II

(Acts whose publication is not obligatory

COUNCIL

COUNCIL DECISION

of 23 March 1993

adopting the annual economic report for 1993 and determining the economic policy orientation for the Community in 1993

(93/258/EEC)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Decision 90/141/EEC of 12 March 1990 on the attainment of progressive convergence of economic policies and performance during stage one of economic and monetary union [1], and in particular Article 4 (1) thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament [2],

Having regard to the opinion of the Economic and Social Committee [3],

HAS ADOPTED THIS DECISION:

Article 1

The Annual Economic Report for 1993, attached to this Decision, is adopted, as are also the economic policy orientations for the Community put forward in the report.

Article 2

This Decision is addressed to the Member States.

Done at Brussels, 23 March 1993.

For the Council
The President
S. AUKEN

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[1] OJ No L 78, 24. 3. 1990, p. 23.
[2] Opinion delivered on 12 March 1993 (not yet published in the Official Journal).
[3] OJ No C 108, 19. 4. 1993, p. 31.

ANNUAL ECONOMIC REPORT FOR 1993

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INTRODUCTION AND SUMMARY

The economic outlook for the Community has deteriorated dramatically over recent months. Instead of the hoped-for recovery, 1993 will bring a third year of slow growth with a return to slightly healthier rates of expansion expected for 1994 at the earliest. As a result of this poor growth performance, unemployment is increasing and cannot be expected to stabilize until well into 1994 while budget deficits have swollen and are now higher than at the beginning of the 1980s.

Recovery from the cyclical slowdown which started towards the end of 1990, in line with a generalized world economic slowdown, is held back by a severe lack of confidence and continuing tight monetary policy. The unification of the two German States resulted in an extraordinary demand boost accompanied by a tightening of monetary conditions to control the accompanying inflationary pressures. Thus, in 1990 and 1991, economic activity throughout the Community benefited strongly from these positive demand effects which allowed the Community to escape in 1991 the full brunt of the world slowdown. Subsequently, however, the persistence of inflationary pressures in Germany, notwithstanding a marked weakening in economic activity, led to a situation where monetary conditions in many member countries became tighter than domestic conditions warranted.

In the second half of 1992, the continuing weakness of economic activity contributed to the difficulties encountered in the process of ratification of the Treaty on European Union and was one of the factors which ignited the foreign exchange crisis. The turmoil with the exchange rate mechanism added a significant element of uncertainty to economic prospects and dented the credibility of the EMU timetable. In addition, the continued deadlock in the Uruguay Round negotiations, the mixed signals on the prospects for a recovery in the United States, the weakening of the Japanese economy, the difficulties of the reform process in central and eastern Europe and the ethnic conflict in the former Yugoslavia, all combined to create a very negative business environment. In the closing months of 1992, all business and consumer confidence survey indicators deteriorated sharply.

However, the scope for economic policy to sustain growth in the short terms is limited. Budgetary policy is severely constrained in most countries. Some countries did not use the period of strong growth to consolidate sufficiently their budgets and are now in an even more difficult position. Others have used their healthier starting positions to support growth by allowing the automatic stabilizers to operate, but they have now exploited a large part of the available margins for flexibility. A significant loosening of monetary policy is possible, but is conditional on a reduction in inflationary pressures in Germany and on greater policy credibility in the countries linked to it by the ERM. The Edinburgh growth initiative represents an attempt to exploit any room which is still available without departing from the necessary medium-term stability orientation of the economic policy.

But, on the basis of present policies, a return to rates of growth between 2 and 3 %, possible within say two years, will not be enough to improve significantly the unemployment situation which is likely to remain very difficult for some considerable time. The Community must, therefore, implement medium-term policies which will result in an increase in the sustainable rate of growth so as to be able to put unemployment on a significant downward trend.

The effectiveness of economic policies depends crucially on their credibility. Unfortunately, this has been seriously compromised by recent developments which have also called into question the EMU timetable. Governments must therefore take all possible steps to impress on economic agents their determination and ability to achieve their goals. At the Community level, governments must re-affirm, through appropriate actions, their commitment to the EMU process and show their determination by coordinating their policies more effectively.

In practice this means:

(i) in the short term, implementing measures designed to support growth to the extent possible, without endangering the necessary medium-term budgetary consolidation perspectives (in all countries), or the necessary reduction in inflationary pressures (in some countries);

(ii) in the medium term, following policies aimed at increasing the dynamism and competitiveness of the economies through the removal of market impediments to faster growth, at fostering a healthier climate against which new investment can take place, and creating the conditions for environmentally sustainable growth.

I. THE COMMUNITY ECONOMY IN 1991 to 1993

The Community economy is going through a phase of slow growth which is proving longer and more severe than previously expected. This is in parallel with developments in the world economy which started decelerating towards the end of 1990 and virtually stagnated in 1991. But while initially the Community economy, thanks largely to the growth impulses coming from German unification, performed relatively better than the rest of the industralized world, since mid-1992 it has also been facing serious problems which suggest that a return to more satisfactory rates of growth will only take place in the course of 1994.

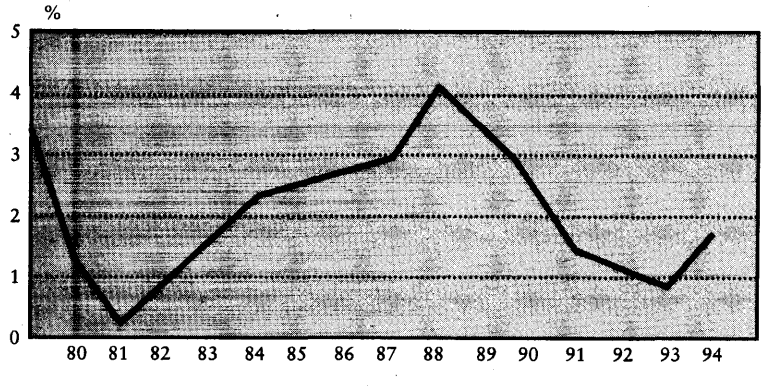
Growth prospects: marked deterioration in the course of 1992

After five years of strong growth, the Community economy started decelerating towards the end of 1990. Until mid-1992, the slowdown was modest with the Community average rate of growth remaining in the 1 to 2 % range. The mildness of the downturn together with the still relatively satisfactory state of fundamentals led prematurely to expectations of a rapid end to the period of slow growth. In the course of 1992, however, prospects deteriorated rapidly. On the one hand, it became evident that the underlying strength of the economy had been overestimated, whilst on the other, it appeared that monetary policy would not be loosened as rapidly as had been expected. In addition, the deterioration in the economic outlook contributed to the political difficulties which surrounded the ratification process of the Treaty on European Union and the foreign exchange crisis which erupted last September. These two events in turn led to a worsening of prospects for recovery through their effect on business and consumer confidence (the factors behind the present difficulties are examined in greater detail in the next section).

Graph 1

Community: real GDP growth

(including the new German Länder from 1992 onwards)



After a surprisingly good first quarter, Community GDP stagnated in the second and third quarters of 1992, and the available evidence suggests that it could have declined slightly in the final quarter. These indications, together with the dramatic drop in business and consumer confidence in the second half of 1992, gave rise to fears that the Community economy might be entering a serious recession. The Edinburgh growth initiative is designed to counter such a possibility.

Poor growth in 1993

Forecasts broadly conducted on the conventional no-policy change assumptions [1] suggest that in the course of 1993 the Community economy could recover slightly. Consumer confidence is expected to improve somewhat leading to a gentle pick up in private consumption followed rapidly by stronger investment. Given the growth profile of 1992, strong first quarter followed by sharply weakening activity, the expected gentle recovery will nevertheless result in an average rate of growth for the year 1993 of only 0,8 % [2], lower than that of 1992 (1,1 %). An extrapolation of the expected 1993 growth trend suggests an average rate of growth for 1994 of about 1,8 %. While there are good reasons to expect that this forecast will materialize, there are large risks on both sides. Cyclical turning points are always difficult to predict, as the experience of the last 18 months has shown once again.

Table 1

The Community economy: Use and supply of goods and services and main economic indicators

(Annual real percentage change)

	Average 1983—1985	Average 1986—1989	1990	1991	1992	[a] 1993
Private consumption	1,8	3,9	3,2	1,9	1,4	¾
Government consumption	1,7	2,0	2,1	2,0	1,6	¾
Gross fixed capital formation	1,1	6,4	3,9	0	0,4	–½
Domestic demand (including stocks)	1,7	4,1	2,8	1,2	1,3	½
Exports of goods and services [b]	4,2	1,2	5,6	5,5 [d]	2,9	5¼
Total demand	2,0	3,8	3,1	1,7	1,4	1
Imports of goods and services [b]	1,4	7,9	5,4	3,8 [d]	3,5	2¼
Gross domestic product	**2,1**	**3,3**	**2,8**	**1,4**	**1,1**	¾
Inflation (deflator private consumption)	7,2	4,0	4,5	5,3	4,6	4½
Employment	0,0	1,3	1,6	0,1	–0,7	–¾
Unemployment (% of active population)	10,4	9,9	8,3	8,8	10,1	11
Public deficits (% of GDP) [c]	–5,3	–3,8	–4,1	–4,6	–5,3	–5¾
Current account balance (% of GDP)	0,3	0,5	–0,3	–1,0	–0,8	–1

NB: The figures for the public deficit and the current account balance include the five new German Länder from 1991 onwards. The figures for GDP and its components, inflation and employment/unemployment include the new Länder from 1992 onwards.

[a] Forecasts.
[b] Extra-Community trade only.
[c] General government net borrowing requirement.
[d] These figures are distorted by the very large increase in trade flows with the former German Democratic Republic. If these transactions are treated as intra-Community trade (i.e. giving figures for the Community including the new German Länder) the figures become –1,3 for exports and 5,8 for imports.

[1] The forecasts presented in this Annual Economic Report are produced on the conventional no-policy-change assumption for most variables, particularly in the budgetary sphere. The cut off date for information was 11 January 1993.

[2] All data for the Community refer to the Community including the five new German Länder, unless otherwise specified.

A generalized downturn

In the course of the last two years growth differentials between Member States narrowed. This is due principally to two contrasting trends. Firstly, the post unification boom in Germany has given way to a sharply accelerating downturn, with the rate of increase in GDP falling from 3,7 % in 1991 (Federal Republic of Germany) to 1,5 % in 1992 and to an estimated decline of 0,5 % in 1993. Conversely the slow and painful emergence of the United Kingdom from its prolonged recession is reflected in an expected turnabout in its performance from a fall of 2,2 % in 1991, followed by a further decline of 0,9 % in 1992, to an increase of 1,4 % in 1993. Most other Member States' performances fall between these two extremes, with sluggish growth of between 1 to 2 % expected to continue into 1993. However, Belgium and the Netherlands, reflecting their close economic links with Germany, are both experiencing relatively sharp slowdowns, with their rates of growth expected to fall to only 0,5 % in 1993.

Weak private consumption

Reflecting the duration and severity of the downturn, all of the components of domestic demand are weak. Private consumption in particular has suffered, with the successive decelerations in its rate of expansion since 1989 expected to continue in 1993, when growth of only 0,8 % is forecast. This contrasts with a corresponding average figure of 3,5 % between 1985 to 1990. This continuing fall is attributable to the sharp decline in real disposable income owing to higher inflation which has eroded nominal wage increases, stagnant employment growth, falling working hours and tax increases in several Member States. A recovery in private consumption is hampered by fears arising from rising unemployment and further falls in consumer confidence, which currently is at its lowest level since the early 1980s. Finally, the need in some Member States (notably the United Kingdom) to reduce high personal indebtedness consequent to the asset price boom of the 1980s, has also encouraged a more cautious approach to spending on the part of consumers.

