TYPE OF TAXATION AS ONE OF THE CENTRAL TAXES. HARMONIZATION OF VAT, HOWEVER, STILL RAISES PROBLEMS RELATING TO STRUCTURES AND TO RATES:
- AS REGARDS STRUCTURE, THERE WAS GENERAL AGREEMENT ON THE NEED TO ACHIEVE A COMMON TAX BASE AS SOON AS POSSIBLE.
- AS REGARDS RATES, IT WAS CONSIDERED IMPORTANT TO SIMPLIFY AND, WHERE POSSIBLE, REDUCE THE NUMBER OF RATES.
- IN ITS EXAMINATION OF THE POSSIBLE EFFECTS OF HARMONIZATION IN THE FIELD OF VAT TAX RATES, THE COMMITTEE WANTS TO EXAMINE FURTHER HOW THE RANGE OF RATES PROPOSED BY THE COMMISSION WILL EFFECT TRADE BETWEEN MEMBER STATES. THERE MAY BE PROBLEMS OF TRADE DIVERSION, IN PARTICULAR IN NEIGHBOURING MEMBER COUNTRIES WHICH WILL FIND THEMSELVES AT DIFFERENT ENDS OF THE PROPOSED RANGE. PROBLEMS ARISING FROM RANGES MAY ALSO BE DIFFERENT AND MORE ACUTE IN THE CASE OF PRODUCTS TAXED AT UPPER RATES THAN FOR PRODUCTS BASED AT LOWER RATES.

Int geogram

- ONSIDERABLE PROGRESS WITHIN THE COMMUNITY, THE COMMITTEE IS OF THE OPINION THAT THE HARMONIZATION OF EXCISE DUTIES, WHICH ARE LESS NEUTRAL THAN VAT, POSES PARTICULAR ISSUES, RELATED ABOVE ALL TO THE LARGE DIFFERENCES WHICH EXIST IN THE NATIONAL OBJECTIVES LIEING BEHIND EXCISE DUTIES. IN FACT, EXCISE DUTIES ARE OFTEN DIRECTLY RELATED TO OBJECTIVES CONCERNING HEALTH, TRANSPORT, ENVIRONMENT, ENERGY ETC. HENCE THE COMMITTEE FEELS THE NEED TO DEVELOP A CONCEPTUAL FRAMEWORK WHICH WOULD TAKE ACCOUNT OF THESE FACTORS.
 - 9. THE PROPOSED LINK OF TAXATION TO THE ECU WOULD IN THE VIEW OF THE COMMITTEE ENTAIL DIFFICULT ADJUSTMENTS WHEN EXCHANGE RATES CHANGE, AND THEREFORE CAUSE PROBLEMS FOR THE MANAGEMENT OF THE EMS. FURTHERMORE, A REGULAR INDEXATION OF DUTIES COULD HAVE ADVERSE EFFECTS ON STABILIZATION POLICIES WITHIN THE COMMUNITY.
- 10. ANOTHER AREA WHICH REQUIRES EXAMINATION ARE THE ECONOMIC DIFFICULTIES AND ADMINISTRATIVE COSTS RELATED TO THE WORKING OF THE CLEARING MECHANISM PROPOSED BY THE COMMISSION.
- 11. IN ITS FURTHER WORK, THE COMMITTEE WILL ALSO EXAMINE VARIOUS TYPES OF ARRANGEMENT FOR ACHIEVING FISCAL HARMONIZATION.
- 12. ON THE BASIS OF FURTHER ANALYSIS TO BE PROVIDED BY THE COMMISSION, THE COMMITTEE WILL FINISH THE MAIN PART OF ITS WORK IN THE NEXT THREE MONTHS AND REPORT TO MINISTERS.

NNNN

9413704 HMTLDN G 21877 COMFU B End of message Pursuant to Article 4 of the Council Decision of 18 February 1974, the Council is asked to adopt this report at its meeting on 7 December 1987. The European Parliament and the Economic and Social Committee should accordingly deliver their opinions at their November meetings.

(Complimentary close.)

(s.) Peter SCHMIDHUBER

Encl.: COM(87) 500 final

oyd/AH/kjf

EUPOPEAN COMMUNITIES THE COUNCIL

ANNUAL ELONOMIC REPORT

TRANSLATION OF LETTER

from : Commission of the European Communities, signed by

Mr Peter SCHMIDHUBER

dated: 6 November 1987

to : Mr Uffe ELLEMANN-JENSEN, President of the Council of the

European Communities

Subject: Annual economic report 1987-1988

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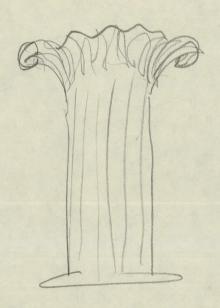
inder Article 4 of the Council Decision of 18 February 1974 on the attainment of a nigh degree of convergence of the economic policies of the Member States of the European Economic Community, the Council is required in the fourth quarter of each year - on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee - to adopt an annual report on the economic situation in the Community and to establish the guidelines to be followed by each Member State in its economic policy for the following year.

I enclose the text of the annual economic report for 1987-1988, drawn up by the Commission on 14 October 1987.

The report describes economic developments and outlook and updates economic policy guidelines in the light of Community strategy.

.../...

COMMISSION OF THE EUROPEAN COMMUNITIES



COM(87) 500 final

Brussels, 21 October 1987

ANNUAL ECONOMIC REPORT 1987 1988

COMMISSION OF THE EUROPEAN COMMUNITIES

COM(87) 500 final

Brussels, 21 October 1987

ANNUAL ECONOMIC REPORT 1987 - 1988

COM(87) 500 final

Annual Economic Report 1987-1988

(Communication from the Commission to the Council¹)

USING THE COMMUNITY DIMENSION TO REINFORCE INTERNAL GROWTH

The Commission's proposed "Annual Economic Report" is submitted to Community institutions in accordance with the Council's 1974 Decision for attainment of a high degree of convergence of economic policies of Member States (Article 4 of Decision 74/120/EEC of 18 February 1974, amended by Decision 75/787/EEC of 18 December 1975 and by Decision 79/136/EEC of 6 February 1979). The Council is required in the fourth quarter of each year - on a proposal of the Commission and after consulting Parliament and the Economic and Social Committee - to adopt an annual report on the economic situation in the Community and to set economic policy guidelines to be followed by each Member State. As was the case last year, the Commission has consulted the representative organisations of employers and trade unions at the Community level.

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^{*} Statistical Annex : separate document.

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1.2. Imbalances in the world economy

The world economy continues to be affected by two severe imbalances: the structure of payments' balances between the industrialized to the structure and the indebtedness of developing countries. In 1987, the current external deficit of the United States is still increasing to reach USD 150 billion (3.5% of GDP). The Japanese surplus (around USD 85 billion or 3.8% of GDP) remains very high. The Community surplus is undoubtedly falling. But the counterpart of this fall is to be found for 1987 essentially in the improvement in the current balance of oil-exporting countries in particular as a result of the fall in their imports. The debt of developing countries has continued to increase (USD 1200 billion in 1987). Restructuring agreements and falling interest rates up to the end of 1987 have moderated its burden. But the recent rise in interest rates again works against these countries.

Positive elements are appearing. Real trade flows are contributing to reestablishing balance on trade accounts. International cooperation is established and is leading to policy adjustments in the right direction. The dollar exchange rate is more stable following the Louvre accord of February 1987. The thrust of this policy was confirmed at the June 1987 summit of industrialized nations in Venice and subsequently at the Group of Seven meeting of September 1987 in Washington. UNCTAD VII has shown that it is possible to arrive at a common view with the developing countries on the main problems affecting the world economy. Meetings of the World Bank and the IMF in September 1987 have made some progress, in particular on the subjects of the indebtedness of African countries and an increase in World Bank funding. Finally, the Uruguay Round of negotiations within GATT provides a basis for continuing efforts to halt and roll back protectionism.

However, there are still appreciable dangers ahead. In 1988, progress towards the restoration of international balance of payments equilibrium will remain slow. The continuation of a large measure of stability on foreign exchange markets remains necessary to allow time for the considerable exchange rate adjustments which have already occurred to produce their full positive effects. Central bank management of interest and international intervention differentials can still contribute here. In order to stabilize durably exchange rate expectations, however, it is above all necessary to progress more rapidly towards the restoration of international payments' equilibrium. Otherwise the gap between interest rates in the United States on the one hand, and Europe and Japan on the other, runs the risks of needing to widen still further. Additional rises in interest rates in the United States could then prove necessary. The situation of developing countries, already affected by the weakening of world trade, would be correspondingly worsened.

In these circumstances, it is desirable for relative trends in domestic demand between the various industrialized countries to continue helping to reduce trade imbalances, while at the same time preserving a high level of world growth. The current prospects for

1. MORE DYNAMIC GROWTH IS NECESSARY AND POSSIBLE

Summary and economic policy conclusions

1.1. Economic situation in the Community and outlook for 1988

Since 1982, the Community economies have strengthened. The level and degree of convergence of inflation rates are unmatched since the 1960s. Rates of return on capital and the adaptability of markets have improved significantly and structural adjustment, which has often been painful, has reinforced productive potential. Until 1986 economic growth effectively strengthened to reach 2.6% on average last year for the Community.

However, growth in 1987, only barely over 2%, is lower than in 1986. Hopes for a further acceleration have not, therefore, been realized. Since the end of 1986 and again in 1987, Community exports to third countries have fallen back in real terms, influenced by two factors. Firstly, the effective appreciation of European currencies has led to a deterioration in Community competitiveness, not only vis-à-vis the United States, but also with respect to other areas such as the newly industrialized countries. Secondly, traditional Community markets show practically no growth on average, with imports of OPEC countries falling very sharply even weakening significantly. On the other hand, Community imports have remained buoyant. Accordingly, the external balance has cost the Community one point of growth both in 1986 and 1987. This represents a contribution of the Community to the international adjustment process which cannot be regarded as negligible. This deterioration in the external climate was offset in 1986 by the impetus given to domestic demand by the improvement in the terms of trade. effects of this improvement on real incomes and private consumption is any petering out. An added factor is that many firms in export sectors have been led to revise their investment plans downwards. fall in extra-Community trade as well as the uncertainty attached to exchange rates and interest rates has contributed greatly here.

hold

In 1988, growth should remain a little above 2%. This level of growth is just about sufficient to stabilise the unemployment rate at nearly 12%, an intolerable level. Extra-Community trade will undoubtedly recover slightly. Its contribution to growth, however, is likely to remain negative, while that of domestic demand should decrease anew. A threat is now emerging. A number of countries - Spain, Italy, Portugal and the United Kingdom - have so far maintained growth rates in excess of 3%. They have thus made a large contribution to sustaining intra-Community trade and growth in the Community. In order to preserve balance on their external accounts, some of these countries run the risk of being forced to put a brake on their own growth if expansion in their partner countries remains mediocre. This would affect the whole Community. This danger would grow if the international environment were to deteriorate further.

and customs formalities, the lifting of tax barriers to the free movement of goods and services, the harmonization of technical standards and the unification of public procurement. In this connection, the Commission has in 1987 made proposals for the approximation of indirect tax rates and the harmonization of their structure and for the unification of public procurement markets.

The reduction in costs which will result from the completion of the internal market, economies of scale, increased competition, and the broadening of the economic basis for research and development, will lead to an easing of the burden on public budgets, productivity gains, an improvement in competitiveness on external markets and a boost to intra-Community trade. The internal market will create fresh opportunities for investment by opening up new horizons for entrepreneurs. For these opportunities to be quickly and fully seized, the irreversible nature of the enterprise must be demonstrated by speeding up its completion. The completion of the large internal market should also derive benefit from an infrastructure network which matches it in scale. The completion of large-scale infrastructure projects of Community interest should contribute here.

The productivity gains made possible will not, however, result in additional jobs and a faster rise in living standards unless productive potential is fully exploited. Stronger growth will also make it easier for the social and regional dimension of the internal market to be taken into account.

1.4 Economic policies

Firstly, it remains essential to pursue structural policies aimed at a greater adaptability of the markets. In this connection the recommendations for supply-side policies contained in the most recent Annual Economic Reports remain entirely valid. In particular, the loosening of the constraints on small and medium sized enterprises, improved competition and the reduction in subsidies affecting the productive use of resources will permit a further reinforcement of the domestic determinants of growth. Also, the greater adaptability of the labour market, the reorganization and reduction of working time, neutral for the level of costs, and investment in vocational training should also boost employment-creation.

The completion of the internal market and the structural policies provide substantial stimuli, which will be able to exert their full effects if they form part of a dynamic macroeconomic process. Investment should increase at a significantly faster rate than GDP over the years to come in order to make up the shortfall of jobs. The outlook for demand, profitability and real interest rates are determining factors. In the absence of an external stimulus, the outlook for demand depends to a great extent on a satisfactory trend of private consumption and therefore on the trend of personal

1988 are not encouraging. It is essential for the United States to continue reducing its budget deficit. But Japan must also make greater efforts to create conditions which are favourable to a more rapid growth in imports, by strengthening growth and further opening up its markets. The Community, in addition, by reinforcing its own growth, would help to support world trade, while at the same time playing its part in the absorption of international payments' imbalances.

1.3 The task ahead: growth, cohesion and the internal market

Given the present situation of the world economy, the Community will no longer benefit from an external impetus. Implementing the cooperative growth strategy for more employment now means: successfully accomplishing the switch from growth underpinned by external factors to growth based on internal forces, shortening the period of conjunctural weakening and thus escaping more rapidly from the trap of slow growth extending into the medium term into which the Community seems to have fallen. In this way, the Community will once again be able to reduce unemployment, derive full benefit from the completion of the large internal market and reinforce its economic and social cohesion. In order to exploit Community strengths to the full, increased cooperation and the pursuit of ambitious Community policies remain essential. It also remains necessary to reinforce the consensus with and between the social partners on the policies required by a more intensive dialogue on all aspects of the strategy at both Community and national level.

To strengthen the Community's economic and social cohesion, all the Member States must coordinate their efforts as provided for in Article 130B of the EEC Treaty, as amended by the Single European Act. Three conditions must be fulfilled. Firstly the task is to create in Europe a climate of buoyant growth; an adequate rate of growth in the most advanced countries is necessary for this. Secondly, for the less-advanced countries it is crucial to implement policies which improve the domestic conditions for their growth, notably the return on, and effectiveness of, their investment as well as the public finance position. This would create the sort of conditions needed to attract inflows of private capital. Thirdly, the Community should support the adjustment process through the structural funds, as well as through its financial instruments and the EIB. The Commission proposes to double the resources of the structural funds in real terms by 1992, and to increase their effectiveness.

The completion of the internal market up to 1992 creates an important new momentum. It is essential not to disappoint the expectations of those involved in economic activity in this enterprise. Rapid progress should be made towards the abolition of frontier controls

There is a grave risk in a situation in which growth remains poor: the countries whose budgetary situation is more difficult could be compelled to take additional measures to attain their objective of public finance consolidation. This would have adverse effects on their own growth and on that of their partners, whose room for manoeuvre would in turn be affected. This shows how important it is for national budgetary authorities to take account of the interdependence among economies of the Community in their policy choices. The accession of Spain and Portugal, which are currently giving substantial support to intra-Community trade, has made this interdependence even wider. It is likely to increase further with the completion of the internal market and the liberalization of capital movements.

In the event of a further slowdown in growth a joint and well timed effort will permit a positive use of the interdependence among Member States, as envisaged in the conclusions reached by the Economic and Financial Affairs Council at its meeting in July 1987. Such an effort will, of course, have to be consistent with the objectives and constraints which exist at national level. However, if each country can count on more rapid growth elsewhere in the Community, its own external and budgetary constraints will be reduced and it will be able to contribute to a non-inflationary strengthening of growth.

Its performance must rely mainly on its own efforts.

The Community is faced with a difficult international environment. It It has major strengths to draw on: the must be self-reliant. structural adjustments in train, the improvement in profitability, the reduction of inflation, all create conditions favourable to stronger growth which will create jobs. The large internal market will give the economies of the Community additional momentum and accelerate technical progress. Its completion will have to be supplemented by effective Community policies which should also contribute to better economic and social cohesion. Closer cooperation between the Member States will improve the effectiveness of economic To reinforce consensus on the policies to be followed, a continuation of social dialogue remains essential. Exploiting the Community dimension will thus enable Europe to make its economies more dynamic and to contribute to stabilizing the international environment.

disposable income. However, to improve profitability and competitiveness further, real wage costs per head must remain moderate. Under these conditions, reductions in the tax burden on households and business should also contribute to greater momentum. Additional cost-effective public investment would also productive potential and at the same time provide welcome support for internal demand. In addition, a fall in real interest rates is desirable. To this end, it is important to avoid calling into question the credibility of the medium term consolidation of public finances, that inflationary expectations stabilise at a low level and that financial external imbalances are absorbed. Such falls would also take pressure off public budgets. If it is to be durable, an acceleration in growth must be compatible with the maintenance of an external position that is sustainable in the medium-term. When supply conditions are improved at the same time, some acceleration of growth is thus possible without jeopardizing the balance of payments objective and without the danger of a resurgence of inflation.

Despite the high level of real interest rates, monetary policy is currently creating sufficient room for financing growth. Even if account is taken of financial innovation in certain countries, monetary growth remains strong. The task now is to prevent the build up of an excessive accumulation of liquidity which would be inflationary. The more favourably that other determinants of inflation, in particular the trend of wage costs, develop, the smaller the risk will be.

Within the EMS, the management of interest-rate differentials has contributed better than in the past to the stabilization of exchange rates. Swift liberalization of capital movements should continue to go hand in hand with efforts to strengthen the system. The outcome of the Economic and Finance Ministers Council at Nyborg constitutes an important step in this regard. In the interests of permanent stability of the system, however, it is vital that this cooperation should continue to be based on a broad consensus on the need for stability-oriented monetary policies.

The scope for monetary policy is now limited. Budgetary policy therefore has a greater role to play. First, the efforts to restructure public expenditure and receipts must be pursued with determination. From the point of view of the public deficits, each country in the Community taken individually is still subject to severe constraints. In some countries the level of public debt is still increasing at an excessive rate and major efforts are being made to put public finances in order. However, the impact of those efforts on deficits is weakened and delayed by low levels of growth and the resultant shortfall in tax revenue. In other countries, the budgetary situation is easier and the tax reductions planned for next year and beyond will provide a welcome boost to growth, the positive effects of which will also be felt in the medium-term. In some of these countries, the consequences on tax receipts of the slowdown in growth, combined with the tax cuts planned, are already leading to an increase in public deficits.

The growth in world trade over the last twelve months has remained below the forecast made last autumn. In the first half of 1987, imports by non-Community countries actually remained flat in volume terms. The expectation at the moment is that total world imports (including the Community) will grow by some 3.5% in 1987, compared with close on 4.9% in 1986 (see Table 3). The prospects for the Community are even gloomier. If world imports (excluding the Community) are weighted to take account of the structure of Community exports, this gives for the current year a figure of less than 1% for the expansion in Community export markets (see Table 5). World trade is not expected to stage a recovery of sorts until 1988. Its sluggish expansion in 1987 is due essentially to the squeeze on imports in the United States.

In the US, the federal budget deficit will probably fall significantly this year, but mainly under the impact of a once-off increase in tax revenue as a result of the tax reform. This specific effect will, however, no longer be felt in 1988. Moreover, the balanced budget originally foreseen under the Gramm-Rudman legislation for 1991 has now been put back to 1993. The fall in the dollar and the resulting increase in import prices will push up inflation in 1987. At the same time, the first signs of the anticipated impact on merchandise trade of the fall in the dollar are being felt. For the first time since 1980, the external balance has contributed positively to the growth in real GDP. Nevertheless with the negative effects of changes in import and export prices exceeding for the moment the gains which they imply in movements in export and import volumes, no contraction in the US trade deficit in nominal terms is to be expected this year (J-curve The current account deficit should also widen further in 1987 and reach USD 154 billion (3.5% of GNP). An improvement can be expected only in 1988. Investment should recover in 1988 after the fall in real terms this year. In total, GNP growth could accelerate

2. ECONOMIC DEVELOPMENTS AND OUTLOOK

2.1 World economy

The overvaluation of the dollar that gradually became apparent in the first half of the 1980s was sharply corrected in 1985, 1986 and in the first two months of 1987 (see Graph 1). The unsatisfactory progress in reducing the US current account deficit and the expectation of a further fall in the dollar temporarily fuelled a self-sustaining process of depreciation. The dollar thus lost some 40% of its value against the ECU between March 1985 and February 1987. There was a return to more settled conditions on the exchanges only after the Louvre accord of February 1987 between the leading industrialized countries had underscored the need to keep exchange rates close to their prevailing levels, and only after this consensus was accompanied by massive central bank intervention. As a result, the rate of the dollar was stabilized at about the level recorded in 1981, a year marked by relatively small current-account imbalances.

The rise in <u>crude oil prices</u> was greater in 1987 than had been expected a year earlier. The average price for Community imports is expected to be in the region of USD 17 per barrel, compared with USD 13.7 in 1986. Unlike in 1986, oil price movements are no longer expected, therefore, to make any contribution to a lowering of inflation rates. A limited rise in the oil price is assumed for the coming year. However, oil prices are prey to major uncertainties stemming from the political tensions in the Gulf and from the precarious nature of the production quotas agreed by OPEC.

Other commodity prices should increase slightly in dollar terms in 1987 and 1988 (see Graph 2). As, at the same time, prices of manufactures will increase more rapidly, the terms of trade of the commodity-exporting developing countries are likely to show a further worsening.

2.2 The adjustment process and international cooperation

International cooperation has been directed towards reducing international imbalances and is leading to policy adjustments that are pointing in the right direction. In particular, the efforts to stabilize the dollar's exchange rate have proved fruitful, but further progress is still needed in eliminating the major imbalances. The two main problems, i.e. current—account imbalances between the leading industrialized countries and the debt burden of the developing countries, are still being acutely felt. Solving them will be a task of overriding importance in the years ahead.

The unprecedented scale of current-account imbalances is illustrated in Graph 3. As early as 1985, these imbalances had become untenable; for the world economy, this heightened the risk of a "hard landing". In this context, the major industrialised countries arrived at a consensus on the desired adjustment in parities which found its expression in the Plaza agreement of September 1985. It was reflected on the foreign exchange markets by a persistent fall of the dollar. Following what, over such a short period, were large exchange-rate adjustments, commitments were made, within the framework of the Louvre accord, to stabilize the dollar's rate so as to enable trade flows to adapt to the new configuration of exchange rates, and thereby to initiate a return to more balanced current-account positions. accord was confirmed at the Group of Seven meeting in September 1987 in Washington. Some progress in correcting external imbalances is evident, but the process also exhibits some worrying trends. It is true that the trade balances of Japan and the Community at constant 1985 prices are moving in the desired direction: implying respective falls of around USD 23 000 million and USD 36 000 million between 1986 and 1988 (see Table 6). These falls only, however, correspond to the improvement in the US balance of USD 36 000 million between these two years. An important counterpart is furnished by the developing slightly from 2.3% in 1987 to 2.7% in 1988.

In Japan, a country heavily dependent on exports, the strong appreciation of the yen last year led to a sharp decline in the GNP growth rate, from 4.5% in 1985 to 2.4% in 1986. For the current and coming years, growth could recover, since the development of domestic demand remains dynamic and the negative contribution of the foreign balance to growth is fading. This process is underpinned by the fiscal package announced by the Japanese government to the worth over 6000 billion yen spending programme worth YEN 6 540 billion that was adopted in 1987. Investment will probably expand at a rate of more than 7%, as a rise in public investment and investment in residential construction looks set to make up for the sluggish nature of productive investment. Despite the recovery in growth, the unemployment rate is expected to remain in 1987, as in 1988, at the historically very high level of around 3%. The Japanese current account surplus should be of the same While falling as a order of magnitude in 1987 as in 1986, around USD 85 000 million (or percentage about 3.8% of GNP). 4.5% in 1986 A of GNP

Leaving aside the newly industrializing countries in Asia, the situation of the developing countries has scarcely improved in 1986-87 owing to the slack rate of growth in the world economy and the depressed level of commodity prices (see Tables 7 and 8). The deterioration in the current-account balances of the developing countries as a whole in 1986 is attributable primarily to lower oil prices and reflects the fall in the oil revenues of oil-exporting countries. The non-oil-exporting countries' current balances were, however, clearly eased. Nevertheless, the private external contribution to the financing of these external deficits remains very small.

The situation of the non-oil developing countries continues to show large differences. While the countries of the Far East continue to record high GDP growth rates, those with middle incomes in Europe and Latin America have performed only modestly. The situation in sub-Saharan Africa, on the other hand, remains extremely disturbing, with falling living standards in certain areas.

worsening of the situation of the heavily indebted developing countries.

However, the key to stabilization of the dollar and to a sustained reduction in external imbalances lies in the establishment of an adequate domestic demand growth differential between Japan and Europe, on the one hand, and the United States, on the other. For experience has shown that the effects of a large exchange-rate adjustment work through more rapidly if growth in the surplus country speeds up, triggering a pick-up in exports that is of crucial importance when it comes to rectifying the external balance of the country running a deficit. In 1987, it would seem that considerable progress is in the process of being made on this front. While the growth in final domestic demand in the US is around 1% below that of its 19 main partner countries, Japan and the Community will register a positive growth differential with respect to their partners of around 1.6% and 0.5% respectively (see Table 4). At the Community level it should, however, be recognised that this development is to a greater extent due to the slowdown in world economic activity than to an acceleration in final domestic demand. What is more, according to the forecasts for 1988, these differentials, except in the Japanese case, will probably tend, if anything, to narrow, instead of growing wider as would be desirable and necessary. Then again, the growth in domestic final demand in the United States in 1988 is expected to be only some 0.7% lower than the average for its major trading partners. relation to the Community, there will be probably no disparity in growth rates whatsoever. If these forecasts were to hold good, external trade would only make a limited contribution next year towards reducing current-account imbalances between the industrialized This could damage the credibility of the adjustment process in the medium term. This would increase the risk of a further fall in the dollar and of escalating protectionist measures. It is essential, therefore, that economic policy should thwart such a development. At the same time, steps must be taken to ensure that the necessary disparities in growth are achieved at a high, but non-inflationary level of growth. Without this, it will not be countries, in particular oil exporters who have substantially reduced their imports. Thus, the adjustment process between the industrialised countries is only advancing very modestly.

It is difficult to tell whether the dollar's present exchange rate is capable of redressing the current-account balance in the medium term. Nevertheless, real exchange-rate movements since 1985 have, to a large extent, compensated for the dollar's tendency to become overvalued during the first half of the 1980s. As for the Japanese yen, its appreciation since 1985 has, in fact, more than offset its earlier real depreciation. It could, therefore, be concluded that the exchange rate modifications which have taken place since 1985 may be sufficient to lead to significant progress towards balance in international payments, to the extent to which they are accompanied by overall macroeconomic policy compatible with a faster adjustment process.

In the first half of 1987 central bank intervention contributed substantially to financing the US current deficit and to stabilizing the dollar. In the long-term, however, this alone cannot achieve the lasting stabilization of exchange rates necessary for a smooth adjustment process. Such a stabilization is conceivable only if a positive interest-rate differential is combined with a negative domestic final in the USA Man in Tapan and Europe demand growth differential between the United States, on the one hand, and Japan and Europe, on the other. The movements in interest rate differentials since the beginning of the year have already contributed to a stabilisation in exchange rates. Thus, for example, between January and August 1987, the interest rate differential between the United States and Germany, on both long and short term nominal rates, has increased by around 1 percentage point, thus preventing a further The short-term forecasts assume that this fall in the dollar. differential does not narrow in 1988. In any event, while the necessary differentials are being maintained, the average level of interest rates must be kept as low as possible. This is because high US interest rates not only harm investment but also lead to a

event, the present problems at international level can be resolved only if current-account imbalances are corrected and the debt crisis defused; given the growing interdependence of economies, this will be possible only if international cooperation and coordination are stepped up. In this respect, the improved multilateral surveillance arrangements agreed upon back in 1985 at the Tokyo Summit and confirmed in June 1987 in Venice could prove to be a useful instrument in avoiding any incompatibilities in economic policy and, where appropriate, identifying any possible divergence in good time. It is also important that the Community speaks with one voice in the international meetings of the coming months. This applies not only to trade policy and the indebtedness problems of developing countries but also in the area of economic and monetary cooperation between the major industrialized blocs.

2.3. The economic outlook for the Community for 1987 and 1988

Economic growth in the Community estimated at 2.2% this year is significantly lower than expected in the last Annual Economic Report. The expectation of faster growth has not, therefore, been realized. Comparison of last year's forecasts with the most recent estimates pinpoints where the two main causes of this development lie: exports, and investment in plant and machinery (see Table 9).

Although, for reasons to do with international adjustment (see above), external trade cannot, basically, be looked to as a source of faster growth in Europe, the contraction in export demand has, even so, been more pronounced than expected. On the one hand, lower crude oil prices have caused the OPEC countries to reduce imports significantly. On the other hand, the price competitiveness of European producers has deteriorated sharply in response to exchange-rate adjustments. Compared with 1985, the Community has had to contend with a rise of 20% or so in its real effective exchange rate against its major trading partners (see table 10). Moreover, a

possible to set about tackling the pressing problem of unemployment in Europe. Furthermore, a recession in the United States would have an adverse effect on those countries running an external deficit and on the heavily indebted developing countries.

This year, the level of developing-countries debt will climb once again, partly as a result of exchange-rate adjustments. the ratio of debt interest payments to exports has declined slightly. The debt burden was eased by reductions in interest rates up to 1986 and by debt-rescheduling agreements, in particular within the framework of the Paris Club. However, the recent rises in interest rates will again make the situation of the developing countries more The Seventh United Nations Conference on Trade and Development in July 1987 in Geneva (UNCTAD VII) showed that it was possible to make a common analysis with the developing countries on the main problems of the world economy. At the September 1987 annual meeting of the World Bank and IMF in Washington some successes could be noted, particularly the negotiations underway to raise the capital of the World Bank. Broad consensus is appearing on the need to support the adjustment efforts of the low-income countries, whose debts are primarily with official creditors, by alleviationg the burden of their debt and by stepping up the volume of capital flows made available at favourable rates. In the other indebted countries. in accordance with the objectives of growth and structural adjustment, it would be necessary to mobilize domestic resources and to tap a sufficient amount of external financing, in particular private capital.

Even so, the industrialized countries themselves must, while helping to strengthen growth worldwide, spurn protectionist measures and open up their markets in order to allow the developing countries to expand their exports, thereby making it easier for them to repay their borrowings. Rapid progress would, therefore, be welcome at the current round of negotiations within GATT (the Uruguay Round). At any

boosted private consumption by around 3%. Nevertheless, with some of the extra income being channelled into saving, the stimulus to growth is not sufficient to set off an appreciable growth dynamic. In 1988, because of a slacker rate of increase in real disposable income, private consumption is forecast to grow at a rate of only some 2.7%.

Although supply-side conditions have improved, the transition from growth underpinned by exports to growth based mainly on domestic factors has not been sufficient to foster progress towards the growth and employment objectives laid down in the Community strategy. The contribution of domestic final demand to GDP growth rose steadily between 1981 and 1986, from -0.5 to +3.5 percentage points, but this has not been enough to offset, to the extent necessary, the distinctly adverse effect of external trade during 1986 and 1987. Since the particularly benign impact of the terms of trade in 1986 is fading, the slowdown that occurred in 1987 could only have been prevented through even more flexible budgetary policy management. During those two years, only intra-Community exports have expanded appreciably, with trade between Spain and Portugal, on the one hand, and the other Community countries, on the other, being particularly buoyant (see Chapter 3.3).

No improvement seems likely for 1988. On the contrary, the growth in domestic final demand will probably decelerate further, to around 2.7% as against 3.2% in 1987 and 3.8% in 1986. This situation is apparent at the same time within the Community, with large disparities in growth rates. Among the larger countries of the Community, in France and Germany for example, the growth of final domestic demand, with rates of increase of only 2.0% and 2.3% respectively in 1988, is likely to be below the Community average. On the other hand expected growth rates of 3.3% in Italy and the United Kingdom and nearly 5% in

number of newly industrializing countries in the Pacific have benefited from an improvement in their international competitiveness as their currencies have fallen in line with the dollar. At the same time the Yen/ECU exchange rate has only risen some 9% so that the Community's price competitivity vis-à-vis Japan has only improved slightly. As highlighted by a business survey conducted in April/May 1987 on behalf of the Commission, the magnitude of exchange-rate adjustment took many firms by surprise, causing them to modify substantially their forecasts and plans (see Table 10). The survey's findings indicate that firms have, in particular, revised their profit forecasts sharply downwards. At the same time, the prospects for sales in the medium term have also become much gloomier. In view of this simultaneous weakening of the two key determinants of investment, it is not surprising that investment projects have been deferred. This explains why the 1987 expansion in investment in plant and machinery as recorded in national accounts fell way below last autumn's forecast.

Revisions to business investment plans already occurred in the second half of 1986. This revision is also showing up in the regular investment surveys conducted in the Community. Whereas, in March/April 1986, real investment growth of 10% in industry was still in prospect for the current year, by October/November that year the figure had been scaled down to 5%. This was the largest revision since 1981. The most recent forecasts indicate a rise of some 3.3% in the volume of gross fixed capital formation in 1988, compared with 3.6% this year, the slight recovery in construction investment not compensating for a weaker growth of investment in plant and machinery.

The trend of <u>private consumption</u> has also been slightly more disappointing than expected. In 1987, a further fall in import prices and the resulting marked increase in personal disposable income again

45%, in Ireland 35%, and in Spain 25%, below the Community average. Since 1985 Spain and Portugal succeeded in somewhat reducing their divergence from the Community average through a higher level of economic growth. In total the improvement remains modest; nor is there any indication that the less-favoured regions will manage to close the gap separating them from the rest of the Community in 1988 quickly. It is, however, essential for economic and social cohesion in the Community that this catching-up process should begin (see Chapter 3.3).

2.4. Employment and unemployment

The slowdown in growth described above implies that the Community has failed to come nearer to meeting its main objective: the substantial reduction of unemployment. For 1987 and 1988, employment is indeed expected to increase by around 0.8% and 0.6% respectively, compared with 0.8% in 1986; but this is still not enough to bring about any major fall in the unemployment rate, which will probably be close on 12% for the Community as a whole during those two years (see Table 1). Nevertheless, the relationship that seems to be emerging in 1987 and 1988 between economic growth and the rise in employment confirms observations made over a number of years, namely that the job content of growth has increased (see the box "Growth and employment").

In 1987 and 1988, total employment is set to rise at an above-average rate in Spain, Italy and the United Kingdom and at a below-average rate in Belgium, Denmark, Greece, Ireland and France (see Table 1). The growth in employment since 1985 has been neither sufficiently broad-based nor sufficiently strong to produce any substantial improvement on the labour market. Rising employment in the service sector is alone helping to compensate for the downward trend of employment in agriculture and manufacturing (see Table 15) and the economy is not expanding fast enough at the moment to reverse, or at least stem, the contraction in manufacturing employment. In sectors subject to painful retructuring within the world adjustment process,

Spain and Portugal are well above the Community average. Furthermore, in some countries growth is coming up against mounting external constraints (see Table 1). These constraints could be eased if the more prosperous Community economies notched up more buoyant growth. Failing that, the rise in Community GDP will probably be no higher in 1988 than in 1987. The external sector's contribution is expected to remain only slightly negative, as the rise in imports loses momentum and the growth of extra-Community exports picks up again.

The favourable trend of prices has continued and inflation is still on the wane in the majority of countries. The rise in consumer prices (just over 3% in the Community) is actually below the average for the 1960s. This stabilization process got under way at the beginning of the 1980s under the impact of monetary policies directed towards stability and has also received a fillip since 1986 from the decline in energy and import prices. Since nominal wages have adjusted rapidly to lower inflation and since the growth of real wages has remained moderate (see Table 14), the particularly favourable external influences have resulted in a positive trend in internal costs, laying the foundations for lasting stability. Although the inflation reduction process is running out of steam at the Community level, a further strengthening of price convergence on the lowest inflation rate is also expected (see Table 12). This arises from the fact that the slide in inflation is particularly pronounced in those countries where the inflation rate is still comparatively high.

There has been little further progress towards convergence of living standards in the Community, that is, <u>real convergence</u>. On the contrary, the disparities, measured in terms of per capita GDP, have tended, if anything, to widen since the first oil shock. This compares with the appreciable progress registered in the 1960s (see Table 13). At present GDP per head in Portugal and Greece is around

of fixed-term employment contracts should have made it easier for those without jobs to find employment. For instance, the proportion of persons covered by a limited-duration contract rose from 5% of the total number of persons employed in 1983 to 5.5% in 1985 in the United Kingdom and from 2.3% to 3.2% in France. In the Federal Republic of Germany, an increase from 4.2% to 6.8% was recorded in a single year (from 1984 to 85). Young people and part-time workers account for an above-average proportion of those covered by limited-duration contracts (see Table 17). This often stems from new laws or specific employment mesures (see Chapter 4.1).

In 1986, for the first time since 1979, the rise in total employemnt brought to an end the upward movement in unemployment. Even so, the increase in the demand for labour barely exceeds the expansion of the labour force. Demographic pressure on the labour market is easing, but the participation rate, especially among women, will probably continue to rise. Consequently, the number of people out of work will remain high in 1988, at 16 million.

As far as the regional distribution is concerned, unemployment is not only higher in the weaker than the more prosperous regions, but has additionally grown at a more rapid pace than the Community average. Thus in 1985, for example, the unemployment rate was more than 20% in the 25 weakest regions while it was 6.6% in the more advanced regions (see Table 20). The most worrying factor is that, according to the projections half the total growth (6.7 million from now to 1995) in the population of working age in the Community, is in the less favoured regions (see Table 21).

The various categories making up the labour force are being affected quite differently by high unemployment. The risk of unemployment is

such as coal, steel and shipbuilding, employment has fallen sharply. Of around 3.2 million jobs lost in industry between 1982 and 1986, 100 000 have been in steel, nearly 150 000 in coalmining and 80 000 in shippards. Further employment shedding in problem sectors are to be expected. This development will have particularly noticeable effects on unemployment, since employment in certain regions often depends crucially on these industrial sectors. For both 1987 and 1988, the manufacturing workforce is again expected to fall slightly. Spain and the Netherlands will probably be the only countries to register a significant rise in industrial employment in those two years. Overall, the growth of employment in the Community is accounted for by the service sector.

New or modified forms of working as well as labour market measures have contributed to the rise in employment. Working time per person employed has fallen in almost all Member States following a reduction and reorganization of weekly working hours and an extension in part-time working. Where the reorganization of working time is concerned, flexible systems (see Chapter 4.1.4) under which employees' working hours can be divorced from operating hours proliferated. expansion in part-time working also makes for more flexible use of labour. In 1986, 13.5% of wage and salary earners (EUR 9) were in part-time employment, compared with only 10.8% in 1979. In Denmark, the Netherlands and the United Kingdom, just under one quarter of wage and salary earners were in part-time employment (see Table 16). The part-time labour force is mainly made up of women, and most of the jobs available are in the service sector. If the reduction in working time and the introduction of part-time working meet the wishes of those in employment and if both can be reconciled with the needs of firms, more flexible organization of working hours and operating hours opens up numerous possibilities for job creation1. The proliferation

growth has improved. Positive external economic conditions cannot, however, be counted on, because of the necessary international adjustment processes.

Although an attempt may be made, against the background of this situation, to quantify the medium-term economic outlook for the Community, the medium-term projections, unlike the short-term forecasts, can on no account be interpreted as a prognosis of probable economic developments. But with the help of plausible assumptions as to international developments, key economic reaction mechanisms and behaviour patterns, and as to the economic policy to be conducted, possible economic developments can be discerned. The medium-term projections prepared by Commission services since the start of the 1980s - in so far as it has so far been possible to observe their outturns - have presented the Community's growth and unemployment problems fairly realistically (see Table 22). However, this relative success does nothing to change the fact that each new projection throws up new uncertainties and that certain developments can be only imperfectly gauged by macroeconomic projections. This is not only true of the international environment, but also of developments in the internal economy. For example, macroeconomic projections take a long time to register - or have so far completely ignored - the gradual changes in economic relationships which stem from the efforts made in all the Member States to improve the adaptability of markets or to promote the completion of the internal market.

The present projection to 1991 assumes that the ECU will not appreciate by very much more against the dollar over the next few years, but the yen will still have some margin for appreciation; the price of oil could gradually increase in the next few years but no new shock is assumed; the situation of the developing countries will

very pronounced among young people, women, the elderly and the unskilled. In the Community, over a third of the unemployed are young people, although the situation differs a great deal from one country to another. In 1986, 48% in Italy and 43% in Spain of the unemployed were under 25 while the corresponding figures for Germany and Denmark were only 22% and 23%, respectively. Nevertheless, in recent years, youth unemployment has fallen back little in the Community as a whole: in 1986, 36% of the unemployed were under 25 as against 38% in 1984; 22.7% of the labour force under 25 (those in employment plus the unemployed) were out of work in 1986 against 23.5% in 1984. development can be put down to an easing of demographic pressures and to the wide variety of programmes to combat youth unemployment, including measures under the European Social Fund. Unemployment among women is also a specific labour market problem. It has risen steadily in recent years, to reach 13.2% in 1986 (see Table 18). In April 1986, on the basis of the Community's labour force sample survey, it was particularly high in Spain (25.9%), Ireland (20.2%) and Belgium (16.8%). Labour market problems are also the reason for a disturbing increase in the number of long-term unemployed. According to the definitions of the labour force sample survey, at the moment, over half of those out of work have been without a job for more than a year, compared with 46% in 1983 (see Table 19). This phenomenon is particularly pronounced in Belgium, Italy and Ireland, where the figure is over two thirds. In Spain and the Netherlands, the proportion of long-term unemployment easily exceeds 50%. sharp increase in long-term unemployment, it is of even more pressing importance that a solution should be found to the problems on the labour market.

2.5. The medium term economic outlook for the Community

In the medium-term unemployment can only be reduced if growth accelerates and at the same time becomes more employment creating. As already shown, a series of domestic economic conditions for stronger

From the point of view of growth and employment, this projection is disappointing, and hardly seems to differ from the reference projection produced for the last Annual Economic Report. But as has been indicated, it does not take sufficient account of the improvement in market adaptability and does not yet integrate the completion of the internal market. If we consider the annual progression of the principal variables, once the externally determined low growth of 1987 and 1988 is over, this year's reference projection shows a somewhat more dynamic growth trend than last year's projection (see Graph 14). Admittedly, the reduction of unemployment is still too small, but employment at the end of the projection period is marginally better, so that the unemployment rate then falls slightly more rapidly. Certainly, these are the first signs of a slight improvement in the outlook; they should not be overestimated, and on no account be interpreted as the probable course of the cycle. If the parameters are varied in the projections, it can be seen, however, that the slight improvement perceived is mainly connected with the assumed reduction in taxes and the slightly more sustained increase in public investment. These support demand and, in conjunction with a moderate development in wages, improve profitability. It remains the priority task of economic policy to strengthen and to accelerate these favourable developments.

