II

(Acts whose publication is not obligatory)

COUNCIL

COUNCIL DECISION

of 17 December 1979

adopting the annual report on the economic situation in the Community and laying down the economic guidelines for 1980

(80/67/EEC)

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 (1), as amended by Decision 75/787/EEC (2), and in particular Article 4 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament (3),

Having regard to the opinion of the Economic and Social Committee (4),

Whereas there is a need for close cooperation in facing up to the problems arising from new adverse economic factors,

HAS ADOPTED THIS DECISION:

Article 1

The Council hereby adopts the annual report on the economic situation in the Community as contained in Section 1 of the Annex and lays down the guidelines to be followed by each Member State in its economic policy for 1980, as contained in Sections 2 to 5 of the Annex.

Article 2

This Decision is addressed to the Member States.

Done at Brussels, 17 December 1979.

For the Council

The President

M. O'KENNEDY

(1) OJ No L 63, 5. 3. 1974, p. 16.
(2) OJ No L 330, 24. 12. 1975, p. 52.
(3) OJ No C 4, 7. 1. 1980, p. 17.
(4) Opinion delivered on 24 and 25 October 1979 (not yet published in the Official Journal).

ANNEX

ANNUAL REPORT ON THE ECONOMIC SITUATION OF THE COMMUNITY AND ECONOMIC POLICY GUIDELINES FOR 1980

1. Economic prospects and objectives for 1980

This report is principally concerned with the policies required for the European Community to cope in the year ahead with the unfavourable turn in the international economic environment.

Taking into account the rise in the price of oil in the past 12 months and the current recession in the North American economy, as well as the many unresolved domestic economic problems in Member States, expectations for 1980 have to be relatively modest.

The essential features of the economic forecasts to 1980, as drawn up by the Commission are given in the table below.

The Community economy 1973 to 1980

	GDP volume growth (%)	Rise in consumer prices (%)	Current account balance of payments 1 000 million (EUA)	General government financial deficits (% of GDP)	Money supply growth (M_2 or M_3) (%)	Unemployed in labour force (%)
1973	6·0	8·4	1·1	—0·7	16·5	2·5
1974	1·6	13·4	—9·5	—1·7	12·8	2·9
1975	—1·6	12·8	0·8	—5·6	12·7	4·3
1976	5·0	11·1	—6·2	—3·8	12·5	4·9
1977	2·3	10·5	1·2	—3·3	12·3	5·3
1978	3·1	6·8	14·0	—4·0	12·7	5·5
1979 (1)	3·1	8·9	—3·3	—4·0	10·9	5·6
1980 (1)	2	9	—5·25	—3·9	10·5	6·2

(1) Forecasts of the Commission staff on the basis of present or anticipated policies.

The Community can aim for a continued moderate GDP volume growth in 1980 of about 2·5 to 3 % in the majority of Member States, which, taking into account the likely weaker performance of some others, would make a Community average of about 2 %. This compares with an average growth rate of a little over 3 % which was experienced, or is now forecast, for both 1978 and 1979.

The oil price rise of about 60 % in the 12 months to June 1979 means for the Community as a whole an initial deflationary impact of the order of 0·7 % of GDP, mounting perhaps to 1 % after a year taking into account various secondary effects.

The slower GDP growth forecast for 1980 means that the growth of total employment being experienced in 1979 is likely to be arrested. With the continued rise in the population of working age (by 0·5 % in 1980), unemployment is likely to rise again somewhat in the Community as a whole, although not in all Member States. Provided that it is clear that monetary and budgetary policies are being achieved and inflationary pressures successfully contained, it may become possible in 1980 to maintain a significant momentum of growth, avoiding anything like the recession which the Community experienced in 1974/75, which led to a doubling of the rate of unemployment.