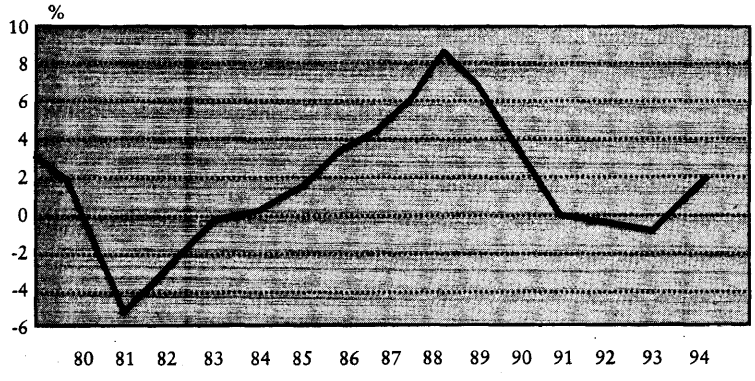
Declining investment

Following the boom in the latter half of the 1980s, investment growth in the Community virtually stagnated in both 1991 and 1992. If the new German Länder are excluded, investment actually fell by 0,3 % in 1992. Spending on equipment and construction have been almost equally affected, with the latter proving to be slightly more resilient to the downturn, especially in 1992. As a consequence the rate of increase of the capital stock has declined and is currently well short of the level required to help counter the high levels of unemployment in the Community. This stagnation in investment is largely a cyclical response to the fall-off in demand, a deterioration of investment profitability (see Graph 13), the effect of the high real interest rates which prevail in many countries and the consequence of increased political and economic uncertainties on business confidence. Conversely, however, the deterioration in the profitability of the capital stock of 1990 and 1991 has given way to a modest improvement in 1992 due to the return, in many countries, to more moderate rates of wage increases. Given the expectation of continued weak demand, a further decline in investment of half a percentage point is expected in 1993.

Graph 2

Investment in the Community

(real % rates of increase; excluding the new German Länder)

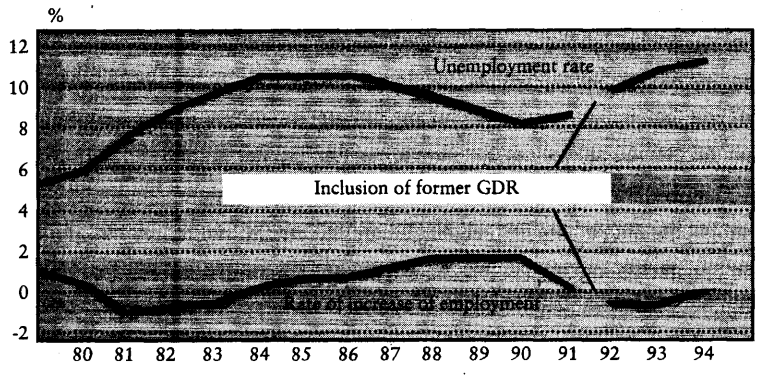


Unemployment: loss of the 1986 to 1990 gains

The effects of the slowdown on employment were felt with a certain delay given the lag with which changes in the rate of increase in employment follow changes in the rate of growth of output. Employment continued to increase strongly in 1990 (1,6 %), but this trend came to a halt in 1991 when it virtually stagnated. In 1992, employment actually contracted by about three-quarters of a percentage point, the first time since 1983 that the number of people in employment actually decreased, and a similar reduction is expected to take place again in 1993. In absolute figures this means that in 1993 almost two million fewer people than in 1991 will be employed in the Community, thus reducing the employment increase since 1984 from nine to about seven millions. Given that the labour force is projected to continue to increase (0,3 % in 1993) more or less in line with the trend of recent years, this employment trend results in a steep increase in unemployment which could reach in 1993 the figure of about 17 million people (including the former German Democratic Republic), or, measured as a percentage of the civilian labour force, a level similar to the peak of 1985 (11 %). Thus, in this important respect, the gains made during the last five years of the past decade will have been lost again in the first three years of the 1990s.

Graph 3

Employment and unemployment in the Community



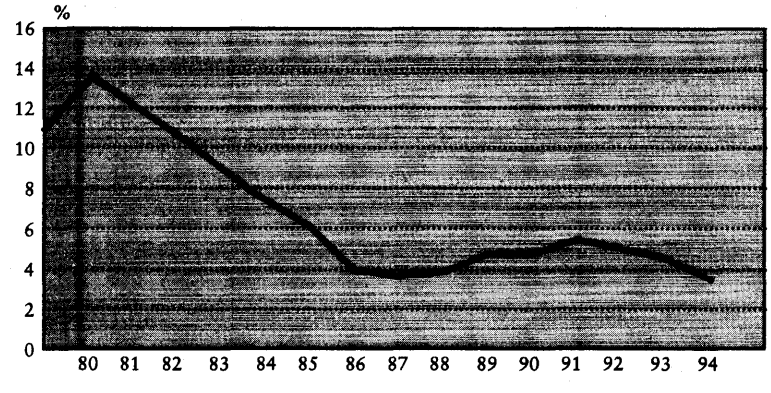
Small overall gains on inflation

The ongoing economic downturn and the continued tight monetary policy stance have contributed to an easing in inflationary pressures in 1992, when the Community private consumption deflator fell to 4,6 %. This improvement is due largely to the relatively better performance in those Member States outside the narrow band of the ERM who, with the exception of Spain, registered significant progress in reducing inflation in 1992, following disappointing progress in the previous year. But significant progress was also made in the countries in the narrow band, which, with the exception of Germany and the Netherlands, all had rates of increases in consumer prices of less than 3 % at the end of 1992. However, owing partly to the inflationary impact of recent currency devaluations in several Member States, the Community rate of inflation is expected to remain almost unchanged in 1993 (4,5 %). The nominal depreciation for the Community as a whole in 1993 implied by the exchange rate assumptions [1] will lead to a stronger growth in import prices in 1993. This in turn will offset the impact of the expected fall in unit labour costs, which are forecast to rise by just 2,9 % in 1993, the lowest increase for several years. New increases in indirect taxation are also expected to add to inflationary pressures in 1993.

Graph 4

Inflation in the Community

(Private consumption deflator = % change p.a.)



Little change in the Community's current account

The Community's current account remained broadly stable in 1992 showing a deficit equal to just below 1 % of GDP. Significantly, all Germany's partners within the narrow band of the ERM registered current account surpluses in 1992. Moreover, with the exception of the Netherlands and Luxembourg, these surpluses represented an improvement on the outturn in 1991, with France registering its first surplus since 1986. Conversely, the United Kingdom, Spain and Italy registered continued and significant deficits, notwithstanding the weak economic conditions and the ongoing recession in the former. Both Greece and particularly Portugal registered sharp falls in their deficits.

[1] The forecasts produced by the services of the Commission are based on a technical assumption as regards exchange rates. In particular, exchange rates within the EMS are expected to remain stable in nominal terms until the end of the forecasting period at the values obtaining at the moment forecasting work started. For other currencies the assumption is stability in real terms. In the case of the relationship between the dollar and the DM the assumption used is: US $ 1 = DM 1,66 for the average of 1993.

ECONOMIC CONVERGENCE IN THE COMMUNITY

The phrase 'economic convergence' is often used to cover two distinct, but not totally independent, processes. The first, more precisely referred to as 'nominal convergence', concerns the gradual convergence towards the best possible results of the performances of the Member States in those areas which directly affect the transition to and the success of a monetary union. The Maastricht criteria which cover actual (consumer price index) and expected inflation (long-term interest rates), budget deficits, public debt to GDP ratios and exchange rate stability relate to this process. The phrase 'real convergence', on the other hand, refers to the long-term process of convergence in living standards, usually approximated by the levels of GDP per head at purchasing power parities (see Statistical Annex, Table 1), of the different regions of the Community.

Nominal convergence

The continuing economic difficulties and the foreign exchange turmoil have led to set-backs in the efforts at achieving the degree of convergence required for transition to EMU. In the budgetary area, this is hardly surprising as weak growth has strong negative effects on public deficits and the Member States who enjoyed relatively healthier budgetary positions have, rightly, allowed the so called 'automatic stabilizers' to operate. As a result, there has been no overall progress towards meeting the targets agreed at Maastricht (a budget deficit not exceeding 3 % of GDP and a public debt/GDP ratio of less than 60 % of GDP). Instead, there was a substantial deterioration in 1991 and especially 1992 in the budgetary situation both in the Community as a whole and in several Member States. This deterioration in turn has not permitted any progress towards reducing public debt positions which have deteriorated in most countries (see Table 2).

The deceleration in the rate of growth, however, has facilitated some progress in reducing the rates of inflation: in 1992, the overall rate of inflation decreased by 0,8 points to 4,5 % (excluding the new German Länder). However, the progress made may now be threatened by the inflationary impact of recent devaluations.

Budgetary situations have deteriorated further

Only four Member States (Denmark, France, Ireland and Luxembourg) are now expected to have had budget deficit (general government net borrowing requirement) outturns of less than 3 % in 1992 — the relevant criterion in the Maastricht Treaty. The deterioration has been particularly severe in the United Kingdom, where the deficit in 1992 is now expected to have increased by over three percentage points to about 6 % of GDP. Elsewhere in the Community there are two notable trends. Member States with relatively sound public finances have allowed the automatic stabilizers to operate, leading to a largely cyclical deterioration in their budget deficits. This deterioration has, however, been restricted to a maximum of about one percentage point of GDP in France and to half a precentage point of GDP or less in Denmark and Ireland.

Conversely, in those Member States where deficit levels were very high, consolidation efforts succeeded in stabilizing or in some cases reducing deficits. Thus Belgium and Italy both limited their deteriorations in 1992 to a quarter of a percentage point or less to 6,7 and 10,5 % of GDP respectively. Both Portugal and especially Greece have made more encouraging progress: Greece has reduced its budget deficit to 13,4 % of GDP from 15,4 % in 1991, while Portugal, in the framework of the implementation of its convergence programme, has reduced its deficit to 5,6 from 6,4 % in 1991. In Spain, the introduction of corrective fiscal measures in the latter half of 1992 checked the deterioration in its public finances and the deficit outturn of 4,6 % of GDP is slightly down on the level in 1991. Finally, the deficit for unified Germany (measured by the general government net borrowing requirement, as is the case for all other Member States) remained unchanged at 3,2 % of GDP.

In the light of continued weak growth, these overall trends (i.e. a continued cyclical deterioration in the Member States with relatively sound public finances and further consolidation in the high deficit Member States) are expected to continue in 1993. As a result, the overall Community deficit level will deteriorate further to 5,7 % of GDP.

Price convergence has improved in 1992

There has been an improvement in 1992 in both the overall inflation picture and the degree of dispersion between Member States. However, the fall in the rate of inflation (private consumption deflator) of 0,7 percentage points to 4,6 %, is less than might have been expected given the weak cyclical position of the Community economy. It also compares unfavourably with the United States and Japan where the price performance in 1992 was much better.