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The depreciation of the dollar continued in 1986 and during the first two months of 1987. More settled conditions on the foreign exchange markets only came about as a result of the Louvre accord of February 1987. The hoped-for repercussions of the depreciation of the dollar have begun to be felt on real flows, but progress is still insufficient. To succeed in stabilising the dollar, until credible

remain difficult, but their imports could again increase appreciably in line with the upturn in world trade. Overall, on these assumptions, world trade (world import volume, excluding the Community) could gradually return to a growth rate of slightly under 5% by 1990/91 (see Table 23). With regard to economic policy in the Community, it has been assumed that the present stance of budgetary policy - including the tax cuts planned in major countries and a slightly more dynamic trend of public investment - would be maintained, that monetary policy would continue to be geared to stability but would leave sufficient margin for real growth and that increases in real wages would remain moderate, but accelerate slightly in comparison with the period 1981-86.

On these assumptions, the average annual growth rate for the Community would be 2.5% in the years 1987-91 (see Table 24). The inflation rate would stabilize at its present level of a little over 3%. profitability of fixed capital would go on rising but at a markedly slower rate than in the previous five-years period (see Graph 13). Corporate investment would improve a little, but not sufficiently to create the desired number of jobs. The increase in employment achieved (0.7% per annum) would certainly produce no more than a slight fall in the unemployment rate; in 1991 it would still be likely to be standing at over 10%. The Community's current account surplus would gradually diminish which, given the needs of the international adjustment process, would be normal; the emergence of a large deficit as a result of growth being accelerated on employment grounds should, however, be avoided. However, this deterioration in the current account balance is chiefly attributable to the assumed rise in the oil price; if it were assumed that in 1989 the oil price stayed at 18 dollars and thereafter did not increase more sharply than the export prices of the industrialized countries, the Community would still have a comfortable current account surplus in 1991.

3. INTERNAL DETERMINANTS OF GROWTH AND THE INTERDEPENDENCE OF THE MEMBER STATES.

Given the changed external situation, the Community's task is to strengthen its growth from its own forces. This is not only the best contribution it can make to restore international equilibria at a highest possible level of growth. High growth for the Community is above all necessary to achieve its internal objectives: the reduction of unemployment, the exploitation of all the advantages flowing from the realisation of the large internal market and the strengthening of economic and social cohesion in the Community. Achieving each of these central internal objectives requires higher growth. Further, progress in achieving any one of the three will contribute significantly to achieving the other two.

Achieving internally-led growth means applying the cooperative growth strategy for more employment which was adopted by the Council for the Community in the 1985-86 and 1986-87 Annual Economic Reports. Stronger growth, in order to be durable and, finally, self-sustaining, must preserve achievements gained from the internal and external economic stability, strengthening them where necessary. It must be supported by improved profitability and adaptability of markets. In this respect, the recommendations on supply policies in the annual reports of previous years remain valid.

3.1. The internal market and the adjustment of economic structures as the engines of growth

The completion of an area without internal frontiers creates important stimuli for both the supply and demand sides in the Community. Removing fiscal and administrative barriers, mutual recognition of technical standards and the opening of markets will have both an immediate as well as a progressive impact. For the private sector the

progress has been achieved on the international adjustment front, requires not only a positive differential in interest rates but also an adequate negative growth gap between the United States on the one hand and Japan and Europe on the other. Although developments have been favourable in this respect in 1987, first indications for 1988 suggest that growth differentials will more probably shrink. If these forecasts were to come to pass, the credibility of the medium-term adjustment process could be compromised. This in its turn could only lead to a greater risk of a further fall in the dollar and a strengthening of protectionist measures. Substantial and credible progress in the absorption of the US budget deficit and a greater opening up of the Japanese market would contribute substantially to averting the danger. Within the Community, the sharp ebb in extra-Community exports, and the consequent worsening of the investment climate, have quashed the hopes of an acceleration in growth which existed last Autumn. In addition, convergence in living standards in the Community is only progressing slowly. On the other hand, the convergence of price developments towards a lower level of inflation is continuing. The growth in employment noted since 1985 has enabled the rise in unemployment to be stemmed in 1986 for the first time since 1979. Reduction in working time, the extension of part time working, moderation in real wages, new forms of working time reorganisation, as well as other employment measures have made growth more employment-creating for several years. Despite these favourable factors, the unemployment rate in the Community will scarcely fall in 1987/88 since growth is slowing down. The increase in long term unemployment is particularly worrying. In the medium term, a more favourable international economic environment cannot be counted on. Within the Community, there are some tentative signs of a slight improvement in growth and employment in the medium term. This stems essentially from the hypotheses of a reduction in taxation and an increase in public investment supporting demand which, in conjunction with a moderate development in real wages, increase profitability. At the beginning of the 1990s, nevertheless, the unemployment rate could still remain above 10%.

following supply-side effects can be expected: (i) first, direct cost savings achieved in trade within the Community, if frontier formalities, additional inspections and certificates disappear; (ii) the easier and less costly it becomes to offer products marketed in one member country in other countries as well, the greater is the incentive to expand production capacities and to produce for the large internal market; the resultant economies of scale can be considerable: productivity rises while unit costs fall; (iii) Because transparency for public and private goods is greater, competition on Community's internal market will intensify. Firms will have a greater incentive to increase their efficiency and to improve the quality of their products. In the medium term this can lead to a more efficient economic structure in the Community; (iv) The large internal market finally also creates substantially better conditions for a greater European research and development effort since it opens up the whole Community as an outlet for the institutes and enterprises involved, benefitting the technological competitiveness of the Community.

The completion of the internal market can also, however, have positive effects on private demand: (1) If competition is wider, lower unit costs lead to <u>lower product prices</u>. As a result competitiveness is improved. This not only strengthens internal trade but also enables demand outside the Community to be better exploited. (2) The greater variety of products available in the large internal market

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to promote self-sustaining growth which is higher and creates more jobs, without jeopardizing internal and external stability: in this way faster growth can be maintained in the medium term.

A dynamic equilibrium must therefore be established in the Community between investment and private consumption. From 1960 to 1973 private investment in the Community increased slightly more rapidly than private consumption, while the proportion of private investment in GDP increased; from 1973 to 1985 there was a complete change in the situation, with investment growth actually falling more sharply than the growth of GDP, the rate of which more than halved (see Table 25). If this investment gap which has grown up over more than a decade is to be closed and today's lack of jobs alleviated, if in the future capacity bottlenecks are to be avoided, and if structural change and the modernization of production facilities are to accelerate, private investment in the Community in the next few years will have to grow substantially more quickly than GDP. Since each unit of output now on average requires more capital than before, this means that the need for capital expenditure to expand production and employment is today considerably greater than in the 1960s (see Table 25). It will therefore be necessary for the share of private investment in GDP in the Community to rise appreciably in the next few years.

This can only be achieved if two essential determinants of private investment, i.e. expectations of demand and profitability, improve simultaneously. However, since the Community cannot for the forseeable future count on any great external boost to demand, the necessary stimulus must emanate from internal final demand in the Community, i.e. from private consumption and from higher investment. Private consumption would therefore have to grow at roughly the same rate as GDP over the next few years, requiring appropriate increases in private disposable income.

- In the Member States it is also necessary to increase the adaptability of the markets in goods, services, capital and labour and to encourage entrepreneurial initiative (see Chapter 4.1.); this improves supply-side conditions, allows firms to react more quickly to the new conditions of the internal market and accelerates the exploitation of its advantages. The associated structural changes can create social and regional problems. In order not to call into question fundamental rights in the fields of social security, of social protection and of working conditions, an issue raised by the Council of Ministers in its resolution of 22 December 1986, appropriate regard must be given to the social dimension and the process of structural adjustment must be accompanied by a wide social dialogue. The strengthening of economic and social cohesion in the Community (see Chapter 3.3 and 4.3) would also facilitate Lastly, the social and regional problems regional adjustment. associated with structural adjustment can be overcome only in an environment of stronger economic growth. Defensive behaviour of governments and social partners will then be easier to avoid.

An important contribution of the internal market is to increase productivity. But for higher productivity to create both greater prosperity and more employment, growth has to be high enough. Admittedly, the completion of the internal market will provide a strong boost for growth, but this can only become fully effective if it goes hand in hand with a more dynamic macroeconomic process.

3.2. The macroeconomic process

Macroeconomic policy must also help to free the Community from the trap of low growth in which present policies and behaviour patterns would place it, even if there are perhaps signs of a slight improvement for the end of the decade (see Chapter 2.5). It must aim

Public investment has suffered severely as a result of the consolidation drive of the Member States. Its share in GDP has fallen by roughly one-third since the beginning of the 1970s. An acceleration in profitable public investment would not only expand the productive potential in the Community more quickly but at the same time would also have a direct effect on demand. The execution of major infrastructure projects of Community interest (see Chapter 3.1) can also contribute to the attainment of this objective.

However, it is not only important to improve demand prospects: profitability must also improve. In this respect, considerable progress has been achieved in recent years. Higher capacity utilization, the fall in the prices of important raw materials and in particular the fact that, for several years, real wage increases have not kept pace with productivity gains have already markedly improved the profitability of physical capital. Nevertheless, it is still not back to the level of the 1960s, when profitability was sufficient to permit self-sustaining growth with low unemployment. profitability yet risen by much in 1987. Given the great need for private investment and until a self-sustaining process of dynamic growth has become a reality, wage trends must therefore continue to contribute to improving the preconditions for investment. In this respect the reduction of the tax burden on wage and salary earners should facilitate moderation in real wage increases per head.

A wages trend which does not increase the pressure on costs and the continuation of a stability-oriented monetary policy make it easier to stabilize inflation at its present low level or to bring it down even further in a number of member countries. This enables inflationary expectations to be adjusted downwards, creating a sound basis for a further <u>fall in long term interest rates</u>. Higher profitability and an increased self-financing capacity of firms would, in addition, reduce tensions between supply and demand for long term

But if investment is to grow strongly, its profitability must rise further for some years (see below); real wage increases in the Community must therefore continue to remain moderate. Moderate increases with stronger growth in employment still allow an appropriate rise in private incomes, provided that budgetary policy also assumes an active role in this process, by contributing to an improvement of conditions on the supply side and to the adequate growth of demand by reducing taxation on private households and firms and by more public investment. To avoid pressure for higher real interest rates which would be unfavourable to private investment, such a budgetary policy should not call into question the improvement of public finance in the medium-term.

A number of member countries have given themselves scope for a more active budgetary policy role by means of the consolidation efforts of the past (see Chapter 5.3). These countries have already cut taxes or are planning to do so. The positive effects of these measures for the medium-term can already be perceived (see Chapter 2.5). should economic growth fall short of expectations for any length of time, these plans may be endangered, since the slackening of growth goes hand in hand with revenue losses for the public budgets and still higher crisis-induced expenditure, which reduces the budgetary room for manoeuvre accordingly. The prerequisite for a credible and realistic policy of medium-term budgetary consolidation therefore seems to be a flexible approach to planned tax cuts, both as regards their scale and timing. The growth-promotion effect is greatest and the danger of unsustainable external imbalances is most limited if those member countries which can conduct an active budgetary policy coordinate their action. Stronger growth in the Community would improve the budgetary situation of the other member countries. - while adhering to their consolidation priorities - could then also contribute to the improvement of growth prospects in the Community (see Chapter 3.3).

rise was from under 46% to over 69%. For visible exports the Community share rose in Spain from over 53% to over 69% and in Portugal from less than 63% to 70%. The completion of the internal market will increase this interdependence even further. In addition the increasing liberalization of capital movements combined with the maintenance of stable exchange rates, particularly within the framework of the EMS, creates an even closer interdependence between the money and capital markets of the Member States.

Because of the ever-closer economic ties, the flows of goods and finance react more rapidly, and this increasingly reduces the autonomy of individual Member States in the conduct of their economic policy. The close economic ties, however, also provide new opportunities for joint action and increase the Community's potential for growth, provided that economic policy measures are more closely coordinated. The stabilization achieved within the framework of the EMS shows that, if monetary policies are coordinated, interdependence can be used to the advantage of all Member States. Further progress along this road can, and must, be made (see Chapter 5.2).

However, it is now important to make use of this interdependence to strengthen growth by also improving the coordination of budgetary policies. This can ease both the external and the budgetary constraints on the Member States. In a situation in which there are no appreciable external stimuli, the result is a substantial increase in the Member States' scope for action. Because of the great significance of intra-Community trade the Member States can expect faster growth to have less serious consequences on their current account balances if it is part of a coordinated approach than if they act in isolation (according to OECD calculations these consequences would be reduced by between one half and two-thirds). This is particularly important for the member countries whose room for manoeuvre in economic policy is limited because of concern for their external equilibrium; at present this is especially true of Denmark

capital. This too will have a favourable effect on investment activity, because financing costs fall and because the relationship between the expected return on physical capital and interest rates on the financial market is shifting more and more clearly in favour of productive investment. But most importantly, falling long-term interest rates will also take considerable pressure off public budgets: in some Member States the public debt already equals, if not exceeds, annual gross national product (see box on interest rates).

Such an increase in growth, underpinned by domestic demand, would also help to eliminate international current account imbalances while maintaining global growth at the highest possible level. This would strengthen confidence in the stability of international economic and monetary relations and would also remove impediments to additional investment. In order to avoid disturbances it is, however, important to preserve, in a satisfactory manner, the external equilibrium of the Community in the medium-term. The Community's competitiveness must therefore be maintained and strengthened. A further improvement in profitability and more adaptable markets will also help to satisfy more internal demand by means of internal production in those circumstances; it is thus possible to maintain external equilibrium in the medium-term even if growth accelerates.

3.3. Interdependence between the Member States

In 1987 almost 60% of the visible import and export trade of the Member States will be conducted with the other Member States (compared with less than 40% in 1958, see Tables 26 and 27). The intra-Community imports or exports of all the Member States represent around 13% of the Community GDP. These trade ties have recently become even closer with the change in the external trade flows of Spain and Portugal as a result of their accession to the Community. Thus in Spain the share of Community in total imports has risen from below 38% (1985) to over 52% (1987); in Portugal the corresponding

The higher interest rates would oblige these countries to make additional adjustment efforts, which would be detrimental to the growth process in the Community as a whole.

Close concertation of economic policies at national and Community level also facilitates efforts to accelerate the catching-up process in the least-favoured countries and regions (Greece, Spain, Ireland and Portugal). Such a process occurred up to the 1970s, notably in Spain, Greece and Portugal, which were able to increase their real per capita GDP distinctly more quickly than the other member countries (see Table 30 and Chapter 2.3). In Spain and Portugal this situation was favoured by above-average investment ratios, with the efficiency of investment high in all four countries. The catching up process was made substantially easier because it took place against a background of high economic growth, which enabled those countries to preserve their external equilibrium.

In the second half of the 1970s the efficiency of investment in these countries fell to the average level of the other Member States (and even far below in the case of Spain). It was only by increasing their investment substantially that Ireland and Portugal were able to continue to close the gap in terms of per capita GDP, but at the price of serious external deficits.

In the 1980s, Greece and Ireland in particular were unable to gain more ground in terms of per capita incomes because their efficiency of investment was below the Community average and the investment ratio had fallen. However, Spain's efficiency of investment recovered to approximately the average level of the other member countries as a result of a vigorous internal adjustment effort: not only equalling them in terms of growth of per capita income, but even now drawing slightly ahead, while still succeeding in preserving external equilibrium.

and France, but also of Italy, Portugal and Spain, where continuation of the present vigorous growth is endangered by the threat of external imbalance. Of course, the acceleration in domestic demand which such an effort brings about would lead to some deterioration in the external accounts of Community countries with the rest of the world. The Community would thus contribute to the re-establishment of equilibrium in international payments. However, in order that this effort results in a durable acceleration in growth, it is necessary that it relies on a simultaneous improvement in supply conditions and does not call into question either a sustainable medium-term external position or price stability achievements. In a coordinated approach the budgetary constraints on tax cuts or additional public investment are also eased as a result of the close trade ties. Each Member State enjoying stronger growth makes an appreciable contribution to the growth of the other Member States; the increase in economic growth and the accompanying additional tax revenue are substantially higher than if initiatives are taken in isolation. It is thus easier to reconcile budgetary policy measures and medium-term budgetary consolidation. Stronger growth in the partner countries also helps to improve the situation of the member countries which still have serious budgetary problems (see Table 29) and after a time enables them to contribute to the common process of accelerating growth.

In the medium-term, a coordinated and differentiated approach for budgetary policies makes it possible to improve the convergence of the public finance situation in the member countries of the Communtiy. Given the increasingly close monetary interdependence within the EMS, this convergence is of special importance. Without it, the member countries whose budgetary situation is relatively unfavourable could be compelled to accept higher interest rates in order to prevent outflows of capital and the resultant pressure on their currency.

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any nearer attaining its principal objective, a substantial and lasting reduction in unemployment. Since the Community cannot expect very favourable external influences in the foreseeable future, it must rely on its own strengths even more than in the past.

In this new environment, application of the Community strategy therefore means making better use of the advantages of the Community dimension: completing the internal market, accelerating the macroeconomic process to achieve stable, higher economic growth and to profit from the interdependence between the Member States. This requires closer cooperation between Member States in the fields of monetary and budgetary policy and the development of Community policies (see Chapters 4 and 5). The Community must also contribute to the strengthening of international cooperation, in order to work in concert with the other large economic areas to reduce international imbalances, ensure more stable exchange rates as well as to avert the threat of protectionism (see Chapter 2.2).

Strengthening social dialogue at national and Community levels remains decisive for widening the consensus on the changes of attitude and the economic policy measures necessary for the success of the Community strategy (see, for example, the 1986-87 Annual Economic Report, Chapter 4.6). At the Community level, important progress has been made, notably two joint opinions of the social partners: one on the fundamental options of the Community strategy (6 November 1986), the other on training and motivation, as well as informing and consulting the workforce when introducing new technologies in the enterprise (6 March 1987, see also Chapter 4.2). Encouraged by this success, the Commission will pursue its efforts, to develop at European level dialogue with and between the social partners on all the themes of the

To revive the catching-up process in the current changed circumstances requires coodinated efforts by all Member States, as laid down in Article 130B introduced into the Treaty of Rome by the Single European Act. For this purpose, growth must accelerate in the Community as a whole, in order to assist the adjustment process and to prevent the least-favoured countries and regions being forced into restrictive policies as a result of domestic or external imbalances which are no longer sustainable. This is only possible if the economically strong member countries make a sufficient contribution to But it is also crucially important for the least-favoured countries and regions to improve their internal growth conditions further, i.e. as regards the profitability and efficiency of investment. This increases capital formation, makes it easier to preserve their external equilibrium despite higher growth and creates the conditions necessary for increased capital imports. In addition, this policy must receive stronger support from the Community institutions, structural funds, the European Investment Bank and the other existing financing instruments, as stated in the communication from the Commission (COM(87)100) to the Council. If, in this way, a lasting and self-sustaining catching-up process can be launched in countries, not only will economic and social cohesion in the Community be strengthened, but in addition the countries and regions which start to catch up as a result of more dynamic growth will also make a considerable contribution to growth in the Community.

3.4. The prerequisites for success

The efforts of the last few years have substantially increased the profitability of investment and the adaptability of markets in the Community, thus favouring higher and more employment creating growth, while preserving internal and external equilibria. However, in the last two years, growth has slowed down, primarily because of external factors; as a result, the economy of the Community has come scarcely

However, such fixed pricy infasives should -40not call into question the improvement of public finance in the medium revan

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moderate rise in real wages, tax cuts and higher public investment will contribute to improving both supply-side conditions and demand The continuation of a stability-orientated monetary expectations. policy will furthermore help to bring long-term interest rates down again, favouring investment and above all easing pressure on the Sack coordination public budgets. In addition, closer coordination of budgetary policies between the Member States reduces external and budgetary constraints which considerably restrict the room for manoeuvre of certain Member States A Lastly, coordinated efforts by all the Member States and the Community are necessary to relaunch the dynamic process of catching up by the least-favoured countries and regions. new circumstances, application of the cooperative strategy means making greater use of the Community dimension, which requires closer cooperation between the Member States, the development of Community policies and a wide-ranging social dialogue at national and Community level.

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Community strategy. This also conforms to Article 118B of the Treaty amended in 1987 by the Single European Act. However, the will to cooperate shown by the social partners at Community level should also be better utilised at national level.

The objectives which the Community has, thus, set itself in its cooperative strategy for growth and employment are still relevant and realisable, though with a certain delay, despite the deterioration in the external environment.

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In the coming years the Community, while preserving achievements on the price stability front, must increase its economic growth, not only in order to contribute to the process of international adjustment while maintaining the highest possible level of world growth, but above all, in order to attain its own objectives: reducing unemployment, making full use of all the advantages of the large internal market and strengthening its economic and social cohesion. Since it cannot expect strong external stimuli, it must rely more on its own strengths. The completion of the internal market will stimulate growth considerably while making Community output more profitable and making it possible to satisfy additional demand within the Community and on export markets. However, in order to make full use of the potential of the internal market for growth and employment, macroeconomic policy must also contribute to higher, self-sustaining growth, without thereby endangering internal and external stability. In this connection it is important for the growth of private investment to rise well above the growth of GDP. In addition to the

preservation and strengthening of fundamental social progress. In the Annual Economic Report 1986-1987, the Commission presented a number of measures to improve market flexibility, partly from the viewpoint of internal market policy.

Also worthy of mention are the Community measures in the approximation of legislation on consumer protection which in substance aim to improve adaptability of markets in goods and services by increasing market transparency. In this connection it is appropriate first to cite the 1979 Directive on the indication of the price of foodstuffs and of the indication of the unit price where quantities presented in standardized packaging are concerned. Similar proposals for other consumer goods have been before the Council since 1983. Information on the characteristics of the products has also been improved and harmonized in the Community. Here the provisions on the labelling of foodstuffs or on the presentation and marketing of dangerous substances should be mentioned. For these product groups, consumer is informed of the composition or the particular characteristics of the products offered by the same means throughout the European internal market. A harmonization of the rules describing other product categories, e.g. on the basis of the proposal on dangerous preparations, would further increase market transparency in the Community.

4.1.3 A series of measures to improve market adaptability, through deregulation and liberalizing market access, concern small and medium-sized enterprises (SMEs). The evidence shows that, within the enterprise sector, such firms contribute most to new employment creation, essentially in the high technology sectors. To further encourage small and medium-sized entreprises' development, two types of action have been taken. The first aims to increase market flexibility and encourage the adaptability of firms. It includes

4. COMMUNITY AND NATIONAL STRUCTURAL POLICIES

4.1. Improving market adaptability

4.1.1. At the European level the completion of the internal market by 1992 stands at the centre of efforts to improve market mechanisms. This was reconfirmed by the European Council of Brussels of 29/30 June 1987, with the observation that it was important to complete the internal market according to the lines laid out in the Commission's White Paper of June 1985. The Council requested the responsible Councils of Ministers for this purpose to make full use of the improved decision-making process introduced by the Single European Under the new provisions of the Treaty (in particular Article 100A) introduced by the Single European Act, it will be possible in future for some two-thirds of the proposals contained in the White Paper to be adopted by a qualified majority of the Council in cooperation with the European Parliament : only fiscal provisions, those relating to the free movement of persons and those relating to the rights and interests of employed persons are excluded from these new rules. The Commission described the progress made in work on the numerous individual proposals in its reports on the implementation of the White Paper in May 1986 and 1987 (COM(86)300; COM(87)203). Commission has also tackled another important area for the removal of frontier controls with its of early proposals (COM(87)320-328) for the approximation of rates and harmonisation of structures of indirect taxes.

4.1.2 Beyond the completion of the internal market, the general objective of improving market adaptability remains valid for economic policy in the Community. In the Annual Economic Report 1985-1986², the Commission pointed out that action with the aim of improving the adaptability of markets, and not only the labour market, should be strengthened. It also stressed that the objective behind efforts to increase flexibility is not to destroy achievements made on the social front but to create jobs and, therefore, that, as far as at all possible, economic efficiency should be reconciled with the

Negotiations on adaptation of working time and flexibility in the duration of use of productive capacity continue. Thus, for example, in the metal working industries in Denmark and the Federal Republic of Germany, long term contractual agreements have been signed providing for a flexible reduction of working hours with wage compensation, arriving at 37 hours per week by 1990 and 1989 respectively. In France a new law on the adaptation of working time and night work for women in industry was adopted in June 1987 increasing the possibility of a flexible modulation of working time arrangements. In Belgium an interprofessional agreement in the National Labour Council on new working time arrangements in enterprises, with the exception of the distributive sector, was concluded in April 1986. It was confirmed by a law in July 1987.

A series of measures aims, in particular, at fighting high unemployment as well as accompanying social measures to structural adaptation in regions or industrial sectors (coal, steel, shipyards) where the need for adjustment is particularly great and important for the labour market. The object of these measures is very often to improve qualifications or for professional retraining of the persons concerned. The Community contributes here through its social funds and social expenditure from the ECSC budget. Another important aspect is aid for employment creation, more particularly in those areas where steel, coal and shipyards are concentrated. In this area too the Community contributes through the regional fund and its financial instruments.

In some countries the number of so-called "atypical" employment contracts, notably with regard to part-time work, fixed-term employment and agency work, has increased considerably in recent years, in particular with regard to new recruitment. This has often happened under the impact of changed laws and administrative provisions.

measures to reduce the burden on business arising from Community regulations such as the simplification of fiscal and company law applicable to small firms proposed by the Commission. Several Member States are also endeavouring to facilitate the creation of new firms by policies in this area. The second type of measure aims to improve the flow of information to firms about European Community and national policies to promote trade and to foster cooperation among enterprises across national borders. These measures are envisaged in the Action Programme for Small and Medium-sized Enterprises approved in November 1986 by the Council.

4.1.4 Adaptability of the labour market continues to be a major concern in the implementation of government employment policies and collective bargaining. In its communication on the internal and external adaptation of firms in relation to employment the Commission has, inter alia, given an overview of recent developments in Member States both at legislative and, where possible, collective bargaining level.

This survey shows that governments and social partners tend to focus on a qualitative adjustment of the labour force. To succeed in the introduction and spread of new technologies it has become increasingly important for the enterprises to have a functional and versatile workforce capable of adjusting quickly to the new technological advances in world markets. In this context, qualification and training programmes have been agreed upon at a bi- or trilateral level.

It is also increasingly recognised that motivation and adaptability of personnel will be significantly enhanced when employees are involved and associated by way of information and consultation in relation to management decisions, especially those with employment implications. On these questions broad agreement has been arrived at between the social partners in the framework of the social dialogue at the Community level (Chapter 3.4).

example, in the period 1979 to 1985, the share of Community exports of industrial products (excluding intra-Community trade) in the exports of OECD countries declined by around 1.4 percentage points and, since 1963, by about twice as much. In the period 1979 to 1985, the United States increased its market share by 0.7 of a point while Japan actually increased its share by over 5 points (see Table 31). If it is true that the loss of market share, now and in the next few years, is perfectly in line with the essential adjustment of trade balances at world level, it is nevertheless worrying that the fall in Community shares is concentrated on industrial sectors in which demand is particularly dynamic (e.g. electrical and electronic products, data processing, and office machinery: a loss of 2.5 points from 1979 to 1985). In these sectors, the United States increased its market share by 1.2 points and Japan by over 7 points. By contrast the Community has gained market shares predominantly in the sectors where the expansion of demand is weak (e.g. a gain of 1.9 points for iron and steel, textiles, and building materials).

A more detailed breakdown at industry branch level (see Table 32) shows that since 1979, the Community was able to win market shares primarily in the areas of wood processing, food production and processing, textiles, clothing and paper. The United States has also lost market shares in most industrial sectors but made gains in important sectors such as office machinery and the electrical industry. All branches of Japanese industry except the food industry gained market shares from 1979 to 1985.

With regard to the evolution of market shares, it is interesting that losses within the Community for European industry in the years 1979 to 1985 were only about half as great as the losses on third country markets (see Graph 14) and that since 1963, these shares have remained

Some progress has also been made towards a more flexible adaptation of labour costs to changed market situations. Measures on profit sharing are envisaged or have been introduced in Belgium, Denmark and the United Kingdom; and in Germany and France the capital-sharing schemes already in existence have been extended.

Measures aimed at better adaptability at the level of firms have been complemented by specific employment policies of Member States. emphasis has been placed in particular on measures facilitating the re-employment of the long-term unemployed1. Continuing their efforts in the area of training and professional qualifications, several Member States are trying to improve the recruitment possibilities of the long-term unemployed, through supplementary motivation programmes and assistance in job search as well as by specific financial incentives (for example the temporary waiving of social contributions in Belgium, France and Ireland, assistance for recruitment in the Netherlands, temporary contribution to wages in the United Kingdom). In other respects, the majority of Member States have created possibilities for temporary employment, in particular targetted at the young embarking on their professional life, in the public service or in non-profit making voluntary organisations. These direct employment measures now cover a considerable number of wage earners (see box on growth and employment).

Finally, a number of governments are endeavouring to improve the climate for personal initiatives by the unemployed. Those without work who become self-employed or wish to start up their own firm can not only count on State assistance in the form of advice and training, but can also receive public aid enabling financial risks to be reduced (often in place of, and sometimes in association with, unemployment insurance assistance).

4.2. Competitiveness, research and development, industry and services

For more than a decade, a series of indicators have shown that many branches of European industry have problems in holding their own against their competitors in the major developed economies. For With regard to the order of magnitude of developments since 1985, the ECU has appreciated by some 50% against the dollar if the average level for 1987 is compared with that for 1985. In the same period, the nominal effective exchange rate of the currencies of the Twelve (weighted average against the currencies of nine major trading partners) has risen by 20%. Since, for the Community as a whole, relative unit labour costs in national currency compared with major industrialized partners have hardly changed, competitiveness bears the full brunt of the appreciation of the effective exchange rate: the Community's cost competitiveness has thus deteriorated by some 20% as a result of the ECU's appreciation. This is another argument in favour of a moderate development in costs in the Community, and particularly labour costs. However, given the scale of the changes which have occurred, it will hardly be possible to compensate in this way only for the deterioration in cost competitiveness.

It is all the more important to make the improvement of competitiveness in terms of production and product technology a priority. The losses of third-country market share in important industrial sectors between 1979 and 1985, irrespective of the exchange rate movements should give food for thought (Tables 31 and 32: electrical goods -10.5 points; motor vehicles -11.4 points; office machinery -6.3 points). In comparison, Japanese export successes in the areas of electronics and motor vehicle construction show the importance of using advanced technologies in traditional industries. In this context it is noteworthy, however, that important branches of European industry (textiles, machine tools and also the car industry) have improved their position thanks to a rationalisation in output as well as by innovation in products and production methods.

In order to improve technological competitiveness, the Community has made considerable efforts to promote <u>industrial innovation</u> by

virtually unchanged. Internal trade has thus clearly had a stabilizing effect for the evolution of market shares in industrial products. Through its beneficial effects on competitivity, the completion of the internal market should, moreover, provide appreciable additional support here.

An unfavourable structural development is also evident in the case of investment activity (see Table 33). In the years 1979 to 1982 investment declined markedly in the sectors in which demand was growing strongly, but with the general recovery in investment activity since 1983, the increase in investment in these sectors, at least up to 1985, has been above average. This indicates some catching up in relation to third country competitors. It probably also contributed to the virtual halting of the decline of employment from 1982 to 1985 in sectors of production in which demand was heavy (see Table 34).

This development in market shares, investment activity and employment should be considered alongside the evolution in the pattern of industrialized countries' exchange rates, in particular the dollar's rise during the first half of the 1980s and its depreciation since May 1985. However, these changes in exchange rates are unlikely to have been decisive by themselves for the evolution of different components of market shares. For example, the loss in the Community's market share for goods in the heavy and medium demand sectors occurred during the period of the ECU's depreciation between 1981 and 1984 (see Table 31). The only increase was in the area of goods for which demand is weak. For the United States the dollar's appreciation over the period 1981-1984 had virtually no effect in the heavy demand sectors, but its effects are discernible for products in the medium and weak demand sectors. This indicates that the influence of technological and organisational factors is crucial, precisely in the sectors where the growth of demand is dynamic.

education and training in new technologies (COMETT) which provides for various procedures on collaboration at the European level between educational establishments and firms.

The more competitive that Community industry becomes in terms of costs and technology, the more room will be created for a dynamic expansion employment most notably misries. There are important intendings between industry and services of the services sector. Experience in Europe since the start of the land a vigorously growing services sector in humans which play a key role industrial sector represents the last project to combing ment growth in the Community in job creation, depends inter alia on demand coming from industry. A vigorously growing services sector therefore represents, particularly from the point of view of employment, a necessary complement to a highly productive and internationally competitive industrial sector. The Commission has recently published a Green Paper on the future economic and regulatory framework for telecommunications in Europe which considers the measures necessary to create a true internal market for the advanced communications services.

4.3. Measures for improved economic and social cohesion

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In accordance with Article 130A of the Single European Act, the Community should develop and pursue its action leading to the strengthening of economic and social cohesion in order to promote its overall harmonious development. The Community has, in particular, fixed as an objective a reduction in the gap between the various regions and the backwardness of the least-favoured regions. Through the use of its structural funds, of its financial instruments and of the EIB's activities, the Community also has an important role to play in support of the Member States themselves in leading and coordinating their policies with a view to attaining the objectives of Article 130A (cf. Chapter 3.3).

concentrating and strengthening research and development programmes in order to close the technological gap. The fact that cooperation between European enterprises in the field of research is still insufficient has without doubt been a disadvantage for Europe until now: as a result, research efforts in the Community have been unnecessarily fragmented, even though research capacity and financial resources for research purposes are in total comparable with those of the United States. Indeed, total research and development expenditure at the Community level (research managed by the Community, EUREKA, ESA etc.) represents between 5 and 6% of total public funding of research in the Community. With regard to the Community budget alone, expenditure on cooperation in research amounts to only some 2.8% of the total. A new era will be opened with the 1987-1991 framework programme for research adopted in July 1987. In the field of modern technologies mention should be made of the programmes ESPRIT (information technology), RACE (communication technology) and BRITE (introduction of advanced technologies to traditional areas production), EURAM (advanced materials) and the biotechnology programmes.

Community research programmes are only one important link in an overall industrial strategy which covers the domestic and international aspects of technology. Thus research programmes aim at creating the necessary base for proposals in the field of international standards as well as to encourage industrial cooperation downstream from research. At the same time, cooperation between various European firms on research is also giving rise to increased cooperation in other fields.

In order to ensure that research has a tangible impact on competitivity and that it is circulated in scientific and industrial circles, the Commission has just launched a Community programme for

occur, it is crucial for the additional financial margin created to be used to expand investment activity.

In its view, The extensive tasks which fall to the Community as a result of the Single European Act, especially the reform of the Structural Funds, require an increase in its budgetary room for manoeuvre. In its reports "The Single Act: A new frontier for Europe" (COM(87)100) and "The financing of the Community budget" (COM(84)101) the Commission has set out guidelines for future budgetary policy. expenditure side the following elements are especially important for the future development of structural policy in the Community : the growth of the EAGGF - Guarantee section should remain limited in the framework of budgetary discipline; its share in the total budget falling from over 60% currently to slightly over 50% in 1992. This slowdown of Guarantee section expenditure will permit a doubling in real terms of committed expenditure for the structural funds by 1992. Moreover, expenditure on research on the basis of proposals for the 1987-1991 framework programme should rise to 3% of the budget against 2.5% at present. On the income side, greater budgetary security would be achieved by the setting of an upper limit of 1.4% Community's GNP for own resources; the Commission has suggested a complementary financial element which would take into account the financial capacity of the Member States. At the same time, greater financial discipline should also contribute to improved financial management.

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The completion of the internal market will enable resources to be better allocated and thus contribute to faster growth, at the same time as stimulating investment. The irreversible nature of the project must, however, be rapidly apparent to economic agents so that they can prepare themselves for change and intervene on the basis of an accurate picture of future developments. This necessitates respect for the timetable fixed in the White Paper and that delays in its

With regard to the structural funds the Commission set out from February policy guidelines for their future organization with five objectives (COM(87)100). Two of these relate to regional policy: achieving growth and adaptation in regional economies structural backwardness and restructuring declining industrial regions. Three of the objectives are more non-regional: combatting long-term unemployment, the integration into employment of young people and speeding up the adjustment of agricultural production structures. The Commission has also proposed that the budget funds committed via the structural funds to the achievement of these five objectives should be doubled in real terms by 1992, concentrating their application as a priority, in conjunction with the financial instruments, on the least-favoured regions. On the basis of these guidelines, it presented a proposal for a Council Regulation on 30 July 1987 (COM(87)376).

Alongside the expansion of the structural funds, the Commission will place special emphasis on the <u>development of new financing instruments</u>. The object of these efforts is to encourage private capital flows, in particular by developing new Community instruments enabling the market to offer new forms of financing combining Community and private capital. The resources raised in this way will would primarily serve to finance projects of special interest for the Community.

The quantitative effects of the proposed measures could be considerable. With the strengthening of structural fund action and the parallel development of loan instruments, the proportion of these resources at the end of the 1980s, in certain less-favoured countries such as Greece, Ireland and Portugal, will stand at a little over 4% of GDP (now slightly over 2%). For the desired effect on growth to

5. MACROECONOMIC POLICY STANCES AND PROBLEMS

The Community is faced with a difficult international environment and must rely on its own resources. It has, nevertheless, major strengths: inflation rates lower and more convergent than for almost 25 years, a relatively comfortable external position overall, a marked improvement in the financial situation and profitability of firms, and structural changes which, although painful, were necessary. These strengths constitute a solid basis from which to implement a monetary and fiscal policy mix aimed at strengthening non-inflationary growth.

5.1. Monetary developments and policy

The rate of money supply growth has declined from the early 1980s: from an average of over 14% during the 1970s, it is now around 10%. This slowing in monetary expansion has backed up the disinflation process. The rate of inflation as measured by the GDP deflator has been reduced from more than 13% in 1980 to about 4% in 1987 (EUR12). At the same time, the rise in per capita wage costs has slowed down appreciably (from more than 14% in 1980 to about 5.5% in 1987), thus making a major contribution to stabilization. Consequently, the restrictive effects of policies of monetary stability have been largely attenuated. Thus there has been a gradual acceleration in the real money supply, i.e. nominal money supply adjusted for inflation, an indicator of the liquidity available to finance real growth. The rate of increase is now about 5%, significantly above that of output.

The convergence of monetary policies has continued to improve appreciably, in particular within the EMS, evidenced by the convergence of targets for money and credit expansion adopted in the

application should be made up for as rapidly as possible. economic restructuring necessary should be facilitated by an increased adaptability of markets, especially in the labour market by intensified vocational training. A series of indicators shows that the structural adjustments in the Community are too slow by comparison with other industrialised countries; this essentially concerns the Community's industrial competitiveness in the high technology This is why it is particularly important that the sectors. Community's aim of increasing its technological competitivity is also rapidly realised within the framework of the European research and development policy, partly by utilising the capacities of small and The reinforcing of the Community's medium-sized enterprises. structural funds, their concentration on a limited number of objectives as well as the development of financial instruments would enable the Community in the Commission's view to contribute more efficiently to achieving the aim of greater economic and social cohesion alongside the efforts undertaken by the Member States themselves. In this context, the Commission lays importance on its proposals on financing the Community budget and strengthening budget discipline being adopted as soon as possible.

obviously made it easier to bring inflation down; but at the same time, the monetary authorities had to keep their own currencies from appreciating too quickly, to prevent too great a loss of competitiveness and to limit the resulting damaging medium-term structural effects. Until the end of 1986, the depreciation of the dollar was accompanied by a reduction in nominal interest rates in the United States and Europe, and by a narrowing of interest-rate differentials between the two regions (see Graph 16).

Since February 1987, exchange rates have stabilized. Following the Louvre Agreement, flexible interest-rate adjustments - leading in particular in 1987 to a wider differential between US and German rates - and substantial intervention on foreign exchange markets have led to credible stabilization of short-term foreign exchange expectations despite persistent international balance-of-payments disequilibria.

In the framework of the EMS exchange rate mechanism, the authorities in most countries have given more consideration to economic developments in their partner countries when conducting monetary policies. Short-term interest rates have been more frequently used to supplement intra-marginal intervention to stabilize bilateral parities between currencies participating in the EMS exchange mechanism. For example, since the end of 1986, German short-term rates declined by nearly one point up to the summer of 1987 while French short-term rates declined only moderately. Central banks are now tending to take better account of external requirements when pursuing their domestic monetary targets, at least as long as the aim of domestic stabilization is not compromised.

Despite the decline in short-term interest rates up to mid-1987 and in inflation rates, long-term interest rates remain relatively high and in recent months have increased in certain countries. In September 1987 in the EMS countries they were a little above those in October 1986,

different member countries: the growth target range for central bank money in Germany was brought down from 4-7% in 1981 to 3-6% in 1987; the target for M2 in France was brought down from 9% in 1983 to a range of 3-5% in 1987. In Italy a target of 7% was adopted in 1987 for the expansion of lending to the private sector. This is well below the rates recorded in the early 1980s, which were over 13%. Although the targets have sometimes appeared too ambitious in certain countries, actual monetary growth has indeed converged to a considerable extent.

The deceleration in monetary growth is now less marked. Most recent recorded outturns show rates of, as appropriate, money or credit expansion higher than the upper target limits adopted for 1987 (see Table 36). The liquidity ratio has increased in most Community countries. To date, these developments have not endangered the downward convergence of inflation rates.

The assessment of monetary policy stances on the basis of indicators of liquidity does involve some uncertainty: rapid financial innovation, structural adjustment on money and capital markets and greater freedom of capital movements can be accompanied by major changes in the relationships between monetary expansion and other variables, particularly GDP. It does seem, however, that the stance of monetary policies to date has been consistent with the requirements of the cooperative strategy; but greater vigilance now seems necessary to prevent excess liquidity from building up in the Community, with the potential for sooner or later refuelling inflation.

Over the past twelve months, domestic monetary policies in Europe have been strongly influenced by events on the foreign exchange markets. The appreciation of the European currencies against the dollar necessary, but they should not, in such conditions, have major repercussions on long-term rates and bank base rates.

5.2. The liberalization of capital movements and the strengthening of the EMS

The aim of free capital movement is part of a wider approach aimed at the completion of the internal market while maintaining the economic and monetary cohesion of the Community. Substantial progress has been made over the past year towards freeing capital movements in the Community.

On 17 November 1986, the Council adopted a new Directive extending compulsory liberalization in the Community to three further categories of capital movements. The Directive took effect on 1 March 1987, although Spain and Portugal have a longer period in which to comply (to the end of 1990 and to the end of 1992 respectively).

Liberalization measures taken in several Member States - Denmark, France, Italy and Spain - already go beyond the strict obligations imposed by the current Directive or the Act of Accession. Capital movements are entirely free in Germany, the Netherlands and the United Kingdom, and, subject to the application of the two-tier exchange market, in Belgium and Luxembourg. Apart from the new members, only two Member States - Greece and Ireland - maintain restrictions, by virtue of the safeguard clause in Article 108(3) of the Treaty, on certain capital movements that are normally free.

These developments encourage the Commission to pursue to completion the initiative launched in May 1986 towards the complete liberalization of capital movements in the Community by 1992. A new proposal for a Directive to this end, also taking account of the specific situation in certain Member States and providing the possibility for dealing with grave disturbances on the money markets when necessary, will shortly be presented to the Council.

while average short-term rates in the same countries had on the whole declined. Moreover, the gap between the long-term interest rate and the present rate of inflation is still very wide. The rapid decline in inflation over the past few years has not yet been fully absorbed in all countries into expected inflation rates, so that the expected gap over a longer period between the nominal interest rate and the inflation rate, a determining factor in investment, is probably smaller than the gap measured on the basis of current observation. Nevertheless, despite a major rise in the return on fixed capital, further rises in long term interest rates could act as a disincentive to productive investment, as well as considerably hampering efforts to restore healthy public finances in countries with a high level of public debt (see box).