The impact on the price level is very significant, especially when the increase in all energy prices is taken into account : an increase in consumer prices of 2 to 2·5 % is the average effect in the Community, without, however, making any allowance for secondary inflation effects (through the price-wage spiral) which have to be limited to the minimum. The price effects

will be working their way through mainly in the second half of 1979. Unavoidably the year-on-year rate of inflation is increased in 1979 and 1980 to about 9 %, compared to the low point of just under 7 % achieved in 1978. The objective should limit the temporary rise in the average inflation rate to no more than 2 % and to re-establish a decelerating trend in the course of 1980. The Community has a special interest in seeing a rapid reversal of the recent tendency for inflation rates to begin again to diverge.

The current account of the balance of payments of the Community is at present deteriorating, and the outcome for 1979 and 1980 is likely to be deficits of the order of 3·25 to 5·25 billion EUA, by comparison with the substantial surplus of 14 billion EUA recorded in 1978. This movement reflects the influence of both the changing relative cyclical position of the European and United States economies and the increased price of oil (which increases the Community's oil bill by some 20 billion EUA). The current account of Member States could well continue to deteriorate until the end of 1979, but a spontaneous recovery should become apparent in the course of 1980 as OPEC imports increase and relative cyclical trends become less divergent. The balance of payments deterioration has for the time being to be accepted, subject to the special position of certain Member States, and to recognition of the overriding priority to strengthen energy policy so as to reduce dependence on imported oil.

The Community is faced with two sets of difficult structural economic problems. The first is the complex of issued linking productivity trends, employment policy and industrial policy. The second concerns energy. Together the handling of these issues will be quite as fundamental to future performance of the Community economy in terms of price stability and growth as issues of short-term economic strategy.

A number of factors suggest that past long-run productivity trends, for example the 4·3 % annual average experienced in the Community in 1960 to 1973, will not be restored in the foreseeable future. While on balance average productivity growth is likely to be lower, the contributing factors are not helpful to employment. The quantity of work available is in no way fixed and increasing productivity is required to dampen the rise of costs and inflation, and to make for a favourable combination of growth, employment and monetary stability.

In industry there is the need for continuing adaptation to new patterns of demand and new manufacturing technologies. Progress in manufacturing industry has to come with exposure to competition, and profitability to assure investment, research and development. Intervention in favour of sectors with declining demand must be limited to helping assure an orderly and socially acceptable restructuring and reduction of capacity.

While the trend in the number of persons directly employed in manufacturing is unlikely in most countries (though there should be exceptions) to absorb much of the present unemployment, a competitive manufacturing sector is both fundamental to the Community's prosperity and economic strength, and to the prospects more broadly for employment growth, for example through its impact on related service sectors. Moreover certain growth sectors should see a marked increase in employment, notably in energy-related industries.

In the tertiary sector there is much greater scope for employment growth, as witnessed by trends everywhere (including the United States where trends have gone further than in Europe), and by the continuing growth in latent demand and supply. Growth is persistently strong for health, education, travel, leisure and social services, although there is also increasing concern over the quality of public services.

Greater indigenous energy production and conservation is now a vital macroeconomic objective, without which the prospects for non-inflationary growth are poor indeed. For the short-run and medium-term oil ceilings have been set by the Community (500 million tonnes for consumption in 1979, and 472 million tonnes of imports in 1985). The evidence suggests that these objectives can be achieved by breaking the past association between the growth of domestic product and oil use, although the feasible extent of this change in trend is still the subject of considerable uncertainty.

To achieve a moderate growth rate in Community GDP in 1980, and to respond also to these issues of structural development, there is a vital role to be played by household savings and private investment including stockbuilding. While these variables are

difficult to predict at all exactly, they should be expected to behave according to a number of basic principles.

In 1980 some decline in the household savings ratio would be desirable, so as to help sustain real demand without increasing costs and thence prices. For this to be possible, inflation expectations need very soon to be calmed down, and this requires confidence in the objectives of economic policy.