The improvement in the degree of dispersion is largely due to the relatively better performance of the Member States with higher inflation levels outside the narrow band of the ERM. All five of these Member States (Spain, Greece, Italy, Portugal and the United Kingdom) registered significant falls in inflation in 1992, except for Spain where only a slight reduction was achieved. Within the ERM narrow band there is little overall change, with slight reductions of up to half of a percentage point in all participants, except Luxembourg where there was a small increase and the Federal Republic of Germany where virtually no change took place. German Federal Republic inflation (4 %) remained the highest in the present narrow band for the second successive year. However, in 1992, only the narrow band members registered rates of inflation within a range of 1,5 percentage points above the average of the three best Member States in terms of price performance, the relevant Maastricht criterion.

The relative improvement outlined above had been expected to continue into 1993. However, recent developments may threaten this further progress. The devaluations in the nominal exchange rates of several Member States increase the prospect of a renewed rise in inflation in the countries concerned through significant import price increases, notwithstanding the weak state of economic activity and high unemployment in these Member States. The impact of these rises on the aggregate inflation figure for the Community will be offset by a reduction in inflationary pressures in the appreciating Member States, where import price rises will be much more moderate. Overall, inflation in the Community in 1993 is expected to remain almost unchanged at 4,5 % (4,4 % excluding the former German Democratic Republic).

Real convergence

All four of the less prosperous Member States registered growth equal to or above the Community average in 1992 (see Table 1 in the Statistical Annex for figures about GDP per head levels). However, the significant progress of the previous few years has stalled. Nonetheless, there are substantial variations within this group. Hence, Ireland with an estimated growth of 2,9 % in 1992, has substantially exceeded the corresponding Community growth figure of only 1,1 %, as it did also in the preceeding three years. Greece, on the other hand, should register growth of only 1,5 %, which is nonetheless the second consecutive year since 1985 that it has exceeded the Community average. This progress reflects its long and painful adjustment process to the economic imbalances accumulated in the 1980s which is finally beginning to pay dividends. Spain's growth performance of only 1,25 % in 1992 is also notable as it represents a very sharp slowdown on the boom conditions experienced during the latter half of the 1980s. Portugal has continued its steady progress in 1992, while suffering also from the general growth downturn.

Notwithstanding their relatively better economic performance, the rates of growth these countries experienced in 1992 were not sufficient to stabilize unemployment which increased everywhere except in Greece. Particularly worrying are the increases recorded in Ireland (from 16,2 % in 1991 to 17,8 % in 1992) and Spain (from 16,3 to 18 %) where unemployment was already the highest in the Community. Unfortunately this trend is expected to continue in 1993 when the rates of unemployment of these two countries are expected to reach levels in the 19 to 20 % range.

Table 2

Main nominal convergence indicators 1990 to 1992

	Inflation (Private consumption deflator)			Budget deficit (General government net borrowing requirement)			Gross public debt (Percentage of GDP)		
	1990	1991	1992	1990	1991	1992	1990	1991	1992
B	3,1	2,9	2,4	-5,7	-6,6	-6,7	128,3	130,1	132,2
DK	2,1	2,4	2,1	-1,4	-2,0	-2,3	66,7	72,2	74,0
D (*)	2,7	3,9	4,0	-2,0	-3,6	-3,4	43,6	45,0	—
D	—	—	4,8	—	-3,2	-3,2	—	42,0	43,3
GR	20,1	18,4	16,0	-18,8	-15,4	-13,4	96,3	102,0	106,7
E	6,4	6,3	6,0	-4,0	-4,9	-4,6	44,5	45,6	47,4
F	3,2	3,2	2,6	-1,4	-1,9	-2,8	46,7	48,5	50,1
IRL	1,7	3,2	2,9	-2,5	-2,1	-2,7	101,6	100,9	99,0
I	5,9	6,8	5,3	-10,9	-10,2	-10,5	97,8	101,3	106,8
L	3,6	2,9	3,4	5,0	-0,8	-0,4	6,9	6,1	6,8
NL	2,3	3,3	3,1	-4,9	-2,5	-3,5	78,8	78,3	79,8
P	12,6	11,9	9,1	-5,5	-6,4	-5,6	68,4	68,5	66,2
UK	5,3	7,2	5,1	-1,3	-2,8	-6,1	39,8	41,1	45,9
EC (*)	4,5	5,3	4,5	-4,1	-4,7	-5,4	59,5	61,4	—
EC	—	—	4,6		-4,6	-5,3	—	60,4	62,8

(*) Excluding the five new German Länder.

II. FACTORS BEHIND THE PRESENT POOR PERFORMANCE

The present poor outlook for the Community economy is the result of various factors which have emerged progressively over the period 1990 to 1992 and whose combined influence has become increasingly stronger. These factors, however, have reduced the growth prospects of the Community economy which, notwithstanding the progress made in the 1980s, does not yet perform as well as could be expected in terms of growth and employment creation compared to other major economies (the factors behind the low potential rate of growth of the Community economy are examined in greater detail in Section IV).

The most important factors behind the present period of slow growth are the world economic downturn, the parallel cyclical slowdown of the Community economy after the strong growth of the second half of the 1980s and the continuing tight monetary policy resulting from conditions in Germany. These factors have combined to prolong the period of slow growth to the point where dissatisfaction with the current economic conditions has made the ratification of the Treaty on European Union more difficult and has precipitated the recent foreign exchange crisis. In turn the political difficulties and the loss of credibility associated with the ERM turmoil have themselves become factors depressing economic activity.

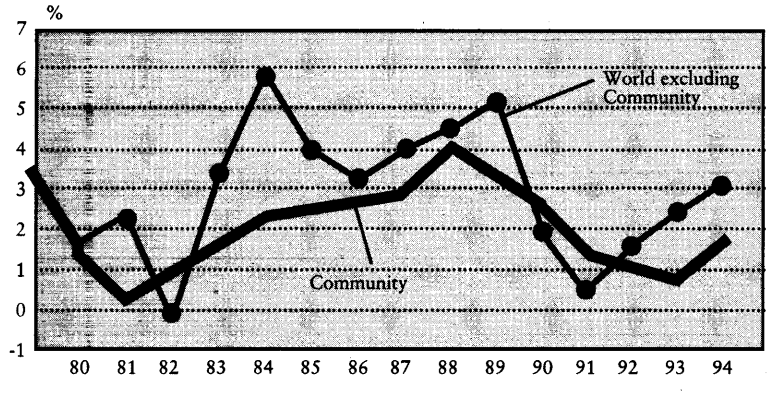
Effects of the world slowdown

The 1988 peak in the rate of economic growth in the Community was in synchrony with that of the world economy since they were largely the product of the same impulses: the delayed effect of the drop in oil prices of 1985/86 and the considerable loosening of monetary policy which followed the stock market crash of October 1987. In 1990, world GDP growth decelerated sharply from the strong rates of growth of 1988 and 1989 (4,5 and 5,2 % respectively) to about 2 % which was followed by a further slowdown to as little as half a point in 1991. In 1992,

activity in the rest of the world recovered slightly, but, at 1,6 %, remained weak. The absence of a stronger rebound is in part explained by the need for firms and households, in a number of OECD countries, to continue to reduce their debt positions following the unsustainable increase in the previous few years. This contraction in the rate of growth of the world economy was mirrored in a reduction in the rate of growth in world trade which in 1991 and 1992 expanded by only 3 and 4,2 % respectively.

Graph 5

Growth in the Community and in the rest of the world



Community export markets were particularly affected. In 1991 they practically stagnated following growth of about 7 % in 1989 and almost 4 % in 1990. In 1992, they are estimated to have picked-up somewhat and to have expanded by about 3,5 %. In addition, exchange rate trends were not very favourable for Community exporters. The nominal effective exchange rate of the Community appreciated by over 10 percentage points between 1989 and 1992 (average level of the years). As a result, Community producers suffered a substantial loss of competitiveness both in domestic and world markets. Community exports to the rest of the world, which had increased by more than 7 % in real terms in 1989, decelerated to a rate of increase of just over 2 % in 1990 and actually contracted by about 2,5 % in 1991 (goods only). Preliminary estimates suggest that in 1992 Community exports may have increased again at a rate of about 2,5 %. It is worrying that the Community has experienced a continuous loss of market share over the last three years. Finally, given that domestic demand in the Community remained stronger than in its trading partners, imports from the rest of the world increased substantially also in 1991 and 1992 (7 and 3,5 % respectively, goods only).

Cyclical component

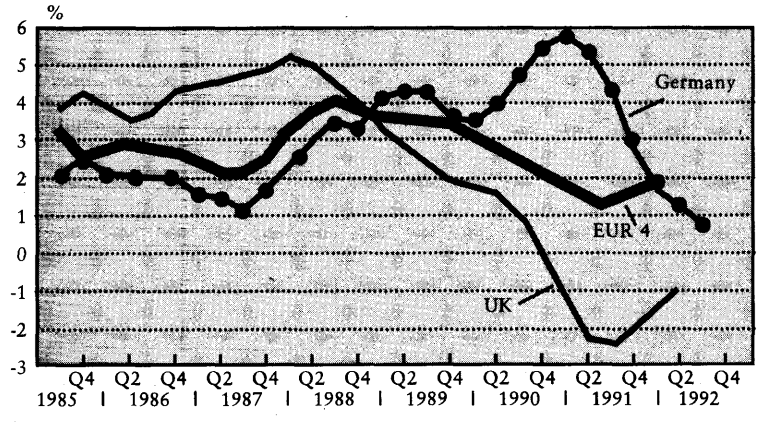
In the second half of the 1980s the Community economy experienced a period of strong growth; the average real rate of increase of GDP for the five year period 1986 to 1990 was 3,2 % while the real rate of increase of domestic demand was 3,9 %. Investment increased particularly strongly with an average real rate of increase over the same period of 5,9 % and almost 7,5 % for investment in equipment. Measures of the potential rate of growth are very uncertain, but it is possible that during this period the actual rate exceeded what the Community economy was able to deliver without the appearance of strains. In any case, the recorded rates of growth of 1988 and 1989 (4,1 and 3,4 % respectively) were clearly in excess of the longer run potential rate however measured. Under these conditions, a cyclical slowdown was to be expected. Indeed, it is reasonable to think that the slowdown would have become already very significant towards the end of 1989 had it not been for the additional expansionary impulses coming from German unfication. In the event this acted as a major European 'demand expansion programme'.

Graph 6

Cyclical differences in the Community

GDP growth in Germany, United Kingdom and EUR 4 (F, I, NL, DK) (*)

(real % change on same quarter of previous year, 3-terms moving averages)



(*) Quarterly figures are available only for six Member States.

The subsequent running out of steam of the Community economies was also reinforced by a more restrictive orientation of economic policy in response to the appearance of macroeconomic imbalances. On the inflation front, less favourable import price trends led to consumer price increases accelerating from rates of around 3,7 % in the years 1968 to 1988 to rates of about 5 % in 1989 to 1991. Wage increases also accelerated from annual rates of increase of less than 6 % in the period 1987 to 1989 to 7,5 % in 1990. In some countries, current account deficits began to give cause for concern. These imbalances, although not as serious as those that the Community had experienced at the beginning of the 1980s, prompted some countries to take restrictive action independently of the general tightening of monetary conditions imposed by the tensions arising from the German unification shock. In addition to these factors, in some countries, especially the United Kingdom and Denmark, the weakness of demand was compounded by the need for households and firms to correct excessive debt positions.