A decline in long-term rates appears desirable. However, the recent development of both long-term and short-term rates confirms that the monetary authorities are limited in their ability to influence long-term rates. Further declines in short-term rates, which would be accompanied by excessive expansion of liquidity, could even lead to higher long-term rates if they again raised inflationary expectations. Alongside domestic factors, long-term rates also reflect tensions on international capital markets. The monetary authorities, for their part, can contribute to a decline in long-term rates by convincing economic operators, through their policy, that they are pursuing the objective of monetary stability in the medium-term, thus durably stabilizing inflationary expectations at a low level. This means that it is still important in the countries concerned to set and to pursue quantitative targets for monetary growth and credit expansion. Moreover, possible tensions in the EMS as the liberalization of capital movements gathers momentum will be the more easily and rapidly dealt with as the monetary authorities are firmly and durably committed to a policy geared towards stability. In particular, more flexible adjustments of short-term rates might become

benefited in their work from Commission proposals, have produced a number of proposals for improving the monitoring of economic and financial developments within the Community. The Committee of Governors has also agreed on a number of operational changes to the EMS. All these proposals were unanimously endorsed by the Ministers for Economic and Financial Affairs at an informal Council meeting held at Nyborg on 12 September.

In order to improve the coherence and the compatibility of various economic policy measures implemented by the Member States and the results thereof, the medium-term monitoring procedure has been strengthened. This exercise is based on a set of macroeconomic indicators defined for the special needs of managing the EMS, but complementary in their use with those adopted at international level.

The greater mobility of capital requires rapid reaction to tensions in the System. While it will still be based on a broad consensus as to the stance of monetary policy, cooperation will now focus more on the problems of the short-term management of exchange rates, and in particular the more flexible use of authorized fluctuation margins, the coordinated management of interest rate differentials and the improvement of practices and conditions for intervention at, or within the margins.

Here too a reinforced monitoring procedure has been established to improve the early detection of tensions which may occur within the System and to agree on how to deal with them.

This pragmatic approach is accompanied by some appropriate changes in the mechanisms of the EMS: in the case of very short-term financing these are an extension of its maximum duration from two-and-a-half to three-and-a-half months, the doubling of the amount eligible for automatic renewal and the changing of the "de facto" acceptance limit on official ECU from 50% to 100%. Lastly, it has been agreed that there will be a presumption that very short-term financing will be available, on certain conditions, for intra-marginal interventions.

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This Commission proposal will be accompanied by two other proposals, permitting recourse to balance-of-payments support facilities to back up a programme of capital liberalization.

Lifting exchange controls is a necessary but not sufficient condition for the introduction of an integrated financial system. Such a system also implies effective freedom of movement for financial services within the framework of sufficiently harmonized rules to guarantee the protection of savings, ensure fair competition between financial intermediaries and avoid the risk of excessively strong distortions in the channelling of capital flows. The adoption and implementation of the proposals in the White Paper on completing the internal market, although not a prior condition for liberalizing capital movements, should make it possible, as far as careful supervision is concerned, to establish such a framework, adjusted to the new international financial environment. On the tax side, too, it is important to approximate company tax arrangements and to establish closer cooperation between the relevant authorities to combat tax evasion.

The removal of all exchange controls between Community currencies, and the further integration of money and capital markets, are major steps towards monetary unification. But they do mean extra constraints on the conduct of the monetary policies of the Member States, which must not be allowed to affect the stability of exchange rates, another necessary condition for the completion and viability of the internal market.

It is thus indispensable to continue along the road of cooperation and convergence in economic and monetary policies, and to reinforce the mechanisms involved in the management and functioning of the EMS. On 12 January 1987, the Community's Ministers for Finance asked the Monetary Committee and the Committee of Governors to examine the practical means of achieving this. The two Committees, which

to faster growth which is durable; it cannot simply be a matter of generating higher domestic absorption in the short-term, with a consequent rapid reduction in the current surplus, and no lasting effects on employment.

In many countries, budgetary stances emerging for 1988 are already in line with the cooperative strategy. For example, tax reductions are expected in Germany, France, the United Kingdom and in Spain as well as in Belgium. Public investment is also beginning to recover in countries such as Germany, France and Denmark. In other countries, however, tight budget policies have meant a further substantial decline in the share of public investment in GDP (see Table 40).

At national level, there are two main macroeconomic constraints on the conduct of public finance policies: the budget constraint in the strict sense and the external constraint. The importance of these constraints varies appreciably from one country to another.

Simply from the point of view of public deficits and public debt, present positions vary widely. However, emerging stances are increasingly convergent. In outline, two groups of countries can be distinguished. In the first group, the general government deficit is over 5% of GDP and in some cases close to 10%. The ratio of public debt to GDP is already very high, and still expanding rapidly at a rate of between 3% and 8% a year. This ratio is particularly high in Belgium, Ireland and Italy, where it is close to or even beyond 100% of GDP. It is lower in Greece and Portugal (60-70%), but the budget

5.3. Budgetary developments and policies

The general government deficit for the Community as a whole is continuing on the declining trend that began in 1982: it is expected to stand at 4.5% of GDP in 1987 compared with 4.8% in 1986 and around 5.5% in 1982. However, the reduction for 1987 is smaller than envisaged in the last Annual Economic Report (1986-87), mainly because of the effect of the unexpected slowdown of growth in 1987 on tax and social contributions and on certain expenditure items. Moreover, the ratio of public debt to GDP is continuing to increase on average in the Community, although rather more slowly than in the early 1980s The total burden of taxation (direct and indirect (see Table 38). taxes and social security contributions), after tending to rise in the 1960s and 1970s, has remained at practically the same level since the early 1980s. It has nevertheless fallen in several Member States. In other respects, current expenditure is expected to continue increasing on average in the Community at a moderate rate, while its share in GDP declines significantly, and the share of public investment remains practically constant.

In the framework of the Community cooperative strategy, budgetary choices should contribute to reinforcing productive potential while achieving or maintaining a trend of public debt that is sustainable in the medium term. Medium-term action for this purpose should be based on a gradual reduction in the tax burden and a special effort in the area of profitable public investment (see Chapter 3.2). Such measures improve supply side conditions as well as strengthening demand. Budgetary policy is increasingly important at present, both because of the international mix of economic policies required to reduce balance-of-payments disequilibria and because of the limitations on the role of monetary policy in actively supporting growth (see Chapter 5.1). It is a question of continuing to create conditions favourable

decline between 1986 and 1988 (from 3.0% to 2.3% of GDP). To the extent that none of these countries can any longer rely on a faster expansion in its partners, it only has, in isolation, very limited extra margins of manoeuvre, where these exist at all. In the United extra margins of manoeuvre, where these exist at all. In the United Kingdom, growth remains close to 3% while the GDP deflator is since (4%) while inflation has accelerated and extend partners of higher oil bries. The depreciation of the pound sterling to the first half of 1987 has given a good stimulus to exports; wage growth is strongly supporting private consumption but is hardly contributing to improving profitability. In these circumstances the government has continued reducing the budget deficit, the reduction being now even more rapid than foreseen in the medium-term financial strategy.

The differences in budgetary trends between these two groups of countries carry serious risks. They complicate the task of the authorities to free the Community more quickly from the slow growth which seems to entrap it into the medium term. First, in the countries where public debt is rising too quickly, even more restrictive efforts to improve public finances may need to be made, in order to compensate for the effects on tax receipts of growth lacking impetus from net exports. This prejudices these countries' growth and has negative repercussions on that of their partners, whose room for The convergence process and that of manoeuvre is affected in turn. improving public finance is thus markedly slowed, which also complicates the task of the monetary authorities, especially in the real interest rates. the convergent fall in and slows Consequently, some countries with currently above Community-average growth, particularly Spain, Italy and Portugal risk being forced (or have already been forced) to give a more restrictive orientation to their policies in order to safeguard their external accounts. harms intra-Community trade, which is currently an important factor in economic development in the immediate term. These countries would

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deficit is still close to 10% of GDP, and in both countries the need for greater recourse to non-monetary financing of the deficit, so as to complete the disinflation process, might further accelerate the expansion of the public debt, which makes it all the more necessary and urgent to restore a basically healthy public finance situation. In Spain and the Netherlands, the level of both the public deficit and the public debt represent significant constraints but less so than in the other countries of the group. The seven countries of this first group, to differing degrees, are making considerable efforts to restore a healthy budgetary situation, which should be reflected in an improvement in budget balances excluding interest from 1985 to 1988 equivalent to 2 to 4 percentage points of GDP. At present, however, these efforts are particularly painful because of low growth and fairly high real interest rates.

In the second group of countries, Denmark, Germany, France, the United Kingdom and Luxembourg, the budgetary cituation is easier; the ratio of public debt to GDP is increasing at a much slower rate, or even declining, from a level already lower than elsewhere. In 1987, the general government budget balance as a percentage of GDP is between -2.8% (France) and +1.9% (Denmark) and +2.8% (Luxembourg). Some of these countries, notably France and Germany, are already using their scope for manoeuvre to support growth, or plan to do so in 1988. Their budgetary balances are in addition affected by the slowdown of growth, as in the case of Denmark, as receipts are depressed and "crisis" expenditure increases. This has already led in 1987 to an increase in the general government deficit in Germany. In Denmark, despite restrictive fiscal measures aimed at redressing the external imbalance, the budgetary surplus will decline in 1987 and 1988. In France, on the government's plans, the general government deficit will

measures should, therefore, be part of a economic policy mix oriented strongly and consistently to price stability.

If one takes account of particular economic circumstances, the contribution of each of these countries to a cooperative solution in the event of growth weakening further would be fairly differentiated. For example, in Denmark and France, the external situation makes it necesssary to varying degrees to maintain a negative growth differential with their main trade partners while further reinforcing productive potential. In Denmark, the persistence of a very high current external deficit is still a constraining factor in the conduct of economic policy. In France, tax reductions already planned for 1988 should now be contributing to reinforcing domestic growth within limits compatible with the external constraint. However, these countries could remain prepared to take further budgetary measures to reinforce their domestic growth as soon as their efforts to improve the competitiveness of their economies and the policies implemented by their Community partners lead to favourable effects on their external accounts. In Germany, tax reductions planned for 1988 will indeed, as is desirable, contribute to the required change-over to domestic They involve some deterioriation in the budget sources of growth. For the moment, deficit, already affected by slower growth. supplementary fiscal measures appear difficult if Germany acts alone. However, in view of the improvement in productive potential already achieved, this country could take full advantage of joint action by the Community partners, which would gradually widen the margin for manoeuvre and might make it possible to speed up the programme of tax thus be unable to draw all the benefits from the internal adjustment efforts which they have already made, and should pursue. They would thus no longer contribute, as at present, to sustaining demand in the Community.

There is a risk that these unfavourable trends could become more acute in the case of a further weakening of world trade or an additional decline of the dollar, which would instigate a new slowdown of growth in the Community. In such circumstances, as has already been envisaged in the conclusions of the July 1987 Economic and Financial Council, it will be a question of being ready to use positively the interdependence which exists between Community economies, within the framework of a joint effort (cf. Chapter 3.3). Such an effort would contribute to the realisation of the internal objectives of the Community and to the correction of the international payments imbalances at a satisfactory level of world growth.

If such an effort is to have lasting favourable effects, it must respect the main macroeconomic equilibria in each of the Member States, in particular the achievement or maintenance of budget and external deficit positions sustainable in the medium term. The type and timing of possible measures should also take account of the economic situation of each country.

Some of the congress

The five countries alone whose budgetary situation is easier, and which together account for close to 70% of the Community's GDP, could currently - from the budgetary aspect - actively support growth.

If this support were an element of a cooperative solution, this would allow offsets against the budgetary or external balance effects. Action taken in isolation by one or other of these countries would run the risk of unsustainable external or budgetary imbalances rapidly arising, without lasting effects on growth. Account should also be

deficit. In both countries, the priority task is to restore a healthy public finance position.

it might be appropriate to consider it Even if such a cooperative solution may appear difficult, its world seems essential in current circumstances, taking account particularly of the uncertainties weighing on the world economy. If growth were to slow down further, action varied to suit each country's circumstances, and well timed, could lead to an average budget deficit for the Community somewhat higher than in present forecasts (4.5% of GDP in 1988). In a situation where markets are considerably more adaptable, and productive capital considerably more profitable, the yield of such action in terms of growth, an acceleration of investment and thus tax revenue can be expected to be much higher than it would have been in the late 1970s or early 1980s. The returns on such a budgetary stimulus would be all the greater, the larger the number of countries participating, so that the initial boost would be more rapidly covered in each country by extra tax revenue. The durable reinforcement of growth in the Community that might result would contribute to the main domestic objective: a reduction of unemployment, and at the same time would facilitate solving the problem of international balance of payments disequilibria.

The country chapters in the second part of this report, which underpin its economic policy recommendations, allow the constraints which each country faces in isolation to be gauged. Whether these concern the level of the external balance or what is necessary to restore healthy public finances, to implement tax reductions or to raise public investment, constraints are tightened as a consequence of the slowdown in growth. This only confirms the necessity of fully taking into account the Community dimension of national economic policy choices.

reductions planned for the years after 1988. In the United Kingdom, there is a greater risk of inflation. More moderate growth of nominal wages would reduce this and also improve the economy's competitivity, thus creating more favourable conditions for investment and employment. The objective of stabilising the sterling exchange rate announced by the authorities after the Louvre accord could also help to contain inflation. This country could, however, contribute usefully to a greater dynamism in the Community if it can continue to sustain its still relatively high real growth rate while preserving monetary stability.

The other countries, whose budgetary situation remains fragile, should rely essentially on the benefits arising to them from faster growth in their partner countries, in order to attain their objectives of budgetary improvement at a higher level of growth. In this other group of countries, situations also differ considerably. In Belgium and the Netherlands, growth is still low. Both countries have an external surplus, and both economies have particularly close relations with their Community partners. They thus benefit to the full from a more dynamic Community context. These two countries could use the margin made available by stronger growth in their Community partners to reinforce the domestic components of demand, while maintaining their aims for the gradual reduction of the budget deficit, or to In Spain, Italy and accelerate the budgetary consolidation process. Portugal, growth is likely to remain higher than average for the Community, although slightly lower than in 1987, and the three countries are making a major contribution to the relatively sustained A higher growth rate in the expansion of intra-Community trade. Community partners would help these three countries to maintain or even increase their present rate of growth while preserving a sustainable external position and reducing their budget deficits as planned, or perhaps even slightly more rapidly. Lastly, in Greece and Ireland, the process of budgetary consolidation is accompanied by very slow growth. Greece is in addition still facing an excessive external

equilibrium constraints. These constraints could be eased in the framework of common and well-timed effort which would take account of the existing interdependence between the Member States. In the case of a new slowdown in growth, five Community countries with an easier budgetary situation could join in such an effort to varying degrees, while the other countries took advantage of such faster growth in their partners to realise their aims of consolidating their public finances, if appropriate, at a higher level of growth. Such an effort would allow a faster convergence of budgetary positions and reduce the risk of some countries being forced to slow their own growth rates because of tighter budgetary and/or external constaints, which would have negative repercussions on their partners.

deceleration in monetary growth continues but at a less pronounced pace than previously. The even more pronounced deceleration of prices and costs creates a satisfactory margin for real growth. A certain vigilance is, however, now necessary to avoid a buildup in the economy of excess liquidity. Following the Louvre accord the dollar's exchange rate has been more stable. Within the EMS, more flexible management of money market rates has contributed more effectively than in the past to stabilising bilateral parities. The pursuit of monetary policies oriented in a credible and durable manner towards stability are contributing to further falls in long-term interest rates, which remain high despite the fall in short-term rates and in inflation. Within the EMS, such policies would enable an easier surmounting of the tensions which could arise from the already accelerated liberalisation of capital movements. The progress made in September 1987 at the Economic and Financial Council's meeting at Nyborg should also contribute to this. With monetary policy no longer being able to support growth actively without certain risks, and the need for an improvement in the international economic policy mix, the role of budgetary policy becomes more prominent. On average for the Community, the budget deficit is still declining somewhat. The budget outlook for 1988 is that this is consistent with the direction of the cooperative strategy and will contribute to improving supply-side conditions while giving some support to demand. If carried out as part of an economic policy durably aimed at preserving price stability, faster reductions in taxes and additional public investment, compatible with a public debt position sustainable into the medium-term, would contribute to further reinforcing the determinants of growth. The implementation of budgetary policies enabling growth to be better supported, however,

The greater job content of growth in recent years is not a new phenomenon, but continues a trend which has been apparent since the rst oil crisis in 1973. There is, however, reason to believe that this trend has become somewhat stronger in the 1980s and that the factors causing it differ.

The following factors in particular should be considered as helping to increase the job content of growth:

- a) The reduction of average working time per person employed, which means that the input of labour can be shared between more persons. A fall in average working time per person employed can be achieved by reducing weekly working time and lengthening annual holidays for full-time workers, and for an increasing proportion of part-time workers.
- b) The structural shift towards the service sector. According to the three-sector theory, as the prosperity of an economy increases, a growing proportion of the national income is spent on services. Since the service sector is generally more labour-intensive than goods production, this increases the employment-creating effect of growth as a whole.
- c) The slowdown of the substitution by the factor capital for the factor labour. In other words, the increase in the national product is produced with a relatively larger input of labour and a relatively smaller input of capital. The increase in capital intensity is declining. The slower substitution of capital for labour curbs the rise in the average productivity of labour in the economy as a whole. Growth becomes more employment-creating.

These three factors are not independent of one another, but they all overlap. It is therefore not possible to measure the influence of each of the factors accurately. Nor do the said three factors entirely explain the greater job content of growth.

Taking the long-term average, working time per person employed fell by just under 1 % a year in the four large industrialized countries of the Community (EUR4) (see Table 2). In the 1960s and 1970s reductions of working time permitted no more than slight increases in employment (0.1% and 0.2% a year respectively); in the period 1985/80 they still weakened the decline in employment. Unlike the 1960s and 1970s, when the shorter working week time and longer holidays were clearly to the fore, in recent years it is the spread of part-time working in the Community which has substantially contributed to the greater effect on employment of growth. Table 3 shows the extent to which the growth of employment in recent years is attributable to increasing part-time work. In the period 1985/83 it was based exclusively on the increase in part-time jobs; the number of full-time workers actually fell

Box: Growth and employment

In the years 1986/83 the annual growth rate of real gross domestic product in the Community was only half as great as in the period 1973/60, but that of employment almost doubled. In the 1991/86 medium-term projections this - in labour market terms - favourable relationship between growth and employment is expected to continue (see Table 1).

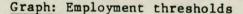
Table 1 : Growth and employment in the Community

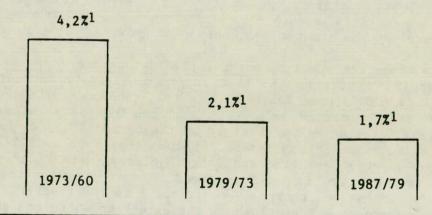
	1973/60	1979/73 Average	1983/79 annual cha	1986/83	1991/861
Real GDP	4,8	2,4	0,8	2,4	2,6
Employment	0,3	0,1	-0,6	0,5	0,6

¹ Projection.

Source: Commission services.

This means that in the Community, the growth threshold, above which an increase in employment is to be expected, is now substantially lower than it was in the 1960s. According to estimates by the services of the Commission, in the 1960s this threshold was reached when real GDP grew by 4.2%, in the period 1979/73 when it grew by 2.1% and in the period 1987/79 when it grew by 1.7%.





Employment increases when this annual increase in real GDP is exceeded.

Source : Estimates by the services of the Commission.

measured by the contribution of the factor substitution of capital for labour to the increase in the productivity of labour per man-hour (see Table 5). Over the period 1973/60 in the private sector (i.e. total economy excluding agriculture, housing and the public sector) it averaged 1.8% a year compared with only 1.3% for the period 1986/79 The decline was particularly striking in Germany and (for EUR4). Italy. Moderate real wage increases in the member countries and the plentiful supply on the labour market were probably contributory The number of The pressure to rationalize has eased. profitable jobs has increased. This stimulated the increase in employment in labour-intensive areas (such as the service sector). continuing tendency for factor substitution to slow down can probably be expected from the moves which have now started to dissociate company hours from individuals' working time. It is important in the future to conserve these effects which give growth a greater job At the same time the declining content and also to extend them. growth rates for labour productivity per man hour and for capital productivity (see Table 5) indicate that the efficiency of the economic process has declined. Economic growth today requires a relatively greater input of the two factors, labour and capital, than it did before. For strong and employment-creating growth, a more than proportionate increase in investment is therefore also necessary.

State employment measures have admittedly somewhat strengthened the trend to employment-creation in recent years. In 1985 and 1986 well over 1 million workers were employed in such programmes in the Community. But this employment effect was partly offset by the significantly slower rise in the number of public service employees (increase averaging 1.0% a year over the period 1985/79, compared with 2.3% for 1979/73). In most member countries the tendency is how to make only slight increases in the present number of persons employed in such programmes, mainly because of budgetary constraints. So, although such specific measures of labour market policy can be expected to have a stabilizing effect on employment, they cannot be expected to increase the job content of growth any further.

Summary: The threshold above which the growth of the economy as a whole leads to an increase in employment has fallen from real national product growth of over 4% a year in the period before 1973 to under 2% in the 1980s. This increased effect on employment can be explained by reductions in average working time per person employed, with part-time work becoming increasingly important, and by the slower factor substitution of capital for labour which curbs the rise in labour productivity per man-hour. In addition there is the more than proportionate expansion of the service sector which is particularly employment intensive. These effects cannot be added together easily, since they are interrelated, but probably account for most of the increased job content of growth.

slightly. The figures show clearly that the effect on employment of shorter working time (per person employed) depends not only on the size of the average reduction, but also, and more importantly, on whether the reduction of average working time is due to the increase in part-time work or to the reduction of the working time of full-time workers.

Even if the increase in part-time jobs is concentrated on the service sector (the proportion of part-time workers in total employment has risen from 16.1% in 1983 to 17.3% in 1985), a slight increase in this proportion can also be seen in industry (from 5.1% in 1983 to 5.7% in 1985). Male part-time working is also increasing slightly (3.4% of all male workers in 1985 compared with 2.8% in 1983), although part-time work is still predominantly a female preserve (28.7% of all female workers in 1985 compared with 24.4% in 1983).

As a provisional result it must still be remembered that the spread of part—time work goes a long way towards explaining the higher job content of growth. To the extent that part—time work is desired by those concerned and does not represent a form of involuntary underemployment, there is nothing to be said against this trend, especially if part—time work is covered by collective agreements and does not carry with it greater disadvantages in terms of social security cover or promotion opportunities. But the fact remains that part—time workers are frequently recruited from the "latent reserve" (e.g. housewives) and therefore do not reproduce a corresponding fall in the number of the registered unemployed.

The structural shift towards the service sector is continuing. 1960 a steadily increasing proportion of total employment and gross domestic product has been attributable to the servicce sector (see Table 4). In recent years this trend has grown even stronger. Until 1973 the real gross value added of the service sector grew in proportion to the growth of the economy as a whole; since then it has been growing more than proportionately. The high effect of growth on employment in the service sector has increased in the last few years (see Table 4). An annual average increase in real gross value added in the service sector of just under 3% in both 1984 and 1985 was accompanied by an increase in employment of approximately 2% in each of those years. In the period 1979/73, a 3.2% annual average increase in real gross value added in the service sector was associated with a 1.7% annual average increase in employment. Much of the increased effect on employment probably stems from the greater use of part-time workers.

The long-term trend in the Community towards higher capital intensity and the relative substitution of labour has slowed down in the Community since the first oil crisis in 1973. This can be

Table 3: Percent	tage ch	ange	in em	ploym	ent, 1	9 83- 85	(%)				
	В	DK	D	GR	F	IRL	I	L	NL	UK	EUR10
Total	0,8	5,6	0,8	1,3	-1,2	-4,3	0,9	0,6	3,3	3,3	1,1
Contribution 1)	to the	chan	ge in	tota	1 empl	oyment	:				
- Full-time workers	0	4,0	0,4	1,4	-2,5	-4,2	0,2	0	1,1	0,9	-0,1
- Part-time workers	0,8	1,6	0,4	-0,1	1,3	-0,1	0,7	0,6	2,2	2,4	1,2

With regards to the breakdown into full and part-time workers undertaken in accordance with the results of the Labour Market Sample Survey, it should be borne in mind that this survey is carried out in only one week of the year - in the spring - and therefore may not be fully representative of the annual average.

Source: Eurostat, Labour Market Sample Survey, 1983, 1985.

Table 2: Total labour input, average working time per person employed, and total employment (annual average percentage change)

	1970/60	1980/70	1985/80	1983/80	1985/83
Federal Republic of Germany					
- Total labour input - Working time - Total employment	-0,8	-1,2	-1,2	-1,6	-0,4
	-1,0	-1,1	-0,5	0,3	-0,8
	0,2	-0,1	-0,6	-1,3	0,4
France - Total labour input - Working time - Total employment	0	-0,4	-2,0	-3,1	-1,3
	-0,6	-0,9	-1,6	-2,1	-0,7
	0,6	0,5	-0,4	-1,0	-0,6
Italy - Total labour input - Working time - Total employment	-1,1	-0,7	0	-0,2	0,3
	-0,6	-1,2	-0,6	-0,5	-0,8
	-0,5	0,5	0,6	0,3	1,1
United Kingdom - Total labout input - Working time - Total employment	-0,9	-0,7	-1,1	-3,1	2,2
	-1,1	-0,9	-0,5	-1,0	0,4
	0,2	0,2	-0,7	2,1	1,7
EUR4 - Total labour input - working time - Total employment	-0,7	-0,8	-1,1	-1,8	0,2
	-0,8	-1,0	-0,8	-0,9	-0,5
	0,1	0,2	-0,3	-0,8	0,7

Source: Eurostat, OECD Employment Outlook 1987.

Table 5: Contribution of factor substitution to the productivity trend in the private sector1); annual growth rates (%).

private sector1);	annua.	r grown	Il lates	(%).			
	D	F	I	UK	EUR4	USA ²)	Japan ²)
Labour productivity							
per man-hour ³)				2.1	, E	1,8	9,6
1973/60	4,3	5,1	6,5	3,1	4,5	0,1	3,0
1979/73	3,8	3,4	2,2	2,7	3,1	0,3	3,8
1986/79	2,5	2,4	1,4	2,7	2,3	0,5	3,0
Capi tal							
productivity				1 7	-0.0	-0,3	-0,5
1973/60	-2,1	0,2	0,5	-1,7	-0,9	-0,8	-1,5
1979/73	-1,3	-1,2	-0,7	-1,8	-1,3	-0,5	-3,0
1986/79	-2,0	-2,0	-1,2	-1,5	-1,7	-0,5	3,0
Total factor							
producti vi ty					2 7	1 2	5,8
1973/60	1,9	3,4	4,7	1,7	2,7	1,2 -0,1	1,4
1979/73	1,9	1,8	1,3	1,4	1,7	0,1	1,3
1986/79	0,8	0,8	0,6	1,5	1,0	0,1	1,5
Contribution of the subst	itution						
of capital for labour							
to the increase in labour							
productivity per man-hour		Se but	The same		1.0	0.5	3,5
1973/60	2,4	1,7	1,7	1,4	1,8	0,5	1,6
1979/73	1,9	1,6	0,9	1,3	1,4	0,2	2,5
1986/79	1,6	1,5	0,8	1,2	1,3	0,2	2,5

¹⁾ Private sector = total economy excluding agriculture, housing and the public sector

2) Data available only up to 1985

Definitions

- Labour productivity = real gross value added per man hour.

- Capital productivity = real gross value added per unit at constant prices.

- Total factor productivity = weighted average value of labour and capital productivity. The weights correspond to the shares of factor remuneration in gross value added.

Source: Estimates by services of the Commission.

³⁾ Because of the definition of sectors and of working time (hours worked per week) the values given here are not fully comparable with the data in Table 2.

⁻ Contribution of the substitution of capital for labour to the increase in labour productivity per man hour = the difference between the growth rates of labour productivity per man hour and of total factor productivity. (see European Economy, No. 20, June 1984).

Table 4: Employment and growth in the economy as a whole and in the service sector in the Community (EUR12)

		1968/60	1973/68	1979/73	1985/79	1983	1984	1985
Total employment	% p.a.	0,1	0,5	0,1	-0,3	-0,5	-0,1	0,6
Real gross domestic product	% p.a.	4,6	4,9	2,4	1,2	1,4	2,3	2,4
Employment in the service sector	% p.a.	1,7	1,9	1,7	1,5	1,2	1,9	2,2
Real gross value added in the service sector	% p.a.	4,5	5,0	3,2	2,1	2,0	2,8	2,9
		1960	1968	1973	1979	1983	1984	1985
Employment in the service sector as a proportion of total employment	76	39,1	44,2	47,3	51,8	55,7	56,8	57,6
Gross value added in the service sector as a proportion of gross domestic product	Z	48,1	52,7	53,5	57,2	59,2	59,4	59,5

Source: Eurostat

appreciable in all the countries. According to Commission estimates, the assumed fall of 0.8 of a percentage point in long term interest rates could have an effect on the budget deficit averaging between 0.5% and 0.6% of the Community's GDP, after the entire debt has matured and has been refunded at a lower rate. A cautious evaluation puts the reduction attainable over four years at 0.4 of a percentage point of GDP. As a result of this reduction in the interest burden, budgetary policy could gradually be given more flexibility.

This reduction would be of particular benefit to the countries with the highest level of public debt. It would contribute to an above average degree to reducing the rising tendency of the public debt, which these countries can at present curb only by creating larger and larger surpluses on their budgets excluding debt interest. It would thus contribute to the desirable closer convergence of public debt, positions which in its turn would be bound to have favourable repercussions on the downward convergence of interest rates themselves.

The assessment which can be made of the level of nominal interest rates is clasely bound up with their differential with the inflation rate, i.e. the "real interest rate". Inflationary expectations are crucial in this respect. But since they cannot be directly observed, the "real interest rate" measured by the differential between the nominal rate and the current inflation rate is often used as an initial approximation. However, this measurement creates very special problems when there is sharp and rapid variation in the inflation rate. In this case the current inflation rate and the anticipated inflation rate probably differ widely, with the economic agents' expectations proving false. The choice of the inflation indicator is also difficult. As general rule, the different indicators of inflation (GDP or private consumption deflators, nominal unit wage

Box : Long term interest rates

There are two main reasons why lower long term interest rates would make it easier to implement the cooperative strategy: first lower interest rates would help to boost investment. But - perhaps more importantly - they would take substantial pressure of public budgets, heavily burdened by debt servicing costs. This would create more room for manoeuvre for faster budgetary consolidation or a boosting of growth.

The decision to invest depends very heavily on the differential between the expected profitability of the investment and the financing cost or the yield from a financial placement. This differential must be increased to stimulate more dynamic investment. Profitability has already risen substantially in recent years. However, as an indication, the average profitability of productive capital in the Community is not yet back to its average level in the 1960s (see Graph 12). Further improvements must and can still be made. But a fall in long term interest rates would also have a favourable influence on investment. According to econometric analyses of Commission services, a lasting fall of 0.8 of a percentage point in long term interest rates, based on the stabilization of inflationary expectations at a low level would increase the annual volume of private investment by a little over 2% in four years; the annual growth of private investment would accelerate by an additional 0.4-0.5%.

The other important element in the assessment of long term interest rates is their impact on <u>public deficits</u> and hence on the management of budgetary policy. A fall in interest rates first has an immediate effect on the cost of new debt. Also, as the old debt is refunded, the fall in interest rates, provided that it is lasting, takes the equivalent amount of pressure off public budgets. Although the immediate effect may often be ignored, except for the countries where

First, at international level, the absorption of domestic and external saving represented by the United States' budget and external deficits and the debt situation of the developing countries places a heavy burden on international capital markets. To the extent that these imbalances are corrected, scope would be created for interest rates to fall on international markets, and consequently on the European capital markets.

Secondly, within the Community, the return to stability is a relatively recent phenomenon and the disinflation process is not yet complete in all countries. If monetary policies remain lastingly and credibly geared to stability and if, year for year, inflation rates remain low, inflationary expectations should still be able to fall, and this would have a favourable effect on interest rates. progressive improvement in the balance between domestic saving and investment should also contribute to a relative fall in real interest Such an improvement is possible if, within the framework of the cooperative strategy, the faster rise of investment can be based on rising profitability accompanied by a progressive increase in the margins for self-financing, and thus with a simultaneous increase in The pursuit of policies which permit, where domestic saving. necessary, a progressive consolidation of public finances and which improve the convergence of public debt positions should also contribute to reduce tension on the capital markets and would also facilitate the task of monetary policy in external and internal stabilization. The reduction of interest rates in the Community which would thus be possible would contribute to establishing at a lower level the differential between European and U.S. interest rates necessary to stabilize the dollar.

costs) move in parallel. However, when major changes occur in relative prices, e.g. as in 1986 following the improvement in the terms of trade resulting from the depreciation of the dollar and the fall in oil prices, major differences may appear in the movement of these various indicators. All these factors must be taken into account when assessing the level of real interest rates and the room which exists for them to fall in the future.

As a historical comparison, the present differential between the nominal long term interest rate and the inflation rate is wide, at around 5% (see Graph). This is, of course, distinctly wider than in the 1970s, when it was close to zero, or even negative. But then it was the expression of monetary instability and of high and rapidly fluctuating inflation rates rather than a reflection of the relative scarcity of capital. In many countries interest rates then lost the role which they ought to have in channelling scarce resources from saving into the most profitable allocations. This has probably led to a waste of capital and has made the productive process even more capital-intensive. But the differential is also now slightly wider than in the 1960s, a period which from the point of view of monetary stability is more comparable with the present period. The high level of real interest rates is also a sign of inadequate saving relative to the financing needs of the various economic agents.

Since the beginning of the 1980s, stability-oriented monetary policies have enabled interest rates to ensure balance on the capital markets more effectively. Their relatively high level can be explained by several factors; if these factors move favourably one can hope for a lasting fall in real interest rates without the achievement of stability being called into question.

FOOTNOTES

Chapter 2

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1) An enquiry undertaken for the Commission shows that only 10-20% of part-time workers would wish to increase their hours worked, while the proportion of full-time workers who would prefer to work less is around 30% (see European Economy, No. 27, "Employment problems: views of businessmen and the workforce"). This enquiry also reveals that a more flexible management of working-time and of production would enable an increase in employment perhaps reaching 6%.

Chapter 4

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1) Cf. "Completing the internal market" - White Paper of the Commission at the request of the Council. EC Commission document, Luxembourg 1985.

2) See Annual Economic Report 1985-86, in European Economy, No. 26,

November 1985, Brussels, pp 10 and 42 et sqr.

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1) See Annual Economic Report 1986-87, in European Economy, No. 30, November 1986, Brussels, pp 63 et sqr.

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1) COM(87)229

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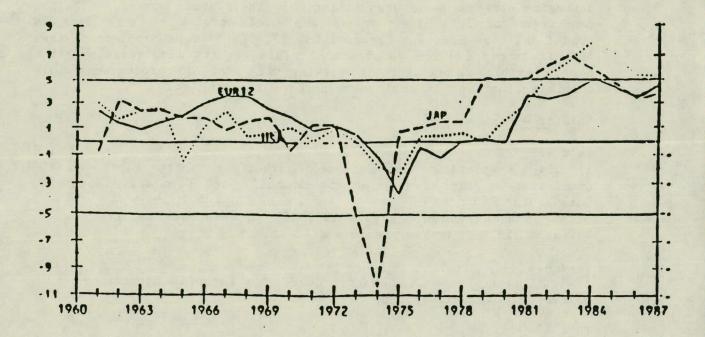
1) For a more detailed description see the Memorandum on the fight against long-term unemployment (COM(87)231)

Chapter 5

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1) Long-term commercial credits, acquisition of securities not traded on a stock exchange and the admission of securities on the capital markets.

LONG TERM INTEREST RATES (annual average)

Differential between nominal rates and variations in the price of GDP



- 1. GDP prices have been chosen as representing underlying domestic inflation. Their evolution is on a long term average roughly indentical with the evolution of the prices of private consumption (average for the years 1970 to 1985: prices of GDP: +10.1% per annum; prices of private consumption: +10.0% per annum on average for EC 12). But, in some years, wide differentials exist when the terms of trade change substantially (e.g., 1974: prices of GDP, 13.0%: prices of private consumption, 14.6%; 1986 prices of GDP, 5.6%; prices of private consumption, 3.7%; on averages, EC 12).
- 2. The nominal interest rate corresponds to the weighted average of representative nominal long term interest rates on the capital markets of the Community countries (weighting: GDP prices and PPA 1985).

PART II

THE ECONOMIES OF THE MEMBER STATES

ECONOMIC RELICY IN MEMBER STATES. reasons: the size of the gross debt, which reached the equivalent of 125% of GDP in 1987 (the corresponding figure for the Community as a whole being 61%), with external debt alone equivalent to 20% of GDP; the burden of interest payments, which will approach 11% of GDP (the corresponding figure for the Community as a whole being 5%); and the fact that the reciprocal multiplier effects between the debt and interest payments have still not been brought under control.

After an appreciable reduction (about 3% of GDP) in the central government borrowing requirement in 1987, mainly thanks to major public expenditure cuts, the Government intends to bring the budget balance down to 7,4% in 1988 so as to achieve the programmed objective of 7% of GDP in 1989. This will involve a new series of expenditure cuts, especially on social transfers and operating expenditure, and the creation or new budget revenue, partly from the privatization of certan public sector activities.

At the same time, the Government has announced an ambitious programme or tax reform, spread over the period 1989-93, including a reduction in the number and level of personal income tax rates, the effects of which would be partially offset by the discontinuation of a series of tax allowances in favour of enterprises and households. The programme has not yet been presented to Parliament.

To attenuate the effects on the labour market of public finance austerity and moderate economic growth, the Government's programme for

BELGIUM

In <u>Belgium</u>, energetic budgetary adjustment undertaken during 1987 marked the real growth rate of domestic demand, which slowed to 1,6%; as the real contribution of the external balance was again negative, the GDP growth rate fell to 1,3%. Against this somewhat slack background, fixed investment by firms nevertheless remained very sustained, increasing by almost 8% in volume for the second year running, while public investment declined by 10%. Private consumption increased by only 1,5% in real terms, owing to a slowdown in real disposable income. The volume of imports increased faster than that of exports, but the terms of trade continued to improve and the balance of payments on current account showed an appreciable surplus (2,3% of GDP). The consumer price rise was kept to 1,8% on annual average. Unemployment diminished slightly, despite the contractionary effect of budgetary measures on employment.

Real personal disposable incomes could grow slightly faster in 1988; as a result, and assuming a further reduction in the savings ratio, private consumption will be able to expand at the same rate as in 1987. Private investment will continue to grow, stimulated by wider profit margins and given the still moderate trend of real wages. The contribution or the external balance to growth should become positive, since cost competitiveness is again improving. In these circumstances, the current account surplus should be maintained at around 2,5% of GDP. The real GDP growth rate could be close to 2%, while the unemployment rate should fall slightly. While remaining moderate, inflation could accelerate slightly, partly because of a turnround in the trend of import prices.

It is still an absolute priority objective to restore healthy public finances. Further efforts in this direction are imperative for several

BELGIUM

towards reducing the budget deficit is likely to loosen the constraint imposed by changes in capital movements on interest rates. Along with a balance of payments surplus on current account, this development should also enable the authorities to reduce the external debt that has accumulated since 1979.

The success of the recovery plan for the Belgian economy depends on the interaction of a number of tactors. A low inflation rate must help to bring down interest rates, stimulate investment and reduce the burden of interest on public debt. Wage moderation should safeguard competitiveness and maintain profitability at a satisfactory level. If these conditions are met, growth might revive and make it easier to achieve the twofold aim pursued by the Belgian authorities : reduction in the budget deficit and reduction in the burden of compulsory levies - an objective that fits in with the strategy recommended by the Community, which is expected to have favourable employment. If it is to be a success in practice, the authorities must keep control of public expenditure and the Belgian economy must also be able to take advantage of sufficiently dynamic intra-Community trade. The implementation of the tax reduction programme could than be confined to using the "budgetary dividend" generated by an improvement in the conditions of growth in the Community.

1988 also includes a set of direct specific measures in favour of employment, including opportunities for reduced social security costs in certain sectors, and facilities for young and long-term jobseekers. Job creation in the private sector is still being helped along by a steady decline in real unit labour costs. On the basis of wage agreements for 1987 and 1988, the increase in real wages should be below productivity gains.

Moreover, improvements in the operation of labour markets have made it possible to improve the flexibility of supply conditions. New laws introducing more flexible provisions on Sunday work, night work and working hours, came into force in July. Under these laws, new arrangements for work can be introduced by collective agreement negotiated at sectoral or firm level. This increased flexibility, along with the moderation of internal costs, creates favourable conditions for the development of exports and investment.

The policy introduced in 1982 to restore profitability and healthy finances in the business sector has already improved business investment, particularly in 1986-87.

Monetary policy should continue to preserve the stability of the exchange rate of the Belgian franc within the European Monetary System, while using the margin for manoeuvre available to encourage a decline in interest rates and thus lighten the burden of servicing the public debt. The realignment of January 1987 involved revaluing the Belgian franc by 2% against the ECU, after the 1% revaluing of the preceding realignment in April 1986. This policy has been made easier by the fact that the current balance of payments is showing a considerable surplus, and initiation performance is good. Progress

DENMARK

In Denmark, after five years with growth in excess or the Community average, the gross domestic product is estimated to have shown a small decline in real terms in 1987. While exports of goods and services stagnated already in 1986, the growth of activity had been sustained by an exceptionally rapid expansion of domestic demand (5,7% increase on average over 1985). Towards the end of the year, however, key domestic demand components turned distinctly downwards in response both to the deterioration of export prospects and the resulting worsening of the investment climate and to the sharp tightening of fiscal policy undertaken in several steps in the course of the year and of measures aimed at increasing the saving ratio of private households. Private consumption, thus, declined by some 5% (actual rate, from the third to the tourth quarter of 1986 and is, even with some rise in the course or 1987, likely to show a small decline on average for 1987 over 1986. Dwelling construction is estimated to have contracted by some 10% and business investment is also likely to have dropped. Although public investment rose somewhat over the 1986 level, total gross fixed asset formation, therefore, is estimated to have declined by some 6 1/2%. With, furthermore, a fall in the level of inventory formation, total domestic demand may have declined by almost 2% in real terms. Imports fell even faster than domestic demand and since exports remained rather unchanged the contribution to growth from net exports was positive although not enough to prevent a small contraction of domestic activity. The number of persons employed nevertheless, probably rose marginally but less than the fairly rapid increase in the labour force. The rate of unemployment, therefore, after having been on a declining trend since 1983, rose somewhat from 1986 to 1987.