Investment, including stockbuilding, is typically the most volatile component of the business cycle : in 1975 investment fell 5 % in volume terms in the Community as a whole, while the running down of stocks alone contributed 2 % to the decline of GDP. The indicators at present are not unfavourable. Investment activity has been strengthening in 1979, and forecasts and surveys suggest continued buoyancy in 1980 in the Community as a whole. As regards stocks, business surveys show that their level has continued to decline throughout the past 18 months, which means that there would seem to be a low probability of a running down of stocks, assuming that other economic behaviour remains sound. Both investment and stockbuilding, however, are highly sensitive to the financial condition of the enterprise sector — both as regards profitability and availability of credit. These factors in turn are going to depend greatly on whether households in the next year accept — through the development of their nominal incomes — the terms of trade loss imposed by the oil price rise ; or whether they seek to shift this loss to the enterprise sector or to government's finances through compensatory wage claims.

2. Principles for policy at the Community level

It is the particular role of the Community to identify the common problems that cannot be solved adequately at the national level, and to work out the concerted response that can give the better result.

The Community has embarked upon a new venture in the European Monetary System, which has helped provide over the last half-year a much needed stability in intra-Community exchange rates, as well as in September an efficient procedure for a limited adjustment to central parities. The exchange-rate stability provided by the system needs to be extended beyond the currently participating countries, for example by developing a concerted policy along with the United States towards the dollar.

In the period ahead in which the balance of payments effects of the new oil price rise have to be absorbed the credit mechanisms of the Community, as augmented with the European Monetary System, provide the means of assuring solidarity between Member States.

Without pretending that allegiance to a system of exchange-rate stability, itself subject to all the tensions that divergence in economic performance can create, is an adequate solution to the Community's economic policies, the European Monetary System provides a framework for the construction of a set of short- and medium-term policies, which while inevitably modulated to the particular circumstances prevailing in each Member State, present together a coordinated approach to tackling these problems.

In the present situation a concerted response is called for according to which Member States should move together through two successive phases of policy. The first and immediate need, given that the oil price rise be fully communicated to the consumer, is to prevent a secondary increase in the rate of inflation. This means that in the period from now to about mid-1980 the evolution and the distribution of incomes has to be adjusted either through lower real income claims or through a temporary adjustment to the full working of indexation mechanisms (the details of course would vary here by country). This done, the European Monetary System will serve to reinforce the defences against monetary divergences.

Provided that this is achieved, there should be some room for manoeuvre for policy to develop. Control over monetary aggregates should be kept steadily to present strict policies, but, provided that inflationary expectations are decisively lowered, it should become possible and desirable to move in due course to more supportive budgetary policy, if also investment and consumption were weaker than expected. The policy-mix could also in such an eventuality, or to some extent alternatively, include a de-escalation of interest rates. The judgments on these issues, and the possible policy adjustments to follow, would require a strongly concerted articulation.

A further immediate, and unconditional requirement is the strengthening of energy policy in the Community. The 1985 oil import ceilings agreed in June at Strasbourg have in September been specified in more

detail. Progress is now required to implement these objectives by setting into motion the profound structural developments in the production and saving of energy by governments, enterprises and households. The price mechanism must be put powerfully to work at the level of energy users, while Governments should take the lead with investment programmes and incentives to the private sector.

At the Community level there are a number of further policy instruments available. In particular the Community's instruments of structural policy are growing with increasing budgetary intervention through the Social Fund, EAGGF (Guidance Section), and Regional Fund and in the domains of industry and energy, as also with increasing loan financing for investment through the European Investment Bank, and the Commission's Euratom, ECSC and new investment financing facilities. These various financing activities are entirely directed towards the priority requirements of the economic situation : employment, industrial and infrastructural investment and energy developments.

3. **Main lines of policy for 1980**

Monetary policy has an important counter-inflationary role to play. For 1979 it seems likely that monetary policy will succeed in bringing down the rate of growth of monetary expansion to about 11·5 % on average in the Community, which is about the same as the rate of growth of nominal gross domestic product. This reflects a more restrictive general stance of policy by comparison with 1978 when, in the interests of helping restimulate growth, money supply was permitted to grow about 13 % — nearly 2 % faster than nominal gross domestic product.