German unification and its policy consequences

German unification constituted for the Community a textbook case of a major asymmetric shock. At the macroeconomic level, unification implied the creation of a huge gap between aggregate demand and supply within Germany. Supply was severely reduced in the Democratic Republic while demand was supported by huge transfers from the Federal Republic. These transfers were financed mainly by a higher public sector deficit which witnessed a deterioration of more than 3 % of GDP within one year after unification.

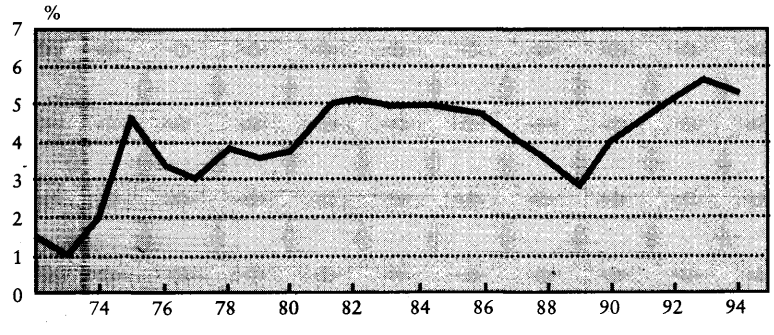
Given that no corresponding cuts in German Federal Republic domestic demand took place, the effects were predictable. Notwithstanding an enormous swing in the current account position of Germany (from surpluses equal to 4 to 5 % of GDP between 1986 and 1989 to a deficit of almost 1 % of GDP in 1992) which bears testimony to the high degree of integration reached by the European economies, GDP growth in the Federal Republic of Germany reached 5,1 % in 1990 with rates of growth of almost 6 % in the last two quarters of 1990 and the first quarter of 1991. Demand in other Member States also received a substantial boost. It is estimated that the growth rates of the other Member States were raised on average by about half a percentage point a year in both 1991 and 1992. This above-potential growth in the Federal Republic of Germany led to tensions in the labour market and in the markets for goods

and services. Wage increases accelerated from a trend of about 3 % a year in the period 1987 to 1989 to 4,7 % in 1990 and 5,8 % in 1991 while inflation reached rates of about 4 % in 1991 and 1992 (public utility prices and indirect tax increases were also contributing factors).

This situation resulted in an unbalanced policy mix with short-term interest rates, which had been increased in response to the first signs of the appearance of inflationary pressures and expectations, remaining high. The strong degree of financial integration of the Community, the weight of the German economy and, above all, the ERM constraints reinforced by deeply ingrained market expectations that the DM would never be devalued *vis-à-vis* other Community currencies, led to tight monetary conditions in the rest of the Community. A situation was therefore created where the other Member States after a first phase during which the effects of German unification substantially boosted growth, positive demand effects outweighed the restrictive effect of tighter monetary conditions, were now receiving deflationary impulses coming from a continuing tight monetary policy stance at home combined with a weakening of activity in Germany. This situation created policy coordination problems and ultimately resulted in a very delicate situation since most Community countries were experiencing in 1991 and 1992 very weak demand. Particularly difficult was the situation of the United Kingdom which was undergoing a severe recession.

Graph 7

General government net borrowing requirement in the Community (% of GDP)



A restrictive policy stance

As a result of the above developments, macroeconomic policy over the past two years has generally been restrictive and, of necessity, focused on the correction of the imbalances inherited from the previous strong growth period. Nonetheless, the overall Community budget deficit has continued its upward trend and in 1992 reached an unprecedented record level of 5,3 % of GDP. This increase of 0,7 percentage points on the outturn in 1991 is attributable to the impact of the downturn on public finances as the automatic stabilizers were allowed to play in many Member States. Moreover, this aggregate result was substantially influenced by the deterioration of over three percentage points in the United Kingdom deficit. Elsewhere in the Community discretionary policy actions have been broadly neutral with the loosening in some Member States being largely offset by a corresponding tightening in others. In 1993, these trends should continue, and the overall Community deficit is projected to increase further to 5,7 % of GDP with expectations of a further sharp deterioration in the deficit of the United Kingdom of over two points of GDP.

Monetary conditions in the Community remained tight during most of 1992, as evidenced by strongly inverted yield curves, and the strength of Community currencies against third currencies and also, in some countries, a deceleration of monetary aggregates and/or falling asset prices. This tightness contributed to the longer-than-expected downturn. As noted above, the stance of monetary policy was dominated by events in Germany, whose interest rates continued to set the floor for nominal interest rates in the ERM, with very minor (at least in 1992) exceptions in the case of the Netherlands and Belgium. To counter strong inflationary pressures in Germany, the Bundesbank increased its official interest rates in December 1991. Most other ERM participants followed suit. The rise in rates was not inappropriate in the high-inflation

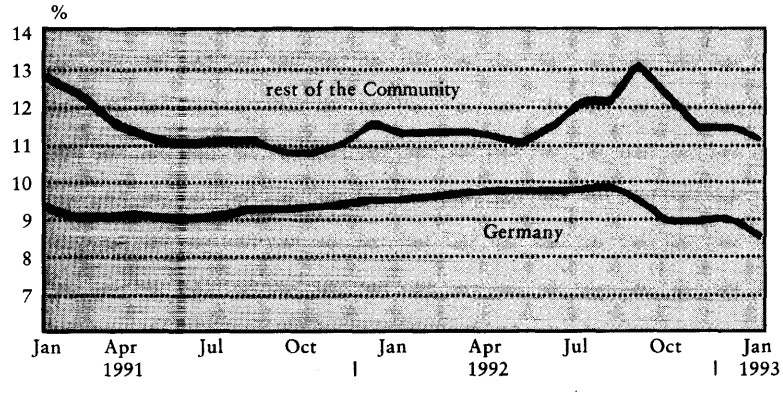
countries, but was not obviously in line with domestic needs in the other narrow-band countries. In July 1992, the Bundesbank, faced with money growth twice as high as the target range, raised its discount rate. Only Italy similarly raised an official rate, but the Bundesbank move eliminated market expectations of an early downward movement in interest rates in Europe. Combined with a further fall in the dollar, as the Federal Reserve continued to cut United States short-term interest rates, the July move additionally tightened monetary conditions in the Community.

German short-term rates reached a peak in the second half of August (see Graph 8). Thereafter, despite continued high rates of M3 growth, German rates trended downwards, particularly in response to the effective appreciation of the DM implied by the ERM crisis and partly as a result of the defence of the French franc.

Graph 8

Short-term interest rates in Germany and in the rest of the Community

(monthly averages January 1991 to January 1993)



Political difficulties and ERM turbulence

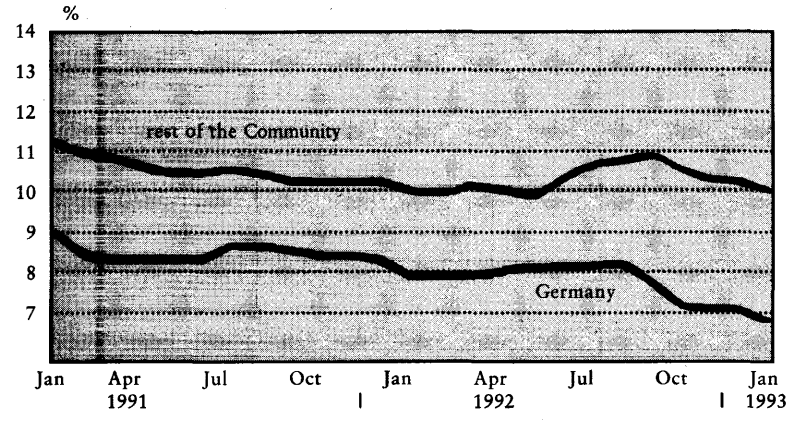
The difficulties which the ratification of the Treaty on European Union encountered, rejection by Danish voters, narrow approval in the French referendum, difficult parliamentary debates in some other countries, have complex causes. It must be presumed, however, that the deterioration of the economic situation has been a contributory factor as people became more worried about their future and more fearful of change *per se*. The appearance of these difficulties only served to add to the Community's economic problems.

The rejection in June 1992 by Danish voters of the Treaty led market participants to expect a weakening of the commitment to the agreed path towards EMU, which particularly affected the countries with the largest budgetary adjustments to make or the weakest cyclical positions. As a result, the increase or re-appearance of risk premia on many of these countries' currencies *vis-à-vis* the DM started a vicious circle as economic prospects for these countries deteriorated further, thus raising additional doubts on the ability and willingness of govenments to carry out painful adjustments in a difficult moment, with the higher interest rates increasing the debt servicing burden and making budgetary consolidation still more difficult. Furthermore, exchange-rate parities, which had not been adjusted for five-and-a-half years, were, in a number of cases, out of line with the achievement of internal balance without the need for a prolonged period of inflation at rates below those in partner countries. At the same time, economic evidence was pointing to a substantial worsening of the economic situation in most Member States and survey results started casting doubts on a positive vote in the French referendum called for September 20.

Graph 9

Long-term interest rates in Germany and in the rest of the Community

(monthly averages January 1991 to January 1993)



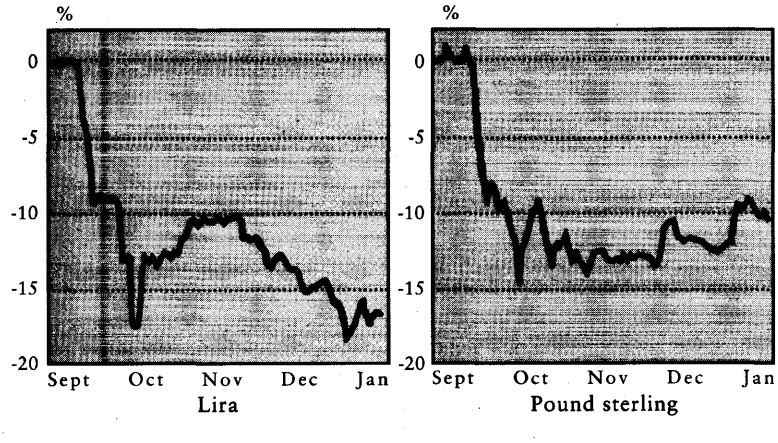
These developments led markets to doubt seriously the ability of many governments to defend the existing parity grid within the EMS exchange rate mechanism and served to ignite the recent foreign exchange crisis (see box for a description of developments). If these events represented the spark, the fuel for the fire had been accumulated over years by the continued existence of large imbalances in many, although not all, of the countries affected.

The parity adjustments which have taken place and the temporary suspension of the participation of the Italian lira and the pound sterling have to a certain extent changed the nature of the policy problems faced by Member States, but they have not reduced their difficulty. The temporary support to economic activity that can be expected from a lower exchange rate and the resulting improved price competitiveness must be weighed against the need to restrict the general stance of macroeconomic policy to prevent inflationary pressures degenerating into a prices/wages spiral. Budgetary adjustment may be easier to achieve to the extent that activity is stronger, but lower interest rates are still difficult to achieve and, in those countries whose currencies now fluctuate freely, the reductions which have taken place were obtained at the cost of substantial depreciations which are bound to create significant inflationary risks in the medium term and economic uncertainty.