Belgium : Main economic aggregates - Annual % changes								
	1983	1984	1985	1986ª)	1987 ^b)	1988b)		
-Gross) value	6,0	7,2	6,7	6,9	3,4	4,0		
domestic) volume	-0,3	1,6	1,5	2,3	1,3	1,8		
product) deflator	6,3	5,5	5,1	4,4	2,1	2,2		
-Private consumption								
defiacor	1,3	6,5	4,8	1,3	1,8	2,5		
-Gross fixed) private	-3,6	4,4	3,8	6,6	7,0	4,9		
capital) public	-7,6	-8,8	-13,1	-7,2	-11,0	0,2		
formation , total	-4,3	2,2	1,2	4,8	5,0	4,4		
volume of: construction	-5,5	-4,8	-0,4	1,6	1,6	3,1		
which equipment	-2,3	13,9	3,5	9,1	9,2	6,0		
-Domestic demand at constant								
prices	-2,5	1,7	1,3	3,4	1,6	1,7		
Gap with respect to other								
Community countriesc,	-3,8	-0,1	-1,0	-0.3	-1,0	-0,6		
-Compensation) nominal	6,0	5,8	4,4	2,5	3,7	3,0		
or employees) rear Ad)	-0,3	0,3	-0.7	-1,8	1,6	0,8		
per nead) Bd)	-1,3	-0,6	-0,4	1,2	1,9	0,5		
-Productivitye)	0,9	1,7	0,6		1,2	1,6		
Real unit labour costs	-1,2	-1,4	-1,2	-3,1	0,4	-0,8		
Competitiveness ^t)	-2,2	-1,3	1,1	4,5	3,8	-0,6		
-Employment	-1,1	0,0	0,8		0,1	0,2		
Registered unemployed as %								
of the civilian labour	14,4	14,5	13,7	12,6	12,4	12,1		
forces)	Appled topical and	2.,5						
-Current balance as %								
or GDP	-0,6	-0,4	0,4	2,4	2,3	2,3		
-Long term interest rate	11,8	12,0	10,6		7,6	7,4		
-Money supply")	7,0	6,1	6,7	10,7	8,0	6,0		
-Net lenging or borrowing	,,,	,,,	,,,					
requirement of general ¹)	-11,3	-9,4	-8,4	-8,7	-0,6	-6,1		
government as % of GDP	11,5	,,,	,,,					
Public dept as % of GDP	105,1	111,0	11/,9	120,3	125,3	128,4		
Public debt interest	105,1	111,0	11,,5	120,5	,-			
	9,4	9,9	10,6	11,1	10,9	11,0		
as % of GDP	7,4	7,7	10,0	11,1	10,5	11,0		

a, Estimates of the commission services, September 1987

c) Differences in percentage points

DENMARK

b) Forecasts fo the Commission services, September 1987, on the basis of present policies

d, A: GDP deflacor; B: private consumption deflator

e) Gross value added per occupied person in the whole economy

f) Effective exchange rate (vis-à-vis 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive rigure = loss of competitiveness.

^{8,} EUROSTAT definition

n, End of year

¹⁾ This "borrowing requirement" is substantially different to the concept of "the net balance to be rinanced" to which national budgetary policy refers and which includes loans, advances and equities and certain other exchequer operations.

the continued Assuming unchanged policies, implying, notably, implementation of the general guidelines for the development of central and local government expenditure and unchanged rules of taxation the financial situation of general government should change little in 1988. The slow growth of private sector demand will exert a dampening effect on receipts from indirect taxes but direct taxes are expected to rise tast as a result of the widening of the tax base following the tax reform (notably the lowering of the scope for deducting interest payments). Interest payments on the public debt are expected to fall somewhat and the general government budget surplus may, therefore, remain broadly unchanged or perhaps even increase a little over the level of 1,9% reached in 198/. The need to strengthen even further the external account remains imperative and warrants a considerable surplus on the general government budget as long as the saving of the private sector remains insufficient. The financial deficit of the private sector, which rose from 2,7% of GDP in 1985 to 8,6% in 1986 fell somewhat in 1987 but is, in fact, torecast to remain as high as 3,9% of GDP in 1988. A more lasting improvement of the financial balance of the private sector will require further measures to enhance household savings and will also warrant a continued prudent stance of monetary policy.

The deterioration of the private sector's financial balance in 1986 (reflecting both a decline in the saving rate and a strong upturn in dwelling construction and business investment) in fact prompted a sharp rise in nominal long term interest rates — from some 9% in March 1986 to more than 12% in September 1987. Short term interest rates, apart from a brief rise in January 1987 in the period immediately preceding the EMS alignment, have not increased fully in line with long term rates, implying a rise in the steepness of the

Import prices are estimated to have fallen by some 3 1/2% in national currency terms but domestic unit labour costs have risen substantially faster than in 1986 (in part as a result of a shortening of the working time) and consumer prices are expected to have shown a rise of 4% against some 3,5% in 1986.

Despite this acceleration of inflation, nominal incomes showed a marked deceleration and the rate of increase of tax receipts - exceptionally high in 1986 as a result of major tax rises - slowed down considerably. Government expenditure, on the other hand, accelerated as a result of wage and salary improvements for civil servants and a rise in transfers to households. The general government budget surplus, therefore, may have declined from 3,3% of GDP in 1986 to some 1,9% in 1987. The balance of trade in goods and services, which had been slightly negative in 1986, again turned positive in 1987 and as the net interest payments to abroad remained practically unchanged, the current external deficit was reduced from 5,1% of GDP in 1986 to 2,9% in 1987.

Activity is expected to recover somewhat in the course of 1988 mainly in response to a continued improvement of the external balance in volume terms. The growth of export markets is unlikely to accelerate much and competitiveness may deteriorate further. On the other hand, given the weakness of the domestic market, producers may to some extent shift supply to external markets and exports may, therefore, nevertheless rise faster than in 1987. Real domestic demand is forecast to continue its decline, although at a somewhat slower rate and this will be reflected in a further drop in the volume of imports. On average for the year gross domestic product may show a rise below 1% and the rate of unemployment is likely to increase over the level of 1987. Domestic cost increases will slow down but a rise in import prices will push up costs and the rate of increase of consumer prices is, therefore, unlikely to drop. Given the expected deterioration of the terms of trade (reflecting both a rise in import prices and a fall in export prices of agricultural products) the trade balance in current prices is not improving fully in line with the change in the volume balance. Moreover, the balance on invisibles may deteriorate as a result of a fail in net transfers from the Community. The current external deficit is, nevertheless, likely to tall from 2,9% of GDP in 1987 to some 2.2% in 1988.

Denmark : Main economic aggregates	- Annual % changes							
	1983	1984	1985	1986ª)	1987 ^b)	1988 ^b)		
\	10,4	9,4	9,7	8,4	4,4	5,1		
-Gross) value	2,5	3,5	4,2	3,4	-0,2	0,9		
domestic) volume	7,6	5,7	5,3	4,9	4,6	4,1		
product) deflator								
-rrivate consumption	6,8	6,5	4,9	3,6	4,1	4,0		
deflator	5,0	12,0	11,5	19,9	-7,6	-3,8		
-Gross fixed) private	-14,8	0,1	14,7	-5,3	1,9	2,1		
capital) public	1,9	10,5	11,9	16,8	-6,6	-3,2		
formation , total		7,3	8,6	19,4	-7,1	-4,3		
volume of: construction	1,9	14,5	15,9	13,9	-6,1	-1,9		
which equipment	1,8	14,5	13,5					
-Domestic demand at constant		, ,	5,7	5,7	-1,9	-0,7		
prices	1,4	4,1	5,1	,,,				
Gap with respect to other			2.2	1,9	-4,7	-3,1		
Community countries ^C)	-0,2	2,1	3,2	5,1	7,2	5,2		
-Compensation) nominal	8,2	5,4	4,6	0,2	2,5	1,1		
of employees) real Ad)	0,5	-0,4	-0,6	1,4	3,0	1,2		
per nead) Bd)	1,4	-1,1	-0,2			1,2		
-Productivity ^e)	1,8	1,8	0,8	1,2	-0,8 3,3	-0,2		
Real unit labour costs	-1,3	-2,1	-1,4	-1,0		0,2		
Competitiveness ^f)	0,9	-3,6	1,1	7,4	9,1	-0,1		
	0,3	1,5	2,9	2,0	0,8	-0,1		
-Emproyment					7 7	8,6		
Registered unemployed as %	10,1	9,9	8,7	7,6	7,7	0,0		
of the civilian labour								
force ^g ,						2.2		
-Current balance as %	-2,6	-3,4	-4,7		-2,9	-2,2		
of GDP	14,4	14,0	11,6	10,5	11,9	11,0		
-Long term interest rate	25,5	17,0	15,8	8,0	4,3	4,4		
-Money supplyh)	-7,2	-4,1	-2,1	3,3	1,9	1,7		
-Net lending or borrowing								
requirement of general								
government as % of GDP	62,6	67,6	65,8	61,7	59,1	53,3		
Public debt as % of GDP	02,0	0,,0						
Public debt interest	8,1	9,7	9,9	8,8	8,2	7,8		
as % of GDP	0,1	,,,						

a) Estimates of Danmarks Statistik, April 1987

c, Differences in percentage points

e) Gross value added per occupied person in the whole economy

b, Forecasts fo the Commission services, September 1987, on the basis of present policies

d) A: GDP deflator; B: private consumption deflator

t, Effective exchange rate (vis-à-vis 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive figure = loss of competitiveness.

⁸⁾ EUROSTAT definition

n) End of year

yield curve. The difference between Danish and German short term interest rates, nevertheless, has widened very considerably since the beginning of 1986. This decoupling of Danish interest rates from the general lowering of rates within the EMS was instrumental in maintaining the relatively strong position of the Krone within the band of fluctuation and, thus, in dampening the rate of increase in consumer prices in the face of an acceleration of domestic cost increases. The tightening of domestic monetary conditions, in fact, to a large extent took place as an "endogenous" adjustment to these cost increases rather than as a deliberate change in the policy stance. Any progress made by reducing the deficit in the current balance of payments would be helpful in reducing long term interest rates and in stimulating private investment.

Growth was exceptionally vigorous during the years 1984-1986, notably as a result of a strong boom in private investment fostered by improved profitability and benefiting from favourable export prospects. However, the widening of the gap between the expansion of internal demand in Denmark and in other Community and Scandinavian countries together with tne deterioration of cost and price competitiveness, increased the current balance of payments deficit to an unsustainable level. In view of this situation and of the high level of external debt and related interest payments, the relaxation of the external constraint should remain the primary objective of government policy. To this end the contribution of fiscal and monetary policies is essential, but wage restraint will be equally important, so as to ensure a return to a dynamic growth process which was successfully achieved in the recent past. A strengthening of foreign demand could help to reduce the external constraint. Increased growth in intra community trade sustained by appropriate macro-economic policies in the member States would be helpful in this respect.

1 1/2% in 1987. Under those circumstances employment showed only little increase. The resulting annual average increase of around 1/2% was not sufficient to bring unemployment down below the average level for 1986. As in the previous year, the real balance on goods and services deteriorated significantly, to only slightly over half its 1985 level. Nevertheless, mainly because of a further major improvement in the terms of trade, the current account surplus fell by only around half a percentage point, to 3,7% of GDP.

The expansion in domestic demand is expected to show only a modest slowdown from 1987 to 1988. The increase in real gross private wage and salary income may slow down to just below 4%. However, the tax cuts planned for early 1988, will boost the rate of increase in disposable incomes? With slightly faster growth in export markets and assuming only a small rise in the real effective exchange rate of the German mark, exports are expected to grow moderately, while imports might increase at much the same rate as in 1987. As a result, GDP may expand very close to 2% in 1988. Despite some acceleration of consumer prices (to just below 2%) real disposable income of households may, therefore, show a rise of around 2%. The reduction in the current account surplus will be similar in scale to that of 1987, but it might still be above the 3%-of-GDP mark in 1988.

Employment during the year will probably rise to a similar extent as in 1987, but a further contraction is expected in employment in manufacturing. With a probable increase in total employment of around 70 000, unemployment is likely to edge up again.

The overall price increase in the Economy, around 2 %, would be broadly in line with domestic got in creases.

FRG

FEDERAL REPUBLIC OF GERMANY

Economic prospects for the <u>Federal Republic of Germany</u> are currently viewed relatively cautiously. In the second half of 1986, the strong appreciation of the German mark, principally against the US dollar, was reflected in a decline in exports in real terms and an increase in imports, particularly of finished goods. Although domestic demand remained buoyant, the influence of the external sector tended increasingly to blunt the overall economic performance.

In 1987 this dampening influence of the external side has again strongly marked the development of the economy. Following a further rise of some 10% in the German mark's value against the US dollar and with economic activity suffering exceptionally from harsh winter weather, aggregate production contracted in the first quarter. Admittedly, the factors holding back exports weakened as the year progressed, and exports started to recover markedly from the second quarter on; on average for the year they may, nevertheless, in volume terms remain below their 1986 level. Domestic demand went on growing at a distinctly more rapid rate than aggregate production, even though it tell far short of the high 1986 growth rate - not least because of some deceleration in private consumption. The untavourable trend of exports also dampened investment in equipment, although some revival appeared to take place at the end of the year. However, investment was channelled primarily into rationalization schemes. Investment in building and construction showed no growth, not just due to bad weather but also since the trendwise decline in residential construction not yet slowed down. Since demand increasingly met by imports, which enjoyed a competitive price edge, and since exports stagnated, the growth of GDP amounted to around

Although the Federal Republic of Germany is already making a major contribution towards eliminating international payments imbalances, with the growth in domestic demand probably exceeding the growth of GDP by over 2 1/2% in real terms between 1986 and 1988, the current account surplus, as a result of the terms of trade improvement, is being reined back only gradually.

Budgetary policy is still directed towards reducing the proportion of scarce resources taken up by the state by imposing tight restrictions on the rise in expenditure. Even so, a pronounced change in the stance took place in 1986. Up to 1985, the main purpose of the restrictions on expenditure was to trim budget deficits and to stem the rise in public debt as a percentage of GNP. Since 1986, nowever, the headroom available has been used to ease the burden or taxation. Following the reduction in direct taxation in 1986 (equivalent to 0,6% of GDP), a somewhat larger step will be taken in 1988 (0,6-0,7% or GDP), with the tax cuts originally planned being augmented in the wake of the Louvre accord of February 1987 by bringing forward DM 5 billion of the tax retorm scheduled for 1990. The remaining parts of the retorm will result in tax cuts equivalent to somewhat less than 1% of GDP from 1990 onwards. In addition, budgetary policy served to underpin growth last year and has continued to do so this year, especially as public investment in goods and materials has risen at a much taster rate than GNP. Alongside this, the automatic stabilizers have been able to produce their full effects this year since, by and large, the Government has not attempted to make up for revenue shortfalls due to the degree of capacity utilization with corresponding cuts in expenditure. As a result, the total public authority deficit in 1987 is expected to widen again significantly for the first time since 1981.

The above-mentioned tax cuts, amounting to DM 13 000 million-14 000 million (0,6-0,7% or GDP), will be the main reature or budgetary policy in 1988. These cuts will not only stimulate demand, but also

The nigh level and rising trend of unemployment are still extremely worrisome teatures. Wage bargainers and economic policymakers are together facing the challenge of making full use of the opportunities for scaling down unemployment. Wage settlements concluded earlier this year suggest that the wage costs per capita in 1987 will increase by some 3,5%. The only reason why the resulting increase in unit wage costs did not so far damage business profits was the significant improvement in the terms or trade. A moderate rise in real wages therefore remains necessary if the propensity to invest is to be maintained despite the loss of competitiveness resulting from appreciation. However, the wage settlement recently reached in the metal industry contains some positive elements : working time will be progressively reduced by a total of one and a half hours, with agreed annual wage increases translating into a rise of around 4% in hourly wage costs. This settlement in the metal industry is the first in which wage bargainers have reached an agreement spanning three years. This will allow tirms to make plans on a safer basis much in line with the government's policy with respect to the macroeconomic framework. Given the importance of this branch of industry, which accounts for some 50% or employment in manufacturing, the pattern has been set for wage costs in the economy as a whole in the medium term, and this will be an important factor influencing monetary and financial policy.

In view of the prospective small did me in red unit labour Golds. In spite of the rise of about 1.5% in unit wage costs, the overall profit situation of enterprises in general remains healthy. The net rate of return (measured as the net operating surplus in proportion of the net capital stock) has increased from the trough of 1981 and should next year be back to the level of the early 1970s. As firms can count on steady - although still rather moderate - growth in demand, investment conditions are in general not unrayourable.

growth will be impeded by further undesirable upward pressure on the DM. Developments since May 1987 have, however, clearly shown the limitations the Bundesbank faces in influencing long-term interest rates. Since May, the capital market has not followed the targets established by the Bundesbank. On the contrary, there was a rise of more than 0,5 points in the current yield on public loans, less in response to changes in investors' inflationary expectations than to movements in exchange rates and international interest rates. From a monetary policy viewpoint, a slowdown in monetary expansion would be welcome in order to start next year with a lower rate of growth. If the external environment were to prove more stable than in 1986/87, there would probably be a good prospect of this happening.

The attempts to make markets more adaptable have continued. In recent months, the main objective in many cases has been to facilitate market access for new firms set up by the self-employed and by enterprises, to improve their access to new equity capital and to remove as many as possible of the numerous obstacles they encounter. Against this, scant progress was made in dismantling subsidies. The latter were, in fact, increased substantially, especially in 1986, partly as a result of the German mark's appreciation but also under mounting political pressure from interest groups. By taking further modest steps towards reducing weekly working time and by expanding the scope for flexible working arrangements the two sides of industry have helped improve employment opportunities; at the same time, the Federal Labour Office stepped up efforts to provide vocational and further training.

serve to improve incentives to effort on the part of employees and tirms. In view of the fairly modest growth prospects, a further expansion in the deficits cannot, therefore, be avoided. The Central Government (combined Federal Government and Länder) deficit will probably reach to 2,7% or GDP in 1988, corresponding to a rise or 0,3 points over 1986, while the total public authority cash dericit (central and local government, and the special Federal runds) might even rise to some 3% in 1988. Since the growth in expenditure has, in any case, already been adjusted to the more unravourable trend in revenue, a temporary widening or the deficits under the impact of tax cuts provides no justification for any weakening of confidence in the soundness of budgetary policy. However, through dismantling subsidies and deciding on how the tax reform is to be financed, care must be taken to ensure that the expansionary torces in the economy are given tull rein. An energetic dismantling of subsidies should, particular, prevent the preservation of production structures for which there will be no future whatsoever in the longer term.

Since the beginning of 1986, the Central Bank money stock has been expanding at an average annual rate of over 7% while the nominal national product has been rising by no more than around 5%. As a result of falling interest rates, the faster pace of monetary expansion was, at the outset, attributable principally to growth in highly liquid forms of money but then, from about the middle of last year, the money supply aggregates expanded on a broader front. Low interest rates, together with falling prices, significantly eroded the opportunity costs of holding money, while the money supply was characterized by strong growth in credit institutions' claims on non-residents.

However, monetary policy still shows some contlict between domestic and external objectives; under such circumstances, there is a danger that the measures which are inherently necessary to curtail monetary

F.R. or GERMANY: Main economic aggregates, 1983-1988					nnual %	changes
	1983	1984	1985	1986	1987ª)	1988ª
\ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \	4,8	4,8	4,3	5,7	3,3	3,7
Gross) value	1,5	2,8		2,6	1,4	1,9
domestic) volume	3,3	2,0	2,2	3,1	1,9	1,8
product) detlator	3,3	2,0	-,-			
-Private consumption	3,2	2,5	2,1	-0,5	0,6	1,8
derlator		1,2	-0,1	2,5	1,2	1,6
-Gross rixed) private	5,1	-2,1	0,8	7,3	2,9	0,7
capital) public	-8,6		-0,1	3,1	1,4	1,4
tormation) total	3,2	0,8		2,4	-0,4	0,8
(volume) of construction	1,7	1,6	-5,6		3,8	2,3
which : equipment	5,6	-0,5			2,5	2,3
-Domestic demand at constant prices	2,3	2,0	1,0	3,7	2,5	2,5
Gap with respect to other					0 /	-0,1
Community countriesb)	1,6	-0,1	-0,9	-0,1	-0,4	
-Compensation) nominal	3,9	3,5	3,1	3,9	3,3	2,9
or employees) real ^c) A	0,6	1,4	0,9		1,4	1,1
per nead) B	0,7	1,0	1,0		2,6	1,1
-Productivity ^d)	3,0	2,8	1,8	1,8	0,8	1,6
Real unit labour costse)	-2,4	-1,3	-0,9		0,6	-0,5
Profitability ^f)	11,5	2,1	5,2		-3,2	-2,2
idem (1970 = 100)	85,4	87,2	91,7	96,3	93,2	91,2
1dem (1970 - 100)	-0,9	-4,3	-2,6	10,0	5,7	-0,0
Competitiveness8)	-1,5		0,7	1,0	0,6	0,3
-Employment						
Registered unemployed as %	8,4	8,4	8,5	8,1	8,1	8,2
or the civilian labour forceh)	0,4	,,,				
-Current balance as %	0,7	1,3	2,4	4,1	3,7	3,2
or GDP	7,9	7,8	6,9		5,7	5,7
-Long term interest rate	7,0	4,6	4,5	7,8	6,9	5,9
-Money supply ¹)	7,0	4,0	7,5	,		
-Net lending or borrowing	2 5	-1.9	-1,1	-1,2	-1,6	-2,0
or general government	-2,5	-1,9	-1,1	1,2	-,-	
as % or GDP						
-Total public authority			2.1	-2,2	-2,6	-2.9
cash dericit as % of GDPK)	-3,3	-2,6				45,2
Public debt as % of GDP	40,9	41,8	42,5	42,0	45,0	75,2
Public debt interest				2.0	2,9	2,9
	3,0	3,0	3,0	3,0	4.9	4,7

a) Forecasts of the Commission services, April-May 1987, on the basis of present policies

b) Differences in percentage points

c) Derlated by : A - GDP derlator; B - private consumption derlator

d) Gross value added per occupied person in the whole economy

e) Ratio of real wages per head to productivity

t) Net operating surplus relative to net capital stock at current replacement cost

⁸⁾ Etrective exchange rate (vis-à-vis 19 industrial countries) on the basis of unit labour costs for the whole economy; positive figure = loss of competitiveness

h) EUROSTAT definition

¹⁾ Central Bank Money Stock, Q4 over Q4

K) Territorial Authorities and special Federal funds; rinancial statistics concept.

All in all, the outlook for economic development in the Federal Republic in 1988 do not appear fully satisfactory — notably since no further reduction in unemployment is to be expected. Judging from past experience, a recovery in the trend of exports, as seen from mid-1987, will with a certain lag lead to a general upturn in the domestic growth leading ultimately to a further reduction of the external surplus. However, should economic growth significantly loose momentum, it would be desirable to reconsider the stance of budgetary policy not only with a view to prevent a further deterioration of the labour market but also to avoid a slowdown of the process of renewing productive capacity. This could lead to a certain deterioration of the budget position but should not affect the credibility of the policy of budgetary stabilisation, particularly if monetary policy remains consistent with the growth of productive potential.

inflation rate and excluding the effect from import prices. In addition, very moderate growth was authorized for farm incomes. The strict incomes policy produced a 10% reduction in real wages and a 7% reduction in real personal disposable income in the period 1986-1987.

However, as a result of initial doubts by private economic agents about the durability of the plan and because of speculative behaviour, private consumption contracted only slightly, entailing a sharp drop in the personal savings ratio, helped especially by the very high degree of liquidity in the personal sector. The public sector net borrowing requirement was reduced from 17,6% of GDP in 1985 to 13,7% in 1986, partly as a result of an increase in the taxation of oil products which offset the fall in oil prices. In 1987, a further reduction to 12% of GDP is likely, but this level is higher than the objective set in the context of the programme.

This development, together with a volume of sales of treasury bills and medium-term paper that fell short of expectations, caused the domestic credit expansion target to be exceeded even though bank lending to the private sector was generally within the rates envisaged. Consumer price inflation, after fluctuating around 20% for a number of years but rising to 25% at the end of 1985, was cut to 17% in 1986. The rate is expected to fall by approaching three percentage points on a year-end basis in 1987 despite the inflationary effect caused by the introduction of VAT.

The curtailment of domestic demand and the lower oil bill were very beneficial to the balance of payments on current account, which showed a deficit of 9,8% of GDP in 1985, 4,3% in 1986 and 3,1% in 1987. The current account deficit in 1986, at USD 1,7 billion, is formally in line with the target set in connection with the Community loan, but the deficit for 1987, while lower than in 1986, is likely to be somewhat higher than the target.

GREECE

In Greece, the year 1987 has seen further progress stabilization, even though it has not been possible for all the targets initially set to be complied with. The deficit on current account narrowed further as domestic demand and GDP contracted; the public sector deficit as a proportion of GDP fell again and the monetary aggregates expanded less than in 1986. Inflation showed a downward trend, while unemployment remained unchanged, the fall in total employment being offset by a similar decline in the labour In 1988, activity will tend to return to positive growth. Both consumption in volume and the savings ratio of households are likely to steady and investment will continue to rise, leading to a real growth of demand and output. Prices should rise at a slower rate after having been affected by exceptional factors in 1987, but the public sector deficit will only narrow if additional measures are taken, while no appreciable improvement is likely in the current account of the balance of payments.

The end of 1987 is the official date for the completion of the stabilization plan. Adopted at the end of 1985, this plan was designed to achieve a rapid improvement in the balance of payments through a deliberate cutback of domestic demand, in order to stabilize the level of the external debt from 1988 onwards. The plan was supported by the Community authorities which granted a balance of payments loan for the purpose. The objectives involved reducing the rate of inflation to 10% by the end of 1987, cutting the public sector net borrowing requirement by 8% of GDP over two years and limiting domestic credit expansion to 17% in 1986 and 11% in 1987.

Wage policy, the key instrument for restraining domestic demand, was based on a system of degressive indexation focused on a targeted

GREECE

The country's productive capacity has been considerably weakened as a result, so that continued efforts need to be made in 1988 to contain the pressure of domestic demand and thereby avoid a deterioration in the balance of payments. However, in view of the scale of the adjustment of real wage incomes in the past two years, wage policy can no longer be the main instrument for managing demand. Wage negotiations should take account of a rate of inflation that is consistent with the macroeconomic objectives pursued, while the degressive structure of wage rises will gradually have to be abandoned, as this has produced a levelling of incomes that is not conducive to productivity growth. Overall, this policy might be consistent with a slight increase in real wages in the course of the year.

In these circumstances reducing the public sector deficit will have to be the prime instrument of demand management. It will be difficult to apply, especially since the social security deficit is tending to increase, while income policy will not contribute to the moderation of the public sector wage bill to the same extent as in the previous two years and certain exceptional receipts will no longer accrue. essential changes in legislation should be made rapidly : in particular, reorganizing the pensions system, widening the tax base through fuller taxation of certain categories of tax payer, and containing the wage and salary bill in the public service through a ban on new recruitment and restriction of wage and salary increases below the average in the economy. Alongside the dismantling of export subsidies which began in 1987, agricultural subsidies, which again rose significantly in 1987, will need to be cut. Rationalization of the management of public enterprises and agencies should help to reduce both the budget transfers to them and their own deficits.

Substantial progress has been made in reforming the financial system. Preferential interest rates for certain categories of operator have been abolished. The general level of interest rates, which previously had been lower than the rate of inflation, has been raised and commercial banks have been granted a degree of freedom in fixing their lending rates. The strict administrative rules and regulations governing the administration of credit have been made more flexible and efforts have been made to place treasury bills and medium-term paper with private non-banks. Continuation of these efforts, together with the creation of an efficient non-bank financial market, should facilitate the implementation of monetary policy and contribute to the modernization of the financial system, which is essential for the development of the country.

For a humber of years the public sector in Greece has been expanding repidly with a significant increase in the public debt. Getting the current officits in the central government budget under control is dearly, priority, but the deficit of the social security system reison. The rapid deterioration in this field is described the properties of the beginning of the 1980s, of substing the control of the social security period to the social security security period to the social security period to the social security security period to the social security security period to the social security security security period to the social security sec

Coductive investment, brought about with a since the end of 1985 the Ding out price controls; combined Coosts and a consistent exchange course a significant improvement in the course is expected to lead to a significant, although initially into the structure of their

Greece : Main economic aggregates	es 1983-1988 - Annual % changes					
	1983				1987 ^a)	1988a)
-Gross) value	20,3	23,0	19,6	20,6	15,8	12,2
domestic) volume	0,3	2,6	2,1	1,3	-0,8	0,5
product) deflator	19,9	19,9	17,1	19,0	16,7	11,6
-Private consumption						
deflator	18,6	18,0	18,4	22,1	16,0	12,0
-Gross fixed) private			-			•
capital) public		.				
formation) total	-1,9	-4,7	3,4	-4,8	-2,0	3,7
volume of: construction	3,9	-7,7	2,6	-3,4	-5,5	3,7
which equipment	-8,2	-0,9	4,4	-6,5	2,2	3,8
-Domestic demand at constant						
prices	-0,7	0,8	4,9	-0,3	-0,6	0,3
Gap with respect to						
Community countries b)	-0,4	-2,5	3,0	-4,5	-3,4	-2,2
-Compensation) nominal	21,8	22,6	20,4	13,7	12,5	12,0
of employees) real A C)	1,5	2,3	2,8	-4,5	-3,6	0,4
per head) B C)	2,7	3,9	1,7	-6,9	-3,0	0,0
-Productivity d)	-0,1	2,9	1,0	0,3	0,1	0,2
Real unit labour costs	1,6	-0,6	1,9	-4,7	-3,7	0,2
Competitiveness ^e)	-3,4	1,4	-2,1	-13,6	-2,9	-3,5
-Employment	-1,0		1,1	0,3	0,1	0,2
Registered unemployed as %						
of the civilian labour	7,9	8,1	7,8	7,4	7,4	7,5
force f)						
-Current balance as %						
	-4,7	-4,1	-8,2	-5,4		-4,1
of GDP	18,2	18,5	15,6	15,8	17,3	16,0
-Long term interest rate -Money supply 8)	20,3	29,4	26,7	18,5	17,3	11,7
-Money supply 6) -Net lending or borrowing						
requirement of general	-8,9	-10,1	-13,6	-10,7	-10,6	-9,8
government as % of GDP		The state of the				
Public debt as % of GDP	44,3	53,2	62,6	64,3	65,4	67,2
Public debt interest	Up All Files					
	3.4	4.6	5,4	5,9	6,5	6,9
as % of GDP						

a) Forecasts of the Commission services, September 1987.

b) Differences in percentage points

c) A: GDP deflator; B: private consumption deflator

d) Gross value added per occupied person in the whole economy

e) Effective exchange rate (vis-à-vis 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive figure = loss of competitiveness.

f) EUROSTAT definition

g) End of year

In view of the medium term public finance objectives and in order to stabilize the external debt in 1988, budgetary policy for the coming year should aim at making up the slippage from target recorded in 1987 and also at achieving substantial additional progress in reducing the public sector net borrowing requirement as a percentage of GDP. An active monetary policy seeking a further deceleration in domestic credit expansion should accompany this restrictive stance. In these circumstances, domestic demand would decline further, the inflation rate would fall below 10% by the end of 1988 and the deficit on current account of the balance of payments should narrow to about 2% of GDP.

The current account surplus will probably go on shrinking and show a moderate deficit (1/2% of GDP) as a result of the buoyancy of imports, which is attributable mainly to the continuing wide difference between the growth of domestic demand in Spain and elsewhere in the Community. Employment growth, while slower, will still be significant at a rate of 1.7% whereas the unemployment rate is expected to decline only slightly because of the strong growth of the labour force. The disinflation process is likely to continue despite a somewhat faster increase in import prices.

The Governments' economic policy, which has been broadly unchanged since 1983, remains consistent with the guidelines of the cooperative growth strategy for more employment. Its main focus is the elimination of the macroeconomic disequilibria – of which unemployment is clearly the most worrying – and the modernization of the structures of production, the need for which has grown as Spain is rapidly opening up its economy to the outside world. In the medium term, this policy seeks to achieve average real economic growth of 3 1/2-4% a year, underpinned mainly by buoyant investment and exports, a reduction of the order of half a percentage point of GDP per year in the general government borrowing requirement, and convergence of the rate of inflation towards the Community average. The gap between per capita incomes in Spain and the most prosperous countries in the Community could thus go on narrowing.

Major progress was already made in 1986 and 1987 in implementing the growth strategy for more employment, the most positive aspect clearly being the upturn in productive investment. With profit margins being rebuilt and the economic environment improving, businesses have demonstrated their willingness to modernize production equipment and take up the challenge of Community membership, arising not only in the form of the dismantling of barriers as provided for in the Accession Treaty but also in that of the completion of the internal market by 1992. The strong growth in employment was likewise a positive result and confirmation of cyclical buoyancy and renewed business confidence: non-agricultural employment is likely to increase by 3.3% in 1987 and 2.4% in 1988, although much of this will be in the form of part-time

SPAIN

In 1987 Spain will again see higher economic growth than the other member countries, with domestic demand expanding a good deal more rapidly than in the rest of the Community. Real gross domestic product will increase by over 4%. Private consumption has been stimulated not only by real wage increases in the private sector but also by the sharp increase in non-agricultural employment. The very strong expansion of fixed investment continued, reflecting the continuing favourable trend of company profits, positive sales prospects and the need for modernization of productive equipment in the face of increasingly strong competition from abroad following the country's accession to the Community. Export performance, which was poor in 1986, improved gradually during the year thanks to strong demand from the other Community countries. Import growth remained very rapid and the exceptional buoyancy of domestic demand was therefore only partially reflected in the gross domestic product. Similarly, the trade deficit widened rapidly and the fall in the current account surplus was only slowed down by the rapid growth of receipts from tourism. Very good employment growth allowed the unemployment rate to fall below 21%, but its decline continues to be hampered by the sharp growth in the labour force. The fall in inflation continued, helped by the evolution of food prices, so that the official objective will probably be achieved (5%, on a twelve-month basis, for the consumer price index by the end of 1987).

The main tendencies observed in 1987 should continue in 1988, by and large; real GDP should grow by approximately 3 3/4%. Domestic demand is likely to remain buoyant but may slow down a little, with this movement apparent in both consumption and investment. In particular, following the surge in productive investment in 1986/87, the renewed fall of enterprises' financing capacity may well exert a moderating influence. Exports, moreover, are likely to slow down slightly, notwithstanding some improvement in markets.

SPAIN

increase in the spring, the level of short-term interest rates declined a little after the summer, but this still leaves them relatively high. What is more, long-term interest rates have been affected by this movement even though inflationary expectations remain favourable. This means that putting interest rates back on a downward path requires an appropriate mix of budget management and monetary policy geared to disinflation.

For employment to go on improving, there is a need for strong and indeed faster economic growth, with the emphasis on productive investment and exports. Economic policy must give priority to the moderation of wage costs, not only because of the scale of the imbalances on the labour market but also in order to reduce inflation and improve the competitiveness of the economy. Excessive wage increases would in particular lead to an unduly sharp upsurge in private consumption, sucking in even more imports.

In a medium-term context, the current account balance may well become an increasigly severe constraint: even on an optimistic view of the modernization of the capital stock, domestic supply will for years to come remain insufficient to counteract the combined effects of an increase in the rate of import penetration caused by the buoyancy of the economy and a growth rate of intra-community trade that is lower than would result from general application of the cooperative strategy for more employment. Imports must therefore be expected to grow more rapidly than exports and the trade deficit to continue to widen. Even if the trend of the balance on invisible transactions is likely to provide partial compensation, the authorities must take care to ensure that the deterioration in net borrowing of the nation does not place an excessive burden on enterprises. The general government deficit must therefore be reduced to a level well below 5% of GDP in 1988 so as to free extra financial resources for strong growth in productive investment.

or temporary work contracts. With the activity rate and the female labour force participation rate relatively low, the positive employment trend has prompted many "discouraged workers" to enter the labour market. As a result, the labour force is growing a good deal more rapidly than the population of working age. In the circumstances, employment will need to rise strongly over many years if the level of unemployment is to come down significantly.

Following the breakdown of the social dialogue in early 1987 the Government, in an effort to secure greater industrial peace and rule out the risk of wages getting out of control in the years ahead, took the initiative in the summer of proposing the conclusion of a new social pact for the remaining period of the current Parliament (1988-90). Although conclusion of such a pact has come up against difficulties, consultations as wide-ranging as possible should be held, not only on the evolution of wages and salaries and working conditions, but also on the economic and social strategy for the medium term.

The drive to reduce the general government borrowing requirement should help to cut it from 5.7% of GDP in 1986 to 5.0% in 1987 and 4.9% in 1988. On the revenue side, maintenance of the main direct tax rates and scales in 1987 and greater efficiency in collection will probably produce a significant measure of fiscal drag. On the expenditure side, targets have been widely missed in 1987 despite the moderation in subsidies to public enterprises. There will therefore have to be effective control of expenditure in 1988 if the general government borrowing requirement is to be reduced and any room created for lower direct taxes and social security contributions.

Monetary policy had to deal with some strains in the first half of 1987 as the growth of private sector liquid assets (ALP) was largely in excess of objectives. This overshooting was due to strong loan demand from the private sector since the second quarter of 1986, and more recently to the upsurge in monetary financing by the public sector and an increase in the external counterpart. Following a sharp

FRANCE

Given that the international economic environment is turning out less favourable in 1987 than was expected in the autumn of 1986, it has been more difficult to achieve the objectives for growth and employment set by the Government that took office following the The growth of gross domestic product, elections of March 1986. estimated at 1,2% in real terms for 1987 as a whole, was entirely based on the expansion of domestic demand, the external balance making a negative contribution. Despite some downward revision of investment intentions due to the deterioration of the international environment, productive investment was the most dynamic component of demand, expanding considerably in distributive trades and private industry, although it contracted in the large national corporations and in agriculture. As investment by households rose by some 2% in real terms and as general government investment was also up, gross fixed capital formation as a whole rose only slightly less than the 3% recorded last year. Private consumption, on the other hand, lost momentum, mainly because of the slower increase in wage incomes. Thus, the rate of growth of real domestic demand slowed down markedly, from 3,5% in 1986 to 2,2% in 1987.

The rise in consumer prices remained fairly moderate: the annual average rate was virtually unchanged from 1986. The downward pull of import prices was almost imperceptible, but the rise of domestic costs began to slowdown.



SPAIN : Main economic aggregates	: 1983-1988 -	Annual	% chang	ges		
	1983	1984	1985	1986ª)	1987 ^b)	1988b)
-Gross) value	13,6	13,0	10,9	15,1	10,0	7,9
domestic) volume	1,8	1,9	2,1	3,5	4,1	3,7
product) deflator	11,6	10,9	8,6	11,2	5,7	4,1
-Private consumption						
deflator	12,4		8,3		5,4	4,2
-Gross fixed) private	-2,1	-7,2	0,8	14,1	12,5	9,4
capital) public	-5,2	8,5	20,7	2,1	12,5	7,2
formation) total	-2,5	-5,1	3,9	11,9	12,5	9,0
volume of: construction	-2,0	-5,4	2,0	6,9	9,4	6,9
which equipment	-3,5	-4,6	7,1	20,2	17,0	12,0
-Domestic demand at constant						
prices	0,3	0,0	2,3	6,5	6,2	4,8
Gap with respect to						
Community countries ^c)	-1,2	-2,3	0,5	3,0	3,4	2,5
-Compensation) nominal	16,0	10,1	9,9	8,7	6,5	5,3
of employees) real A ^d)	3,9	-0,7	1,2	-2,3	0,8	1,1
per head) Bd)	3,2	-0,7	1,4	-0,1	1,0	1,0
-Productivitye)	2,8	3,9	3,3	1,5	1,7	1,9
Real unit labour costs	1,0	-4,4	-2,1	-3,7	-0,9	-0,8
Competitiveness ^f)	-12,1	0,6	0,2	3,2	0,9	-0,1
-Employment	-1,0	-2,0	-1,2		2,4	1,7
Registered unemployed as %						A STATE OF
of the civilian labour						
force8)	18,7	20,7	22,0	21,6	20,8	20,5
-Current balance as %						
of GDP8)	-1,5	1,3	1,7	2,0	0,6	-0,4
-Long term interest rate	16,9	16,5	13,4	11,4	12,7	12,3
-Money supplyh)	16,0	13,3	12,9	12,2	12,0	10,0
-Net lending or borrowing						
requirement of general						
government as % of GDP	-4,8	-5,5				-4,9
Public debt as % of GDP	34,5	41,2	46,5	47,3	49,2	51,6
Public debt interest						
as % of GDP	1,3	2,0	3,4	3,9	3,7	3,7

a) Estimates of the Commission services, September 1987.

b) Forecasts of the Commission services, September 1987.

c) Differences in percentage points

d) A: GDP deflator; B: private consumption deflator

e) Gross value added per occupied person in the whole economy

f) Effective exchange rate (vis-à-vis 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive figure = loss of competitiveness.

g) EUROSTAT definition

h) End of year.

The macro-economic conditions for an appreciable increase in employment continue to be fragile, however, since the expansion of activity is still being hampered by the external constraint and subject to the achievement of greater flexibility in the French economy.

The slowdown in domestic costs deriving from wage restraint and, to a lesser extent, the realignment of January 1987 led to gains in European market shares that partially offset losses on markets outside the Community. It is important to maintain the trend towards real wage moderation in 1988, so that French exports can continue to benefit from an improvement in price competitiveness, and so that the rate of penetration on the French market, in particular for consumer goods, can at least be stabilized.

On the supply side, the authorities have continued their efforts to stimulate the adaptability of the economy. In 1986, their efforts mainly concerned the labour market, e.g. by adaptation of working time arrangements and conditions of dismissal; in 1987, the authorities concentrated on liberalizing capital movements and foreign exchange, and on improving the flexibility of the money market, as well as removing the last remaining price controls. All these measures should contribute to greater adaptability to the changing conditions of demand, and should improve competitiveness. They should be an incentive to more intense investment activity.

The authorities have earmarked about three quarters of the revenue originally expected from privatization for the reimbursement of the public debt; the remaining quarter is to be used as endowment of capital to public sector enterprises. Receipts in excess of the forecasts, some 20 billion francs, will be distributed in similar proportions as between debt reimbursement and supply of capital to public enterprises. In this way will be brought to an end the financial rehabilitation and the reduction of the level of debt of these enterprises.

Assuming no notable change in the real exchange rate, but allowing for a slightly higher expansion of export markets than in 1987, shipments to abroad in 1988 should give the French economy a stronger boost. Domestic demand, on the other hand, may only strengthen slightly. The improvement in rates of return will underpin investment in plant and machinery, while residential building might continue to increase moderately. On the other hand, even though disinflation is likely to progress in 1988, private consumption will hardly expand by more than 1,7% in real terms since households' incomes, especially overall wage incomes, are rising only modestly.

In view of the fairly high rate of penetration on the French market, imports are likely to progress in parallel with exports. The external balance is unlikely to make much positive contribution to the growth of GDP in real terms, which might stand at about 1,5 to 2%, a rate that does not hold out hope for a reduction in unemployment. Despite the rising trend of prices for oil and other raw materials, the terms of trade may improve somewhat. The balance of payments on current account (national accounts definition) will probably be in equilibrium after a slight deficit in 1987.