The target rates of monetary expansion for 1980 should be kept either lower, or at the most not higher than those set for 1979. Except for certain cases where a continuing trend decrease in the velocity of circulation is to be expected, the rate of monetary expansion should be aimed at slightly less than that of nominal gross domestic product, so as to signal, and indeed to work towards a deceleration trend in the rate of inflation in the course of 1980. For the Community as a whole, money supply might (on the basis of Commission estimates, assuming continuation of existing policies) be constrained to a growth of 10·5 % — slightly below that projected for nominal gross domestic product (11·25 %).

Nominal interest rates may have to remain high by historical standards to permit a sufficient non-monetary financing of public deficits. When inflation is seen to be on a decelerating trend again, it would be desirable to lower interest rates so as to stimulate investment and ease the debt service burden on the public finances. An eventual de-escalation of interest rates would be, typically, the task of concerted policy moves across the Community ; the need for improved coordination in this field has been heightened by the operations of the European Monetary System.

Budgetary policy was expansionary in both 1978 and 1979, the financial deficit of general government in the Community as a whole having risen successively from 3·3 % of GDP in 1977 to 4·0 % in 1978 and in 1979. It is now desirable to move into a phase of falling public deficits relative to GDP, so as to help allow the shift of savings in private investment, and to reduce the public finances' contribution to monetary expansion. But the extent of these reductions should be varied by country according to several criteria : the strength or weakness of economic activity, the size to which public deficits have grown over recent years, the extent to which inflationary expectations remain live, consistency with monetary policy objectives and the urgency of the need to shift resource utilization from public to private sectors for reasons of balance of payments constraints or to strengthen the directly productive base of the economy. The mix of these criteria lead to a range of desirable outcomes, between reductions in the government deficit as a share of GDP in some cases (for example Germany, Ireland, Italy, the Netherlands, the United Kingdom), to their approximate stability in some others. For the Community as a whole the financial deficit of general government is likely to decline from 4·0 % of GDP in 1979 to 3·9 % in 1980 ; the borrowing requirement of central governments would in general move in a similar direction (although the Community average is expected to remain stable in terms of GDP share because of some exceptional financial transactions).

This evolution is appropriate on the basis of the underlying macro-economic objectives and forecasts. However, budgetary policy has to retain its automatic contracyclical function, which means that if the rate of growth of economic activity were faster than forecast, the public deficits should reduce by a greater

margin, and if economic activity should be weaker, public deficits would turn out to be greater. It would not be appropriate as of now, as a response to the effects of the oil price rise, to return to a phase of general, unconditional reflation through budgetary policy, because of the constraints already mentioned. However, there are conditions in which a more active budgetary policy could become appropriate in 1980, notably in circumstances where this could help establish firmer and less inflationary growth (see further below in relation to income bargaining), and where this was consistent with the objectives of monetary policy.

Income bargaining behaviour will in the year ahead carry a major responsibility for determining whether the present economic difficulties can be absorbed without damaging the prospects for continuing economic progress. Over the past 18 months, the evolution of wage incomes has on average in the Community, though there are exceptions, helped the deceleration of inflation recorded in 1978 and has since then in most countries avoided aggravating the acceleration of inflation (which was due in substantial measure to a deterioration in the terms of trade thus not warranting compensatory wage claims). The nominal growth of hourly wages in the Community as a whole evolved as follows : 12 % in 1977, 11 % in 1978 and 10 % in the second quarter of 1979 over one year earlier.