Graph 10

Changes in the value of the lira and the pound sterling *vis-à-vis* the DM since the beginning of September 1992

(percentage changes relative to 1. 9. 1992)



The foreign exchange crisis is likely to have an adverse effect on growth in the Community as a whole since the increase in activity in the countries whose currencies have depreciated is unlikely to fully offset the losses in the countries whose currencies have appreciated. In addition, the crisis has affected the credibility of the EMU timetable and added a significant element of uncertainty to economic agents' plans.

To make matters worse, over the closing months of last year tensions and uncertainties appeared over the possibility of reaching an agreement on the current round of GATT trade liberalization. Since the freeing of trade aimed at in the Uruguay Round is expected to impart a substantial positive stimulus to world trade and growth, conclusion of the long round of negotiations had been eagerly awaited and the appearance of new difficulties must have been perceived as an additional new adverse development. Finally, the continued uncertainty surrounding the prospects for political and economic reform in central and eastern Europe and the ethnic conflict in the former Yugoslavia were additional factors depressing business and consumer confidence. Hence the political and institutional sphere in the second half of 1992 failed to provide economic agents with the stable and credible framework they need and actually contributed to depressing their confidence.

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CHRONOLOGY OF RECENT EVENTS IN THE EXCHANGE RATE MECHANISM

2 June 1992: danish voters narrowly reject the Maastricht Treaty by referendum leading to the emergence of exchange rate tensions within the ERM and rises in short term interest rates in several Member States.

2 July 1992: The United States Federal Reserve announces the seventh consecutive reduction in its discount rate to only 3 %, accelerating the recent rapid depreciation of the dollar relative to Community currencies.

16 July 1992: The Bundesbank raises its discount rate by three quarters of a percentage point, but leaves the Lombard rate unchanged at 9,75 %.

25 August 1992: Publication of first polls suggesting a negative vote in the French referendum.

28 August 1992: Fuelled by growing fears over the unsustainability of the Italian budget deficit, the lira falls to its floor in the ERM.

3 September 1992: The United Kingdom, under growing pressure to increase interest rates in defence of sterling's weakness, chooses instead to arrange lending facilities for an amount equal to seven and a quarter billion pounds to bolster its external reserves.

4 September 1992: The United States further reduces the federal funds rate one-quarter of a percentage point to 3 % and the dollar falls to a record low relative to the DM. Italy raises interest levels sharply in an attempt to raise the lira above its ERM floor, and announces that it will be making use of the very short term financing facility.

6 September 1992: The informal EcoFin Council in Bath reaffirms its commitment to existing exchange rate parities in the ERM. A succession of opinion polls point to the possibility of a rejection of the Maastricht Treaty in the French referendum.

8 September 1992: Finland floats the Markka and Sweden increases its short-term rates.

14 September 1992: In an effort to relieve ever mounting tensions within the ERM and to reduce massive speculative attacks on the lira, a 7 % devaluation of the lira is agreed. The Bundesbank reduces the Lombard rate and the discount rate by a quarter and a half of a percentage point respectively and announces a reduction in the rate for securities repurchase agreements of half a percentage point.

16 September 1992: Notwithstanding massive central bank intervention and a cumulative five point increase in the minimum lending rate, sterling falls substantially and the Chancellor announces its suspension from the mechanism. The lira also suffers further massive speculative attacks and also falls to its new ERM floor. The Swedish Central Bank increases its marginal lending rate to 500 %.

17 September 1992: Italy abandons attempts to maintain the lira within the ERM and temporarily suspends its participation in the mechanism. The Spanish peseta is devalued by 5 %. The Danish krone, French franc and Irish punt are all subject to speculative attacks requiring central bank intervention and rises in interest rates.

20 September 1992: The narrow approval of the Maastricht Treaty in the French referendum fails to dissipate doubts on the prospects for its eventual ratification by all Member States and tensions intensify within the ERM over the following days.

23 September 1992: Joint statement by the French and German authorities that 'no change in the central rates is justified'.

19 November 1992: Following several weeks of relative calm and a gradual return to pre-September interest rate levels within the ERM, tensions are revived following Sweden's decision to abandon its peg to the ecu.

22 November 1992: The Spanish peseta and the Portuguese escudo are both devalued by 6 %, while pressure continues to mount against the French franc, the Danish krone and in particular the Irish punt. Conversely short-term money market rates continue to fall in Germany, Belgium and the Netherlands.

10 December 1992: The Bundesbank increases its M3 monetary target for 1993 by one percentage point at both extremes to a range of 4,5 to 6,5 %. Norway suspends its ecu peg putting pressure on the Danish krone and the French franc.

13 December 1992: The European Council in Edinburgh announces a growth initiative in order to aid recovery. A formula to accommodate the Danish rejection of the Maastricht Treaty and a new Cohesion Fund to promote growth in the less developed Member States are also agreed.

Early January 1993: Tensions are again revived in the ERM after the Christmas lull on financial markets and interest rates are raised in France and Ireland. The French and German authorities re-affirm their commitment to the existing DM/franc parity. The Bundesbank reduces its repurchase rate by 15 basis points (to 8,60 %) with corresponding reductions in Belgium and the Netherlands.

30 January 1993: The Irish punt is devalued by 10 %.

III. THE NEED FOR AN ADEQUATE RESPONSE

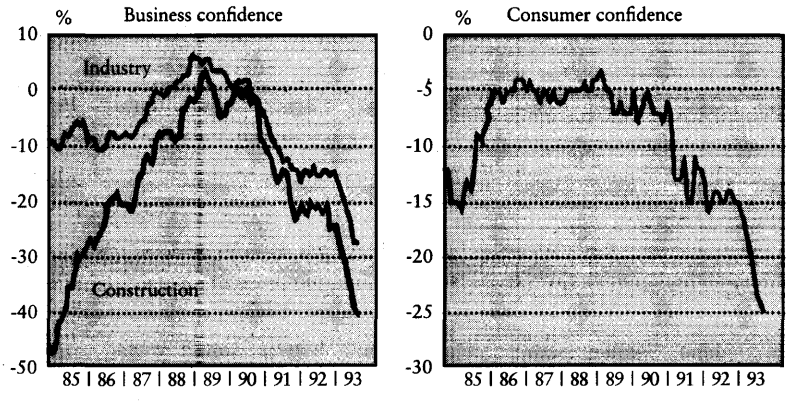
The continued weak economic conditions, the absence of sustained signs of recovery and the alarming increase in unemployement have led to increased fears of a slump developing in the Community economy. These fears lay behind the call for a rapid policy response which was recently endorsed by the Edinburgh Council. This initiative will now proceed as planned and is expected to contribute positively to the prospects for recovery in the Community. However, the outlook for 1993 still remains uncertain. A more positive outcome than that presented in Section I cannot be excluded, but there are also risks that the path to recovery could be longer. More worrying, however, is the fact that, notwithstanding the improvement which took place during the 1980s, the growth potential in the Community appears to be very low. Estimates of potential growth are always difficult to make, but it seems clear that without a significant break from recent trends the Community economy can only be expected to return gradually to rates of growth of between 2 and 2,5 %. These are barely sufficient to stabilize unemployment and do not open up any medium-term prospect of significant reductions: even if in 1995 to 1996 growth were to return to rates of about 3 %, as various medium-term forecasts suggest, unemployment could still be as high as 10 to 11 %.

The possible adverse political consequences of such a scenario require little elaboration. Unemployment on such a large scale is a very serious social problem and an economic waste. But also in relation to economic policy alone, there is a genuine fear that this situation might lead to more serious problems in the years ahead. Unemployment and uncertainty about the future may well endanger many of those projects on which the economic future of the Community rests: full implementation of the residual Single Market decisions, economic and monetary union, liberalization of world trade. But there is also a danger that the present difficulties might lead to disillusion with the medium-term economic strategy followed during the 1980s which may be considered wrongly to have failed to deliver its promises.

The present economic difficulties and, in particular, the turmoil on the foreign exchange markets, are not a product of the medium-term orientation of economic policy followed since the beginning of the 1980s, but are much more the result of the failure to implement it in full. In particular, it is to be regretted that the period of strong growth in the second half of the 1980s was not exploited to make more significant progress towards nominal convergence. Inflation has been reduced, even if unsatisfactory situations still exist in some countries, and this constitutes one of the most significant results obtained. However, unemployment, even if it has come down somewhat, is still unacceptably high. In addition, budget deficits have remained far too high. Furthermore, the countries which presented the most serious budgetary imbalances often made the least progress. Structural adjustment progress has also fallen well short of what might have been achieved.

Graph 11

Survey indicators for the Community



The goal of the medium-term policy orientation Member States have repeatedly confirmed is the return to a macroeconomic framework of stability similar to that experienced in the 1960s and until the first oil shock. The conditions required for a smooth and successful transition to EMU, which will in itself improve growth conditions, correspond exactly to this goal. Low inflation will create the conditions for faster growth and lower budget deficits will contribute to higher national saving ratios. During the 1960s, most Member States had budget deficits well below the 3 % goal set in the Treaty on Europan Union and eight countries experienced average rates of inflation within one and a half percentage point of the 2,7 % resulting from the average of the three best performers (Greece, Luxembourg and either Portugal or Germany who had the same average rate of inflation).

Unfortunately, the present situation has led to doubts on the soundness of the medium-term policy orientation followed by Community governments. Some doubt the effectiveness of these policies while others have a reduced faith in the determination and ability of governments to pursue them. In this situation governments must act decisively to show that they have the determination and ability to pursue the agreed goals and to convince economic agents that this policy orientation will bear fruit. Concretely this means that governments will have to implement policies which face a multiple challenge.

— *Firstly,* to act decisively to support growth without putting at risk medium term growth prospects, i.e. above all preserving the commitment to the promotion of growth in conditions of price stability.

— *Secondly,* to create the conditions which will permit stronger employment creation in the medium term.

— *Thirdly,* to pursue policies designed to promote greater real convergence in employment and GDP per head.

— *Fourthly,* resume progress towards nominal convergence. This means consolidation of the progress made in curbing inflation and renewed efforts where inflation is still high. In the budgetary area this implies that the countries facing the most worrying imbalances should continue their efforts to reduce their budget deficits notwithstanding the present difficulties, while the others should exploit the expected recovery to return to their medium-term budgetary consolidation plans.

IV. THE EDINBURGH INITIATIVE

The recent European Council declaration on economic growth in Europe finds its origin in the need to act rapidly to restore the confidence of economic agents. Indeed the present extremely depressed level of business and consumer confidence constitutes by itself one of the biggest obstacles on the way to economic recovery; such low levels of confidence could even provoke a further deterioration in economic prospects. But the European Council also stressed that these actions should not be perceived as implying a departure from the necessary medium-term budgetary consolidation. Indeed, credibility depends on following a medium-term strategy which can create the conditions for stronger growth and faster employment creation and which can be seen as possessing the determination and means to implement it. In particular, the European Council stressed the need to pursue seriously and vigorously the policies set out in the convergence programmes as a means of regaining this loss of credibility.

In addition, the European Council agreed new financial perspectives for the period 1993 to 1999. These envisage a 41 % increase in volume terms in the Community resources for structural policies including the Cohesion Fund. This will contribute significantly to strengthening the growth potential of the less prosperous economies, whose allocation under the Structural Funds will virtually double relative to its 1992 level.

IV.1. In the short term

The European Council, at its December 1992 meeting, called on Member States to exploit the macroeconomic margins of manoeuvre available to take actions 'which would boost confidence and promote economic recovery'. More specifically it called on governments to implement a two-pronged approach involving actions at the national and the Community level.