The problem of unemployment is still the major concern of the French authorities. Since the middle of 1986, a series of special measures have been successfully applied, in particular to combat unemployment among young people and long-term unemployment; they include the organization of sandwich courses and exemption from costs for firms recruiting new workers. The system of benefits for long-term jobseekers has been improved, through elimination of the hiatus between exhaustion of entitlement to unemployment insurance benefits and eligibility for State benefits.

markets exercised by the Treasury: if, as expected, that drain is limited, conditions conducive to a fairly steady reduction in real interest rates would be created.

Control of public finances is vital not only from this point of view but also to contain domestic demand within limits compatible with external equilibrium. The Government's aim is to balance, by 1989, the central government budget net of interest payments, i.e. to achieve a deficit equivalent to about 2% of gross domestic product; budgetary policy intentions for 1988 are consistent with this line. As the Government has also committed itself to reducing the tax burden on firms and households (including the reduction of VAT on certain products) in 1988 by about 30 billion francs (some 0,5% of GDP), the increase in public expenditure will have to be limited to about 2% in cash terms. Savings will be made mainly on operating expenditure and subsidies to public sector firms. The net central government borrowing requirement might thus not exceed FF 115 billion. Moreover, the equilibrium of social security accounts might require further efforts to complement the measures taken in May 1987, implying an increase in social security contributions and a plan to streamline expenditure on health. As wage moderation and widespread unemployment place a damper on revenue while the rise in benefits continues, further pressure is put on the financial situation of the social security funds.

The stance of the public finances as a whole seems consistent with the requirements of the present situation and outlook. However, if present forecasts for the world economy turned out to be less favourable than currently envisaged, there would be grounds for reconsidering the stance of budgetary policy, in particular in respect of assessing to what extent it would be appropriate to allow the automatic stabilizers to work.

Monetary policy should also contribute to the expansion of productive investment through the reduction in nominal and real interest rates. It should henceforth be possible to pursue this aim using a strategy more consistent with market forces. From 1 January 1987, credit controls were discontinued and replaced by the use of interest rates as the main regulatory factor. Exchange controls were relaxed in several stages. By harmonizing the maturities Treasury bills with those of commercial paper issued by firms (billets de trésorerie) and negotiable deposit certificates issued by banks, the authorities have decompartmentalized the market in these securities, thus making it more active. Henceforth, firm's borrowing costs will be determined by conditions on the money market rather than by commercial banks' base rates.

This package of measures can influence the behaviour of the monetary aggregates and establish a more direct link with the interest rates applied on international markets. Thus, following increased demand for certificates of deposit, the growth of M3 has tended in 1987 (figures at end July 1987) to increase faster than the upper limit on the monetary authorities' target range, while M1 and M2 developed more slowly than expected. After a sudden spurt immediately prior to the realignment of 12 January 1987, interest rates subsequently gradually declined.

For 1988, the monetary authorities could choose rates of expansion for the monetary aggregates close to the rate of increase in nominal national income. The favourable development of the inflation rate, which is tending to align itself on that of other Community countries such as Germany and the Netherlands, and the consequent decline in inflationary expectations, could contribute to a sharper decline in both short-term and long-term interest rates. The extent of the decline should be determined in particular by the drain on financial

IRELAND

In Ireland, economic recovery is proceeding in 1987 at a slow but steady pace. Despite the appreciable tightening of an already restrictive budgetary stance, real GDP should rise by over 2% this year after zero growth in 1986. Private consumption continues to expand moderately, but aggregate investment has developed unevenly. While reductions in domestic interest rates are supporting investment in plant and equipment, performance in the construction sector remains depressed by talling demand for private housing and reduced public sector activity. On the trade side, export volumes have risen sharply this year and a substantial trade surplus has emerged as imports have developed more slowly. Consumer price intlation is expected to average 3% in 1987, the lowest rate since the 1960's, helped by low import and wholesale prices and the lagged impact of the 1986 oil price reductions. The Irish pound's exchange rate against the currencies of major trading partners has remained stable throughout most of the year, while the significant easing in domestic interest rates is occurring in response to the determined budgetary policy and developments on international money markets. The unemployment rate, however, has continued to edge upwards in the absence of significant growth in total employment.

Economic growth should continue in 1988, albeit at a modest rate in the context of a further sharp budgetary contraction. The slow upward trend in private consumption may continue, while the improvement in business confidence inspired by further progress in reducing the

cance : Main economic aggregates 1983-1988 - Annual % changes							
	1983	1984	1985	1986	1987a)	1988a	
-Gross) value	10,5	8,9	7,5	6,9	4,5	4,6	
domestic) volume	0,7	1,4	1,7		1,2	1,9	
product) deflator	9,7	7,5			3,3	2,6	
-Private consumption							
deflator	9,7	7,5	5,7	2,5	3,1	2,6	
-Gross fixed) private	-3,6	-2,4	0,2	2,1	2,3	2,8	
capital) public	-3,6	-1,6	6,2	7,6	1,4	2,0	
formation) total	-3,6	-2,3	1,1	3,0	2,2	2,7	
volume of: construction	-2,9	-3,4			1,8	2,3	
which equipment	-4,1	-1,4		4,3		3,0	
-Domestic demand at constant			1113/194				
prices	-0,4	0,6	2,2	3,5	2,2	2,0	
Gap with respect to						-,0	
Community countriesb)	-1,7	-1,6	-0,3	0,0	-0,7	-0,5	
-Compensation) nominal	10,1	8,6	6,7	4,0	3,0	3,5	
of employees) real AC)	0,4	1,0	0,9	-0,8	-0,3	0,9	
per head) BC)	0,4	1,0		1,5	-0,1	0,9	
·Productivity ^d)	1,3	2,5	2,0	1,7	1,4	1,9	
Real unit labour costs	-0,9	-1,5	-1,1	-2,5	-1,7	-1,0	
Rates of returne)	3,2	16,9	5,8	13,5		1,5	
idem (1970=100)	52,2			73,3		75,5	
Competitiveness ^f)	-2,9		1,7		-0,5	-1,5	
Employment	-0,6	-1,0	-0,3	0,3	-0,2	0,0	
Registered unemployed as %				,,,	,,,	0,0	
of the civilian labour							
force ^g)	8,8	9,9	10,3	10,5	10,7	11,0	
Current balance as %					,	11,0	
of GDPh)	-0.9	-0,1	0,0	0,6	0,0	0,0	
Long term interest rate	14,4	13,4	10,9	8,4	9,0	8,5	
Money supply ¹)	11,2		5,6	4,4	6,3	6,0	
Net lending or borrowing			,,,	,,,	,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,	0,0	
requirement of general	-3,2	-2,7	-2,9	-2,9	-2,8	-2,3	
government as % of GDP			-,,	-,,	2,0	2,5	
Public debt as % of GDP	30,7	32,9	35,2	37,0	38,9	40,3	
Public debt interest	30,,	,,,	33,2	37,0	50,5	40,5	
as % of GDP	2,6	2,8	2,8	2,8	2,8	2,7	

a) Forecasts fo the Commission services.

b) Differences in percentage points

c) A: GDP deflator; B: private consumption deflator

d) Gross value added per occupied person in the whole economy

e) Net operating surplus on the net capital stock of current replacement cost f) Effective exchange rate (vis-à-vis 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive figure = loss of competitiveness.

g) EUROSTAT definition

h) On the basis of national accounts definitions. The corresponding figures on the basis of Bank of France definitions (current balance of payments) are as follows: 1981 1982 1983 1984 1985 1986 1987 -0,8 -2,2-0,9 -0,20 0,5 0,0

i) End of year

training, greater emphasis needs to be given to the development or management and marketing skills in order to support the parallel efforts being made to expand export-based industry and services.

Budgetary policy in 1987 has been characterised by a relatively large riscal contraction. As a percentage of GDP, the Exchequer Borrowing Requirement is expected to fall by some 2% to under 10%. The Current Budget Dericit should fall by more than 1% of GDP. The adjustment in the public finances is being achieved through cutting or deterring capital expenditure, miscellaneous savings in the provision of services and a tight control on increases in the Exchequer wage bill. Indeed, wage moderation throughout the public sector is a key element of the budgetary strategy as a means to control State expenditure and encourage more moderate wage demands in other sectors of the economy. In this, as in many other areas, budgetary policy has been broadly successful in 1987 and has facilitated a sustained decline in real domestic interest rates, which began the year at over 10% at the short end.

Persistent imbalances in the public finances are imposing a serious constraint on economic growth through high interest rates, heavy taxation and the diversion of public funds into debt-servicing and away from more productive uses, and significant budgetary adjustments are required over a period of years. Stabilisation of the public debt/GDP ratio, on the basis of reasible medium-term growth and interest rate assumptions, would require a reduction of the Exchequer Borrowing Requirement to about 5-6% of GDP. This implies further substantial real reductions in non-interest expenditure over the coming years.

budget deficit should help to stimulate private investment. Continued low price intlation and the likelihood of a sustained reduction in domestic interest rates will help maintain the present level of competitiveness or the export sector and, while import volumes should rise in phase with consumer demand, another healthy trade balance is probable. Growth in GDP is expected to be about 1 1/4% in real terms in 1988. This may be sufficient to entail some expansion of private sector employment outside of agriculture, which could help to contain the upward drift in the unemployment rate.

The public finances and unemployment are undoubtedly the major structural problems tacing the economy. While recent demographic developments, including emigration trends, have offset the strong underlying growth in the labour supply, no significant reduction in unemployment can be expected without sustained growth in employment. This in turn will depend on a stronger performance by the economy in general. The re-establishment of a favourable environment for growth through further budgetary adjustment is thus an essential precondition for progress in reducing unemployment. In addition, to ensure that growth has a high employment content, more attention must be given to the supply side of the economy, where greater flexibility is desirable. Changes in the wage formation process in the early part or this decade has promoted a more flexible and cost-sensitive evolution of wages, but there are other areas of the labour market - working patterns, protective legislation, administrative costs of employment which could also be examined. Meanwhile, moderation in wages is essential to protect existing levels or employment. Training and marginal employment schemes remain an important short-term response to the difficulties in the labour market. In the context of vocational

IRELAND : Main economic aggregates,	1983-1988			Annual % changes			
	1983	1984	1985	1986ª)	1987 ^b)	1988 ^b)	
-Gross) value	9,7	11,1	6,1			4,1	
domestic) volume	-0,6	3,2	1,1	-0,3		1,3	
product) detlator	10,3	7,7	5,0	5,7	2,9	2,7	
-Private consumption							
detlator	8,6	9,4	4,5	3,6	3,0	3,2	
-Gross tixed) private	•		4,7		5,3	6,8	
capital) public			-5,2		-8,0	-6,5	
formation) total	-9,0	-2,4	-4,4	-2,3	-0,7	1,0	
volume of construction	-14,4	-3,9	-9,6	-5,3		-4,1	
which: equipment	-2,3	-0,9	0,9	0,3	3,0	5,0	
-Domestic demand at constant prices	-2,9	0,2	-1,3	0,8	0,0	0,2	
Gap with respect to other							
Community countriesc)	-2,9	-1,7	-3,6	-2,9	-2,8	-2,3	
-Compensation) nominal	11,9	11,8	6,5	6,1	6,1	4,9	
or employees) reald)A	-1,4	3,8	1,4	0,4	3,1	2,1	
per head) B	3,0	2,2	1,9	2,4	3,0	1,6	
-Productivitye)	0,0	6,2	4,6	0,1	2,8	1,1	
Real unit labour costst)	-0,2	-0,5	-2,3	0,3	0,3	0,9	
Competitiveness8)	2,4	-2,2	-0,2	7,4	-2,1	0,8	
-Employment	-1,9	-1,9	-2,2	-0,4	-0,3	0,2	
Registered unemployed as %							
of the civilian labour forceh)	14,9	16,6	17,9	18,4	18,5	18,2	
-Current balance as %							
or GDP	-6,3	-5,5	-3,2	-1,8	-1,1	-0,3	
-Long term interest rate	13,9	14,6	12,6	11,1	11,3	10,5	
-Money supply1)	5,6	10,1	5,3	-1,0	9,3	6,4	
-Net lending or borrowing							
or general government							
as % or GDP	-11,8	-9,7	-11,4	-11,2	-10,0	-7,5	
Public debt as % of GDP			117,9		136,0	138,0	
Public debt interest							
as % or GDP	9,1	9,6	10,6	10,9	10,3	10,2	

a) Estimates or the Commission services, September 1987

b) Forecasts of the Commission services, September 1987, on the basis of present policies

c) Differences in percentage points

d) Derlated by : A - GDP derlator; B - private consumption derlator

e) Gross value added per occupied person in the whole economy

f) Ratio of real wages per nead to productivity

⁸⁾ Errective exchange rate (vis-à-vis 19 industrial countries) on the basis or unit labour costs for the whole economy; positive figure = loss or competitiveness

h) EUROSTAT derinition

¹⁾ M3; end or year

In 1988, therefore, budgetary policy must continue to be restrictive; it would be appropriate to achieve another staged reduction in the Exchequer Borrowing Requirement of at least 1 1/2 percentage points of GDP from the expected outturn for this year. This stance should be consistent with continued real GDP growth in 1988. This rinancial constraint precludes any reduction in the overall burden of taxation in 1988, although the budgetary authorities should be considering possible options to widen the tax base and rationalise the tax structure in future years. In deciding on possible cuts in public expenditure it seems appropriate to concentrate on those areas where savings are also possible in the medium term. An obvious area for consideration is the Exchequer wage bill where further control can yield significant savings. In view of the difficult employment conditions, wage moderation in the economy as a whole is a crucial tactor in order to maintain competitiveness and to restore a healthy growth process sustained by the development or investment exports. The expansion of social transfers should also be limited and greater emphasis placed on a more effective matching of benefits with needs.

conditions, and assuming no change in the terms of trade, the balance of payments on current account should show only a fairly small deficit. The unemployment rate is unlikely to change much compared with 1987.

Some slowing in inflation during the course of 1988 seems likely because of the inclusion in the new collective agreements of a commitment that no wage increases will be granted beyond those already settled, taking into account also the restrictive nature of monetary policy. The extent of the slowdown in prices is still uncertain, however. The Government's target of 4,5% inflation on average for 1988 presupposes some deceleration in prices during the year (by about one percentage point from January to December), but this does not appear absolutely guaranteed, given the trend in productivity and the development of the public finances, especially in regard to expenditure.

Indeed, budgetary policy still faces the structural problem inherent in the size of the deficit and the persistent upward trend in the public debt. On the basis of the revised national accounts (1) the debt/GDP ratio has now reached 90%. The medium-term plan approved in June 1986 aimed at stabilizing this ratio by 1990, by eliminating the deficit net of interest, without changing the level of taxation, and by keeping debt servicing costs at about 6% of GDP. This would lead to a reduction of almost half in the Treasury deficit as a percentage of GDP compared with the level reached in 1986, subject to real growth averaging about 3,5% from now to 1990 and the inflation rate coming down to 3% from 1988. However, the weaker-than-expected development of economic activity and the trend in real interest rates since the end of 1986 required an updating of these projections. The new

⁽¹⁾ Revised national accounts published in 1987 raised GDP by 17,7% in 1986, which automatically reduced the relative size, as a percentage of GDP, of a series of budget indicators (public debt, borrowing requirement, burden of taxation, etc.).

ITALY

In Italy, a rapid expansion of domestic demand and imports has resulted in 1987 from the delayed effects of the reverse oil shock, from the wage increases agreed at the beginning of the year within the framework of the three-yearly collective negotiations and from some acceleration in the pace of public expenditure. The strength of demand has exerted downward pressure on the trade balance, leading the authorities, soon after the formation of the new government following the early elections on 15 June, to tighten monetary policy and take a series of tax measures, in order to restrain household consumption and avoid a rekindling of inflationary expectations.

For 1987 as a whole, domestic demand will rise by over 4%, the real external balance will deteriorate three times as fast as in 1986 - due also to the weakening of exports - and the growth of GDP will be about 3%. Despite a fairly favourable year for tourism, the surplus achieved last year on current account will to a large extent disappear. The revival in inflation recorded since July is likely to continue for a period following the increases in a range of indirect taxes. Although employment increased once again in the services sector, flat export markets and some worsening in business output prospects held back industrial recruitment, and the unemployment rate continued to rise.

In 1988, some slowing in household disposable income, together with the budgetary and credit measures, should lead to a slightly less rapid growth of domestic demand. However, an acceleration of exports, which are expected to benefit from stronger growth of international markets, should allow the negative contribution to growth from the real foreign balance to be reduced significantly. In total, real GDP should grow by nearly 3%, only slightly less than in 1987. In these

TRUY

The increasingly restrictive stance of monetary policy in 1987 was made necessary by the brisk acceleration in private sector credit demand and by the overshooting of the budget target. The limits set for growth by the end of the year of the main credit aggregates (6-9%for private sector credit and 11% for total domestic credit on the basis of a Treasury deficit of LIT 100 000 billion) were exceeded during the first half of the year. The financial market situation continued to tighten during quarter, obliging the third authorities to raise interest rates on several occasions. These precautionary moves must be seen against the background of the further measures introduced in May to liberalize capital movements, abolishing the compulsory interest-free deposit required on purchases of foreign securities. The Commission was thus able, early in August 1987, to abrogate the authorization granted to Italy under the safeguard clause of Article 108(3) of the EEC Treaty. However, with capital outflows growing in scale during the summer, and since part of domestic credit seems to have been used for such operations, and also for other short-term transactions, the monetary authorities have recently reintroduced measures restricting bank credit. The potential risks attaching to domestic and external equilibrium make a moderating stance desirable for monetary policy in 1988. It would be advisable to retain indicative rates of expansion for the main aggregates compatible with nominal GDP growth close to 7 1/2%.

The reform of wage indexation and the wage rises foreseen in the next few years at branch level are liable to encourage a gradual slowdown in prices, providing there are no wage increases other than those already planned; but rapid disinflation seems unlikely without a strong expansion of investment, the only means of durably reducing external dependence and speeding up productivity gains. Business investment should become the key factor in keeping the growth of the Italian economy sufficiently rapid and healthy.

macro-economic framework foresees growth slightly above 3% per year for the period 1988 to 1990, and a continued reduction in inflation. The objective of bringing the Treasury net borrowing requirement excluding interest payments into balance in 1990 is reaffirmed, which would still imply a small increase in the public debt/GDP ratio by the end of the decade.

This objective appears ambitious, especially in the light of public finance developments in 1987 and the budget proposals for 1988 presented at the end of September. Whereas the Treasury borrowing requirement should not have been more than LIT 102 000 000 million (10,2% of GDP) in 1987, the outcome will be closer to LIT 110 000 000 million, due to the faster rate of expenditure caused by, among other factors, the implementation of the new wage agreements. In 1988 the government intends to limit the borrowing requirement to 109 500 000 million, which would hold the deficit as a percentage of GDP at about the same level as the initial objective for 1987, but still leaves a margin of 3 percentage points compared with the deficit aimed for in 1990 (about 7 1/2% of GDP). The budget proposals include a reduction in personal income tax (IRPEF) and in health insurance contributions for the self-employed and also an increase in family allowances. These various measures will be more than offset by additional revenues, especially from increases in certain indirect taxes and through a speeding up in the collection of direct taxes. Nevertheless, substantial spending cuts(1) will be necessary to limit the public deficit in 1988. This represents an important step towards achieving the budget balance targeted for 1990, which is crucial not only for equilibrium of the public finances but also for the return to lasting monetary stability.

⁽¹⁾ Not yet fully specified at the time of writing this text.

Italy : Main economic aggregat	s 1983-1988 - Annual % changes
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	1983	1984	1985	1986	1987a)	1988 ^a)
-Gross) value	15,9	14,1	11,8	11,0	8,7	7,6
domestic) volume	0,5	3,5	2,7	2,7	3,0	2,8
product) deflator	15,3	10,2	8,9	8,0	5,5	4,7
-Private consumption						, 0
deflator	14,9	11,4	9,3	6,3	4,8	4,9
-Gross fixed) private						
capital) public					2.5	2 0
formation) total	-1,6	4,4	3,3	1,2	3,5	2,8
volume of: construction	0,8	0,6	-0,5	-0,7	1,0	2,1
which equipment	-4,2	8,9	7,4	3,1	6,0	3,5
-Domestic demand at constant						
prices	-0,4	4,4	3,1	3,2	4,5	3,3
Gap with respect to						
Community countries ^b)	-1,8	3,0	1,1	-0,6	2,0	1,0
-Compensation) nominal	16,0	11,4	10,2	7,7	8,3	6,0
of employees) real AC)	0,6	1,1	1,2	-0,3	2,8	1,3
per head) BC)	1,0	-	0,8	1,4		1,1
-Productivity ^d)	0,1	3,4	1,8	1,9	3,0	2,1
Real unit labour costs	1,0	-2,6	-0,5	-0,6		-1,1
Competitiveness ^e)	11,9	2,0	3,1	10,5	7,2	2,9
-Employment	0,5	0,8	1,4	0,8	0,3	0,2
Registered unemployed as %					11.2	1/ 2
of the civilian labour	10,9	11,9	12,9	13,0	14,2	14,3
force ^f)						
-Current balance as %		Situation .		0.0	0.2	0
of GDP	0,4	-0,6				
-Long term interest rate	18,0	14,9		11,7	10,9	11,6
-Money supplyg)	13,2	12,1	11,1	9,4	8,9	6,6
-Net lending or borrowing					10 /	10 /
requirement of general	-11,0	-10,8	-12,3	-11,3	-10,4	-10,4
government as % of GDP			01.	00 (02 6	97,9
Public debt as % of GDP	72,1	77,7	84,6	88,6	93,6	97,9
Public debt interest	35 35 35		0.1	0 5	7 7	7,9
as % of GDP	7,5	7,6	8,1	8,5	7,7	1,5

a) Forecasts fo the Commission services, September 1987, on the basis of present policies

b) Differences in percentage points

c) A: GDP deflator; B: private consumption deflator
d) Gross value added per occupied person in the whole economy
e) Effective exchange rate (vis-à-vis 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive figure = loss of competitiveness.

f) EUROSTAT definition

g) End of year

An economic policy stance based on monetary strictness and flexibility of wage adjustments is certainly behind the favourable results recorded in recent years. With a view to the creation of a single market by 1992, it seems necessary to reinforce internal structures so that the opening of markets can contribute to raising the growth From this point of view, healthier public finances and freedom of capital movements are two priority objectives. The opening of capital markets should enable financial institutions to diversify investment opportunities and to increase the fluidity of financial circuits. The authorities have a special role to play in reinforcing productive capacity; this presupposes an improvement in economic infrastructure, and also a reorganisation of public sevices. In the same context, it would seem desirable to reconsider energy policy options, in view of Italy's strong dependence on imported energy, and of the risks which an increase in the oil bill would bring for the balance of payments.

The defence of the competitive capacity of the Italian economy is the key factor for continued healthy expansion and a reduction in unemployment. Although economic growth has been relatively more satisfactory in Italy over the past few years than in most of the other Community countries, it has been associated, except in 1986, with a considerable positive differential in the growth of domestic demand in relation to the rest of the Community, while the real exchange rate of the lira appreciated up to the beginning of 1987. Monetary and budgetary policies must together contribute to limiting both the rise in costs and the increase in domestic demand to an extent compatible with maintaining external equilibrium. The authorities would obviously have more margin for manoeuvre if joint action taken by the Member States managed to increase intra-Community trade.

Economic policy in the Grand Duchy corresponds, from many points of view, to the main thrust of the cooperative growth strategy for more employment. The budgetary margin for manoeuvre, resulting from the restructuring of the steel industry, is being used to reconstitute the financial resources of central government investment funds and to reinforce the competitive position of firms, in particular by reducing direct taxation on companies. Tax reductions to firms and households involved amounts equivalent to aimost 2,5% of GDP in 1987, without endangering budget equilibrium.

On the other hand, wage trends are disturbing, in view of the extreme openness of the Luxembourg economy and the need not only to improve companies' profitability but also to safeguard their competitive position. For the economy as a whole, per capita wages increased in real terms by 3,9% in 1987, and forecasts for 1988 point to a probable increase of about 2,0%, well in excess of the simultaneous increase in productivity (0,4% in 1987 and 1,2% in 1988). The accumulation of wage rises and social security charges could put a brake on possibilities of economic development in the longer term.

The policy of diversification and of restructuring the productive apparatus has not only made the economy less dependent on the steel industry, but has also enabled the creation of new jobs. Moreover, specific measures such as early retirement schemes have helped to keep the number of unemployed at a very low level. Since frontier workers and immigrant workers are increasingly being employed in a number of occupations, the authorities have developed vocational training and

LUXEMBOURG

In <u>Luxembourg</u>, economic growth weakened in 1987, and the rate of expansion of gross domestic product in real terms fell to 2%. Households' consumption was boosted by an appreciable increase in their disposable incomes, sustained among other things by tax reductions; but gross fixed capital formation in industry, which had expanded strongly in earlier years, was somewhat hesitant as demand weakened in the steel sector. Slack sales of steel products also led to a smaller rise in total exports. Imports also slowed down. The inflation rate remained moderate thanks to the decline in import prices; the rate of unemployment rose marginally.

In 1988, gross domestic product should grow by about 1,8% in real terms. In view of the decline in sales of steel, the increase in total exports will be slow. Although the rise in per capita wages snould be comparable with that of the previous year, the benefit to households of the tax reductions will be lower, and their disposable income will rise more slowly in real terms than in 1987. Private consumption is consquently expected to expand less rapidly. Corporate investment should continue on the slower trend that began in 1987, and residential construction should stabilize. The private consumption deflator could speed up markedly as a result of higher import prices. Labour shedding in the steel industry will have little effect on the unemployment rate, which is expected to decline slightly.

Luxembours : Main economic aggregates	- Annua	al % cha	anges			
	1983	1984	1985	1986a)	1987 ^b)	1988b)
-Gross) value	11,2	12,1	5,5	6,7	4,6	4,0
domestic) volume	3,2	5,5	2,9	2,5	2,0	1,8
product) deflator	7,7	6,3	2,5	4,1	2,5	2,2
-Private consumption						
deflator	8,1	6,4	3,3	0,3	0,5	2,3
-Gross fixed) private	-8,0	-0,6	2,6	5,3	2,8	1,2
capital) public	-9,0	-3,7	0,6	3,1	2,2	3,2
tormation) total	-8,3	-1,3	2,1	4,8	2,7	1,7
volume of: construction	-8,6	-3,1	1,2	3,2	3,0	1,8
which equipment	-7,5	2,5	4,0	7,9	2,0	1,5
-Domestic demand at constant						
	0,5	1,7	0,8	3,7	3,3	2,1
prices	malarities of					
Gap with respect to other		:	:	:		:
Community countries ^C)	6,9	7,0	4,1	4,0	4,4	4,2
-Compensation , nominal	-0,7	0,7	1,5	-0,2	1,8	1,9
or employees) real Ad,	-1,1	0,5	0,7	3,6	3,9	1,9
per head) Bd)	3,9	4,6	1,6	0,4	0,4	1,2
-rroductivitye)	-4,5	-3,7		-0,5	1,5	0,7
Real unit labour costs	-0,4	0,6	1,4	2,4	1,0	0,4
-Employment	-0,4	0,0	.,,			
Registered unemployed as %	1 6	1,7	1,6	1,4	1,5	1,4
of the civilian labour	1,6	1,,	1,0		-,-	
force ^f)						
-Current balance as %	20 5	20 0	41,9	40,4	38,7	37,8
of GDP	38,5	38,9	7.5	8,7	(8,2)	:
-Long term interest rate	9,8	10,3	9,5	:	:	
-Money supplyg,	:	•				
-Net lending or borrowing	0.0	2.0	1. 1.	3,9	2,8	3,1
requirement of general	0,2	2,0	4,4	3,3	2,0	3,1
government as % of GDP			11.1	1 / 7	14,7	14,8
Public debt as % of GDP	14,6	14,6	14,4	14,7	14,7	14,0
Public debt interest		T E		1 2	1 2	1,1
as % of GDP	1,0	1,2	1,3	1,3	1,3	1,1

a) Estimates of the Commission services, September 1987
b) Forecasts fo the Commission services, September 1987, on the basis of present policies

c) Differences in percentage points
d) A: GDP deflator; B: private consumption deflator

e) Gross value added per occupied person in the whole economy

¹⁾ EUROSTAT definition

^{8,} End or year

guidance to absorb the persistent hard core of unemployment. Furthermore the authorities intend to set up the legal framework necessary to allow the flexibility of the labour market to be increased by other measures, such as the reorganization of the working week and a revision of laws on Sunday working subject to the agreement of all parties involved.

In 1988, general government net lending should be slightly higher than in 1987; this should enable the resources of the public investment funds to be increased. The increase in public expenditure will not be able to offset the effects of the weakness of export demand, but the reduction in the direct taxation on businesses, granted under the 1987 and 1988 budgets, will be a further effective aid to the policy of diversifying the economic structure and the reduction in personal taxation should stimulate consumption. Nevertheless, some caution is still called for in the management of expenditure since social policy measures (early retirement, pensions, public sector wages) are sure to reduce the available budgetary margin.

should rise only slowly. Unless there is an appreciable improvement in the external environment, the volume of business investment will barely increase in 1988 and public investment should stagnate. After declining in 1987, consumer prices might rise slightly, as the effects of lower natural gas and import prices gradually fade. Despite a slight deterioration in the terms of trade, the balance of payments surplus on current account should stabilize at the 1987 level. The number of persons employed is expected to increase by about 1% partly as a result of the implementation of programmes to promote employment and training, and the extension of part-time working; the unemployment rate should consequently rall to around 11% of total labour force.

The economic policy stance adopted since the autumn of 1982, which has made possible an appreciable reduction in the public sector deficit, an increase in employment and a more flexibly operating labour market, has been confirmed by the new government which took office in July 1986. The government agreement stresses the need to reduce major imbalances – the budget deficit and the high level of unemployment – without increasing the fiscal burden and if possible reducing it and to maintain the purchasing power of households on the whole. The authorities are aiming to cut the numbers unemployed by 200 000, bringing them down to 500 000 by 1990.

On the budgetary side, the government programme provides for a reduction in the central government deficit from 8% of net national income in 1987 to 7% in 1988, 6% in 1989 and 5,25% in 1990. In view of the commitment to stabilize the burden of taxes and parafiscal charges, the burden of adjustment will fall mainly on expenditure. Substantial savings will be achieved by freezing social transfer payments, making a substantial reduction in subsidies to the private sector and cutting the numbers employed in the civil service.

NETHERLANDS

In the Netherlands, the growth of GDP in volume terms slowed down in 1987 to a rate of some 1,7% notably as a result of weaker domestic demand. As in 1986, private consumption, stimulated by a substantial increase in real personal disposable incomes, expanded by nearly 3% in volume terms, but public consumption and investment contracted. After rising strongly for a number of years, business investment and especially purchases of plant and machinery fell off appreciably while public investment declined mainly because of the completion of the large water engineering projects. While export sales of natural gas were again down on the level of the previous year, manufactured exports were relatively buoyant in spite of the large appreciation of the guilder in 1986 and 1987. The positive export result was obtained by reducing profit margins.

The number of persons employed grew by 1,4% in 1987 partly as a result of the expansion of part-time work and unemployment contracted. The trade surplus declined considerably and the balance on current transactions consequently fell from almost 3% of GDP in 1986 to 1,9% in 1987.

In 1988, the growth rate of gross domestic product, affected, as in 1987 by a declining energy production is again expected to slow down and should barely reach 1,2% in real terms. Exports of goods should increase at nearly the same rate as in 1987, but the growth of domestic demand will probably weaken markedly. The increase in personal disposable incomes will hardly reach 1,2% in real terms, in particular because of the slow rate of rise of wages. Even assuming a fall in the savings ratio by comparison with 1987, private consumption

NETTERING

differential required to support this aim might gradually narrow if expectations of price rises remain low. The propensity to invest should thus be stimulated. On the home front, monetary authorities reached an agreement with the banks at the end of 1986 under which the latter will limit creation of liquidity to 11-12% for two years. The targets for increasing the money supply set by the central bank seem appropriate to guarantee an adequate degree of liquidity for the economy, while helping to keep the rate of inflation down.

Budgetary policy, although restrictive, still involves spending considerable resources on suitable training of workers and job creation for younger and older jobseekers. In addition, decentralization of wage negotiations is continuing, and this will make it possible to adapt wages more closely to sectoral increases in productivity and hence to continue the overall moderation of real wage increases. The efforts to reduce the rigidity of the labour market operation also include a freeze on the minimum wage, which affects the range of primary incomes and which is important for the evolution of companies' wage costs because of its close link with the average wage. Insofar as the authorities have formally witdrawn from the wage determination process, the development of real labour costs will depand more on market forces and on the attitude of the two sides or industry. By lowering the tax burden on individuals the authorities contribute to the objectif of wage moderation. As productivity gains are still low, real wage rises should remain very limited so as to encourage a process of investment-led growth, which started in 1985 and 1986, but which has since tended to weaken once more.

The achievement of these aims is based on fairly favourable assumptions for the international environment, a stabilisation of the labour income share in GDP between 1986 and 1990 and an increase in employment, expressed in man-years, of over 3% during the same period accompanied by a reduction in working hours and a spread of part-time work. Any economic outturn which is less favourable than forecast would require an additional effort in order to safeguard the adjustment desired by the authorities.

Since 1983, real progress has been made in the consolidation of public finances, making it possible to reduce the net general government deficit; however, the international environment and the loss of non-tax revenue in 1986 and 1987 imposed a halt on the advance towards the multiannual targets. In 1988, the main thrust of budgetary policy is unlikely to be very different from that applied at present, which is mainly geared to containing expenditure.

Higher than forecast growth in tax revenue led the authorities to reduce the level of taxation on personal income by HFL 1,35 billion for 1988. However the possibility that expenditure will exceed budget targets has forced the government to impose further cuts in addition to those already planned in the government agreement. The final result is a slight easing of the budget target (the central government deficit will probably be 7,2% of NNI in 1988 whereas the original target was 7% and the comparable deficit for 1987 is 7,6%). The overshooting remains within acceptable limits, given the weak growth which does not favour efforts to restore healthy public finances. It does, however, imply that expenditure cuts must be somewhat intensified over coming years, if multiannual objectives are to be achieved, in view of the steady rise in interest payment on the public debt until 1991.

Central bank management gives high priority to the stability of the parity of the guilder against the German Mark. The interest rate

PORTUGAL

The upturn in economic activity that started in 1985 has continued since, underpinned by the brisk recovery of domestic demand. However, following a marked increase in 1986 (+4,3%), real GDP (1) is likely to increase slightly less in 1987 (3 3/4%). This slowdown is due exclusively to the increased contractionary effect exerted by the external balance and the slower rate of stock building. Private consumption, by contrast, maintained its vigorous rise as part of a catching-up process while investment growth accelerated appreciably, spurred in particular by the effects of the country's accession to the Community. The improvement in employment strengthened and the unemployment rate fell significantly (from 8,6% in 1986 to 7,2% in 1987). At the same time, inflation showed a clear slowdown even though it still diverged markedly from rates in the other member countries. The external surplus went down significantly following the recovery in 1985 and 1986.

Under the impact of an appreciable deceleration in domestic demand and despite good export performance, the growth in real GDP¹) should be close to 3% in 1988. The improvement in employment is expected to be less strong leading to a significantly slower reduction of unemployment. In line with the authorities' objectives, major progress will again be made in bringing down inflation. The balance of payments on current account will probably deteriorate further and should, for the first time since 1984, close with a deficit (of the order of 1% of GDP).

The differential between the growth rate of Portugal's domestic demand and that in the other member countries, while smaller than in previous years, will still be substantial in 1988. Admittedly, this is justified by the need to make further progress on reducing Portugal's structural deficiencies through a sustained recovery in the investment ratio, which is still a good deal lower than the level recorded until the beginning of the 1980s. But in view of the uncertainties

¹⁾ At 1985 prices. Calculated on the basis of the previous year's prices, growth would be 5,2% in 1987 and 4,2% in 1988.

	1983	1984	1985	1986 ^a)	1987b)	1988b
-Gross) value	3,3	5,0	4,1	3,1	0,7	1,7
domestic) volume	1,4	3,2	2,3	2,4	1,7	1,2
product) deflator	1,9	1,8	1,8	0,7	-1,0	0,5
-Private consumption						
deflator	2,7	2,0	2,5	0,2	-0,8	1,0
-Gross fixed) private	3,3	5,1	7,4	9,6	3,9	0,8
capital) public	-4,6	7,6	-7,7	-8,8	-1,1	0,0
formation) total	2,1	5,5	5,1	7,2	3,3	0,7
volume of: construction	-2,6	3,6	-3,1	4,9	2,6	0,5
which equipment	10,0	8,2	16,9	9,9	4,1	0,9
-Domestic demand at constant						
prices	1,5	1,7	2,5	3,9	2,3	1,0
Gap with respect to other						
Community countries ^c)	0,4	-0,5	0,2	0,2	-0,3	-1,4
-Compensation) nominal	3,2	0,2	1,4	1,6	1,9	1,6
of employees) real Ad)	1,3	-1,5	-0,4	0,8	3,0	1,1
per head) Bd)	0,4	-1,7	-1,1	1,4	2,7	0,6
-Productivity ^e)	3,4	3,2	1,0	0,6	0,8	1,0
Real unit labour costs	-2,0	-4,6	-1,3	0,2	2,1	0,1
(ompetitivenessf)			-2,6	5,8	2,7	-0.7
-Employment			1,3	1,8	0,9	0,2
Registered unemployed as %						
of the civilian labour	14,0	14,3	13,1	12,1	11,4	11,0
force8)						
-Current balance as %						
of GDP	3,1	4,2	4,3	2,8	1,9	1,8
-Long term interest rate	8,8	8,6	7,3	6,4	6,3	6,4
-money supplyh)	10,5	7,7	10,5	4,4	3,5	5,5
-Net lending or borrowing	10,5		10,5	-116-5740		,,,
requirement of general						
government as % of GDP	-6,4	-6,3	-4,7	-4,7	-5,6	-5,9
Public debt as % of GDP	61,9	66,4	69,9	73,0	79,3	85,2
Public debt interest		30,7	0,,,	. 5,5		
as % of GDP	5,7	5,9	6,0	6,0	6,0	5,9

a) Estimates of the Commission services, September 1987

over page

D) Forecasts fo the Commission services, September 1987, on the basis of present policies

c) Differences in percentage points

d, A: GDP deflator; B: private consumption deflator

e) Gross value added per occupied person in the whole economy

f) Effective exchange rate (vis-à-vis 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive figure = loss of competitiveness.

⁸⁾ EUROSTAT definition

h) End of year

government borrowing requirement, which was set for the first time in 1987 and involves cutting it from 8,8% of GDP in 1987 to less than 5% of GDP as from 1990-91, will not be achieved without a continuous drive to contain operating expenditure, a reduction in transfer payments, notably to enterprises in the competitive sector, and a widening of the tax base. A rapid implementation of the tax reform would play a positive role in this context. In the absence of tangible results in this field, the policy of improvement of infrastructure and, more generally, the required contribution from budgetary policy to increasing the country's investment ratio, improving vocational training and making appropriate use of human capital will be placed in jeopardy. This would be particularly so if, failing a sufficient reduction in the public deficit already in 1988, the external account deteriorated at an excessive pace, requiring a return to restrictive policies which, until the recent past, hampered the country's growth process and the scope for bringing down agricultural underemployment.

Achievement of the budgetary objective is essential if the task of monetary policy is to be eased both domestically, especially as regards the necessary moderation in of the growth of the monetary aggregates, and from the point of view of exchange rate performance. Only on this condition will it be possible to continue reducing inflationary expectations and maintaining the downward movement of interest rates. Fresh progress on modernizing financial channels would also be helpful.

By influencing inflationary expectations and the evolution of production costs, continued pursuit of the active policy of social dialogue makes an essential contribution to the balanced and sustained expansion that is necessary if the Portuguese economy is to succeed in becoming progressively integrated into the Community. In particular, there is a need for the consensus on the 6% inflation rate aimed at for 1988 to be maintained and effectively taken into account in wage negotiations for next year.

surrounding the external environment and because of the Portuguese economy's heavy dependence on oil imports and its increasing openness, such a trend carries risks for current payments. Application of the programme for the structural correction of the external deficit and unemployment (PCEDED) adopted in March and confirmed at the end of August when the new government announced its programme to Parliament, will allow to avoid these risks, all the more so as the envisaged policies are largely in line with the Community's cooperative strategy for growth and employment.

Marked progress has already been made towards improving the conditions of demand and supply. The policy of planned depreciation of the escudo and wage policy in particular have been made to serve greater nominal convergence with the other member countries. Since July 1986 a permanent Council for social dialogue has been playing an active role in this field. Adjustment measures in the fields of taxation and the modernization of financial markets are supporting the investment drive. The Community for its part is continuing to make a significant contribution in order to promote greater real convergence and a reduction in the gap between Portugal's level of development and that in the other Member States. The relative share of the Community's structural Funds and financial instruments in Portugal's gross domestic product thus reached more than 2.8% in 1986. Overall, however, the recent beginning of the process of convergence, both real and nominal, remains insufficient and fragile. This process must therefore be actively continued and indeed strengthened.

Budgetary policy has a particularly important role to play in this context. The reduction in the general government borrowing requirement achieved in 1985 was continued by the authorities in 1986 thanks in particular to taxes on oil products and the introduction of VAT. However, the trend of the central government's budget for 1987 reveals the need for an accompanying rigour in order to achieve the tax receipts projected in the budget, particularly as regards value added tax. The objective of a reduction in the medium term of the central

PORTUGAL: Main economic aggregates	1983-1988	- Ann	nual % c	hanges		
The state of the state of	1983	1984	1985	1986ª)	1987b)	1988 ^b)
-Gross) value	23,7	23,4	25,9	23,1	15,3	10,5
domestic) volume	-0,3	-1,7	3,7		3,7	3,0
product) deflator	24,1	25,6	21,3	18,0	11,2	7,3
Private consumption						
deflator ^c)	25,5	29,3	19,3	12,1	9,3	6,5
-Gross fixed) private				AL.		
capital) public						
formation) total	-7,5	-18,0	-1,8	9,9	14,6	10,5
volume of: construction	-3,0	-13,5	-4,0	4,7	9,5	9,0
which equipment	-13,1	-23,0	1,0	16,0	20,0	12,0
-Domestic demand at constant	.,,	,				
	-7 0	-7,0	0.6	8,5	8,3	5,0
prices	,,,					
Gap with respect to Community countries ^d)	-8,7	-8,4	-1,7	4,3	5,1	2,4
	21,6		22,0		11,9	8,5
-Compensation) nominal	-2,0		0,6		0,6	1,1
of employees) real A ^e)	-3,1	-7,4		4,1	2,4	1,9
per head) Be)	1,4	-0,4	4,2		1,3	1,9
-Productivity ^f)	-3,4	-4,2	-3,6		-0,6	-0,8
Real unit labour costs		-4,2		1,2	-0,2	-1,2
Competitiveness8)	-8,3		-0,5		2,3	1,0
-Employment	-1,7	-1,3	-0,5	0,2	2,5	-, -
Registered unemployed as %						
of the civilian labour	7.0	0.5	0.7	8,6	7,2	6,8
forceh)	7,9	8,5	8,7	0,0	1,2	0,0
-Current balance as %				2.0	1 /	-1,0
of GDP	-7,2	-3,0	1,7	3,9	1,4	
-Long term interest rate	30,3	32,5		17,9	15,1	14,3
-Money supply ¹)	16,3		29,1		17,0	13,0
-Net lending or borrowing A^{1})	10,4	13,3	11,0	9,2	9,4	8,3
requirement of general B 1)	9,1	12,0	10,0	8,2	8,8	7,8
government as % of GDP					71 0	70 5
Public debt as % of GDP	56,2	61,2	64,8	67,1	71,8	78,5
Public debt interest						
as % of GDP	6,4	7,1	7,8	9,3	8,1	7,2

a) Estimates of the Commission services, September 1987.

b) Forecasts of the Commission services, September 1987.

c) Series different from the official retail price index.

d) Differences in percentage points

e) A: GDP deflator; B: private consumption deflator

f) Gross value added per occupied person in the whole economy

⁸⁾ Effective exchange rate (vis-à-vis 19 industrial countries) on the basis of unit labour costs for the whole economy. Positive figure = loss of competitiveness.

h) EUROSTAT definition

i) End of year

¹⁾ A: Including loans, adavances and equities; B: excluding loans, advances and equities.