Seen in a medium-term perspective, however, there is still a way to go before the relative shares of wage and salaried income on the one hand and that of the enterprise sector on the other, are restored to levels that may be considered normal for the stimulation of productive and employment creating investment. In the first instance the social partners have to agree — in each country in its particular setting as regards the nature of wage contracts and negotiating practises — to limit to the minimum the repercussion of energy price rises into incomes. In countries with fixed wage contracts, this means not seeking to renegotiate them before their normal expiry. In countries with comprehensive and rapid-acting wage indexation mechanisms it is necessary either to withhold payment of some part of future indexation adjustments so as not to pass on the recent energy price rises, or alternatively, to make equivalent reductions in claims for real purchasing power increases. These principles are being respected in some Member States, but problems remain in other countries with wage indexation practises. These differences are dangerous, since they risk leading to a renewed divergence in relative inflation trends between Member States.

In the period ahead real wage increases should be near to zero in the Community on average : maintenance of purchasing power but hardly more. As between Member States there will be a range of justifiable outcomes around this average, depending upon recent productivity performance, the financial position of the enterprise sector and on the degree of price stability actually established.

Behaviour along these lines will permit a more continuous advance in real economic growth and better employment prospects than would otherwise be the case. Failure to adjust in this way to the energy price shock would on past experience lead to a much more disagreeable result.

The general employment strategy has to count on employment growth in services of the widest range, while still aiming at high productivity performance in manufacturing industry. The role of government must be to favour those trends through its labour market, industrial and regional policies, although there are constraints (notably budgetary) on the extent to which governments should directly intervene in labour markets. In the past three years the scale of direct employment measures by governments has considerably increased. The number of persons benefiting from four main categories of manpower policy intervention (employment creation subsidies, work experience programmes, public sector job creation programmes, and employment maintenance measures) has increased from an estimated 1·4 million persons in 1976 to 2·1 million in 1977 and further in 1978 for the Community as a whole. These measures are of significant size in relation to the number of registered unemployment.

With the persistence of high unemployment in almost all the member countries and the prospect of an acceleration in the growth of the labour supply in the next five to 10 years, proposals to step up cuts in working hours or to extend work-sharing have become a major topic in discussions on labour market policy. There is no way of saying with certainty how great the short- and longer-term employment effect of cuts in working hours would be. Cuts in working hours are not a quick-acting panacea, nor can they be a substitute for general growth and adjustment policies. One should envisage — without, however, aggravating the costs of enterprises — some strengthening of the long-term trend in the reduction of annual working hours (the working week or holidays), alongside other forms of work-sharing (schemes for earlier and flexible retirement, part-time working, reduced overtime) and the development of a wider array of vocational training and further training schedule.

4. Policy in the Member States

In *Denmark,* the risk exists of a further significant worsening in the current balance of payments deficit in 1980 as a result of the deterioration in the terms of trade. Despite the recent adjustment of the krone in the European Monetary System, economic growth will remain subjected to a pressing external constraint. In these circumstances, official action will need to aim primarily at ensuring a lasting moderation in costs, particularly in order to obtain an improvement in the balance of payments. This means that the growth in incomes in 1980 should be considerably lower than in preceding years implying a smaller rise than now expected within the framework of existing agreements. In this regard, steps must be taken to ensure that automatic indexation does not cause the impact of the higher cost of imported energy supplies to be passed on to nominal incomes. For this reason, an alteration in the nature of the indexation system would seem to be highly desirable. Even after the increase in indirect taxation and the reduction in public expenditure decided last June, the general government borrowing requirement could rise from its level of 1 % of GDP in 1979 to 2 % of forecasted GDP in 1980. It could become necessary to reduce this deficit unless the rise in incomes is lowered substantially. To provide room for financing the increased balance of payments deficit and maintaining the krone's position on foreign exchange markets, monetary policy will have to continue to be aimed at keeping interest rates high and maintaining strict controls on lending.