Member States were invited to take concerted action in three main areas:

(i) exploiting the margins for manoeuvre available in the budgetary area to implement measures to encourage private investment and to switch public expenditure towards infrastructure and other growth-supporting priorities;

(ii) strengthen structural adjustment efforts, for example, through action to reduce subsidies and measures to enhance competition and market flexibility;

(iii) promote wage moderation with particular regard to the public sector given the important demonstrative role it plays and the positive effects on budgetary consolidation.

Work in this direction has already commenced within the EcoFin Council. Ministers have started considering measures of the type recommended with a view to their early implementation. It is hoped that governments will be able to announce the different measures that will be taken in a confidence enhancing manner. A simultaneous and concerted announcement would magnify the psychological effect and could be achieved through the presentation of the various national initiatives as a joint package, with specific commitments regarding the timetable for implementation of the individual national components. This is particularly appropriate in the case of a number of national measures which are common to more than one Member State and which consequently warrant joint action at the European level. Among the latter there is a strong case for simultaneous action in such areas as housing,

small and medium-sized enterprises, infrastructural projects, market liberalization and institutional matters.

The Community is to contribute to the joint action through initiatives in a variety of areas ranging from additional efforts to improve the efficiency of the research it funds, rapid and effective implementation of the single market, the acceleration of actions in favour of SMEs to remove the backlog of pollution abating investment, to action to finance infrastructure projects notably connected with trans-European networks. To this end the European Investment Bank has been invited to establish a new, temporary lending facility of ECU 5 billion for the purpose of promoting trans-European networks (TEN). In addition, a European Investment Fund with a capital of ECU 2 billion will be established with contributions to its capital from the EIB, the Community and other private financial institutions. The Fund will extend guarantees for TEN projects, throughout the Community and for small and medium-sized enterprises, especially in assisted regions. Member States, the Commission and the EIB will undertake a joint effort aimed at using the resources thus made available to foster projects which might be implemented rapidly.

IV.2. In the longer term

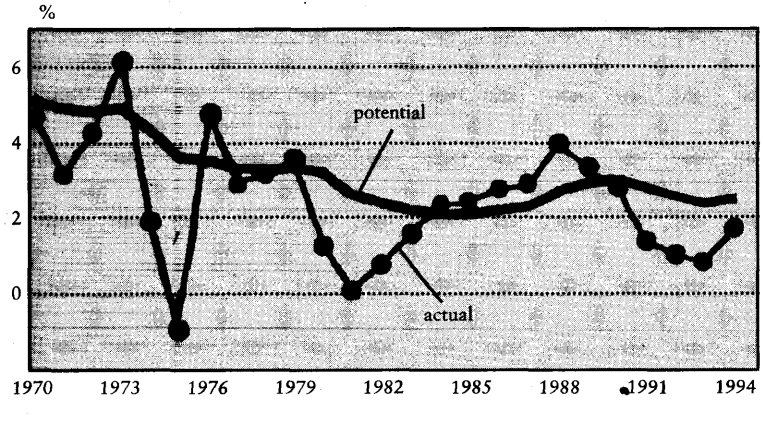
Employment growth in the Community cannot be enhanced significantly without generating faster economic growth whilst at the same time improving the efficiency of the labour market. Since the mid 1970s, the rate of GDP growth at which Community employment begins to increase, the so-called 'employment threshold', has remained stable around 2 % per year. Given the expected trends of the population of working age and participation rates, the Community economy would need to grow at a sustained rate of 2,5 % if unemployment is to be stabilized. The implication is that a major reduction of unemployment is unlikely to be achieved within an acceptable time span unless economic growth can be maintained at a rate which is higher than this.

For instance, a sustainable growth of 3,5 % would reduce the unemployment rate by between three quarters and one percentage points per year. During the second half of the 1980s an average rate of growth of 3,2 %, coupled with emerging beneficial effects of various supply-side measures, reduced the rate of unemployment from 10,8 % in 1985 to 8,3 % in 1990. However, during this period, the underlying potential growth rate probably did not exceed 2,5 to 2,75 %, whereas during the 1960s and until the beginning of the 1970s it was still well above 4 %. As a consequence, after an initial taking up of the existing slack in capacity, the Community economy experienced overheating problems which, together with other factors, led to the present cyclical slowdown, as described in Section II.

Graph 12

Actual and potential rate of growth in the Community

(approximated by the rate of increase of the stock of capital)



Notwithstanding the fact that the degree of capacity utilization has fallen again, which leaves some scope for expansion without undue inflationary pressures, there is little doubt that maintaining rates of growth in excess of 3 % over a number of years requires a significant increase in the rate of growth of the productive potential of the Community economy. The Community must generate greater efficiency in the use of its resources and shift more of these resources into productive investment so as to improve its industrial base and its competitiveness. This must be the economic policy priority for the medium term. Achievement of this goal would allow the reduction of unemployment to more acceptable levels as well as promoting progress towards EMU and towards greater economic and social cohesion. Thus a greater commitment is required on two fronts, namely:

— increasing the dynamism of the Community economy by removing structural impediments which constrain the rate of increase of the productivity of capital and labour, and

— generating sufficient investment which means increasing the investment ratio in the Community by a substantial amount.

(i) If those two objectives are to be realized, it will be necessary to ensure that incentives are not impaired which means that the impetus of supply-side policies must continue. Thus, a greater commitment to structural measures aimed at improving the supply side of the economy is essential both at the Community level and in the individual Member States. Such measures are necessary, first and foremost, to complement the Single Market programme which is increasingly exposing the many structural rigidities which continue to exist and which exert a high cost in terms of the misallocation of resources, higher unemployment and inflation and inadequate adjustment to changing economic circumstances.

At a time when both fiscal and monetary policy are severely constrained by existing imbalances, it is imperative that the potential for promoting growth through the removal of such rigidities and through increased investment in the Community's human resources is fully exploited.

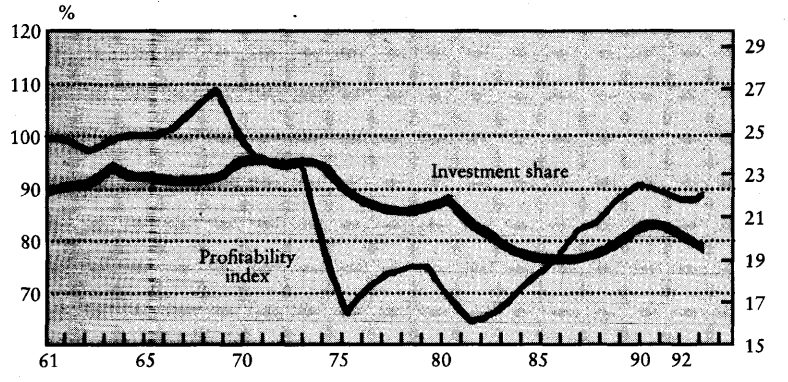
Member States must take the necessary measures to increase flexibility in their economies. In the absence of nominal exchange rate adjustments in full EMU, such flexibility will be essential to ensure that their economies can adapt to changed economic circumstances without increases in unemployment. Similarly, the Community must continue its effort in the areas of competition, improved infrastructure including research and development, training, the removal of trade barriers and, most of all, the implementation of the Single Market.

(ii) Given the present degree of capital intensity and the prevailing capital/output ratio, the investment ratio should increase substantially. If rates of growth of the order of 3,5 % per year are to become sustainable, the investment ratio should increase from the present level of less than 20 % of GDP to about 23 to 24 %. Such a substantial increase can only be achieved over many years and will depend on a favourable development of many different factors. In particular, investment profitability must increase, and be expected to remain high; the growth of demand and its composition must remain adequate; and a progressive shift of resources towards savings must take place simultaneously.

Graph 13

Profitability of fixed capital and investment share in Community GDP 1961 to 1992

(Left scale: profitability index 1961 to 1973 = 100)
(Right scale: share of fixed investment in GDP, in %)



The large deterioration in capital profitability that occured during the 1970s (Graph 13) was partly corrected during the 1980s but there is still some ground to make up. Indeed it is likely that the profitability of capital will have to increase to even higher levels than in the 1960s given the present high levels of real interest rates which are not expected to be reduced significantly over the medium term not least in view of the demand for savings from the rest of the world (eastern European countries, LDCs, etc.).

Table 3

Saving-investment balance for selected years

(Community excluding the former German Democratic Republic percentages of GDP)

	1961—1973	1981	1986	1989	1992
Household saving (1)	10,0	12,0	10,3	8,6	9,8
Corporate saving (2)	11,0	9,0	11,2	12,0	11,2
Private saving (3=1+2)	21,0	21,0	21,5	20,6	21,0
Public saving (4)	4,0	–1,0	–0,8	0,8	–1,7
National saving (5=3+4)	25,0	20,0	20,7	21,4	19,3
Current balance (6)	0,4	–0,6	–1,3	–0,1	–0,5
Gross fixed capital form (7)	23,2	20,9	19,0	20,7	19,6
Changes in inventories (8)	1,4	–0,3	0,4	0,8	0,2
Gross capital formation (9) (7+8) = (5–6) = (9)	24,6	20,6	19,4	21,5	19,8

The experience of the 1980s has shown that the most effective means of securing of required increase in capital profitability is a return, over an adequate number of years, to a moderate growth of real wages per head with respect to labour productivity. Indeed, this was the wage pattern achieved between 1981 and 1989 in most Member States. In the Community, real wage-cost per wage earner increased on average by slightly less than half the increase in labour productivity.

A similar favourable development during the 1990s would allow for the achievement of the required level of profitability. To this end, it is essential that wage setting procedures become, if necessary through additional structural reforms, more conducive to the necessary wage developments. Such moderate wage increases would still allow for the expansion and composition of demand necessary to sustain profitability expectation. As labour productivity

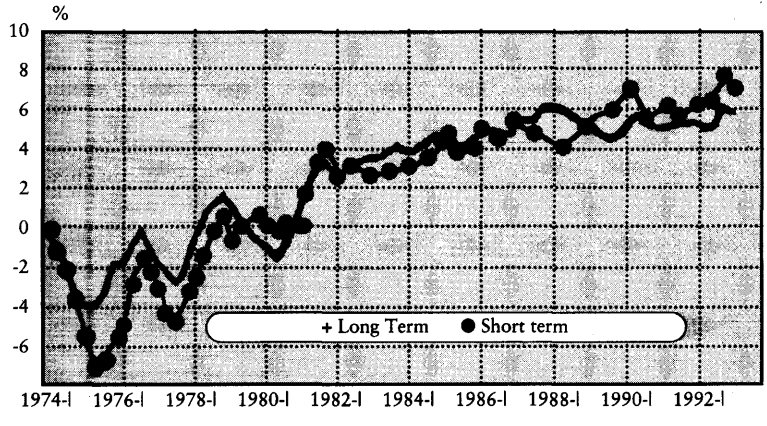
increases with higher fixed investment and investment in human resources, real wage increases may then also be higher, thus triggering what could become, hopefully, a virtuous cycle.

But the necessary increase in the investment ratio needs also to be accompanied by an equivalent increase in national savings. Indeed, given the present current account position of the Community and the need for it to return to a net capital exporter position more appropriate to a highly developed economy, national savings may have to increase even more. Private saving has been very stable over a long period while public saving has deteriorated substantially under the impact of increased public debt and higher real interest rates (see Table 3 and Graph 14). Under these conditions an increase in national savings appears to require, first and foremost, a major reduction in public dissaving. But private savings, and in particular that of enterprises, should be encouraged.