The conclusion is that the various measures necessary for achieving the authorities' macroeconomic objectives must be implemented energetically. Only on this condition will it be possible to maintain satisfactory growth, both quantitative and qualitative, and to bring inflation down progressively to a rate close to the Community average.

reduction in the basic rate of income tax to 27% in the March Budget. Overall, business and consumer confidence has tended to strengthen and a pick-up has begun in business investment, particularly in manufacturing, after a period of sluggishness since 1985 which partly reflected changes in the corporation tax system. The upward pressure on sterling in the first half of the year enabled bank base rates to be reduced by a cumulative 2 percentage points, giving further support to domestic demand, although this movement was partly reversed in August as a result both of some temporary weakening of sterling and of strong credit demand.

In 1988, developments should remain positive, given a relatively encouraging world outlook. Another strong rise in private consumption is likely, particularly if, as expected, the inflation rate steadies and there is a further reduction in the basic rate of income tax. Growth in fixed investment should become more marked. Export volumes may, however, rise more slowly, implying some deterioration in the current balance. In total, real GDP is forecast to rise by about 2 1/2%, somewhat slower than in 1987.

The expansion of activity has begun to have an increasingly large impact on the unemployment figures. Around 1 1/4 million new jobs have been created since the trough in employment in 1983. Employment growth has strengthened in recent quarters particularly, with a strong increase in male employees at the start of 1987. Until recently, the composition of employment growth has been such as to reduce the impact of rising employment on the unemployment total. But the downward trend

UNITED KINGDOM

In the United Kingdom the expansion of economic activity, which has been under way without interruption since 1981, has gained strength since mid-1986, and the growth of real GDP in 1987 is expected to be about 3 1/2%. Registered unemployment has shown a clear downward trend since the middle of 1986, and employment has begun to rise more rapidly again. Although the sharp fall in inflation last year has been partially reversed, the twelve-month rate of retail price inflation has risen only slightly during the course of 1987, remaining close to 4%. The current account has weakened to a lesser extent than earlier seemed likely, despite a deterioration of over 3% in the terms of trade during 1986 and 1987.

also

stronger supply side performence and notably The relative strength of the economy in 1987 reflects the 17% fall in the effective exchange rate between the third quarter of 1985 and the final quarter of last year, which increased the price competitiveness of the economy. Weak export market growth has thus been felt less in the United Kingdom than in countries with appreciating currencies. Exports picked up sharply in the latter part of 1986 and have remained at a high level throughout the current year, despite the 5% appreciation of sterling in the months up to the June general election. In addition, subdued imports in the early part of 1987 suggest some import substitution and an improved supply response from the economy.

Private consumption, though no longer making the dominant contribution to growth, has continued to develop vigorously in 1987. inflation and a steadying of the saving ratio after its fall last year have only partly offset the boost to consumption coming from rapid growth in nominal earnings and other personal incomes, and from the

growth in final demand and as domestic production of oil gradually declines in the medium term. To limit the deterioration requires that the supply response of the economy must be sustained and improved; this in turn depends on maintaining competitiveness through achieving changes in unit labour costs in line with those of the UK's main competitors and keeping the exchange rate stable, and on a steady expansion of the productive capacity of the economy. On the invisibles account, the income stream from the growing stock of foreign assets has risen in value. While the strong growth in net factor income recorded in 1986 is unlikely to be sustained over the medium term, invisible earnings should be sufficient to offset much of the deficit on visible trade this year and to make a substantial contribution in subsequent years to holding the current account deficit within limits which do not place a major constraint on growth.

Considerable progress has been made in achieving the budgetary objectives set within the tramework of the Medium-Term Financial Strategy. The buoyancy or non-oil revenues and the acceleration of the privatisation programme enabled the long-term objective or bringing the public sector borrowing requirement down to 1% or GDP to be achieved ahead of schedule in the financial year 1986/87. With borrowing at a low level the policy emphasis has now switched to using the room created by strict control of expenditure to reduce the burden or taxation further when it is prudent to do so (with a cut in the basic rate or income tax to 25% as one specific goal). In the current tinancial year, 1987/88, nowever, there remain upward pressures on expenditure, particularly in the areas of public service pay and local authority expenditure, where central government exercises relatively little control. Given /underlying / revenue buoyancy, however, particularly with the strengthening in the oil price, any excess on spending plans which cannot be absorbed by the reserve provision is

In the current linaucal year 1967-86 the Government is latest livecary to be a Pobl of fl billion (1/4 per lent of Gol), compared to the budget projection of fly bordern (1 per cont of Gol). This reflects both lugher tax resemble, mainly as a remain of factor than expected real conomic grown, and love spending the looks theorper approxis to be heading to the third enecessive year of significant undersines on budget plane

in unemployment has now been firmly established, and in large part appears attributable to the strong growth of the economy. The government's employment and training programmes also contributed to increased employment and reduced unemployment. In recent months they covered almost 400 000 persons, slightly more than a year earlier.

at about to

The unemployment rate is still over 10% and the continued rapid rise in per capita earnings and unit labour costs is worrying. Towards the end or 1986 there was some moderation in the level of wage settlements, but because of a rise in overtime working this did not show up in the underlying rate of increase in average earnings, which has continued almost unchanged at close to 7 1/2% since 1983. Indeed, the size of pay settlements seems to have begun to increase again recently. Apart from a recession-induced decline at the beginning of the 1980's, real wages have risen strongly in the current decade. But been a significant recovery in at the same time there has profitability achieved through subscantial productivity gains, particularly in manufacturing. The capital stock has been rising only slowly in recent years. With more firms reporting capacity constraints and unemployment still very high, an appreciable extension of productive investment is doubly necessary. In this regard, the recent clear signs of a pick-up in business investment are encouraging.

In 1986, as the oil price tell and the strong expansion of private consumption pulled in imports, there was a marked deterioration in the visible trade balance. Improved competitiveness temporarily helped to stabilise the position in the first half of 1987, but some further deterioration is now likely as imports pick up again in response to

surveillance can be maintained consonant with deregulation. Other supply side measures include reductions in the basic rate of income tax, tax incentives to promote profit-related pay, extensive employment and training measures, help for small firms which are seen as an important engine of growth, trade union reform and a considerable expansion of the privatisation programme.

One possible problem racing the authorities is how to react should the external environment in 1988 be weaker than is now expected. It nominal CDP appeared to be growing more slowly than intended, it might be appropriate to ease the stance of policy, for example by allowing the public sector borrowing requirement to rise temporarily above its planned medium-term path of 1% of GDP in order to give some support to pominal demand.

In 1988 and subsequent years, a main task is to ensure that the improvement in labour market conditions now under way is sustained and strengthened. Bearing in mind that the growth in employment has been stronger in some regions than others and that pockets of high the Commission's view is that a possible of high might be unemployment persist, it seems to be appropriate for the authorities to consider using some or the scope available for tax cuts in the next tinancial year for targeted action in the high unemployment areas, perhaps through reductions in taxes affecting the cost of employment, in order to stimulate the creation of new jobs and to attract investment to these areas. A drive to improve the level effectiveness of vocational training in these regions would also be a prudent step in view of worries about skill shortages in the economy. In this context, it would also be desirable to promote labour mobility by taking appropriate measures to make available sufficient reasonably priced accommodation, especially in the South East where activity is strongest; the shortage of such accommodation at present is a disincentive to mobility. The authorities have recently placed more emphasis on the need to rehabilitate decayed inner city areas, through unlikely to cause overshooting on the Budget projection for the public sector borrowing requirement equal to 1% of GDP.

only the narrow money measure MO now has target In regard to monetary policy, the role of targets for specific monetary aggregates, other than MO, the narrow money measure, has become less important. The information content of the aggregates about the growth of nominal income has become blurred by the effects of deregulation and innovation in financial markets. Even so, the authorities have made it clear that the behaviour or liquidity is a key factor to be taken into account in assessing monetary conditions. The rapid growth in M3 this year, although partly explained by extensive Bank of England intervention to hold down the rise of sterling in the first half of the year, may suggest too rapid an expansion of personal sector credit, and needs to be kept under review. For many years the objective of monetary policy has been to attain a balance between domestic monetary conditions and the exchange rate which will place a steady downward pressure on intlation. An increased emphasis does, however, appear to have been given to the exchange rate as an indicator of monetary conditions. The authorities accepted a significant downward adjustment in the exchange rate during 1986 tollowing the tall in the oil price, and managed this relatively smoothly from the interest rate point of view. After the Louvre Agreement in February 1987 the Chancellor of the Exchequer stated that a period of stability for sterling and other exchange rates would be desirable, and, helped by a judicious mixture or intervention and interest rate changes, the sterling/DM cross rate has remained within a relatively narrow range.

The Government continues to press ahead with structural policies designed to promote the functioning and flexible operation of markets. In regard to the financial markets, a wide range of legislative and other controls has been abolished since 1979. At present, a key concern in this regard is how an adequate level of

UNITED KINGDOM : Main economic aggre	gates, 19	83-1988	3	Annu	al % cha	nges
	1983	1984	1985	1986	1987ª)	1988ª)
-Gross) value	8,9	6,4	9,9	6,5	7,4	7,6
domestic) volume	3,6	2,0	3,7	2,9	3,2	2,7
productb)) deflator	5,2	4,3	5,9	3,5	4,0	4,7
-Private consumption						
deflator	5,0	4,7	5,2	3,6	3,0	3,9
-Gross fixed) private	2,7	8,6	4,1	-0,5	4,7	3,8
capital) public	36,6	11,9	-3,1	4,4	-2,5	3,7
formation) total	5,2	8,2	3,1	0,3	3,8	3,9
(volume) of construction	7,3	7,9		4,3	3,5	4,0
which: equipment	4,2			-4,0	4,2	3,7
-Domestic demand at constant prices	4,5	2,7		3,8	3,2	3,3
Gap with respect to other			Mark Tale	No. of Parts		
Community countries ^c)	4,2	1,0	0,8	0,0	0,6	1,2
	9,1	5,1		7,2	6,8	6,6
-Compensation) nominal	3,7					1,8
of employees) reald) A	3,9	0,4	2,0			2,6
per head) B	4,7	0,2	2,4	2,3		1,8
-Productivity ^e)	-1,0	0,6	-1,1		0,9	0,0
Real unit labour costs ^t)	9,9	0,7	2,2	-1,4	-1,5	-1,8
Profitability8)		85,3	87,1	85,9	84,7	83,1
idem (1970 = 100)	84,7			-5,3	-0,3	3,0
Competitivenessh)	-7,6				1,4	0,9
-Employment	-0,8	1,7	1,5	0,0	-,-	,,,
Registered unemployed as %		11 0	12.0	12,1	11,0	10,4
of the civilian labour forcei)	11,6	11,8	12,0	12,1	11,0	10,4
-Current balance as %		0.1	0.0	-0,3	-0,5	-0,8
of GDP	1,0				9,3	9,5
-Long-term interest rate	10,8	10,7		9,8	21,7	11,9
-Money supplyj)	10,3	9,8	13,1	18,9	21,1	11,,
-Net lending or borrowing						
of general government		2.0	2.0	2.7	-2,0	-2,0
as % of GDP	-3,6	-3,9		-2,7		54,1
Public debt as % of GDPk)	57,5	59,3	57,5	57,6	56,2	54,1
Public debt interest				, -	4. 2	4,1
as % of GDP	4,7	4,9	5,0	4,5	4,3	4,1

a) Forecasts of the Commission services, September 1987, on the basis of present policies

c) Differences in percentage points

f) Ratio of real wages per head to productivity

i) EUROSTAT definition

J) Sterling M3; end of year

b) Expenditure measure at market prices. On the basis of the average estimate of GDP at factor cost, the corresponding volume figures for 1986, 87 and 88 are 3,0%, 3,8% and 2,7% respectively.

d) Deflated by : A - GDP deflator; B - private consumption deflator

e) Gross value added per occupied person in the whole economy

⁸⁾ Net operating surplus relative to the net capital stock at current replacement cost

h) Effective exchange rate (vis-à-vis 19 industrial countries) on the basis of unit labour costs for the whole economy; positive figure = loss of competitiveness

k) General government gross debt at market values

a better coordination or existing public programmes and private sector initiative. This could be a suitable opportunity for some judiciously chosen increases in capital expenditure in these areas, particularly on intrastructural repairs.

While a better regional differentiation of real wages would be desirable, there is a more pressing need to moderate the level of wage increases generally in the economy if competitiveness is to be maintained and satisfactory employment growth sustained. Government does not rayour the use of an incomes policy as it would be inconsistent with its goals of freeing markets and encouraging greater wage differentiation. Tight control on public sector wage settlements is, however, an important means of influencing wage trends in the wider economy. An extended period of exchange rate stability, which would be reinforced by rull entry of the United Kingdom into the European Monetary System, could also in due course exercise a moderating effect on wages by influencing inflationary expectations. At the same time renewed efforts to achieve comprehensive reforms in the structure of personal taxation and social security are desirable, in spite of the lukewarm reception given to the recent green paper, not only in order to strengthen incentives and to reduce poverty and unemployment traps, but also to help in achieving wage moderation.

Annex

Proposal for a COUNCIL DECISION

adopting the annual report on the economic situation in the Community and laying down economic policy guidelines for 1988.

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Decision 74/120/EEC of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community, as amended by Decision 75/787/EEC and by Decision 79/136/EEC, and in particular Article 4 thereof,

Having regard to the proposal from the Commission,
Having regard to the opinion of the European Parliament,
Having regard to the opinion of the Economic and Social Committee,

HAS ADOPTED THIS DECISION :

Article 1

The Council hereby adopts the annual report on the economic situation in, and economic policy guidelines to be followed by the Community, contained in Part 1 of the annexed Report; and lays down the economic policy guidelines to be followed by the Member States, contained in Part 2 of the annexed Report.

Article 2

This Decision is addressed to the Member States.

Done at Brussels, 198

For the Council

The President

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Annual Economic Report 1987-88

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STATS ANNEX TO ANNUAL EFFORT

Statistical Annex
to the
Annual Economic Report 1987-88

Table 1: Summary of main macroeconomic aggregates by country 1960-1988

a) Real GDP, % change p.a.

	1973 1960	1980	1981	1982	1983	1984	1985	19861	19871	19881	
	4,9	2,5	-1,5	1,9	-0,3	1,7	1,5	2,3	1,3	1,8	В
DK.	4,3	1,6	-0,9	3,0	2,5	3,5	13,9	33,4	-0,2	0,9	DK
D	4,4	2,2	0,2	-0,6	1,5	2,7	2,6	2,6	1,4	1,9	D
GR	7,7	3,4	-0,3	-0,2	0,4	2,8	2,1	1,3	-0,8	0,5	CK
E	7,3	2,4	-0,2	1,2	1,8	1,9	2,2	23,5	1(4,1)	3,7	E
P	5,6	2,8	0,5	1,8	0,7	1,5	1,1	2,0	1,2	1,9	F
IRL	4,4	4,4	3,4	1,4	-1,9	4,2	2,0	-0,3	2,5	1,3	IKL
T	5,3	2,8	1,1	0,2	0,5	3,5	2,7	2,7	3,0	2,8	1
1	4,1	1,5	-1,0	1,5	3,2	5,5	2,9	2,5	2,0	1,8	L
L NL	4,8	2,4	-0,7	-1,4	1,4	2,4	1,7	2,4	1.7	1,2	NL
	6,9	3,3	0,5	3,2	-0,3	-1,6	3,3	14,3	23,7	3,0	P
P UK	3,1	0,9	-1,2	1,0	1 3,8	2,2	23,7	12,9	33,2	2,7	UK
EUR12	4,8	2,3	0,0	0,6	1,5	2,4	2,5	2,6	2,2	2,3	EUR12
		2.1	2.1	-2,5	3,4	6,6	2,9	2,9	2,3	2,7	USA
USA JAP	3,9 9,6	2,1	2,1	2,8	3,2	5,0	4,5	2,4	2,9	3,5	JAP

b) Real final domestic demand incl. stocks, % change p.a.

	1973 1960	1980 1973	1981	1982	1983	1984	1985	19861	19871	19881	
В	4,8	2,6	-4,3	0,4	-2,5	1,8	1,2	3,4	1,6	1,7	В
DK	4,6	0,7	-4,1	3,5	1,4	4,1	5,4	5,7	-1,9	-0,7	DK
	4,5	2,3	-2,6	-2,0	2,3	1,9	1,5	3,7	2,5	2,3	D
D GR	8,2	2,1	1,8	2,9	0,8	-0,4	5,3	-0,3	-0,6	0,3	GR
		2,2	-2,3	1,1	-0,1	-0,5	2,7	6,5	6,2	4,8	Ε
E	7,8	2,9	-0,3	3,7	-0,4	0,6	1,9	3,5	2,2	2,0	F
P	5,8		3,0	-2,9	-4,1	1,0	-0,4	0,8	0,0	0,2	IRL
IRL	5,4	3,6	-1,2	0,3	-0,5	4,5	3,2	3,2	4,5	3,3	I
I	5,5	2,5		0,4	0,5	1,7	0,8	3,8	3,3	2,1	L
L	3,9	2,1	0,7			1,4	2,2	3,9	2,3	1,0	NL
NL	4,9	2,4	-4,6	-0,9	1,5	-6,6	0,5	8,5	8,3	5,0	P
P	7,5	2,8	2,5	3,4	-7,4		2,8	3,8	3,2	3,3	UK
UK	3,2	0,4	-1,7	2,1	4,7	2,8	2,0	,,,	,-		
EUR12	5,0	2,1	-1,7	0,9	1,0	1,9	2,4	3,8	3,2	2,7	EUR12
	4.0	1 0	2,8	-1,5	5,1	8,6	3,4	3,9	1,7	2,0	USA
USA JAP	4,0	1,8	2,1	2,8	1,8	3,8	3,6	4,0	3,9	4,1	JAP

c) Balance of current transactions with the rest of the world as a X of GDP

	1973 1960	1980 1973	1981	1982	1983	1984	1985	19861	19871	19881	
	1,0	-1,4	-4,6	-3,3	-0,5	-0,4	0,5	2,4	2,3	2,3	В
D	-1,9	-3,5	-3,0	-4,2	-2,6	-3,5	-4,6	-5,1	-2,9	-2,2	DK
DK			-0,5	0,5	0,6	1,1	2,2	4,1	3,7	3,2	D
D	0,8	1,0	-0,7	-4.4	-5,1	-4,1	-8,3	-5,4	-4.2	-4,1	GR
GR	-2,9	-1,8		-2,5	-1,5	1,3	1,7	2,0	0,6	-0.4	E
E	0,1	-1,9	-2,7		-1,7	-0,8	-0,8	0,6	-0,0	0,0	F
P	0,3	-0,8	-1,4	-3,0		-6,1	-3,8	-1,8	-1,1	-0,3	IRL
IRL	-2,3	-7,7	-14,7	-10,6	-7,0		-0,9	0,8	0,2	0,0	I
I	1,4	-0,5	-2,2	-1,6	0,3	-0,6	42.4	40,4	38,7	37,8	L
L	7,0	20,7	23,0	35,2	38,5	38,9		2,8	1,9	1,8	NL
NL	0,7	0,8	2,2	3,2	3,1	4,1	4,3		1,4	-1.0	P
P	0,1	-6,1	-11,8	-12,7	-6,3	-1,9	3,0	3,9			UK
UK	-0,1	-0,9	2,3	1,2	0,7	-0,3	1,0	-0,3	-0,5	-0,8	
EUR12	0,4	-0,4	-1,0	-1,1	-0,2	0,1	0,6	1,5	1,1	0,8	EUR12
		0.3	0.3	-0,0	-1,0	-2,4	-2,9	-3,3	-3,5	-3,1	USA
USA	0,5	0,3	0,3		1,8	2,8	3,7	4,5	3,8	3,3	JAP
JAP	0,5	0,1	0,5	0,7	1,0	2,0	-,,	,			

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Table	2:	Summary	of	main	economic	aggregates	for	EUR12	1960-1988
Table	4 .	2 dimmar A	OI	mc T TT	CCOMOME	~000			

	$\frac{1973}{1960}$	1981 1973	1982	1983	1984	1985	1986	19871	19881
Gross domestic product							0.4		5.0
- nominal	10,2	14,4	11,2	10,1	9,1	8,7	8,4	6,2	5,9
- real	4,8	2,0	0,6	1,5	2,4	2,5	2,6	2,2	2,3
- deflator	5,1	12,1	10,6	8,5	6,5	6,1	5,6	3,9	3,5
Gross fixed capital formation ²	5,5	-0,2	-1,8	0,2	1,6	2,3	3,4	3,6	3,3
- construction	:	-1,4	-2,4	0,4	1,2	-3,1	2,7	2,0	2,6
- equipment		1,7	-1,0	2,1	5,8	9,2	4,2	5,3	4,0
Share of nominal gross fixed									
capital formation in GDP									
- total	23,1	22,1	20,1	19,6	19,3	19,1	18,9	19,1	19,2
- public	3,811		3,0	2,9	2,8	2,8	2,7	2,7	2,8
Private consumption ²	5,0	2,3	0,7	1,3	1,4	2,5	3,9	3,1	2,7
Domestic demand (incl. stocks)	,	,							
- in the Community	5,0	1,6	0,9	1,0	1,9	2,4	3,8	3,2	2,7
	-0,5	-0,6	0,9	-1,8	-3,4	-1,1	0,1	0,5	0,0
- gap with respect	0,5	٠,٠	,,,		The state of				
to other OECD countries	4,6	12,2	10,4	8,5	7,0	5,9	3,7	3,2	3,4
Inflation (private	4,0	12,2	10,4	,,,					
consumption deflator)									
Compensation per employee	10,0	14,8	11,1	9,9	7,4	6,8	6,0	5,4	4,7
- nominal			0,6	1,3	0,3	0,9	2,2	2,1	1,3
- deflated by the price	5,1	2,3	0,0	1,5	0,5	,,,	,		
of private consumption		2 /	0 4	1.3	0,8	0,7	0,4	1,5	1,2
- deflated by GDP prices	4,6	2,4	0,4	2,0	2,3	1,8	1,8	1,4	1,7
Productivity ³	4,5	2,1	1,5	102,2		99,6	98,2	98,3	97,8
Real unit labour costs4	100,3	104,0			72,7	77,7	82,1	80,9	81,1
Profitability ⁵	108,2	72,8	63,5	66,4	86,6	85.8		101,6	101,8
Competitiveness ⁶	101,3	108,9	99,2	93,6		0,6	0.8	0,8	0,6
Employment	0,3	-0,1	-0,8	-0,5	0,1	12.1	11.9	11.8	11,7
Unemployment rate (as % of	7	7		7 10 17	11,7			11,0	,
the civilian labour force)	2,27	5,17		7 10,47				1,1	0,8
Current balance (as % of GDP)	0,4	-0,6	-1,1	-0,2	0,1	0,6		-4,5	-4,5
Net lending or borrowing of	-1,08	-4,18	-5,5	-5,3	-5,3	-5,2	-4,8	-4,5	-4,5
general government (as % of GDE	?)	_	-			.7 ,	50.0	61 /	63,6
Public debt (as % of GDP)	37,58	43,49	48,2	51,5	54,8	57,4	59,0	61,4	
Money supply ¹⁰	11,47	13,7	11,3	11,2	9,5	8,5	10,2	10,2	8,6
Long-term interest rate13	7,1	10,7	12,6	10,7	10,4	9,6	7,9	7,8	7,7

¹ Economic Forecasts, September 1987

² At constant prices

³ Real GDP per person employed in the whole economy

⁴ Compensation per employee deflated by GDP prices divided by real GDP per person employed, index 1970 = 100

⁵ Estimate for EUR4: non-agricultural business. Index 1970=100. Net rate on net capital stock

⁶ Relative unit labour costs in the Community vis-à-vis its 9 main industrial partner countries, in a common currency, index 1970 = 100

⁷ EUR9 (EUR12 excluding Greece, Spain and Portugal)

⁸ EUR9 (EUR12 excluding Greece, Ireland and Portugal), 1973 and 1981 respectively

^{9 1981 (}EUR12)

¹⁰ Annual average. Broad money supply M2 or M3 according to country 11 EUR9 (EUR12 excluding Greece, Ireland and Portugal), 1970 to 1973

¹² EUR9 (EUR12 excluding Greece, Ireland and Portugal)

¹³ EUR10 (EUR12 excluding Spain and Portugal). Data from 1961, levels Source: Eurostat and Commission services

Table 1: (cont.)

) Private consumption	deflator.	Z	change	p.a.
-----------------------	-----------	---	--------	------

	1973 1960	1980	1981	1982	1983	1984	1985	19861	19871	19881	
В	3,7	7,8	8,0	7,3	7,5	6,2	4,8	1,3	1,8	2,5	В
DK	6,6	10,8	12,0	10,2	6,8	6,5	4,8	3,6	4,1	4,0	DK
D	3,6	4,9	6,0	4,7	3,2	2,4	2,1	-0,5	0,6	1,8	D
GR	3,5	16,0	23,4	20,8	17,9	18,4	18,6	22,1	16,0	12,0	GR
E	6,7	17,8	14,3	14,5	12,3	10,7	8,3	8,9	5,4	4,2	E
P	4,7	10,8	12,8	11,2	9,5	7,2	5,5	2,5	3,1	2,6	P
IRL	6,0	16,1	19,6	15,9	10,0	7,5	4,2	3,6	3,0	3,2	IRL
I	4,8	17,6	17,9	15,9	14.8	11,4	9,3	6,3	4,8	4,9	I
L	3,1	7,4	8,7	10,8	8,1	6,4	3,3	0,3	0,5	2,3	Ĺ
NL	5,0	7,2	6,3	5,3	2,7	2,5	2,6	0,1	-0,8	1,0	NL
P	3,4	22,0	18,3	22,5	25,5	29,3	19,0	12,1	9,3	6,5	P
UK	4,8	15,7	11,4	8,7	5,0	4,8	5,2	3,6	3,0	3,9	UK
EUR12	4,6	12,3	12,0	10,4	8,5	7,0	5,9	3,7	3,2	3,4	EUR12
USA	3,1	8,0	8,7	5,8	4,0	3,9	3,3	2,2	4,1	4,9	USA
JAP	6,2	9,0	4,4	2,6	1,9	2,1	2,2	0,7	0,2	1,5	JAP

e) Total employment, % change p.a.

	1973 1960	1980	1981	1982	1983	1984	1985	1986	19871	19881	
В	0,6	0,1	-2,0	-1,3	-1,1	0,0	0,8	1,0	0,1	0,2	В
DK	1,1	0,4	-1,3	0,4	0,3	1,5	2,8	2,0	0,8	-0,1	DK
D	0,2	-0,3	-0,7	-1,7	-1,5	0,1	0,7	1,0	0,6	0,3	D
GR	-0,5	0,8	4,9	-0,8	1,1	0,3	1,0	0,3	-1,0	0,3	GH
K	0,8	-1,3	-3,0	-1,0	-0,8	-3,0	-1,0	2,0	2,4	1,7	E
7	0,7	0,3	-0,6	0,1	-0,4	-0,9	-0,3	0,3	-0,2	-0,0	F
IRL	0,1	1,2	-0,9	0,1	-2,2	-1,6	-2,8	-0,4	-0,3	0,2	IRL
I	-0,4	0,8	-0,0	0,6	0,5	0,8	1,4	0,6	0,6	0,8	T
L	1,1	0,6	0,3	-0,3	-0,3	0,6	1,4	2,4	1,0	0,4	Ĺ
NL	0,9	0,3	-1,5	-2,5	-1,9	-0.4	1,1	1,8	0,9	0,2	NL
P	-0,5	0,3	1,2	-0,4	4,3	-1,5	-0,3	0,2	2,3	1,0	P
UK	0,3	0,1	-3,9	-1,8	-1,2	2,0	1,3	0,6	1,4	0,9	UK
EUR12	0,3	0,1	-1,3	-0,8	-0,5	0,1	0,6	0,8	0,8	0,6	EUR12
USA	1,9	2,0	0,9	-0,5	1,0	4,8	2,4	2,3	2,5	1,9	USA
JAP	1,3	0,7	0,8	1,0	1,7	0,6	0,7	0,8	0,8	1,0	JAP

f) Unemployment rate 2 as a $\mathbf X$ of the civilian labour force

	1973	1980 1973	1981	1982	1983	1984	1985	19861	19871	1988	
В	2,4	6,8	11,1	13,0	14,3	14,4	13,6	12,6	12,4	12,1	В
DK	1,2	5,5	8,7	9,3	10,1	9,9	8,7	7,6	7,7	8,6	DK
D	0,9	3,6	4,8	6,9	8,4	8,4	8,4	8,1	8,1	8,3	D
GR	:	:	4,2	5,8	7,8	8,1	7,8	7,4	7,4	7,5	GR
E		:	14,4	16,2	17,7	20,6	21,9	21,5	20,7	20,3	E
7	1,1	4,7	7,7	8,7	8,9	10,0	10,5	11,1	11,3		
IRL	5,1	8,1	10,2	12,3	14,9	16,6	17,9	18,4		11,7	F
I	5,7	5,9	8,1	9,7	11,0	12,0	12,9		18,5	18,2	IRL
L	0,1	0,4	1,0	1,3	1,6			13,0	14,2	14,3	1
NL	1,4	5,3	8,8	11,8		1,8	1,7	1,4	1,5	1,4	L
P			:		14,2	14,5	13,3	12,1	11,4	10,9	NL
UK	2,2	4,5	9,1	10.6		8,5	8,6	8,6	7,2	6,8	P
		7,3	7,1	10,6	11,6	11,8	12,0	12,1	11,0	10,4	UK
EUR12		:	:			11,7	12,1	11 0	11 0	11 7	nun 1 2
EUR 9	2,2	5,1	7,7	9,3	10,4			11,9	11,8	11,7	EUR12
		-,-		,,,	10,4	10,9	11,1				
USA	5,3	6,8	7,6	9,7	9,6	7,5	7.2	7.0	()	(0	
JAP	1,4	1,9	2,2	2,4	2,7		7,2	7,0	6,3	6,0	USA
				-,-	-,'	2,7	2,6	2,8	3,0	2,9	JAP

Source: Eurostat and Commission services

¹ Economic Porecasts, September 1987
2 The rates presented here are based on the number of registered unemployed on a common Eurostat definition, except for Greece, Spain and Portugal where national survey results are presented

Table 4: Contribution to prices) ²	real	GDP :	growth	(in)	percent	age po	oints a	at 1980
	1981	1982	1983	1984	1985	1986 ¹	19871	19881
EUR12								
Domestic demand (excluding change in stocks)	-0,5	0,3	1,1	1,4	2,3	3,5	2,9	2,7
Change in stocks	-1,3	0,6	-0,1	0,5	0,0	0,2	0,3	0,1
Balance of trade in goods and services.	1,7	-0,3	0,5	0,5	0,1	-1,2	-1,0	-0,4
GDP growth	0,0	0,6	1,5	2,4	2,5	2,6	2,2	2,3
Deviation of change in domestic demand from that in other OECD countries 3	-3,5	0,9	-1,8	-3,4	-1,1	0,1	0,5	0,0
USA								
Domestic demand (excluding change in stocks)	1,9	0,0	4,7	6,9	5,1	4,1	1,3	2,3
Change in stocks ⁴	0,9	-1,5	0,5	2,0	-1,5	0,3	0,7	-0,1
Balance of trade in goods and services	-0,8	-1,0	-1,8	-2,4	-0,7	-1,2	0,3	0,5
GDP growth	2,1	-2,5	3,4	6,6	2,9	3,1	2,3	2,7
Deviation of change in domestic demand from that in other OECD countries 3	2,5	-1,2	3,2	5,4	0,3	0,3	-1,0	-0,7
Japan								
Domestic demand (excluding change in stocks)	2,2	2,8	2,1	3,2	3,4	4,1	4,4	4,0
Change in stocks	-0,1	-0,1	-0,4	0,5	0,1	0,6	0,1	0,1
Balance of trade in goods and services	1,7	0,1	1,4	1,3	1,0	-1,3	-0,8	-0,4
GDP growth	3,9	2,8	3,2	5,0	4,5	2,4	2,9	3,5
Deviation of change in domestic demand from that in other								
OECD countries ³	1,4	3,6	-1,5	-1,6	0,6	0,2	1,6	1,7

Source: Commission services

 $^{^{\}rm l}$ Economic Forecasts, September 1987 $^{\rm l}$ Due to statistical discrepancies, the sum of the contributions is not always identical to total GDP growth

³ Domestic demand (including stocks) growth differential from a weighted average of OECD partner countries. The weighting structure is the same as that used to calculate effective exchange rates

⁴ Including statistical discrepancies

	1986 ¹	19871	1988
eal gross national/domestic product	t - % change o	on preceding	year
UR12	2,6	2,2	2,3
ther OECD	2,8	2,5	2,9
- USA - Canada	2,9 3,2	2,3 3,2	2,7
- Japan	2,4	2,9	2,9 3,5
- Rest OECD	2,6	2,2	2,3
otal OECD	2,7	2,4	2,7
olume of world trade (goods) - % cl	hange on prece	eding year	
UR-definition ²			
- excluding EUR	3,8	2,1	3,5
- including EUR	4,9	3,5	3,9
ECD-definition ³			
- excluding EUR	4,2	3,1	3,9
- including EUR	4,3	3,4	4,0
orld export prices in USD - % change	ge on precedir	ng year	
w materials excluding fuels	5,1	4,1	4,8
rude oil (fob)	-49,7	26,2	4,1
rude oil (fob)	-49,7 19,2	26,2	4,1
rude oil (fob) anufactured products	-49,7 19,2 ns of USD 52,8	26,2 11,4 44,8	4,1 5,9 36,3
rude oil (fob) anufactured products alance on current account - billion JR12 ther OECD	-49,7 19,2 as of USD 52,8 -87,8	26,2 11,4 44,8 -94,8	36,3 -89,9
rude oil (fob) anufactured products alance on current account - billion JR12 ther OECD - USA	-49,7 19,2 as of USD 52,8 -87,8 -141,3	26,2 11,4 44,8 -94,8 -154,3	36,3 -89,9 -147,3
rude oil (fob) anufactured products alance on current account - billion JR12 ther OECD - USA - Canada	-49,7 19,2 as of USD 52,8 -87,8 -141,3 -6,3	26,2 11,4 44,8 -94,8 -154,3 -4,0	36,3 -89,9 -147,3 -1,5
rude oil (fob) anufactured products alance on current account - billion JR12 ther OECD - USA - Canada - Japan	-49,7 19,2 ns of USD 52,8 -87,8 -141,3 -6,3 85,8	26,2 11,4 44,8 -94,8 -154,3 -4,0 84,9	36,3 -89,9 -147,3 -1,5 79,0
rude oil (fob) anufactured products alance on current account - billion JR12 ther OECD - USA - Canada - Japan - other OECD	-49,7 19,2 ns of USD 52,8 -87,8 -141,3 -6,3 85,8 -25,9	26,2 11,4 44,8 -94,8 -154,3 -4,0 84,9 -21,5	36,3 -89,9 -147,3 -1,5 79,0 -20,0
rude oil (fob) anufactured products alance on current account - billion JR12 ther OECD - USA - Canada - Japan - other OECD	-49,7 19,2 ns of USD 52,8 -87,8 -141,3 -6,3 85,8 -25,9 -35,0	26,2 11,4 44,8 -94,8 -154,3 -4,0 84,9 -21,5 -50,1	36,3 -89,9 -147,3 -1,5 79,0 -20,0
rude oil (fob) anufactured products alance on current account - billion JR12 ther OECD - USA - Canada - Japan - other OECD otal OECD	-49,7 19,2 ns of USD 52,8 -87,8 -141,3 -6,3 85,8 -25,9 -35,0 -33,0	26,2 11,4 44,8 -94,8 -154,3 -4,0 84,9 -21,5 -50,1 -6,9	36,3 -89,9 -147,3 -1,5 79,0 -20,0 -53,6 -2,4
rude oil (fob) anufactured products alance on current account - billion JR12 ther OECD - USA - Canada - Japan - other OECD otal OECD PEC countries ther developing countries	-49,7 19,2 ns of USD 52,8 -87,8 -141,3 -6,3 85,8 -25,9 -35,0 -33,0 -7,2	26,2 11,4 44,8 -94,8 -154,3 -4,0 84,9 -21,5 -50,1 -6,9 -8,6	36,3 -89,9 -147,3 -1,5 79,0 -20,0 -53,6 -2,4 -14,4
rude oil (fob) anufactured products alance on current account - billion JR12 ther OECD - USA - Canada - Japan - other OECD otal OECD	-49,7 19,2 ns of USD 52,8 -87,8 -141,3 -6,3 85,8 -25,9 -35,0 -33,0	26,2 11,4 44,8 -94,8 -154,3 -4,0 84,9 -21,5 -50,1 -6,9	36,3 -89,9 -147,3 -1,5 79,0 -20,0 -53,6 -2,4

Other developing countries include China, Yugoslavia and South Africa Other countries exclude intra-COMECON trade

Source: Commission services

¹ Economic Forecasts, September 1987
2 Growth rate of world imports
3 Arithmetic average of respective growth rates of world imports and exports

Table 6: Real trade balances 1985-19882											
	1985	19861	19871	19881	change 85/86	change 86/88					
	a) <u>in</u>	billion	s USD at	1985 pr	ices						
USA Japan EUR12 Germany Developing countries - OPEC - other developing countries	56,0 11,9 28,1	39,4 -17,3 21,7 86,6	23,0 -42,3 16,1 104,1		-16,6 -29,2 -6,4 29,5	-35,5					
	b) as	% of GDP	at 1985	prices							
USA Japan EUR12 Germany	-3,1 4,2 0,5 4,5	2,9	1,6 -1,6	1,2							

¹ Economic Forecasts, September 1987
2 Balance of payments basis, Fob-Fob

Source: Commission services

Table 5: Merchandise imports and exports (volume) (% change on the preceding year)

		Imports			Exports		Mark	cet grow	rth1		Export	
	1986	19872	19882	1986	19872	19882	1986	19872	19882	Pe 1986	rformand 1987 ²	
EUR12 total - intra-EUR4 - extra-EUR4	6,7 6,0 7,4	5,7 4,5 7,5	4,6 3,9 5,7	2,0 5,6 -2,1	2,0 5,3 -1,9	3,3 4,7 1,5	4,1 7,2 0,5	3,3 5,5 0,7	3,9 4,5 3,1	-2,0 -1,5 -2,6	-1,3 -0,2 -2,6	-0,6 0,2 -1,6
USA	13,9	2,5	2,6	7,7	11,8	11,1	2,7	3,0	4,4	4,9	8,6	6,4
Japan	10,1	6,2	5,2	-2,7	-4,9	0,6	3,8	2,6	3,4	-6,3	-7,3	-2,7
OPEC	-20,5	-17,0	-0,0	6,0	2,5	4,4						
Other developing countries	-0,9	4,3	4,9	6,0	4,6	4,4						
World	4,9	3,5	3,9	3,4	3,4	4,4						
World excluding EUR	3,8	2,1	3,5	4,2	4,1	5,0						

¹ Change in imports from third countries weighted by the regional export structure of the respective country or

² Economic Forecasts, September 1987
3 Index for exports divided by an index for growth of markets
4 Estimates of the Commission services

	1981	1985	1986	1981	1985	1986	1981	1985	1986	1981	1985	1986
		tal imp						Subgroup	ps ⁷ :			
				Countri debt-sei	les with	n recent problems	Fi:	fteen he	eavily ountries	Sub-Sa	haran A	frica
			a) Extern	nal fina	ancing						
Net external borrowing - Long-term borrowing from	129,5	44,2	41,5	86,3	13,7	14,4	65,2	5,7	9,1	9,2	4,0	5,7
official creditors - Reserve-related liabilities	31,4 12,2	24,0 2,8	30,6 7,1	17,1 9,1	16,2	16,5 7,3	6,5 1,4	7,7 -0,5	6,7 2,2	4,8	4,0 1,8	4,0
- Other net external borrowing ⁶	85,8	17,4	3,8	60,1	-4,9	-9,4	57,3	-1,5	0,2	2,0	-1,8	1,4
			b)	Externa	l indeb	tedness						
Total debt ² Debt ratio ³ Debt service ratio ⁴ Interest service ratio ⁵	708,0 30,4 22,2 12,3	954,1 39,8 25,0 14,2	1036,3 41,5 27,1 13,3	462,0 37,6 32,9 18,6	585,9 48,6 36,7 23,8	621,6 50,3 42,0 23,2	332,3 32,8 39,3 22,8	416,5 46,2 42,1 29,6	433,5 60,3 49,8 30,0	48,6 44,6 19,3 9,1	65,1 65,7 24,9 11,1	74,1 67,8 29,6 11,3

l All developing countries except Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, United Arab Emirates.

Source: IMF World Economic Outlook 1987 and Commission services

² For all developing countries (capital importing and capital exporting countries) total debt amounted to around 1101 billion USD in 1986. The IMF forecasts for 1987 an increase to about 1198 billion USD of which 1128 billion represents the total debt of capital importing countries

³ External debt relative to GDP

⁴ Debt service relative to exports of goods and services

⁵ Interest service relative to exports of goods and services

⁶ Residually calculated. The amounts shown reflect mainly net external borrowing from private creditors and

⁷ According to different commonly used classifications

	1981	1985	1986	1981	1985	1986	1981	1985	1986	1981	1985	1986
		develo										
				Fue	l expor	ters	Non-f	uel exp	orters			
											porters nufactu	
Current account balance	-48,5	-23,8	-46,3	34,8	3,0	-37,1	-83,2	-26,8	-9,2	-15,2	-4,2	13,0
- Trade balance	37,1	45,4	7,2	120,4	67,4	15,2	-83,2		-8,0	-25,2	-12,2	1,9
- Net services	-100,7	-90,6	-79,5	-68,8		-40.0	-31,9	-40,0	-39,5	0,8	-2,6	-0,5
- Unrequited transfers	15,1	21,3	26,0	-16,8			31,9	35,1	38,3	9,1	10,6	11,5
Oil trade balance	216,8	118,4	63,8	278,1	155,2	87,4	-61,4	-36,8	-23,6	-25,3	-15,6	-10,0
Resource balancel	-30,7	20,0	-3,5	17,2	1.6	-39,2	-47,8	18,5	35,7	-5,2	4,0	21,2

¹ The resource balance is intended to show the availability of external resources to an economy. In the present context it has been calculated as the current account balance minus net investment income. A positive resource balance reflects an outflow of financial resources and vice-versa.