In the *Federal Republic of Germany,* the Government's stimulatory programmes that were adopted mainly in 1978 have set in motion a vigorous economic upswing which, to an increasing degree, is being underpinned by the endogenous expansionary forces in the economy, notably investment. The development of employment has shown a more favourable trend than was expected at the beginning of the year. These results can be partly attributed to decidedly moderate wage settlements. While the price climate has deteriorated, this is largely due to the rise in the price of oil and to the increase in value-added tax which took effect on 1 July 1979 (the latter intended as a medium-term change in tax structure). The leading economic indicators suggest that, despite a slow down in the course of the year, the favourable economic situation will continue into 1980. This means that some reduction in the financial deficit of the public authorities as a whole from the level of 3 % GDP foreseen for 1979, can be envisaged next year. Nonetheless, the risk of a marked weakening of economic activity remains. Aside from uncertainties on the export side, internal demand, in particular private consumption, could slow down significantly. If this were distinctly more pronounced than at present expected, financial policy could already have a compensatory effect before the entry into force of the reduction of personal income tax planned by the Government. The rate of increase of 'central bank money' is at present close to the lower limit of the range of from 6 to 9 % set last year by the Bundesbank. For the year to come, the Bundesbank has fixed a target rate of growth of from 5 to 8 % from the fourth quarter of 1979 to the same quarter of 1980. This has therefore ensured that, from the point of view of the money supply, a relatively limited margin for price increases has been kept to. This policy stance should make it easier for the social partners to conclude moderate wage settlements, an indispensable condition for balanced growth over the next year.

In *France,* economic policy remains oriented towards structural reform. The higher contributions introduced in order to put social security on a sounder footing have been combined with rather strict central government budget management. At the same time, the underpinning of economic activity, for the end of 1979 and the beginning of 1980, has been assured by measures to boost investment and to help low-income groups. This overall stance should be prolonged into 1980 in order to permit growth to continue at an adequate level and so that external trade can be kept close to equilibrium (despite the deterioration in the terms of trade observed in 1979 and expected for 1980); the State budget on an execution basis should be such that, in 1980, the net borrowing requirement is kept within the 1979 limits, that is 1·7 % of GDP, thus leading to a stabilization of the net borrowing requirement of public administrations. With a combination of a moderation of economic growth and continuing increases in productivity, the increase in employment will slow down in 1980. Moreover, due to the sharp increase in the number of persons entering the labour market for the first time, and in spite of the recent measures in favour of young people, a further increase in unemployment is to be expected. This increase creates the risk of a rise in the savings ratio which could imply a marked slowdown in the evolution of real private consumption. Should there be a marked slow down in economic activity, it would be necessary to reinforce the arrangements instituted in 1979 in order to support economic activity to the extent possible in the context of external constraints. In other respects, in order to reduce inflationary pressures, it would be advisable, not only to pursue a policy of moderation on nominal incomes but also to restore free competition in all branches of the economy, including in particular the services sector. Restructuring of the economy will also have to be sought through a limitation in the subsidies granted to the nationalized companies. The overall aim of monetary policy will continue to be the

stability of the franc. To this end, the present level of liquidity of the economy should be held steady or even reduced.

In *Ireland,* growth will remain moderate in 1980 owing to a slower expansion of domestic demand and despite an anticipated improvement in the performance of agricultural exports. The initial impact of dearer imported raw materials, is liable to be amplified by the automatic effect of wage indexation which will have unfavourable consequences on job creation and lead to a deterioration in unemployment, given the rapid rise in the labour force. In addition, the worsening of the balance of payments deficit will prove to be a major constraint on economic policy. Thus budgetary policy should manage domestic demand strictly and should be geared towards a substantial reduction in the net borrowing requirement of central government as a percentage of GNP, in keeping with the aim, set in 1978, of bringing this to 8 % in 1980. In addition, increases in incomes should not aim to compensate for the deterioration in the terms of trade. In this respect, it would be desirable for the social partners to consider a change in the indexation clause. If this change is not made, the level of settlements following the termination of the current provisions should be influenced by the fact that an inappropriate compensation for the deterioration in the terms of trade will have already been made. In order to help the balance of payments and support reserves, monetary policy will have to remain tight based in particular on the maintenance of a strict ceiling on domestic credit.