Graph 14

Community interest rates: real short and long-term rates

(Quarterly figures; interest rates less current rate of inflation)



V. MACROECONOMIC POLICIES AND POLICIES FOR STRUCTURAL ADJUSTMENT

Macroeconomic policies must be geared to facing the short and medium-term challenges described in the two previous sections, and they must be implemented bearing in mind the already stated need to increase credibility. This task could be greatly facilitated through improved coordination of national economic policies.

The most important contribution macroeconomic policy can make to the prospects for recovery is to bring about conditions allowing a reduction in short-term interest rates on a sound basis. This essentially requires that any continuing inflationary pressures due to excessive wage increases and unbalanced budgetary positions be reduced. Negotiations and agreements between the social partners, where possible, could bring positive results through the encouragement of lower nominal wage increases with positive effects on inflationary expectations. Decisive and credible action in most Member States to put public finances again on a medium-term consolidation path would ease the task of monetary policy via a similar reduction in inflationary expectations. Institutional measures such as an adaptation of existing budgetary procedures and the granting of full independence to central banks ahead of the EMU schedule could also produce significant results in this respect. Currently, Spain is taking a helpful lead in this direction.

V.1. Monetary policy

Given the commitment to the ERM and that, by and large, German interest rates continue to set the floor for interest rates within the system, a weakening of inflationary pressures in Germany

could provide a major opportunity for a more general reduction in interest rates while progress in the other countries will depend also on action to reduce the risk premiums.

In September 1992, the Bundesbank took the opportunity afforded by the appreciation of the DM to effect modest reductions in its official discount and Lombard rates as well as in the rate for security repurchase agreements. This has been followed recently by further cuts in short-term rates and by a market-induced sharp fall in long-term interest rates (see Graphs 8 and 9). This confirmed that the cuts in short-term rates had been soundly based and had not given rise to expectations of higher inflation in the long term. However, most of its ERM partners have, as yet, been unable to fully effect similar reductions owing to the need for continued vigilance on the exchange rate implications.

The scope for yet further reductions in German interest rates (particularly at the short end of the market) is crucially dependent on the success of the authorities' anti-inflationary strategy. A number of factors are expected to contribute to the desinflationary process in Germany in 1993. The appreciation of the DM within the ERM and the general slowdown in growth, both in Germany and elsewhere, are all putting downward pressure on prices. Moderation of wages and deceleration of monetary growth are expected to create the potential for interest rate cuts. But further progress is needed given that the present rates of increase of nominal unit labour costs and monetary growth are still not considered to be consistent with price stability. Similarly, the ongoing high level of the underlying budget deficit is continuing to fuel inflation. But on the other hand, there is evidence of a more pronounced downturn in Germany with an ever-growing number of indicators — falls in industrial production, reduced export orders, company closures, the succession of poor quarterly growth figures, etc. — pointing to its severity.

The Commission forecast of a stagnation in output in Germany in 1993, if realized, will obviously increase disinflationary forces and hence the potential for interest rate cuts. However, it could also increase the already strong pressures on public finances through its impact on automatic stabilizers. If these latter pressures are not sufficiently controlled they could reduce the scope for a monetary easing. The 'solidarity pact' currently being discussed would be a most welcome development. Such a pact, including a measure of wage moderation over many years and a credible medium-term budgetary consolidation programme, would further bear down on inflationary expectations, and hence allow the necessary significant reduction in short-term interest rates. As expectations are revised, long-term interest rates could also fall further.

Other Member States find themselves in different situations. In those countries whose currencies did not depreciate during the foreign exchange crisis, inflation does not give cause for concern and, in any case, lower import prices will reduce inflationary pressures further. Some of these countries (France and Denmark), however, still experience positive interest rate differentials *vis-à-vis* the DM. These countries should maintain the medium-term course and try to improve further the credibility of their policies thus allowing a reduction in interest rate differentials *vis-à-vis* the DM. A loosening of monetary conditions in these countries, however, will depend largely on developments in Germany.

A second group of countries is made up by the Member States whose currencies depreciated within the ERM (Ireland, Spain and Portugal). Monetary conditions in Spain and Portugal will depend essentially on the ability of governments to improve substantially their stability performance and thus reduce the still very large interest rates differentials *vis-à-vis* the DM. In Ireland, it will be essential to maintain the stability-oriented policies of recent years. A final group, formed by those countries whose currencies are outside the ERM (Italy, the United Kingdom and Greece), has a relatively larger degree of freedom in determining short-term interest rates. This freedom, however, is constrained by inflationary risks, which, given the size of the depreciations that have already taken place, are considerable. In these two last groups of countries wage moderation policies will play a crucial role since these will have to ensure that the recent depreciations do not lead to faster inflation and that progress towards nominal convergence resumes as soon as possible in those cases where a temporary setback is inevitable.

V.2. Budgetary policy

As noted previously, unsatisfatory budgetary positions are complicating the conduct of monetary policy in many Member States. The budget deficit in the Community is now at a record level, exceeding even that of the early 1980s. Furthermore, the burden on policy making is now much more severe given that debt/GDP ratios have increased substantially and real interest rates are much higher than in the 1960s and 1970s. This current unsatisfactory state of most Member States' public finances has also very severely restricted the room for fiscal manoeuvre in the current downturn.

The essential priority for the public finances in many Member States remains their medium-term consolidation. The continued high deficit levels are in themselves a major factor in the present economic difficulties and in the recent turmoil on the foreign exchange markets. They serve to keep long-term interest rates high, crowd out private investment and act to fuel inflationary expectations.

In these conditions, it is even more necessary to orient public expenditure towards those sectors where it will most influence growth prospects. This objective requires switching expenditure towards those sectors where the pay-off in terms of growth (investment in infrastructure, environmental protection, research and development, training etc.), is vital to the medium-term performance of the economies.

The heterogeneous budgetary situation between Member States also warrants a differentiated approach. In several Member States, notably Italy and Greece, the more immediate effect of any fiscal expansion would be more likely to result in sharply increased interest rates and correspondingly increased debt servicing charges, renewed tensions on foreign exchange markets and increased inflationary pressures, rather than in an increase in output. In these Member States there is no alternative, therefore, to the continuation of the existing stabilization efforts, which in several cases are already showing positive signs of progress. In the few countries with less pressing problems the 'automatic stabilizers' may be allowed to continue to work, particularly on the revenue side.

In all cases, however, there is a need for caution to ensure that policy credibility is not undermined. The existing convergence programmes will need to be updated to take into account the deterioration in the economic situation and, in the countries where the public finance situation is most worrying, it is essential that any slippage in the implementation of the convergence programmes be identified early and any necessary corrective measures implemented without delay.

V.3. Structural policies

V.3.1. Continued need for structural reform at the national level

Member States must press ahead with the structural adjustment efforts which they have already initiated. These efforts complement initiatives taken at the Community level, particularly in relation to the completion of the Single Market. By their very nature, the benefits of structural adjustment measures tend to become apparent only over the medium term. This should not be allowed to serve as a reason for delaying their implementation. The fact that such measures are seen to be put into effect helps to restore credibility which produces positive effects also in the short-term.

A vast array of structural measures remain to be implemented at the national level. Governments could send a strong signal to economic agents of their determination to break with past behaviour by announcing and implementing a significant programme in this area. The need for such action is being increasingly felt as the Single Market comes into effect and the increased exposure to greater competition in key sectors such as the energy, communications and transport markets. This is facilitated by the continued existence of impediments to market access. The persistence of continued high levels of State subsidies is also serving to distort competition and impede possible change. Total State aids in the Community between 1988 and 1990 averaged an estimated ECU 89 billion annually (about 2 % of Community GDP), with nearly half of it (ECU 36 billion) going to the manufacturing sector alone. Under these circumstances, there is a need for a reduction in these subsidy levels.

There is also an ongoing need to examine the necessity for government intervention, the attendant costs and the alternatives. Improved efficiency needs to be encouraged in the public sector, through increased competition with the private sector where appropriate. A high level of social protection is a distinctive feature of the Community identity which must be maintained. Environmental protection needs, in many instances, to be increased. Yet, there is ample scope for simplifying procedures and reducing the administrative charges implied by some regulations without compromising these two aims. This is particularly the case for small and medium-sized enterprises (SMEs), which because of their limited size and resources are particularly vulnerable to unnecessary or over-complicated procedures. If the job-creating potential of SMEs is to be fully exploited, it is essential that their growth is unhindered by such rigidities. The State role in the provision of infrastructure and housing also needs to be critically examined with a view to removing existing structural obstacles to growth.

However, it is in relation to labour markets that the need for tackling structural rigidities is imperative. Some progress was made in this respect in the latter half of the 1980s. However the co-existence of continued high levels of unemployment, emerging labour shortages and a resumption of wage inflation towards the end of the decade clearly indicates that this was insufficient. More needs to be done to ensure that a resumption of economic growth results in strongly increased employment rather than a repeat of the previous patterns of inflationary wage increases followed by restrictive macroeconomic policies.

In addition, specific action is needed in relation to unemployment. Its causes are complex and deep-rooted. To get unemployment moving downwards will require not just a resumption of growth, crucial as that is, but structural actions, including special measures for all those who are particularly vulnerable, such as young people, women and the long-term unemployed, and including actions to improve the functioning of the labor markets, especially at the local level.

There are many areas where specific action is urgent. Skill shortages and mismatch between skills offered and skills demanded are very widespread. Initiatives at both the national and the Community levels are necessary to improve training systems. Also necessary are measures to increase the geographical mobility of workers. In addition, in many cases it may be necessary to modify wage setting procedures to make them more responsive to macroeconomic conditions and the existence of large numbers of unemployed workers.

V.3.2. Structural adjustment at the Community level

At the Community level there were contrasting results in 1992 in relation to the removal of structural rigidities. At one extreme, the further progress towards the completion of the Single Market and the agreement on the European Economic Area represent breakthroughs that will generate positive economic benefits well into the future. At the other extreme, the delay and difficulty in bridging the narrow gap separating the principal parties on the GATT Uruguay Round already represents a costly lost opportunity.

The Single Market programme is a central pillar of the Community's economic strategy and has provided both the impetus and the rationale for the EMU project. It is impossible to conceive of EMU in the absence of the full freedom of capital labour, goods and services provided for under the Single Market. The Community has set itself therefore the goal for the next few years not only of finalizing the Single Market agenda, but, most importantly, of making it work.

On the basis of the 1985 White Paper, the economic environment for Community enterprises has fundamentally changed in the direction of opening up national markets: allowing free circulation of goods, services, and capital, through mutual recognition, opening up public procurements and abolishing frontier controls. The application of new indirect taxation regimes, in particular, has opened the way to important cost reductions for businesses in intra-Community trade through the removal of all fiscal formalities linked to the crossing of internal borders. These developments have led to a significant restructuring of Community

companies, an effort that should be supported at the Community level by putting at the disposal of business and individuals a legal framework of cooperation.

In the first place, the rules adopted must be made a reality. Effective and equitable enforcement of Community legislation has to be a top priority. The Commission presented to the Council in December 1992 a clear strategy to ensure the efficient functioning of the Single Market based on the provision of information, transparency in Community law and cooperation between administrations. This is not exclusively a Community responsibility; Member States should share in the effort on the basis of a permanent partnership.