Source: IMF World Economic Outlook 1987 and Commission services

² Countries are grouped by predominant export. Fuel exporters and non-fuel exporters are subgroups of the total. Exporters of manufactures are those non-fuel exporters, whose exports of manufactures accounted in 1980 for over 50% of their total exports.

Table 10:Bilateral nominal, nominal and real effective exchange rates
Index 1970=100 and % change on preceding year)

		Bi lat nomi exchang Level	nal	Nomi effec exchang Index		Relative labour con national Index	osts in		
EUR12		ECU	'USD						
average average	60 - 69 70 - 77	1,059 1,137		101,9		98,5 103,8		100,3 104,7	
	1978	1,274	11,7	94,7	0,6	111,5	1,9	105,7 115,4	2,4
	79	1,371	7,6	100,9	6,5	114,4	2,5	122,9	6,5
	80	1,392	1,6	102,6	1,6	119,9	4,8	105,3	-14,3
	81	1,116	-19,8	86,1	-16,1	122,4	2,1	99,2	-5,9
	82	0,980	-12,2	80,0	-7,0	123,9	1,2	93,6	-5,6
	83	0,890	-9,1	73,2	-8,5	127,8	3,2	86,6	-7,5
	84	0,789	-11,4	66,6	-9,1	130,1	1,8	85,8	-0,9
	85	0,763	-3,3	65,3	-1,8	131,4	1,0	95,3	11,1
	86	0,984	29,0	72,4	10,8	131,7	0,2	101,6	6,6
	874	1,136	15,4	77,2	6,6	131,6	-0,0	101,8	0,2
	884	1,180	3,9	78,2	1,3	130,2	-1,1	101,0	0,2
USA		USD	/ECU						
average	60-69	0,945		98,9		99,6		98,6	
average		0,879		89,7		88,4		79,3	
	1978	0,785	-10,4	80,2	-9,2	79,7	1,4	63,9	-8,0
	79	0,730	-7,0	77,9		82,0	2,9	63,9	-0,0
	80	0,718	-1,6	77,8		82,4	0,5	64,1	0,4
	81	0,896	24,7	87,7	12,8	82,0	-0,4	72,0	12,3
	82	1,021	14,0	98,3	12,0	83,1	1,3	81,6	13,4
	83	1,123	10,1	103,9	5,7	82,3	-1,0	85,5	4,7
	84	1,267	12,8	112,0	7,8	82,2	-0,1	92,0	7,7
	85	1,310	3,4	116,5	4,0	82,8	0,7	96,5	4,8
	86	1,016	-22,5	95,0	-18,4	81,5	-1,6	77,5	-19,7
	874	0,881	-13,3	85,0	-10,5	81,3	-0,2	69,1	-10,8
	884	0,848	-3,7	82,1	-3,4	82,0	0,9	67,4	-2,5
Japan		Yen	/ECU						
Average	60-69	0,00262		98,1		101,3		99,3	
Average	70-77	0,00291		111,3		113,5		127,5	
	1978	0,00374	14,5	153,5	21,8	116,5	-3,6	178,8	17,4
	79	0,00333	-11,1	142,2		109,0	-6,4	155,0	-13,3
	80	0,00317	-4,6	136,4	-4,0	100,6	-7,7	137,3	-11,4
	81	0,00408	28,4	155,0	13,6	95,1	-5,5	147,5	7,4
	82	0,00411	0,8	147,3		89,7	-5,7	132,1	-10,5
	83	0,00473	15,2	163,3	10,9		-2,7	142,4	7,8
	84	0,00535	13,0	172,2			-3,5	145,0	1,8
	85	0,00554	3,6	177,4			-3,9	143,5	-1,0
	86	0,00606	9,4	228,5			-0,2	184,4	28,5
	874	0,00601	-0,9	246,6			-0,9	197,3	7,0
	884	0,00612	1,9	256,9	4,2	79,8	-0,3	204,9	3,8

Table 9: Comparison of forecasts for 1987 (EUR12): October 1986 - September 1987 - % change on the preceding year

	Oct. 861	Sept. 872
Real GDP	2,8	2,2
Private consumption	3,5	3,1
Gross domestic fixed capital formation	5,1	3,6
Construction	3,2	2,0
Equi pment	6,9	5,3
Exports of goods and services	3,7	1,9
Private consumption deflator	3,0	3,2
Employment	0,8	0,8
Current balance ³	0,9	1,1
Unemployment rate ⁴	11,7	11,8

¹ Economic Forecasts, October 1986 2 Economic Forecasts, September 1987

^{3 %} of GDP 4 % of the civilian labour force

Table 11: Business survey results on the revision of plans and expectations in response to exchange rate changes (weighted balance)1

	В	D	GR	E	F	IRL	I	L	NL	UK	
Domestic production	-23	-10	-15	-1	-18	-11	-6	-41	-25	+2	
Number employed	-15	-13	:	-19			:	-42	-25	-8	
Domestic investment (nominal)	-10	-8	-18	+23	-8	-11	+10	+4	-9	-2	
Investment abroad (in national currency)	-8	-2	:	+2	-1	0		+3	-6	-3	
Profits	-39	-35	-59	:	-37	-12		-51	-49	-32	
Domestic selling prices	-14	-5	+55	0	-12	-10	0	-6	-42	+20	
Export prices in national currency	-51	-19	+25	0	-28	-22	-2	-89	-68	+4	
Medium term sales expectations	-23	-15	:		:	-19	:	-34	-41	-5	

p.m.: exchange rate changes Jan.1986/May 1987 against the

against the
- USD +34,9 +36,8 +11,5 +22,3 +25,6 +20,2 +29,1 +34,9 +36,8 +17,1
- weighted average of
the currencies of 19 +7,5 +11,6 -10,8 -0,4 +1,1 -1,5 +4,7 +7,5 +8,4 -4,2
main trading partners

Denmark did not take part in this special survey.

Source: European Community business survey

The special survey was conducted in April/May 1987. The wording of the question was: "The appreciation of the national currency has prompted us to revise plans/expectations for 1987 that we announced last autumn". The offered response categories were: no change/no response, revised sharply upwards, revised somewhat upwards, revised sharply downwards, revised somewhat downwards. The balance has been calculated on the basis of responses for total industry, with sharp revisions being given a double weight.

The results for Portugal are not yet available.

Table 10(continued):

1 The nominal effective exchange rate is the weighted average of the exchange rate of a currency with respect to the main 9 (EUR12) or 19 competing countries. The weight attributed to each currency reflects the importance of the respective country as a bilateral trading partner and as a competitor on third markets (double export weights).

Index of unit labour costs in the country or zone in question in relation to the weighted average of unit labour costs in the main 9 (EUR12) or 19 competing countries in national currency. This indicates the relative competitiveness of the country or zone in question in the absence of any movements in exchange rates.

The index of the real effective exchange rate is derived by multiplying the index of the nominal effective exchange rate by a similarly calculated index of the relative change in price or cost levels in national currencies, in the present case unit labour costs in the total economy. Such an index can also be used as an indicator of the competitiveness of a country, where an increase in the index (index of relative unit labour costs in a common currency) reflects a deterioration in cost competitiveness.

4 Economic Forecasts, September 1987

Table 13:	Real	convergence	-	per	capita	GDP ²	and	its	divergence	in	the
	Commu	ini ty									

Community by								
	1960	1970	1975	1980	1985	1986	19871	19881
В	96,1	99,5	103,0	104,4	101,7	101,8	101,2	101,0
DK	119,8	116,7	111,3	109,5	116,7	117,8	115,1	113,6
D	118,2	113,6	109,6	114,2	116,0	116,2	115,6	115,4
GR	38,7	51,7	57,1	58,4	56,1	55,3		52,6
E	58,3	72,3	80,1	73,8	72,3	72,7	73,9	74,6
F	101,4	106,1	110,4	111,6	109,0	108,2	106,8	106,2
IRL	61,9	61,4	63,0	64,7	63,8	62,3	62,7	62,3
I	91,4	100,6	97,7	102,0	103,2	103,5	104,4	105,1
L	141,3	125,3	122,7	120,5	127,5	127,5	127,4	127,0
NL	120,0	117,3	116,3	112,4	107,3	106,7	105,9	104,4
P	38,2	47,4	50,3	54,3	52,6	53,2	53,8	54,1
UK	128,3	108,0	105,7	100,7	103,9	104,2	105,3	105,8
EUR12	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0
Weighted standard deviation EUR12	26,2	17,9	15,5	16,8	17,6	17,5	17,2	17,1
Ratio of 4 poorest to 4 richest countries	41,0	56,3	63,4	60,0	58,6	58,9	59,9	60,4

¹ Economic Forecasts, September 1987
2 GDP per capita at current prices and purchasing power standards as a percentage of the Community average

Table		Deflator elopmen		private	cons	sumpti on	and	converg	ence of	price
	1969 1960	1977	1981 1977	1982	1983	1984	1985	19861	19871	19881
B DK D GR E F IRL I L NL P	3,2 5,7 2,7 2,4 5,9 4,2 4,5 3,7 2,3 4,1 2,7	7,4 10,0 5,5 10,7 13,5 8,3 13,8 13,0 6,8 8,0 13,4	5,6 10,6 4,7 18,6 16,3 11,3 15,2 16,5 6,2 5,5 21,6	7,3 10,2 4,7 20,8 14,5 11,2 15,9 15,9 10,8 5,3 22,5	7,5 6,8 3,2 17,9 12,3 9,5 10,0 14,8 8,1 2,7 25,5	6,2 6,5 2,4 18,4 10,7 7,2 7,5 11,4 6,4 2,5 29,3	4,8 4,8 2,1 18,6 8,3 5,5 4,2 9,3 3,3 2,6 19,0	1,3 3,6 -0,5 22,1 8,9 2,5 3,6 6,3 0,3 0,2 12,1	1,8 4,1 0,6 16,0 5,4 3,1 3,0 4,8 0,5 -0,8 9,3	2,5 4,0 1,8 12,0 4,2 2,6 3,2 4,9 2,3 1,0 6,5
UK	3,7	12,6	12,6	8,7	5,0	4,8	5,2	3,6	3,0	3,9
EUR12 EMS	3,7 3,6	9,9 8,7	11,3 9,9 Measur	10,4 9,8 res of di	8,5 8,3	7,0 6,4	5,9 5,1	3,7 2,4 average ²	3,2 2,5	3,42,9
EUR12 EMS	0,9	2,5	4,7	4,6 3,4	4,7	4,6 1,9	3,9 1,7	4,1 1,8	2,7	1,8
			Measu	res of d	lispers	ion rel	ated to	lowest ²		
EUR12 EMS	1,4	4,7 3,6	7,4 4,8	7,7 5,5	7,6 5,1	7,0 3,8	5,2 2,5	5,8 2,7	5,0 2,9	3,2 1,7

Economic Forecasts, September 1987
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)

Table 15: Sectoral developments in employment (EUR10)

Lyt	1980 1970	1980 1	.985 .983 .ual av	1986 ¹ verage rate	19871 2 of change	19881 2	1970 % share o employmen	
Employment in								
- Agriculture	-3,2	-2,4 -	-2,4	-			11,2	7,0
- Industry	-0,8	-3,3 -	-1,4	-0,2	-0,5	-0,3	41,7	33,2
- Services	1,9	0,9	2,0		-	-	47,1	59,8
Total	0,3	-0,6	0,5	0,8	0,8	0,6	100	100

¹ EUR12 2 Economic Forecasts, September 1987

Table		minal v			wage	s and	real	unit	labour	costs
	1973- 1960	1980- 1973	1981	1982	1983	1984	1985	19861	19871	19881
		a)	Nomi n	al com	pensat	ion pe	r emplo	yee		
В	8,9	11,6	6,5	8,2	6,0	5,8	4,4	2,5	3,7	3,0
DK	10,7	11,7	9,2	11,9	8,2	5,3	4,8	5,1	7,2	5,2
D	9,2	7,4	5,2	4,2	3,8	3,4	3,0	3,9	3,3	2,9
GR	10,2	21,1	21,5	27,8	21,3	21,2	21,7	13,7	12,5	12,0
E	14,5	21,8	15,7	13,8	14,5	11,8	9,9	8,7	6,5	5,3
F	9,9	14,7	14,3	13,7	10,6	8,1		4,0	3,0	3,5
IRL	11,3	19,5	18,1	14,4	11,6			6,1	6,1	4,9
I	11,6	20,2	22,6	16,2	16,0	11,4	10,2	7,7	8,3	6,0
L	7,4				6,8	7,2	4,1	4,0		4,2
NL	11,4	9,5	3,5	5,8	3,2	0,4	1,3	1,6	1,9	1,6
P	12,0	25,2	19,9	20,1	16,6	18,7				
UK	8,3		13,2	9,3	9,1	5,1		7,2	6,8	The second secon
	10,0			11,1					5,4	
		compe		n per	emp]	Loyee	deflat	ed by	the	private
C	onsumpt	ion defi	lator							
В	5,1	3,5	-1,4	0,9	-1,4	-0,4	-0,3	1,2	1,9	0,5
DK	3,8	0,8	-2,5	1,5	1,3	-1,1	-0,0	1,5	2,9	1,2
D	5,4	2,4	-0,8	-0,5	0,6	1,0	0,9	4,4	2,6	1,1
GR	6,5	4,4	-1,6	5,8	2,9		2,6	-6,9	-3,0	0,0
E	7,3		1,2	-0,6	1,9			-0,2	1,0	1,1
F	5,1	3,5	1,3	2,3				1,4	-0,1	1,0
IRL	5,0	2,9	-1,2	-1,3	1,5		3,2	2,4	3,0	1,6
I	6,5	2,3	3,9	0,2	1,0		0,8	1,3	3,3	1,0
L	4,2	3,4	-0,2	-3,5	-1,2	0,7	0,7	3,6	3,9	1,9
NL	6,0	2,2	-2,7	0,5	0,4	-2,0	-1,3	1,4	2,7	0,6
P	8,3	2,7	1,3	-2,0	-7,1	-8,2	0,8	4,1	2,4	1,9
UK	3,3	1,6		0,6	3,9	0,4	2,0	3,5	3,6	2,6
EUR12	5,1	2,5	0,9	0,6	1,3	0,3	0,9	2,2	2,1	1,3
			c)	Real u	nit la	bour c	osts2			
	0.3	, ,	1.0	2.0	_1 1	_1 2	_1 2	-2 1	0.4	-0,8
В	0,3	1,4	1,0	-2,0	-1,1	-1,2	-1,3	-3,1	0,4	-0,0
DK	0,2	0,5	-1,2	-1,3		-2,3	-1,5	-1,1 $-0,8$	3,4	
D	0,5	-0,0	0,3	-1,2	-2,5	-1,2 $-1,6$	-1,1	-5,4	0,6	-0,5 0,1
GR	-2,5	1,9	6,5	1,7 -2,2	2,5	-4,0	2,4	-3,7	-0,9	-0,8
E F	0,5	-0,2 1,0	0,4	-0,7	-0,1	-1,6	-1,4	-2,5	-1,6	-1,0
IRL	-0,0 -0,4	1,2	-3,5	-2,4	0,0	-0,7	-2,4	0,3	0,3	1,0
I	0,2	0,3	2,2	0,3	0,6	-1,6	-0,1	-2,4	0,3	-0,7
L	-0,2	3,3	1,7	-5,0	-4,3	-3,9	-0,7	-0,3	0,9	0,6
NL	1,0	0,2	-2,7	-1,3	-2,0	-4,4	-1,6	0,2	2,1	0,1
P	0,3	1,4	4,0	-5,2	-1,5	-5,0	-4,8	-5,0	-0,7	-0,8
UK	0,3	0,0	-1,3	-1,3	-1,1	0,8	-1,0	1,2	0,8	-0,1
EUR12	0,2	0,3	0,5	-1,0	-0,7	-1,5		-1,4	0,1	-0,5
LUKIZ	0,1	0,5	0,5	1,0	,,	-,,	-,-	-,-	,,.	,,,

¹ Economic Forecasts, September 1987
2 Compensation per employee deflated by the GDP deflator and divided by real GDP per person in total employment

	Uni t Ki ng		Fra	ince	Germany		
12 Cont. 1460	1983	1985	1983	1985	1984	1985	
Fixed term contract % share of:	cts						
- Total	5,0	5,5	2,3	3,2	4,2	6,8	
salaried							
employment					4,2	7,0	
- Men	3,8	4,0	2,0	3,1	4,2	6,4	
- Women	7,0	7,4	2,7	3,3 4,1	7,6	8,9	
- Part-time	11,5		2,1 2,3		3,6	6,4	
- Full-time	2,5	2,4 9,8	7,0	10,9	9,5	16,7	
- Young persons under 25 years	10,2	7,0	7,0				
% change:	1985	/1983	1985	/1983	19	85/1984	
" Change.							
- Employment unde	r +1	1,2	+3	6,2		+64,0	
fixed term cont				1 0		+0,8	
- Total salaried employment	+	1,9		1,0		.0,0	

Source: Wissenschaftszentrum, Berlin on the basis of EC labour force sample surveys for France and the UK and Microcensus (Statistisches Bundesamt) for Germany

Table 16:	Percent	age of	emplo	yees	working	part	-time	e of t	otal em	ployees
	В	DK	D	F	IRL	I	L	NL	UK	EUR9
1975	4,1	22,3	10,1	6,5	4,7	4,0	4,8	8,8	17,9	10,2
1979	5,5	24,6	10,8	6,9	4,1	3,7	5,4	10,8	17,9	10,8
1983	8,3	25,6	12,0	8,9	5,8	3,5	6,2	20,9	19,4	12,3
1985	9,3	25,3	12,3	10,5	5,8	4,5	7,1	22,4	21,7	13,5

Source: Eurostat, "Employment and Unemployment 1987" Table VI/2 and previous issues. Based on Community labour force sample survey.

Table 19: Long-term	unemployment 1 as $\%$ o	of total unemploy	ment
	1983	1984	1985
В	64,1	67,1	68,2
D	38,4	43,4	46,9
DK	32,2	30,9	32,0
GR	32,3	37,1	43,4
Е	52,5	53,4	56,3
F	39,6	39,1	43,8
I	54,6	60,5	63,6
IRL	35,2	44,5	62,23
L	32,7	29,3	36,8
NL	46,9	n.a.	56,4
P	45,2	43,5	48,4
UK	44,8	45,5	48,7
EUR12	46,32	48,32	52,12

¹ Unemployment of more than 1 year duration

2 Estimate

Source: COM(87)231 final on the basis of EC labour force sample survey

Spain: national survey

Portugal: national definition of unemployment

³ The change of format of the question in 1985 appears to have affected the response

Table 18: Structure of u	nemployment (EUF	(12)1		
	1984	1985	1986	
Unemployment rate in %				
- Total	10,5	10,7	10,8	
- Men	9,3	9,4	9,3	
- Women	12,5	12,7	13,2	
- Under 25 years	23,5	22,9	22,7	
- Over 25 years	7,3	7,6	7,8	

l Data are from the harmonised Community labour force sample survey. Accordingly, rates differ from those published for registered unemployment as a percentage of the civilian labour force.

Source: Eurostat, "Employment and Unemployment 1987" Table IV/1 based on EC labour force sample surveys

Table 22: Medium-term projections of Commission services and outturns - EUR10

	% change	
	Projection	Outturn
European Economy n°9, July 1981 - 5th Programme		
1) GDP in volume 1985/80	1,9	1,2
2) Employment 1985/80	-0,2	-0,5
3) Unemployment rate 1 1985, % of civilian	10,2	11,1
labour force		
European Economy n°14, November 1982		
1) GDP in volume 1987/80	1,6	1,4
2) Employment 1987/80	-0,2	-0,2
3) Unemployment rate 1 1987, % of civilian	11,1	10,5
labour force		
European Economy n°18, November 1983		
1) GDP in volume 1987/82	1,9	1,9
2) Employment 1987/82	-0,1	0,2
3) Unemployment rate 1 1987, % of civilian	10,4	10,5
labour force		

¹ Rate obtained by aggregating the rate of Member States calculated according to their national definitions. Rates can therefore differ from harmonised rates published by Eurostat

Table 20: Evolution of unemployment (as a % of labour force)	rates by	region	
	1976	1980	1985
EUR111	4,6	6,2	11,7
25 weakest regions	8,0	11,7	21,1
25 strongest regions	2,4	3,0	6,6

¹ EUR12 excluding Greece

Source: COM(87)230 Annex p. 134

Table 21: Evolution in labour force 1985-951

		The state of the s	
	Increase 1985-1995 ('000)	Annual average growth rate	
1. Total weaker countries			100
and regions	3 442	1,0	
Spain	1 380	0,9	
Portugal	387	0,8	
Greece	338	0,8	
Ireland	291	1,9	
Mezzogiorno	1 046	1,3	
2. Total strongest regions	3 256	0,3	
3. EUR12, total	6 698	0,5	

¹ On the assumption of no net migration between regions

Source: COM(87)230, Annex p. 149

Table 24: 1987-1991 Reference projection of September 1987 - EUR12 (% annual average growth rates, unless otherwise stated)

	1970 1960	1980 1970	1985 1980	1986	1987	1988	1989	1990	1991	1991 1986
1. Real GDP	4,8	3,0	1,2	2,6	2,2	2,3	2,3	2,6	2,8	2,5
2. Unemployment rate (% of labour force)1	2,05	6,15	12,1	11,9	11,8	11,7	11,4	11,1	10,6	10,6
3. Price of private consumption	3,8	10,6	8,7	3,7	3,2	3,4	3,3	3,4	3,4	3,3
4. Balance on current transactions (% GDP)1	0,5	-1,3	0,5	1,5	1,1	0,8	0,7	0,4	0,2	0,2
5. Real domestic demand	4,9	2,9	0,6	3,8	3,2	2,7	2,5	2,7	2,8	2,8
6. Real private consumption	4,9	3,4	1,0	3,9	3,1	2,7	2,6	2,7	2,8	2,8
7. Private investment	6,42	1,8	0,6	3,8	3,7	3,3	3,7	4,2	4,4	3,9
8. Real exports of goods and services	7,9	5,8	4,3	1,6	1,9	3,2	4,2	4,5	4,8	3,7
9. Real imports of goods and services	8,7	5,4	2,4	5,9	5,3	4,4	4,5	4,8	4,8	4,8
10. Total employment	0,2	0,2	-0,5	0,8	0,8	0,6	0,6	0,6	0,7	0,7
11. Productivity (GDP per person employed)	4,6	2,8	1,7	1,8	1,4	1,7	1,7	2,0	2,1	1,8
12. Real unit labour costs3	0,0	0,4	-0,7	-1,4	-0,0	-0,5	-0,3	-0,2	-0,2	-0,3
13. Real long term interest rates	2,3	-0,9	3,0	3,6	5,2	5,6	5,7	5,6	5,4	5,5
14. Index of the profitability of capital ⁴) (1960-69 = 100)	98,9	75,0	61,9	75,9	76,1	78,3	79,6	80,7	81,8	79,3
15. Public deficit (% of GDP)	-0,6	-2,8	-5,2	-4,8	-4,5	-4,5	-4,1	-3,9	-3,4	-4,1

l Level at end of period (in percentage points)

For the forecasting period 1987-91, the years 1987-88 correspond to the short-term forecasts of the Commission services (Economic Forecast 1987-88, September 1987) extended to 1991 with the help of the COMPACT model.

² EUR10 (EUR12 excluding Spain and Portugal)

³ Calculated as the relationship between real labour costs per employee and GDP per person in employment

⁴ The results calculated by the model are a synthetic indicator and cannot therefore be compared directly to those for the business sector presented elsewhere

⁵ EUR9 (EURi2 excluding Greece, Spain and Portugal)

Table 23: Main working hypotheses for the 1987-91 reference projection of September 1987 - EUR12 (% annual average growth rates, unless otherwise stated)

	1970 1960	$\frac{1980}{1970}$	$\frac{1985}{1980}$	1986	1987	1988	1989	1990	1991	1991 1986
A. Hypotheses concerning the international environment										
1. Oil price (USD/barrel)1	1,3	28,7	27,5	13,7	17,3	18,0	19,0	22,0	24,0	24,0
2. Exchange rate ECU/USD	+0,3	-3,0	+12,8	-22,7	-13,3	-3,7	-1,0	-1,0	-1,0	-4,2
3. Exchange rate YEN/USD	0,0	-4,5	0,9	-29,3	-12,6	-5,5	-3,0	-3,0	-3,0	-5,5
4. Imports of goods - USA	8,4	4,5	6,5	13,9	2,5	2,6	3,5	4,0	4,5	3,4
(1980 prices) - Japan	14,4	5,1	1,4	10,1	6,2	5,2	5,5	5,5	5,5	5,6
- Other OECD	7,6	4,1	4,5	6,0	2,0	3,1	3,5	4,0	4,5	3,4
- OPEC	4,5	15,4	-0,4	-20,5	-17,0	0,0	10,0	10,0	7,5	1,5
- Developing countries	6,2	4,9	2,0	-0,9	4,3	4,9	5,0	5,0	5,0	4,8
- Other countries	7,8	7,5	2,6	-2,0	4,5	3,0	4,0	4,0	4,0	3,9
5. World trade excluding EUR12	7,8	5,7	3,2	3,8	2,1	3,5	4,5	4,8	4,8	3,9
B. Economic policy hypotheses										
1. Real public consumption	3,6	3,1	1,5	2,4	1,8	2,0	1,5	1,4	1,3	1,6
2. Real public investment	4,0 2	-0,2	-0,3	1,0	2,9	3,3	2,5	2,5	2,5	2,7
 Annual average change in the share of public current receipts in GDP (in percentage points) 	0,6	0,6	0,5	-0,2	-0,0	-0,2	-0,0	-0,2	-0,0	-0,1
4. Money supply (M2/M3)	10,2 2	14,8	10,4	10,2	10,2	8,6	9.0	9.0	0.0	0 1
5. Nominal long-term interest rates	6,7 2	9,9 2	11,5 2	9,2	9,1	9,1	8,0	8,0	8,0	8,6
6. Labour costs per head	9,2	14,3	9,6	6,0	5,4	4,7	9,0	8,8	8,6	8,9
 Real labour costs per head (deflated by GDP prices) 	4,6	3,2	1,0	0,4	1,4	1,2	1,4	5,0	5,1	5,0

l Level at end of period

² EUR10 (EUR12 excluding Spain and Portugal)

Table 26: Intra-Community share of total imports of goods (at current prices)

	EUR12	B/L	DK	D	GR	E	F	IRL	I	NL	P	UK
1958	35,2	55,5	60,0	36,3	53,7	31,8	28,3	68,9	30,2	50,7	53,4	21,8
1965	44,9	63,6	50,0	46,9	52,1	48,6	46,4	67,7	38,1	61,7	51,9	25,6
1970	50,3	66,3	48,7	51,7	50,9	40,9	56,0	70,1	47,5	63,4	52,6	29,4
1975	49,5	68,5	47,2	51,9	45,1	35,3	51,8	70,3	44,5	58,2	43,9	34,6
1980	49,2	61,6	50,3	49,4	40,9	31,3	52,0	75,3	46,2	54,7	45,3	40,9
1985	53,4	68,6	50,7	53,1	48,1	37,9	59,4	71,7	47,1	55,8	45,9	47,3
1986	57,8	69,9	53,2	54,2	58,3	51,3	64,4	73,0	55,4	61,0	58,8	50,4
19871	58,0	69,5	54,0	55,3	58,5	52,2	63,0	70,9	56,1	62,0	64,2	51,0
19881	58,4	69,7	53,7	56,6	58,4	52,6	63,0	69,4	56,3	61,7	64,0	52,0

¹ Economic Forecasts, September 1987

Table 25: The balance of growth on the demand side: GDP, private consumption, investment by enterprises and net exports in the Community (average annual changes at constant prices, in %)

	GDP	Private consumption	Private investment ²	Net exports ³ (in % of GDP)
1961-73	4,8	5,0	5,9	0,3
1974-85	1,8	2,0	0,7	-0,2
1986-881	2,4	3,2	3,6	0,6

¹ Economic Forecasts, September 1987
2 EUR10 to 1970 (excluding Spain and Portugal) 3 Balance of goods and services, current prices

Table 28: Direct effects on Member States' exports of a 10% increase in their imports (at constant prices)1

	Follo	wing a	10% inc	rease 1	n impor	ts in .	• •					
	B/L	DK	D	GR	Е	F	IRL	I	NL	P	UK	EUR12
exports												
increase												
in (%)							0 0	0 (, ,	0.0	0.0	7 2
В	-	0,1	2,0	0,1	0,1	2,0	0,0	0,6	1,5	0,0	0,8	7,3
DK	0,2	-	1,7	0,1	0,1	0,5	0,1	0,5	0,4	0,0	1,2	4,7
D	0,7	0,2	-	0,1	0,2	1,1	0,1	0,9	0,9	0,1	0,9	5,1
GR	0,2	0,1	2,5	-	0,1	0,9	0,0	1,5	0,3	0,0	0,7	6,4
E	0,3	0,1	1,2	0,1	-	1,9	0,1	0,8	0,4	0,4	1,0	6,1
F	0,9	0,1	1,8	0,1	0,3	- 1	0,1	1,2	0,5	0,1	0,9	5,8
IRL	0,3	0,1	1,2	0,0	0,2	1,0	-	0,3	0,5	0,0	3,6	7,2
I	0,3	0,1	1,9	0,1	0,3	1,6	0,0		0,3	0,1	0,7	5,4
NL	1,5	0,2	2,9	0,1	0,1	1,0	0,1	0,7	-	0,0	1,0	7,6
P	0,4	0,3	1,6	0,0	0,6	1,5	0,1	0,4	0,6	-	1,5	6,8
UK	0,4	0,2	1,4	0,1	0,3	0,8	0,5	0,5	0,6	0,1	-	4,8
EUR12	0,6	0,2	1,3	0,1	0,2	1,1	0,1	0,7	0,6	0,1	0,8	5,7

l Estimates on the basis of the QUEST model. The QUEST model is being developed by the Commission services. For methodological details of the international trade sector in the model, see "Estimation and Simulation of International Trade Linkages in the QUEST model" in European Economy No. 31, March 1987

Table 27: Intra-Community share of total exports of goods (at current prices)

i	EUR12	B/L	DK	D	GR	Е	F	IRL	I	NL	P	UK
1958	37,2	55,4	59,3	37,9	50,9	46,8	30,9	82,4	34,5	58,3	38,9	21.0
1965	49,6	70,8	52,1	46,9	46,6	53,6	51,8	83,8	51,1	69,2	44,0	21,8
1970	53,4	75,2	44,2	49,8	53,5	49,6	58,1	74,3	51,7	72,6	43,8	32,7
1975	52,4	72,4	46,6	46,9	51,6	48,1	53,2	80,4	49,2	73,0	53,8	35,2
1980	55,7	73,2	51,6	51,1	48,2	52,2	55,4	76,0	51,6	73,5	58,6	45,0
1985	54,9	70,1	44,8	49,7	54,2	53,4	53,7	68,9	48,2	74,6	62,5	48,8
1986	57,2	72,9	46,8	50,8	63,5	60,9	57,8	71,9	53,5	75,7	68,0	47,9
19871	58,1	74,5	47,5	52,9	63,4	63,3	56,1	74,0	53,9	76,3	70,0	
19881	58,4	75,0	48,0	53,3	63,5	64,4	56,4	75,0	53,6	76,7	70,6	49,0

¹ Economic Forecasts, September 1987

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Table 30: Real convergence, investment shares, capital productivity and current balances

GDP per hea (at constar changes in	t prices	s, annual	average		CD E IDI D	other Member	
	GR	E	IRL	P	GR,E,IRL,P total	States	EUR12
1961-75 1976-81 1982-88 ¹	6,2 2,3 0,4	5,7 0,6 2,1	3,6 3,0 0,9	5,4 3,4 1,7	5,6 1,2 1,7	3,2 2,3 1,8	3,5 2,1 1,8
Investment (in % of GI						other	
	GR	E	IRL	P	GR,E,IRL,P total	Member States	EUR12
1961-75 1976-81 1982-88 ¹	22,3 23,4 19,2	24,7 22,9 20,4	21,0 27,7 21,2	24,3 27,7 25,3	24,2 23,8 20,9	22,9 21,2 19,1	23,1 21,6 19,3
Marginal ca	apital p	roductivi	lty ²			other	
	GR	E	IRL	P	GR,E,IRL,P total	Member States	EUR12
1963-75 1976-81 1982-88 ¹	0,23 0,09 0,02	0,22 0,02 0,10	0,16 0,11 0,04	0,17 0,12 0,07	0,21 0,05 0,08	0,13 0,10 0,09	0,14 0,09 0,09
Current bal		E	IRL	P	GR,E,IRL,P	other Member States	EUR12
1961-75 1976-81 1982-88 ¹	-2,9 -1,2 -5,1	-0,4 -1,5 0,2	-2,7 -9,6 -4,4	-0,6 -7,1 -1,9	-0,9 -2,6 -1,0	0,4 -0,1 0,5	0,2 -0,4 0,3

¹ For 1987/88: Economic Forecasts, September 1987
2 Additional GDP for one additional unit of capital = change in GDP divided by gross fixed capital formation

Table 29: Effects of raising public investment in certain Member States taking account of interdependence in the Community: illustrative example assuming an increase in public investment of 1% of GDP. (annual averages during first five years)

Follo	owing an	increase in	n public i	nvestment i	n
	D	F	I	UK	EUR4
net lending or borrowing of the public sector changes in (% points of GDP)				
B DK D GR E F IRL I NL P UK	0,2 0,1 -0,7 0,1 0,0 0,1 0,1 0,0 0,2 0,1	0,2 0,1 0,1 0,0 0,0 -0,8 0,1 0,0 0,1	0,1 0,0 0,0 0,0 0,0 0,1 0,1 -0,8 0,1 0,0	0,1 0,1 0,1 0,0 0,0 0,1 0,1 0,0 0,1 0,1	0,6 0,2 -0,5 0,2 0,2 -0,6 0,3 -0,6 0,5 0,2 -0,6
EUR12	-0,1	-0,1	-0,1	-0,1	-0,4
the current balance changes in (% points of GDP)				
B DK D GR E F IRL I NL P UK	0,3 0,1 -0,3 0,1 0,1 0,1 0,2 0,1 0,2	0,3 0,1 0,1 0,1 0,1 -0,4 0,1 0,1 0,2 0,1	0,1 0,0 0,1 0,1 0,0 0,0 0,1 -0,3 0,1 0,0	0,2 0,1 0,1 0,0 0,1 0,1 0,3 0,0 0,2 0,1 -0,4	0,8 0,3 -0,1 0,2 0,2 -0,2 0,6 -0,1 0,6 0,4 -0,2
EUR12	0,0	0,0	0,0	0,0	-0,1

Source: OECD Interlink Model (1987) and calculations by the Commission services

Table 32: Gains (+) and losses (-) in shares of export markets over the period 1985/1979 (in declining order of importance)

		EIR10 ²	
Branches	Losses	Branches	Gains
Electrical goods	-4,39	Leather & footwear	+5,45
Motor vehicles	-4,25	Wood & furniture	+4,86
Rubber & plastic products	-2,53	Textiles & clothing	+3,87
Agric. & industr. machinery	-2,49	Non-metallic minerals &	+2,47
Other transport equipment	-2,27	products	
Office & data mach.; prec.	-2,23	Food, beverage & tobacco products	+2,03
		Paper & printing products	+1,25
Other manufact. products	-0,84	Ferrous & non-ferrous ores &	+1,23
Metal prod. except mach. &	-0,65	metals other than radioactive	
transport equipment		Chemical products	+0,51
Claratoric eductoric			
		USA	
Branches	Losses	Branches	Gains
Other manufact. products	-2,06	Other transport equipment	+5,45
Textiles and clothing	-1,41	Rubber & plastic prod.	+3,63
Ferrous & non-ferrous ores	-1,29	Office & data mach.; prec. &	+3,30
& metals, other than radioactive		optical instruments	10.60
Motor vehicles	-0,86	Paper & printing products	+0,68
Food, beverage and tobacco	-0,52	Electrical goods	+0,66
products		Leather & footwear	+0,52
Wood & furniture	-0,46		
Non-metallic minerals	-0,36		
and products			
Metal prod. except mach. &	-0,24		
transport equipment			
Chemical products	-0,01		
Agric. & industr. machinery	-0,01		
		Japan	Gains
Branches	Losses	Branches	+11,66
Food, beverage & tobacco	0,00	Electrical goods	+9,40
products		Motor vehicles	+5,47
		Office & data mach.; prec. &	,
		optical instruments	+5,26
		Agric. & industr. machinery	+5,24
		Other manufact. products	+3,17
		Non-metallic minerals &	,,,,,
		products	+3,04
		Rubber & plastic prod.	+2,71
		Other transport equipment	+2,20
		Textiles & clothing	+1,75
		Metal prod. except mach. &	
		transport equipment	+1,63
		Ferrous & non-ferrous ores &	,,,,,,
		metals, other than radioactive	+1,35
		Chemical products	+0,78
		Paper & printing products	+0,42
		Leather & footwar	+0,18
		Wood & furniture	

l Market share is defined as the exports of USA, of Japan or EUR10 to the rest of the world in relation to exports of OECD countries to the world

Source: Commission services, VOLIMEX database

² Only extra-Community trade is taken into account

	1963	1968	1973	1979	1980	1981	1982	1983	1984	1985	Diff. 73-68	Diff. 79-73	Diff. 85-79
Total industry						100							
EUR102	31,68	28,63	26,80	27,04	27,25	26,65	26,61	26,03	25,21	25,60	-1,83	+0,24	-1,44
USA	20,92	19,06	15,43	15,26	16,35	17,92	17,20	16,49	16,59	15,99	-3,63	-0,17	+0,73
JAP	6,39	8,92	10,53	11,38	12,43	15,16	14,62	15,60	16,94	16,75	+1,61	+0,85	+5,37
Strong demand													
EUR10 ²	35,00	31,39	27,96	27,40	27,00	25,79	25,75	25,23	24,01	24,86	-3,43	-0,56	-2,54
USA	24,26	22,47	17,51	18,08	19,18	20,70	20,91	20,11	20,74	19,32	-4,96	+0,57	+1,24
JAP	6,22	10,15	12,36	13,06	14,18	17,34	16,53	18,54	20,62	20,20	+2,21	+0,70	+7,14
Moderate demand													
EUR102	31,52	28,17	26,98	26,69	27,66	26,49	26,32	25,34	24,32	24,27	-1,19	-0,29	-2,42
USA	25,43	23,26	18,65	17,66	18,26	20,42	19,12	18,21	17,95	17,87	-4,61	-0,99	+0,21
JAP	3,82	6,37	9,22	10,86	12,24	14,76	13,98	15,03	16,38	16,52	+2,85	+1,64	+5,66
Weak demand													
EUR102	29,64	27,20	25,53	27,23	26,86	27,89	28,12	28,29	28,46	29,16	-1,67	+1,70	+1,93
USA	12,57	10,45	8,90	8,81	10,62	10,42	9,37	8,84	8,53	7,76	-1,55	-0,09	-1,05
JAP	9,98	11,64	10,93	10,53	10,99	13,43	13,52	12,90	13,02	12,38	-0,71	-0,40	+1,85

¹ Defined as share of exports of a certain country or zone in total exports of all OECD countries (at current prices); including 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 and agricultural 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.

² EUR10 excluding intra-Community trade

millions of ECU as a % of to		1985-88:	payment	appropriations
	1985 ¹ EUR10	1986 ² EUR12	1987 ³ EUR12	1988 ⁴ EUR12
Expenditure				(0.1
Agriculture - Guarantee Section	69,9	65,7	63,5	68,1
Agriculture - structural Funds	2,6	2,1	2,6	3,0
Fisheries	0,3	0,4	0,5	0,6
Social Fund	5,0	6,6	7,0	6,4
Regional Fund	5,8	7,1	6,9	7,4
Integrated Mediterranean projects	0,0	0,1	0,5	0,2
Transport	0,3	0,1	0,1	0,2
Energy and industry	0,5	0,2	0,4	0,5
Research and innovation	2,0	1,7	2,1	2,4
Food aid	1,9	0,9	1,6	0,9
	1,9	1,1	1,5	1,2
Development aid	1,,	-,-		
Other expenditure including refunds to Member States	9,8	14,0	13,35	9,1
Total	100,0	100,0	100,0	100,0
pm Absolute amount in millions of ECU		(33635)	(36168)	(39708)
Receipts		. 0	8,9	7,6
Agricultural levies	7,7	6,8		22,6
Customs duties	29,4	24,3	23,2	44,2
Value-added tax (VAT)	53,8	66,1	64,8	
Special contributions	6,8	0,6	0,6	24,9
Miscellaneous	2,3	2,2	2,5	0,7
Total	100,0	100,06	100,07	100,08
pm Absolute amount in millions of ECU	J)(28272)	(33635)	(36168)	(39708)
Maximum rate of VAT	1,0	1,4	1,4	1,0
Effective rate of VAT	1,0	1,379	1,2710	1,011
Budget total as a % of GDP	0,85	0,98	1,00	1,03

1 Outturn. Management accounts 1985.

Provisional Outturn. Report on execution of the 1986 Budget.

4 Preliminary draft Budget for 1988 proposed by the Commission on 15 June 1987.

5 Includes an estimated deficit of 820 Mio Ecu in respect of 1986.

7 The correction of the budgetary imbalance for the United Kingdom which amounts to 2366 million ECU gross is included in receipts.

8 The correction of the budgetary imbalance for the United Kingdom which amounts to 2513 million ECU gross is included in receipts.

9 Except for the Federal Republic of Germany (1,33) and the United Kingdom (0,67). 10 Except for the Federal Republic of Germany (1,35) and the United Kingdom.(0,83).

³ Supplementary and rectifying Budget No. 1 1987 adopted on 3 August 1987.

⁶ The correction of the budgetary imbalance for the United Kingdom which amounts to 2685 million ECU gross is included in receipts.

If the proposed reform were not carried out, the VAT-ceiling agreed on at Fontainebleau (1.4%) would leave a shortfall of about 6 BIO ECU. Even an increased VAT-ceiling (1.6%) would not be sufficient to cover the expenditure planned in the Preliminary Draft budget.