In *Italy,* in spite of the continued growth of the economy in 1979, the current account recorded another substantial surplus. However, there has been a disturbing acceleration in the rate of inflation which is in danger of receiving an additional boost from the interaction of the rise in oil prices and the wage-indexation system. Still greater efforts would therefore seem to be necessary to combat inflation whilst at the same time achieving the transfer of resources necessary to support economic growth. In the public finance field, the guidelines of the economic plan for the three-year period 1979-81, which was presented last January and which has not yet been translated into practical measures, still appear to be appropriate for attaining these objectives. In this connection, steps should be taken to ensure that the deficit of the enlarged public sector (1), expressed as a percentage of gross domestic product, does not exceed 14 % in 1980. Within this broad framework, the share of current expenditure should be cut back, whilst the implementation of government investment projects should be accelerated as far as possible. To meet both these requirements, it would seem necessary to complete the reform of the pensions system, to curb the growth of spending on health care and to speed up the administrative procedures on which the implementation of increased investment largely depends. In the monetary field, the abundant liquidity which has formed in the economy must be gradually reabsorbed. To achieve this aim, the growth in total lending should be moderated and the policy of consolidating the national debt should be continued. In view of the sharp rise in prices and, to a lesser extent, the fall in the surplus on current account, interest rates should be kept at a sufficiently high level. These policy guidelines include certain elements likely to slow down the rate of economic growth. It would therefore seem to be necessary, in line with the three-year plan, to encourage the propensity to invest whilst limiting the growth of hourly wage-rates to that needed to cover the simultaneous increase in prices. With this aim in mind it would be useful to slow down the rate at which the sliding scale adjusts wages and salaries to prices, and instead — in order to ensure that the purchasing power of wage and salary earners is maintained — to grant reductions in taxation.

In the *Netherlands,* economic activity has been fairly buoyant in 1979 ; since mid-1978 unemployment has levelled off at around 4·5 % of the civilian labour force and consumer price inflation has remained relatively low. With export growth expected to slacken, the expansion in Dutch economic activity is likely to slow down slightly in 1980. Given the rapid increase in the volume of exports in 1979 and the foreseeable rise in the export price of natural gas, the trend of the balance of payments on current account looks more favourable and the recovery is probably set to continue. Consequently, economic policy makers' room for manoeuvre in the short-term is slightly greater than forecast. In the framework of the central government draft budget for 1980 the authorities have therefore taken a series of new measures (strengthening of employment, energy saving, stimulation of innovation and structural change) which — taking account of a certain number of fiscal measures — will increase the budget deficit by some 600 million guilders (0·3 % of GDP). It is nevertheless still necessary to press ahead with effort to restrain the medium-term growth of public expenditure — the only way to limit the increase in the tax burden on the economically active section of the population and to secure a lasting improvement in the outlook for employment. With respect to central government borrowing requirement in 1980 the target should be not to exceed 3·6 % of GDP (4·0 % of national income ; this should make it possible to keep the borrowing requirement on a cash basis for general government unchanged at 5 % of GDP (5·5 % of national income). The main risk is an

(1) According to the Community definition, this deficit covers, in addition to the borrowing requirement of general government, also that of ENEL (electricity supply monopoly) and those of the independent public trading bodies and also local authority enterprises. However it excludes transfers to special credit institutions, repayment of commercial debts incurred in the past and changes in bank deposits.

acceleration of inflation which could endanger the achievements realized recently in the field of competitiveness. It is in this context important to avoid that the increase in energy prices provoke an additional increase in nominal incomes.