Table 33: Growth rate of industrial gross fixed capital formation by sector (at 1980 prices)

	1973-1979	1979-1985	1979-1982	1982-1985
Industry, total				
EUR4 ¹	-0,4	1,1	-3,8	6,2
USA	5,5	-0,6	-3,4	2,2
Japan	-2,1	9,7	9,2	10,2
Strong demand				
EUR41	1,9	1,4	-5,5	8,9
USA	7,2	2,1	3,6	0,7
Japan	-0,8	15,8	13,0	18,6
Moderate demand				
EUR41	2,1	0,8	-2,3	3,9
USA	6,4	0,4	-4,1	5,0
Japan	-1,4	8,3	7,0	9,6
Weak demand	5.0		6.7	
EUR4 ¹	-5,0	0,1	-6,3	6,9
USA	3,0	-5,5	-10,0	-0,7
Japan	-3,6	5,4	8,4	2,5

¹ Federal Republic of Germany, France, Italy, United Kingdom Source: Commission services, sectoral data bank

Table 34: Growth rate in employment by sector

	1973-1979	1979-1985	1979-1982	1982-1985
Industry, total				
EUR71	-1,3	-2,5	-2,6	-2,3
USA	0,9	-1,4	-3,6	0,9
Japan	-1,7	1,3	0,9	1,7
Strong demand				
EUR71	-0,5	-1,6	-2,4	-0,7
USA	2,1	-0,3	-1,4	0,9
Japan	-2,0	4,9	4,3	5,4
Moderate demand				
EUR71	-0,6	-2,0	-1,8	-2,3
USA	1,3	-0,5	-2,9	2,0
Japan	-0,9	0,6	0,9	0,4
Wools James J				
Weak demand EUR71	1.0	7 7	7.5	7.0
USA	-1,9	-3,3	-3,5	-3,0
	-0,2	-3,3	-5,9	-0,7
Japan	-2,1	0,2	-0,6	0,9

¹ Federal Republic of Germany, France, Italy, United Kingdom, Netherlands, Belgium, Denmark

Source: Commission services, sectoral data bank

Table 37: Nominal long-term interest rates

Country	1961/69	1970/77	1978	1979	1980	1981	1982	1983	1984	1985	1986	19871
В	6,1	8,1	8,5	9,7	12,2	13,8	13,4	11,8	12,0	10,6	7,9	7,7
DK	7,9	13,2	16,8	16,7	18,7	19,3	20,5	14,4	14,0	11,6	10,5	11,8
D	6,6	8,3	5,7	7,4	8,5	10,4	8,9	7,9	7,8	6,9	5,9	5,6
GR	-	9,8						18,2				
E		-	12,0	13,3	16,0	15,8	16,0	16,9	16,5	13,4	11,4	12,1
F	6,2	9,6	10,6	10,9	13,1	15,8	15,6	13,6	12,5	10,9	8,4	9,0
IRL	-	12,2	12,8	15,1	15,4	17,3	17,0	13,9	14,6	12,7	11,1	11,5
I	6,5	10,2	13,7	14,1	16,1	20,6	20,9	18,0	14,9	14,3	11,7	10,6
NL	5,3	8,3	8,1	9,2	10,7	12,2	10,5	8,8	8,6	7,3	6,4	6,2
P		4 1	-	4	-	_	-	-		25,4		
UK	6,7	11,8	12,6	13,0	13,9	14,8	12,7	10,8	10,7	10,6	9,8	9,3
EUR12 ²	6,5	9,8	10,3	11,2	12,9	15,0	14,2	12,6	11,8	10,8	9,1	8,9
EUR10 ²	6,4	9,5	9,3	10,2	11,8	13,8	12,6	10,7	10,4	9,6	7,9	7,7
EMS ²	6,3	9,2	8,8	10,1	11,5	13,5	12,5	10,6	10,3	9,2	7,8	7,5
USA	4,6	6,5	7,9	8,7	10,8	12,9	12,2	10,8	12,0	10,8	8,1	8,2
Japan		7,7	6,3	8,3	8,9	8,4	-8,3	7,8	7,3	6,5	5,2	4,5

Long-term interest rates adjusted by actual inflation³

Country	1961/69	1970/77	1978	1979	1980	1981	1982	1983	1984	1985	1986	19871
В	2,7	0,2	4,0	4,9	8,1	8,5	6,0	5,1	6,4		3,4	5,5
DK	1,6	2,9	6,3	8,5	9,7	8,4	9,0	6,3	7,9	6,0	5,3	6,9
D	3,2	2,3	1,3	3,3	3,5	6,2			5,7	4,6	2,7	3,6
GR		-1,5	-2,6	-6,2	-0,5	-2,0	-7,6	-0,8	-1,3		-2,7	0,6
E	-		-6,8	-2,9	1,8	3,4	1,9	4,7	5,0	4,3	0,2	6,1
F	1,9	0,9	1,0	0,5	0,8	3,6	2,7	3,7	4,9	4,7	3,4	5,5
IRL		-1,4	2,1	1,2	0,6	-0,1	1,1	2,3	7,8	7,3	5,1	8,4
I	2,1	-2,5	-0,2	-1,6	-3,7	1,8	4,0	2,3	4,3	5,1	3,4	4,8
NL	0,2	-0,1	2,6	5,1	4,7	6,4	4,2	6,8	6,3	4,8	5,6	7,3
P	- 1	-	-	-	-	-		-	-	3,1	-0,1	3,6
UK	2,7	-0,8	1,2	-1,3	-4,8	3,0	4,6	5,5	6,3	4,5	6,1	5,1
EUR12 ²	2,3	-0,4	0.0	0,2	-0,3	3,6	3,3	3,8	5,0	4,4	3,3	4,8
EUR10 ²	2,3	-0,3	0,2	-0,1	-1,1	2,7	2,4	2,6	4,3	3,8	3,0	4,0
EMS ²	2,2	0,3	0,4	1,0	0,4	2,8	2,1	2,1	4,2	3,8	3,9	4,3
USA	1,7	-0,3	0,6	-0,2	1,7	2,9	5,5	6,6	7,9	7,3	5,8	4,7
Japan	1	-1,3	1,4	5,1	4,9	5,0	6,3	6,9	5,9	4,7	3,2	3,8

 $[\]begin{array}{c} 1 \\ 2 \\ \end{array}$ Average of first seven months $\begin{array}{c} 2 \\ \end{array}$ For countries available in the years in question $\begin{array}{c} 3 \\ \end{array}$ GDP deflator

Table 36: Money and credit targets and outturns

	-OA	19	81	198	35	1	986	19	987
		Objective	Outturn	Objective	Outturn	Objective	Outturn	Objective	Outturn (annual rate
D	MZ1	4-7	3,5	3-5	4,4	3,5-5,5	7.0		
F	M2 ²	10,0	11,4	4-6	6,9	3,0-5,06	7,8 4,4	3-6	7,3 (July)
E	мз	14,5-18,5	16		0,5	3,0 3,0	-	3-5	7,2 (June)
	ALP8			11,5-14,5	12,8	9,5-12,5	11,4	6,5-9,5	7,2 (June)
I	TDCE3	16,0	18,2	16,8	17,9	7,5 12,5	-	0,5-9,5	13,7 (June)
	PSCE7					7	11,4	7	1/ 2 / 7 - >
	M2					7-11	9,4		14,2 (June)
UK ⁴	£M39	6-10	13,8	5-9	15,1	11-15		6-9	12,3 (June)
	МО		25,0	3-7			18,1		20,9 (July)
USA5	M1	3,5-6	2,3	4-7	6,0	2-6	5,2	2-6	5,3 (July)
	M2				11,9	3-8	16,5	Thursday.	10,5 (July)
		6-9	9,2	6-9	8,0	6-9	8,9	5,5-8,5	5,7 (July)
	TDCE 3	72 2 4 7		9-12	12,7	8-11	12,2	8-11	11,3 (July)

¹ Central bank money. 2 For 1985 M2R (M2 residents) and for 1986/87 M3. 3 TDCE = total domestic credit expansion. 4 Before 1985, objectives were annual rates for the change from February to April of the next year; from 1985 they concerned the rate of growth over 12 months and the result is for the 12 months ending in December. 5 The United States also have a target for M3. 6 M3, new definition. 7 Domestic credit to the non-state sector. 8 Liquid assets held by the public. 9 The aggregate £M3 was replaced by M3 in May 1987.

	1970	1973	1981	1982	1983	1984	1985	19861	19871	19881
	1970	17/3								
			a)	Total c	urrent	recei pt	8 (% of	GDP)		
	36,5	38,2	45,2	46,8	46,1	47,3	47,8	46,1	46,5	46,3
	46,2	47,3	52,9	52,0	54,4	56,7	57.4	58,7	58,5	59,0
	38,9	42,9	45,6	46,1	45,8	46,1 34,2	46,4	36,0	37,0	37,4
1	26,5	25,1	28,9	32,0	34,0	33,8	35,4	36,4	37,2	37,2
	22,9 39,8	39,4	46,7	47,6	48,2	49,1	49,2	48,8	48,7	48,9
IL	: .		38,4	40,5	42,7	43,0	43,1	39,2	39.7	39,9
	26,7	26,7	34,1	36,2	56,4	54,5	56,9	55,2	54,2	54,2
	35,8	46,4	53,8	54,2	55,6	54,4	55,1	53,4	53,1 33,9	52,2
			33,0	33,3	37,1	34,4	33,1	35,5	40,6	39,7
K	39,8	35,6	41,8	42,5		43,6	43,9	43,7	43,7	43,5
UR12	35,92	36,22	41,8	42,8	43,4	43,0	43,7			
		t) Tota	l expen	di ture i	ncludi	ng capit	a1 ³ (% o	f GDP)	
					67 5	56,7	56,2	54,9	53,1	52,4
	38,6	41,5	58,0	57,8	57,5	60,7	59,5	55,4	56,6	57,3
RK)	42,1	42,1	49,2	49,4	48,4	48,0	47,5	46,7	47.0	47,1
R	:		39,9	39,7	41,5	44,3	48,1	46,7	47,6	42,1
	22,1	22,9	35,6	37,5	38,8	39,3 51,8	42,2 52,1	51,8	51.5	51,3
	38,9	38,5	48,6	50,3	54.5	52,9	54,7	54,0	53,2	52,1
IRL.	29,7	32,8	45,5	47,6	48,8	49,5	50,8	50,5	50,1	50,3
	33,1	36,1	57,9	55,7	56,2	52,5	52,5	51,4	51,4	58,2
NL	42,3	45,4	59,2	61,3	62,0	60,7	59,9 43,1	43,7	42,7	41,7
P UTK	36,9	38,3	42,5	43,6	45,2	45,9	44,6	43,6	42,6	41,7
EUR12	35,62	37,32	47,1	48,3	48,7	49,0	49,1	48,4	48,1	47,8
	c) <u>T</u>	otal ne	t lendi	ng (+)	or borr	of GDP)	-) incl	uding i	nterest p	ayments
	-2,2	-3,3	-12,8	-11,0	-11.3	-9,4	-8,4	-8,7	-6,6	-6,1
B DK	4,1	5,2	-6,9		-7,2	-4,1	-2,1	3,3	1,9	1,7
D	0,2	1,2	-3,7		-2,5 $-8,3$	-1,9 -10,0	-1,2 -13,6		-10,6	-9,8
CR	0,7	: 1	-11,0	-7,7 -5.6	-4,8	-5,5	-6,7	-5,7	-5,0	-4,9
F	0,9	0,9	-1,9	-2,8	-3,2	-2,7	-2,9	-3,0	-2,8 -10,0	-2,3 -7,5
IRL	:		-13,4					-11,2	-10,4	-10,4
I	-3,1 2,7	-6,1 3,3	-11,5			2000		3,9	2,8	3,1
L NL	-1,2	1,0	-5,5		-6,4	-6,3		-4,6	-5,7 -8,8	-6,0 -7,8
P	2,9	: -2,7	-9,5 -2,5			-12,0 -3,9		-8,2 -2,7	-2,0	-2,0
EUR12	0,32	-1,0	2 -5,3	-5,5	-5,3	-5,3	-5,2	-4,8	-4,5	-4,5
		d) Inter	est pay	ments o	n the p	ublic d	ebt (% c	of GDP)	
			7.0	9,2	9,4	9,9	10,6	11,1	10,9	11,0
B DK	3,4	3,3		6,0	8,1	9,7	9,9	8,8	8,2	7,8
D	1,0	1,1	2,3	2,8	3,0		4 .		2,9 6,5	6,9
CER	: .	:	3,2					the Park	3,7	3,7
E	0,6	0,6			2,6	2,7	2,9	2,9	2,8	2,8
IRL	:	:	7,4	9,0	9,4				10,4	10,
I	1,5	2,2							1,3	1,
L	1,1	1,0				A Comment		6,0	6,0	5,
NL P	2,9	2,0	5,		6,4	7,1	7,8	9,3		7,
UIK	3,9					4,9	5,0	4,5	4,3	* '
EUR 12	1,9	2 1,9	2 3,	7 4,	1 4,4	4,8	5,0	5,0	4,8	4,8

¹ Economic Forecasts, September 1987 2 Without Greece, Ireland and Portugal 3 Net of capital transfers received

3,5

Table 38: Synthetic indicators of budgetary policy in the Community

EUR12 ² : General government (% of GDP)											
	19702	19732	1981	1982	1983	1984	1985	19861	19871	19881	
				Receip	ts						
l Indirect taxes	13,1	12,2	12,6	12,7	12,9	13,1	12,9	13,1	13,1	13,1	
2 Direct taxes	9,5	9,8	11,6	11,8	12,0	12,2	12,4	12,2	12,4	12,2	
3 Social contribu- tions received	10,3	11,3	14,0	14,4	14,7	14,6	14,6	14,5	14,6	14,8	
4 Tax burden (1+2+3)	32,9	33,3	38,1	39,0	39,6	39,9	39,9	39,8	40,1	40,2	
5 Other current receipts	3,0	3,0	3,7	3,8	3,8	3,8	4,0	3,9	3,6	3,5	
6 Total current receipts (4+5)	35,9	36,2	41,8	42,8	43,4	43,6	43,9	43,7	43,7	43,5	
			Exp	penditur	<u>e</u>						
<pre>7 Current expenditure (- of which interest)</pre>	30,8 (1,9)		43,1 (3,7)	44,4 (4,1)	45,0 (4,4)	45,2 (4,8)	45,1 (5,0)	44,7 (5,0)	44,5 4,8)	44,3 (4,8)	
8 Public investment	4,0	3,6	3,0	3,0	2,9	2,8	2,8	2,7	2,7	2,8	
9 Other capital expenditure	0,8	0,7	1,0	0,9	0,9	1,0	1,1	0,9	0,9	0,8	
			Bud	get bal	ance						
10 Total :	0,3	-1,0	-5,3	-5,5	-5,3	-5,3	-5,2	-4,8	-4,5	-4,5	
ll Total excluding interest	2,1	0,9	-1,6	-1,4	-0,9	-0,6	-0,2	0,4	0,4	0,4	
			Pul	olic del	ot					-	
12 Percentage of GDP	-	37,5	43,4	48,2	51,5	54,8	57,4	59,0	61,4	63,6	

- - 11,1 6,8 6,5 4,8 2,8 4,0

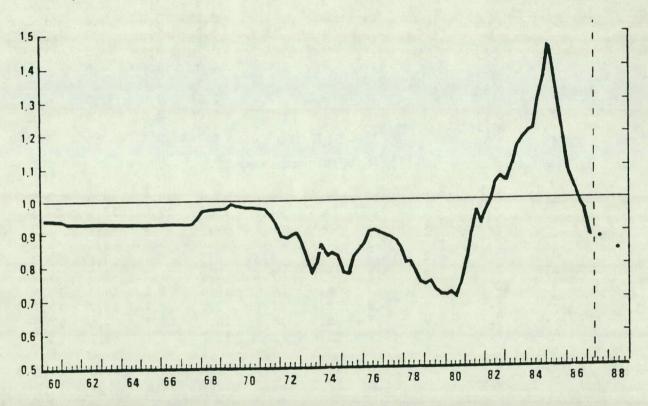
13 % change p.a.

Source: EUROSTAT and Commission services

¹ Economic Forecasts, September 1987
2 EUR12; without Greece, Ireland and Portugal in 1970 and 1973

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





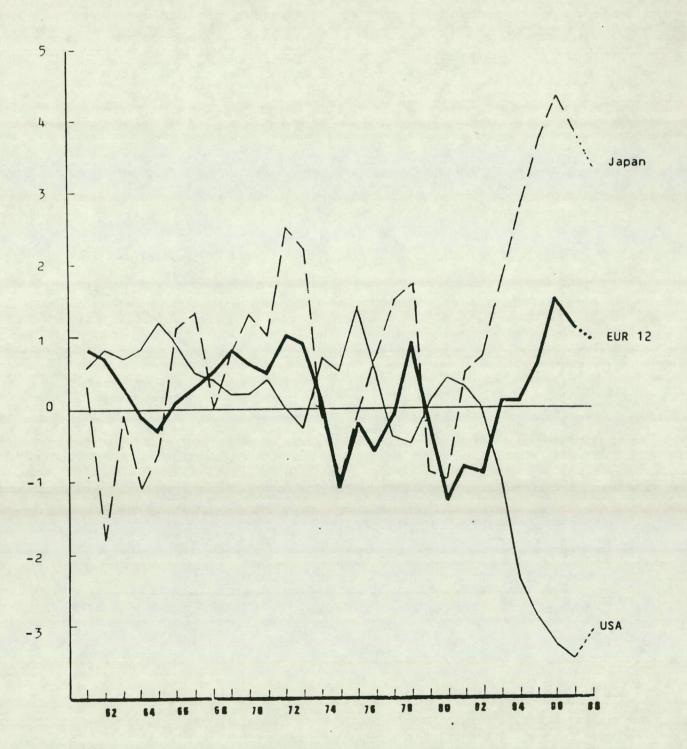
1 For 1987/88: Economic Forecasts, September 1987

Tabl		hare o		cted i GDP	tems of	genera	al gove	ernment	receip	ts and
	1970- 1973	1974- 1980	1981	1982	1983	1984	1985	19861	19871	19881
		a) Gro	ss fixe	d capi	tal form			ral gove		1300
В	4,4	3,7	3,7	3,4						
DK	4,4	3,7	3,0	2,8	3,0	2,6	2,2	1,9	1,7	1,7
D	4,3	3,6	3,2	2,8	2,3	1,9	2,2	1,7	2,1	2,1
GR		:	3,9	2,9		2,4	2,3	2,4	2,4	2,4
E	2,7	2,2	2,3	3,1	3,3	4,1	4,4	4,1	3,7	3,5
F	3,7	3,4	3,2		2,8	3,0	3,6	3,4	3,6	3,7
IRL	:	5,3		3,4	3,3	3,0	3,1	3,2	3,2	3,2
I	2,6	2,9	5,7	5,1	4,4	3,8	3,8		3,2	2,9
L	4,7		3,6	3,7	3,7	3,5	3,7	3,4	3,3	3,4
NL		6,3	6,7	6,7	5,4	4,9	4,8	4,6	4,6	4,6
P	4,4	3,5	3,1	2,9	2,7	2,8	2,5	2,2	2,2	2,2
UK	: , 7	:	4,3	3,4	3,1	2,6	2,5	3,0	3,5	4,1
	4,7	3,6	1,8	1,6	2,0	2,0	2,0		1,9	1,9
EUR12	3,82	3,32	3,0	3,0	2,9	2,8	2,8	2,7	2,7	2,8
					b) Dire	ct taxes	5			
В	12,1	16,8	18,0	19,3	18,6	19,2	19,1	18,4	18,4	18,3
DK	23,8	25,2	25,8	25,4	26,6	27,6	28,5	29,0	28,5	29,5
D	11,5	12,8	12,2	12,1	12,0	12,1	12,5	12,2	12,2	11,9
GR	3,7	4,7	4,7	5,9	5,5	5,9	5,6	6,0	6,1	6,4
E	3,7	5,2	7,2	6,8	7,9	8,3	8,5	8,4	9,7	9,7
F	6,9	7,8	8,6	8,8	8,9	9,1	9,0	9,2	9,3	9,3
IRL	:	10,9	12,9	13,3	14,0	14,9	14,8	15,6	16,3	16,4
I	5,0	7,4	10,9	11,8	12,4	12,7	13,0	12,9	13,7	13,7
L	13,0	18,2	18,0	17,9	19,4	18,2	20,0	18,7	17,5	17,8
NL	14,0	17,0	15,1	14,7	13,6	12,7	12,7	13,4	13,7	13,5
P	:	:	7,7	7,6	8,5	8,3	8,3	7,1	6,4	6,3
UK	13,3	14,2	14,3	14,6	14,4	14,6	14,7	14,0	13,8	13,3
EUR12	9,62	10,92	11,6	11,8	12,0	12,2	12,4	12,2	12,4	12,3
			c)	Social	securit	y contr	ibution	ıs		
В	10,8	12,3	12,7	12,7	13,2	14,0	14,7	14,4	14,7	14,6
DK		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	17,3	17,5	17,4	17,6	17,6
GR	6,6	7,8	9,1	10,2	10,9	11,1	11,5	11,8	11,7	12,3
E	7,4	10,7	13,4	13,3	13,7	13,1	13,1	12,9	12,7	12,6
F	14,8	17,8	19,6	20,2	20,7	21,0	21,2	21,0	21,1	21,4
IRL	:	4,4		5,5		5,8	5,8	5,8	5,8	5,9
I	10,8	12,1	12,8	13,7	14,1	13,7	13,7	14,0	13,8	13,8
L	10,5	14,6	15,6	14,9	14,4	13,6	13,6	13,4	13,7	13,7
NL	14,8	17,4	18,7	19,7	21,9	20,7	20,6	19,5	20,0	
P	:			9,6	10,0	9,3	9,0	8,3		20,0
UK	5,2	6,2	6,3	6,5	6,9	7,0			8,2	8,2
	10,82	13,12	14,0	14,4	14,7		6,9	7,0	7,0	7,0
		, .	- , , ,	-7,7	14,/	14,6	14,6	14,5	14,6	14,6

¹ Economic Forecasts, September 1987
2 Without Greece, Ireland and Portugal.

Source: EUROSTAT and Commission services.

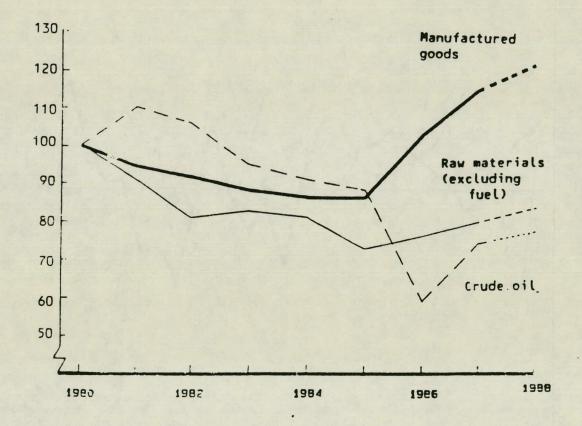
Graph 3 : Balance on current transactions with rest of the world as a percentage of GDP 1



1 For 1987/88: Economic Forecasts, September 1987

Graph 2 : World prices for crude oil, raw materials (excluding fuel) and manufactured goods in USD

(Index 1980 = 100) 1

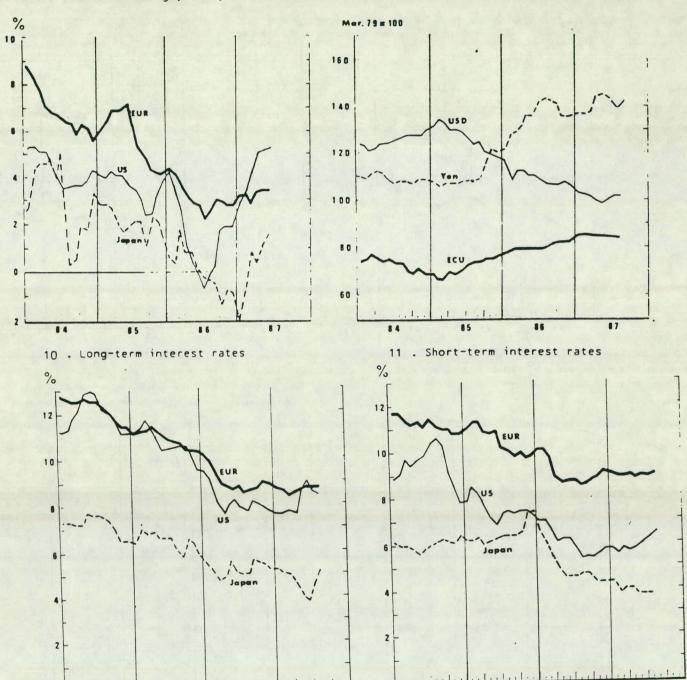


1 For 1987/89: Economic forecasts, September 1987

Source: Commission services

GRAPHS 8 to 1t Comparative evolution of the Community, US and Japanese economies, 1984-87

- 8 . Consumer prices 6-month change, s.a., annual rates
- 9 . Exchange rates
 Index of SDRs per currency unit

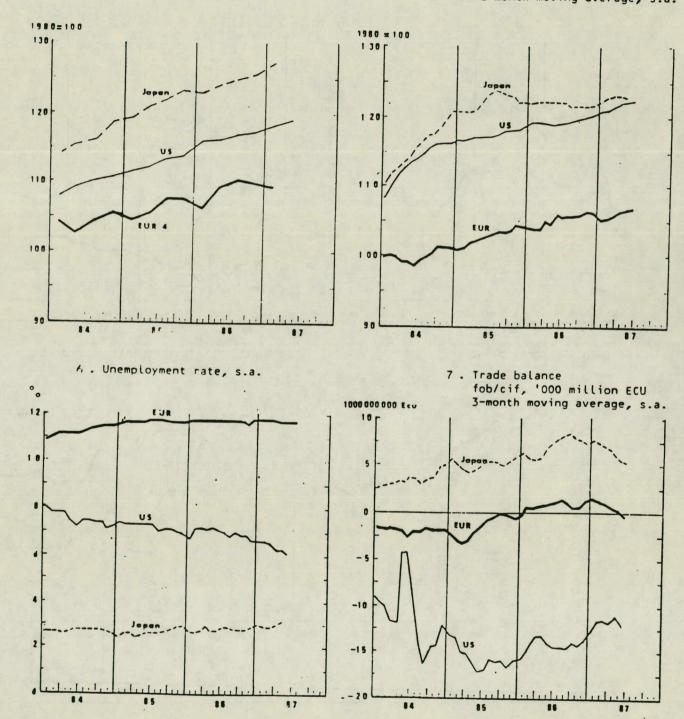


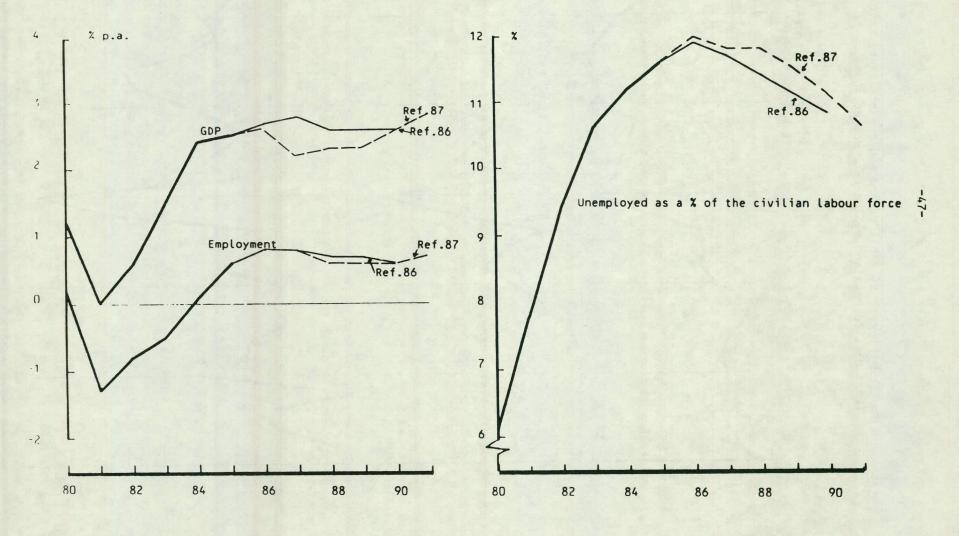
87

GRAPHS 4 to 7: Comparative evolution of the Community, US and Japanese economies, 1984-87

4 . Gross domestic product, s.a.

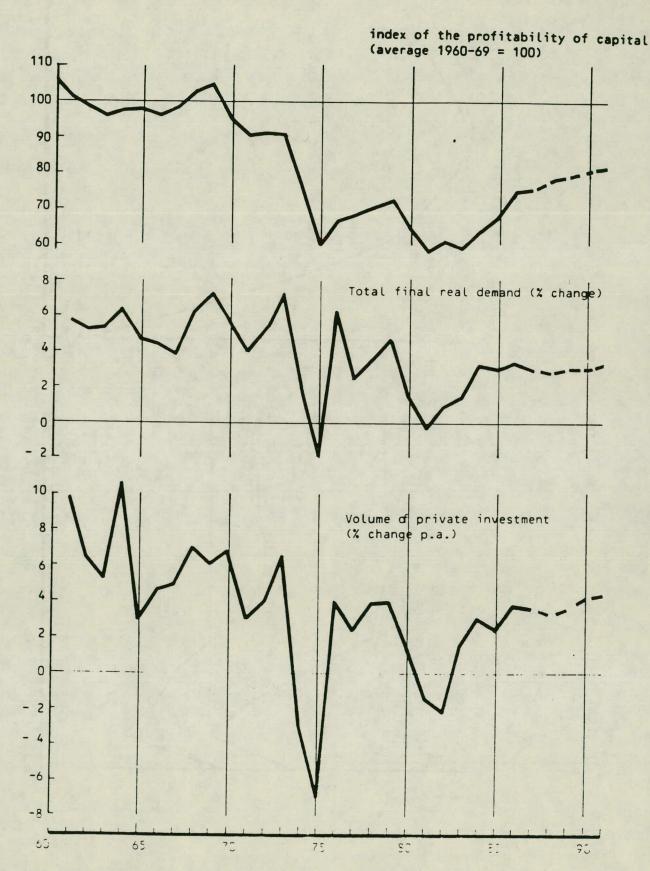
Industrial production
 3-month moving average, s.a.





Source : Commission services

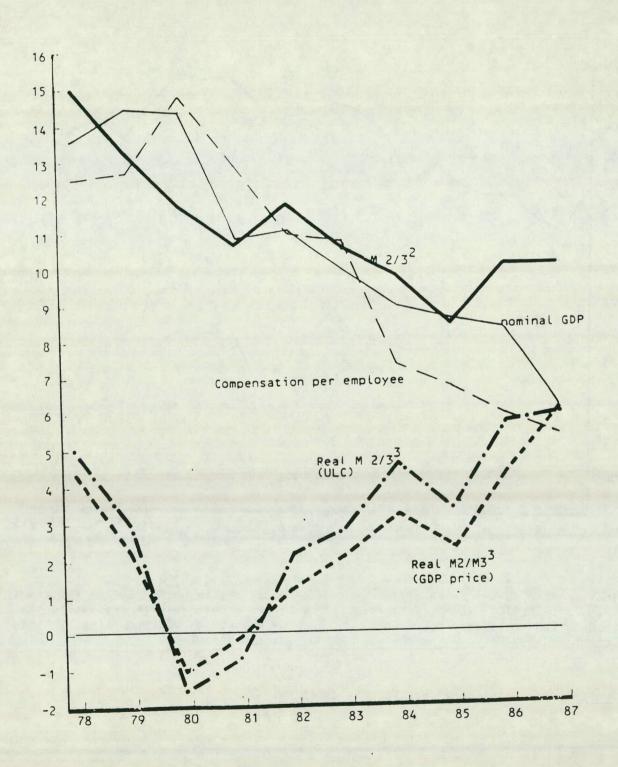
Graph 12: Profitability, total final demand and private investment (past developments and medium term projections)



Source : Commission Services.

GRAPH 15: Money supply in real terms and the deceleration of nominal variables (average annual % change) 1

EUR 12

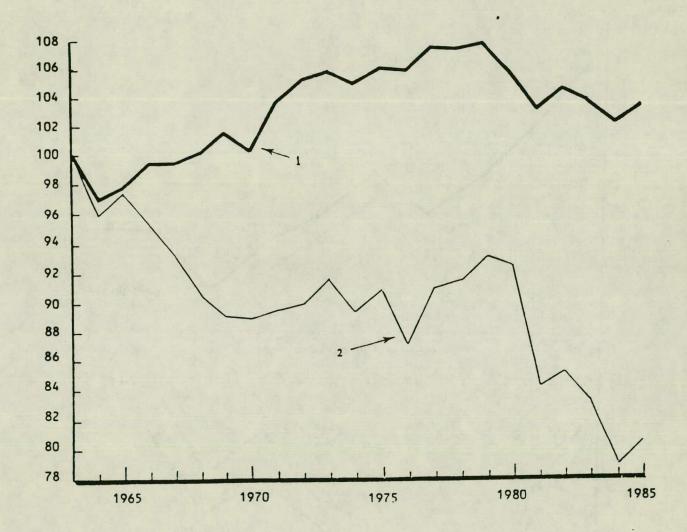


¹ Economic Forecasts September 1987

² Broad money supply, annual average

³ Broad money supply deflated by the index of unit labour costs or GDP prices

Graph 14: Shares of world market for exports of Community industrial products (Indices, 1963 = 100)

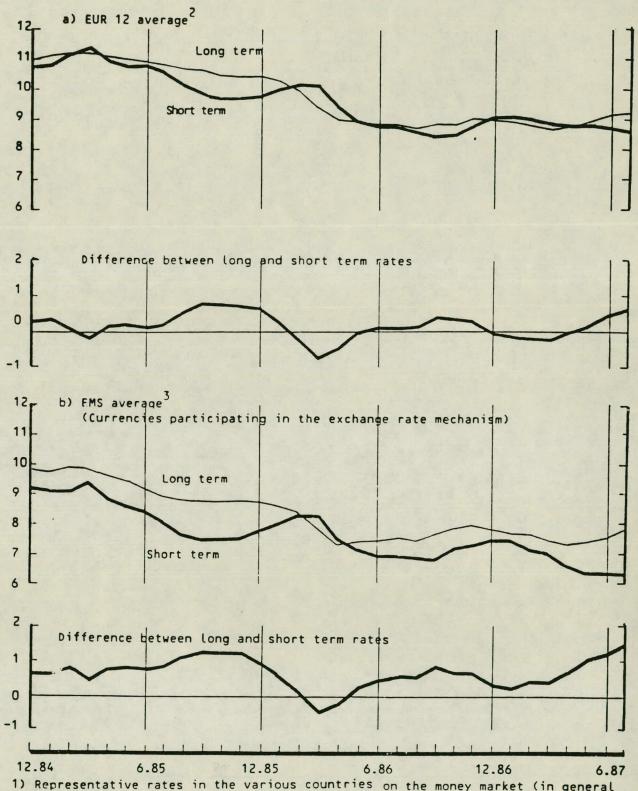


1 Index of the market share of Intra-Community (EUR10) exports with respect to OECD countries exports to the Community (EUR10).

Source: Commission services, VOLIMEX database.

Index of Community (EUR10) exports to third countries with respect to that of exports of OECD countries to the same destination.

Graph 16: Long term and short term nominal interest rates 1



 Representative rates in the various countries on the money market (in general 3 months) and for long term government securities.

²⁾ Private consumption weights.

³⁾ Weighted by relative weights of currencies.



ECOFIN: 7 DECEMBER 1987

TAX APPROXIMATION

Relevant documents: Text of Economic Policy Committee (EPC) Chairman's interim report to Council (attached)

: Telegram no. 4088 on ElC's meeting 26/27 November 1987 (attached)

Objective: To avoid substantive discussion of issues arising from tax approximation [intervention only necessary if others try to embark on such discussion].

Points to make:

- i) Grateful to M Milleron for interim report. Clear that EPC has much work to do before can advise Ministers sure EPC will do thorough job. Look forward to full report early next year.
- ii) Council well aware of responsibilities, but cannot expect to have useful discussion of substance before in possession of full analysis of Commission approach.

<u>Background:</u> Lord Cockfield formally presented his package of tax measures to ECOFIN on 16 November. Ministers then agreed to remit the proposals to EPC for study. No timetable for EPC's work was set.

EPC held its first discussion of the subject on 26/27 November. It was clear that the UK was in a minority (with Denmark, Luxembourg and to a lesser extent Italy, Ireland and Greece) in questioning the Commission's approach to removing fiscal barriers to trade. But <u>all</u> Member States foresaw difficulties of one kind or another arising from the proposals.

The elements giving rise to the greatest problems were the excise duty rate proposals and the clearing mechanism.

After hearing the views of all Member States, EPC's Chairman (M Milleron, France) proposed making a short interim report, on his own authority, to ECOFIN on 7 December. The draft text describes, in generally neutral terms, the first reactions of EPC, identifies some of the difficult areas and outlines the work which still has to be undertaken. EPC will be aiming to complete the main part of its work in the next three months and to report to Ministers then.

The Danish representative at EPC was not enthusiastic about this item appearing on ECOFIN's agenda, but the Commission made it clear they would ask for it to be included. We expect the Presidency simply to call on M Milleron to make his report, and then ask Mr Stollenberg to comment on the Germans' plans for handling tax approximation during their fresidency. Lord Cockfield may wish to make a ritual plea for speedy progress, but other interventions are not expected.

CONFIDENTIAL

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MR ALEX ALLAN

From: Sir G.Littler
Date: 10 November 1987

c.c. Mr Edwards Mr Evans Mrs Lomax Mr Peretz Mr M Parkinson

ECOFIN: CURRENT WORLD MARKET SITUATION

As I mentioned to you at lunch today, we have a very tedious paper sent by Minister Eyskens of Belgium to his fellow EC Ministers as a basis for his demand for a full discussion at ECOFIN on Monday, 16 November. Tietmeyer had just phoned me to wring hands over the risks of the kind of discussion Eyskens (and Delors) might want. We had agreed to speak in parallel to the Danes to steer this into some safer form.

- 2. We have now both spoken to Mr Simonsen's private secretary, who was reasonably understanding and helpful. I pointed to the likelihood that next Monday we would be either still waiting for an imminent US agreement, or after one still in the process of seeing whether a wider G7 agreement was possible. Any publicised ECOFIN discussion would carry some risk of damaging these perhaps delicate processes, or of damaging markets. I therefore urged that, while some discussion was a natural thing, it should be kept as private and restricted as possible and no papers circulated.
- 3. The Danes have taken the point. They say the discussion will be restricted and informal. They say no papers will be circulated: the one by Eyskens can stay as a letter to Ministers but not on the table; the Commission have said they want to table a paper but the Danish Presidency are discouraging them.

(Geoffrey Littler)



cc PS/Paymaster General
Sir G Littler
Mr A J C Edwards
Mr R I G Allen
Mr Taylor
Mr Knox - C&E

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

10 November 1987

Ms Judy Moult
MOVOPS
RAF Room 5178
Ministry of Defence
Main Building
Whitehall
LONDON SW1

Dear Judy

I am writing to confirm the arrangements we made on the 'phone earlier today. The Chancellor will attend the ECOFIN meeting on Monday, 16 November, along with Sir Geoffrey Littler, Andrew Edwards, Richard Allen, Jonathan Taylor and Bryce Knox. The team will depart from Heathrow at 7.30 am (Flight ASCOT 1714), arriving at Abelag at 9.30 am (local time). I would be grateful if you could provide a continental breakfast during the flight.

The Chancellor and his team should be able to leave the ECOFIN meeting at about 4.00 pm. I would be grateful if you could have the aircraft on standby at Abelag from 4.00 pm onwards. Mr Knox will be staying on at the meeting and returning by commercial flight. It would be helpful if we could have tea and drinks available on the return flight - tea if they depart at about 4.00 o'clock and drinks if the departure is delayed until early evening.

I will let you have details of the cars that various members of the team are using to arrive at Heathrow for you to pass on to the VIP Lounge and Security at Heathrow.

Please do not hesitate to contact me if you need any further information.

MRS JULIE THORPE Diary Secretary

Julie Thorpe



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

Robert Fellowes Esq MVO Deputy Private Secretary Buckingham Palace LONDON SW1

10 November 1987

Door Mr Fellowes

The Chancellor of the Exchequer has asked me to write to you and seek Her Majesty's approval to his travelling to Brussels on Monday 16 November. He will return to the United Kingdom on the same day.

MRS JULIE THORPE Diary Secretary

Julie thorpe.



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

10 November 1987

Andy Bearpark Esq 10 Downing Street LONDON SW1

Dear Andy

I am writing to seek the Prime Minister's permission for the Chancellor of the Exchequer to attend an ECOFIN meeting in Brussels on Monday 16 November.

He will travel to and from the meeting by RAF flight Ascot 1714.

The party accompanying the Chancellor would be Sir Geoffrey Littler, Mr Andrew Edwards, Richard Allen, Jonathan Taylor and Mr Bryce-Knox. (Mr Bryce-Knox will be returning by scheduled flight.)

I should be grateful if you, and the other recipients of this letter, would let me know whether there would be any objections to these proposals.

I am copying this letter to Russell Dixon (FCO), William Austen (Government Whip's Office) and Chris Cloke (Sir Robert Armstrong's Office).

MRS JULIE THORPE Diary Secretary



10 DOWNING STREET LONDON SW1A 2AA

From the Private Secretary

11 November 1987

Den Julii

Thank you for your letter of 10 November about the Chancellor's visit to Brussels, 16 November.

The Prime Minister is content, subject to Parliamentary and Government business.

I am copying this letter to Russell Dixon (Foreign and Commonwealth Office), Greg Shepherd (Government Whips' Office) and Paul Cuthbert-Brown (Cabinet Office).

Tour - Arry

P. A. Bearpark

Mrs Julie Thorpe H M Treasury.



BUCKINGHAM PALACE

11th November, 1987.

Dear No Thope.

Thank you for your letter of 10th November, which I have laid before The Queen. Her Majesty has been pleased to give her approval to the Chancellor of the Exchequer's proposed absence from this country on Monday 16th November.

(ROBERT FELLOWES)

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like (?) to slower at this in

MR J TAYLOR THE COMECOFIN 16 NOVEMBER

12/11

FROM: M PARKINSON

DATE: 12 November 1987

briefing

In response to your request for early sight of ECOFIN, I attach the releviant Commission papers and briefing on one of the main items, capital market liberalisation proposals.

Month of Styles

Mark Parkinson.

M PARKINSON

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ECOFIN COUNCIL 16 NOVEMBER

International Economic and Monetary Situation

The text: below was agreed by EcoFin this morning and will be used by the Presidency in briefing the press.

- 2. An attempt by the Southern Member States to include a reference to "cohesion" was seen off, as were efforts by the Belgians and Italians to refer explicitly to interest rate policy and tax reform.
- 3. The Presidency agreed, at the Chancellor's suggestion, to brief the press in addition that Ministers had underlined the need for all countries to resist pressures for protectionism.

Within the framework of the EEC-EcoFin-Council the Buropean Finance Ministers today discussed the most recent developments on the financial and foreign exchange markets.

Taking note of some improvements during the last days they agreed that a more stable market situation is very important for the further economic development in Europe and worldwide.

For this purpose common and coordinated efforts by all countries are needed.

It is of high importance that the fiscal and monetary cooperation agreed at the Louvre be continued and the commitments undertaken implemented by all parties in full and without delay. Especially urgent are early and appropriate decisions on a further substantial reduction of the US budget deficit for fiscal 1988 and fiscal 1989. A further decline of the dollar would aggravate the disadvantages for the world economy including the US.

The European countries are determined to improve the conditions for further internally-generated non-inflationary growth and to contribute to the reduction of external imbalances. The European countries intend to cooperate actively with other countries in decisions to ensure a more stable development of world financial and foreign exchange markets.

The events of the last weeks have emphasised the advantages within the context of the objectives of the European Single Act of setting up a large integrated European market of goods and services and capital. The progressive realisation of these objectives will create in the coming years new opportunities for growth in Europe.

The EMS has played and will play an important role in the coordination of policies between the member countries and in preserving stable relationships between European currencies. All member countries will continue to meet in full their obligations within the existing margins of the EMS. Recent developments have demonstrated that the EMS has been strengthened in appropriate ways by the September decisions of Basle and Myborg.*