In *Belgium*, the recovery of economic activity which began in 1978 accelerated notably in 1979. Despite the effect of the measures to assist employment (training courses for young people, early retirement, etc.) unemployment went on rising, but only for women. The increase in consumer prices has gathered momentum. The current account deficit seemed again to be widening despite relatively buoyant export performance. Growth will probably slacken to some extent in 1980, primarily as a result of the slowdown in the expansion of export markets. This means that the employment situation might well remain precarious. Furthermore, some acceleration in consumer prices seems likely. The most worrying problem for economic policy is still the public finance situation. In the short term, the burden of adjustment has been borne by monetary policy, but a reduction in the budget deficit is the only way to bring about a lasting reduction of the strains on the financial market while stemming the tide of inflation. In order to avoid an appreciable increase in the pressure of taxation and para-fiscal charges, a stepping up of the efforts made in recent years to reduce the growth of central government expenditure is a priority task and should be extended to cover also other public administrations, notably social security. Without such an extension of austerity measures a further rise in the borrowing requirement of general government will be unavoidable, whereas a reduction of the borrowing requirement of central government to 7·1 % of GDP at most should be aimed at for 1980. With respect to incomes it is important to allow for the fact that the terms of trade deterioration limits severely the scope for granting real increases (apart from indexation).

In *Luxembourg*, the economy has been fairly buoyant and unemployment has shown some tendency to fall. The level of tax revenue has turned out to be distinctly higher than expected a year ago mainly owing to the persistent buoyancy of the tertiary sector. In 1979, the general government account will therefore close with net lending of the order of 1·7 % of GDP and should remain in surplus in 1980. Even allowing for some slow-down in the growth of economic activity, it should not decline below 1 % of GDP. To this end, the lending of central government should not be reduced by more than 0·5 % of GDP from 1979 to 1980.

In the *United Kingdom* economic activity has been somewhat unbalanced in 1979. The strong growth of domestic demand was largely met from imports so that the current account of the balance of payments moved into substantial deficit, in spite of North Sea oil production approaching self-sufficiency levels. Sterling remained strong however, as a result of the international energy situation coupled with tight monetary policies in the UK. This helped to dampen price inflation but caused a further deterioration in the UK's competitive position. The new Government identified the main weaknesses of the British economy as being supply-related and is attacking these structural problems by reducing public sector intervention, by improving incentives to the private sector in particular by a sharp change from direct to indirect taxation, while maintaining firm monetary policies. Exchange controls have been removed. Taking into account the effects of the new monetary and budgetary policies, domestic demand is expected to weaken in 1980 and the deficit on the current account of the balance of payments should be reduced. On present policies, the public sector borrowing requirement as a percentage of GDP should not exceed in 1980/81 the figure of 4·5 %, as is now foreseen for 1979/80. Should earnings rise excessively, taking into account moreover the likely fall in output and productivity in 1980, the consequences could be very serious for international competitiveness and particularly, for employment prospects. The Government should, however, not accommodate such developments by adjusting the target rate for the growth of money supply. Establishment of a stable low rate of price inflation and improved conditions of resource allocation have to be overriding objectives.

5. Conclusion

Economic prospects for 1980 have been made more difficult because of the oil price rise and recessionary trends elsewhere in the industrialized world. However, the situation of the European Community has some favourable features: a business upswing has been achieved in 1979, together with improved exchange-rate stability in the European Monetary System, and relatively sound balance of payments situations in most Member States.

The new adverse factors present the Community with three major problems: the inflation-growth combination will be worse for some time ahead, there is a danger of a renewed divergence of price performance between Member States, and there is much to be done for the energy policy response to be adequate in the circumstances.

The following three-pronged Community policy response is required :

(i) in a first phase of policy incomes have to be constrained such that consumers absorb the increased cost of energy and secondary increases in inflation are avoided ; meanwhile monetary policy should be kept strict, and budgetary policy should at this stage provide only very limited compensation for the effects of the oil price rise ;

(ii) provided that it is clear that a durable reduction in inflation has been achieved, it should become possible to adjust policy in due course into a more actively supportive posture, notably if also investment and consumption were found to be weakening significantly ;

(iii) energy policy must in any case be strengthened in all its aspects, since without achieving a deep change in past relationships between oil imports and economic growth, there is little prospect for the latter to progress.

This policy approach does not, in the judgement of the Commission, change the objectives of policy — to give priority to the fight against inflation without stopping growth. Nor should there be fundamental changes in policies defined in the course of recent months ; these policies do, however, require strong and urgent implementation.