In the second place, the technical compatibility of products and processes has to be ensured in order to facilitate the exchanges and foster investment. Following the Council conclusions on the 1991 Green Paper on European standardization the Community has tried to reinforce the procedures and widen the role of standardization in Community legislation.

Business and individuals have to show that they can maximize the opportunities offered by the Single Market. In this regard, the growth initiative taken at the European Council in Edinburgh cannot be dissociated from the economic context and the environment in which the Community acts. Indeed, it is only in a truly internal market that enterprises can reap the benefits of a growth initiative and thus contribute to reversing the negative trends which have been visible recently.

The entry into force of the agreement on the European Economic Area (EEA), notwithstanding its recent rejection in the Swiss referendum, will further enhance the very close trade ties between the Community and the EFTA signatories. The provision in the agreement for the acceptance of the vast majority of the Single Market measures by the latter will further facilitate trade and competition between the two areas and thus give rise to considerable economic benefits. The agreement will also facilitate the expressed intention of these countries to proceed with applications for full membership of the Community. Similarly, the conclusion of association agreements with several central and eastern European countries will encourage greater integration and trade between the countries of central and eastern Europe and the Community.

There is little questioning of the economic benefits which would accrue from a successful conclusion to the Uruguay Round. However, while all parties agree on the necessity for a successful conclusion to the Round and on the risks of failure for continued growth in world trade, a final settlement is still proving elusive. This is particularly disappointing given that the issues separating the interested parties, following recent progress, are now relatively minor relative to the overall benefits at stake. It is imperative therefore that the goodwill of all parties to the settlement of the outstanding differences is obtained as soon as possible.

The current difficulties are reducing the economic policy options and testing the resolve to resist short-term solutions which are known to create more serious problems in the medium term. One of the most effective contributions the Community can make is to help Member States maintain the course. The implementation of the Edinburgh growth initiative will help to restore a measure of confidence to economic agents and thus improve growth prospects. But economic policies must now be resolutely oriented towards improving the growth potential of the Community economies along the lines indicated in this Report.

The Council has adopted the Annual Economic Report for 1993 in this spirit and hopes that its discussion by the European Parliament, the Economic and Social Committee, the social partners and public opinion at large will contribute to the desired goal.

STATISTICAL ANNEX

Winter 1992/93 forecasts

MAIN ECONOMIC INDICATORS 1990 to 1994

COMMUNITY, USA AND JAPAN

(a) GDP at constant prices

(annual % change)

	1990	1991	1992	1993 (1)	1994 (1)
B	3,4	1,9	1,0	1/2	1 3/4
DK	1,7	1,2	1,0	1 3/4	2 1/4
D	5,1	3,7	1,5	-1/2	1
D+	—	—	1,7	0	1 1/2
GR	-0,2	1,8	1,5	1 3/4	2
E	3,6	2,4	1,2	1	1 3/4
F	2,2	1,1	1,9	1	2
IRL	8,3	2,5	2,9	2 1/4	2 1/2
I	2,2	1,4	1,1	3/4	1 1/2
L	3,2	3,1	2,2	2	2 1/2
NL	3,9	2,2	1,3	3/4	1 1/4
P	4,4	1,9	1,7	1 1/4	2 1/2
UK	0,5	-2,2	-0,9	1 1/2	2 3/4
Community	2,8	1,4	1,1	3/4	1 3/4
Community+	—	—	1,1	3/4	1 3/4
USA	0,7	-1,3	2,0	2 1/2	2 3/4
JAP	5,2	4,4	1,5	1 1/2	2 1/2

(b) Domestic demand at constant prices

(annual % change)

	1990	1991	1992	1993 (1)	1994 (1)
B	3,5	1,6	1,9	1/2	1 1/2
DK	-0,8	0,1	-0,4	2	2 1/4
D	4,9	3,1	1,3	-1/2	1/2
D+	—	—	2,2	0	1 1/4
GR	0,8	2,3	1,1	1 1/2	2 1/2
E	4,7	2,9	1,8	1/2	1 3/4
F	2,6	0,8	1,0	1	1 3/4
IRL	6,3	-0,7	-0,9	2 1/4	2 1/4
I	2,7	2,2	1,3	-1/4	1
L	5,1	8,4	3,3	2 1/4	2 3/4
NL	3,5	1,7	0,6	1/4	1
P	5,4	4,1	3,6	3 1/4	4
UK	-0,5	-3,2	0,0	1/2	2 1/2
Community	2,8	1,2	1,1	1/4	1 1/2
Community+	—	—	1,3	1/2	1 1/2
USA	0,1	-2,1	2,1	2 1/4	2 3/4
JAP	5,4	3,0	1,1	1 1/2	2

(c) Deflator of private consumption

(annual % change)

	1990	1991	1992	1993 (1)	1994 (1)
B	3,1	2,9	2,4	2 3/4	2 3/4
DK	2,1	2,4	2,1	1 1/2	2
D	2,7	3,9	4,0	3 1/2	3
D+	—	—	4,8	4 1/4	3 1/2
GR	20,1	18,4	16,0	13 1/2	9
E	6,4	6,3	6,0	5 1/2	5
F	3,2	3,2	2,6	2 3/4	2 1/2
IRL	1,7	3,2	2,9	2 1/4	2 1/4
I	5,9	6,8	5,3	5 3/4	4 3/4
L	3,6	2,9	3,4	4 3/4	3 1/4
NL	2,3	3,3	3,1	2 3/4	2 1/2
P	12,6	11,9	9,1	6 3/4	5 3/4
UK	5,3	7,2	5,1	5	3
Community	4,5	5,3	4,5	4 1/4	3 1/2
Community+	—	—	4,6	4 1/2	3 1/2
USA	5,0	4,2	3,1	2 3/4	2 3/4
JAP	2,6	2,6	2,4	2 1/2	2 1/2

(d) Balance on current transactions

(as a % of GDP)

	1990	1991	1992	1993 (1)	1994 (1)
B	0,9	1,7	1,8	1 3/4	2
DK	0,5	1,3	3,0	3	2 3/4
D	3,5	1,2	0,4	0	0
D+	—	-0,7	-0,8	-1 1/4	-1
GR	-6,2	-5,1	-3,3	-3	-2 1/4
E	-3,7	-3,5	-3,7	-3 1/2	-3
F	-0,8	-0,5	0,1	1/4	1/4
IRL	1,3	6,0	6,7	6 1/2	7
I	-1,4	-1,9	-1,9	-1 3/4	-1 1/2
L	34,2	27,9	19,9	18 3/4	17 1/2
NL	4,0	3,9	3,9	3 3/4	3 3/4
P (2)	-2,5	-3,5	-0,2	-2 1/4	-3 1/4
UK	-4,2	-1,8	-2,1	-2 3/4	-3
Community	-0,3	-0,5	-0,5	-3/4	-1/2
Community+	—	-1,0	-0,8	-1	-3/4
USA	-1,4	0,2	-1,0	-1	-1 1/4
JAP	1,3	2,5	3,2	3 1/4	3 1/2

Note: Community+, these aggregates include values for unified Germany.

(1) Based on the forecasts of January 1993 (final).
Unusually high uncertainties surround the winter 1992/93, economic forecasts which are based on the standard assumption of no change in economic policy, implying that projections for 1994 are essentially extrapolations of expected 1993 trends. Actual outcomes for 1993 and, particularly, 1994 might differ substantially from present forecasts if, *inter alia*, economic policies were to be significantly modified.

(2) Break in series in 1991 to 1992; until 1991: national accounts definitions; from 1992 onwards = balance of payments.

Source: Commission services.

(e) **Number of unemployed as % of the civilian labour force**

	1990	1991	1992	1993 (1)	1994 (1)
B	7,6	7,5	8,2	9 1/4	9 3/4
DK	8,1	8,9	9,5	9 1/2	9 1/4
D	4,8	4,2	4,5	6	6 1/2
D+	—	—	7,5	8 1/2	8 3/4
GR	7,2	7,7	7,7	8 1/2	9
E	16,1	16,3	18,0	19 1/2	20
F	9,0	9,5	10,1	10 3/4	11 1/4
IRL	14,5	16,2	17,8	19 1/4	20 1/2
I	9,9	10,2	10,2	10 1/2	10 3/4
L	1,7	1,6	1,9	2	2
NL	7,5	7,0	6,7	7 1/2	8
P	4,6	4,1	4,8	5 1/2	5 3/4
UK	7,0	9,1	10,8	12 1/4	12 3/4
Community	8,3	8,8	9,5	10 1/2	11
Community+	—	—	10,1	11	11 1/2
USA	5,5	6,7	7,3	7 1/4	7
JAP	2,1	2,1	2,1	2 1/4	2 1/4

(f) **General government lending and borrowing**

(as a % of GDP)

	1990	1991	1992	1993 (1)	1994 (1)
B	–5,7	–6,6	–6,7	–6	–5 1/4
DK	–1,4	–2,0	–2,3	–2 3/4	–1 3/4
D	–2,0	–3,6	–3,4	–3 3/4	–3 3/4
D+	—	–3,2	–3,2	–3 1/2	–3 3/4
GR	–18,8	–15,4	–13,4	–9 3/4	–7 3/4
E	–4,0	–4,9	–4,6	–4 1/4	–3 3/4
F	–1,4	–1,9	–2,8	–3 1/4	–3 1/2
IRL	–2,5	–2,1	–2,7	–3	–3 3/4
I	–10,9	–10,2	–10,5	–10 1/4	–9 1/4
L	5,0	–0,8	–0,4	–1	– 3/4
NL	–4,9	–2,5	–3,5	–3 1/2	–3 1/4
P	–5,5	–6,4	–5,6	–4 3/4	–3 3/4
UK	–1,3	–2,8	–6,1	–8 1/4	–8
Community	–4,1	–4,7	–5,4	–5 3/4	–5 1/2
Community+	—	–4,6	–5,3	–5 3/4	–5 1/2
USA	–2,5	–3,4	–4,8	–4 3/4	–4 1/2
JAP	3,0	2,4	2,2	1/2	1/2

(g) **Total employment**

(annual % change)

	1990	1991	1992	1993 (1)	1994 (1)
B	1,1	–0,3	–0,7	– 3/4	1/4
DK	–0,5	–0,9	–0,7	0	1/4
D	3,0	2,6	0,8	–1	– 1/4
D+	—	—	–0,5	–1	1/4
GR	0,2	–2,0	–0,5	0	1/4
E	2,8	0,2	–1,6	–1 1/2	0
F	1,0	0,4	–0,2	– 1/4	0
IRL	3,3	–0,1	0,1	0	1/4
I	1,1	0,8	0,1	0	1/4
L	4,3	3,6	1,5	1 1/2	1 3/4
NL	2,3	1,3	0,4	– 1/2	0
P	0,9	0,9	–0,2	– 1/2	0
UK	0,7	–3,1	–2,3	–1 3/4	– 1/2
Community	1,6	0,1	–0,5	– 3/4	0
Community+	—	—	–0,7	– 3/4	0
USA	1,2	–1,6	0,7	1	1 1/4
JAP	2,1	1,9	0,5	1/4	3/4

(h) **Compensation of employees per head**

(annual % change)

	1990	1991	1992	1993 (1)	1994 (1)
B	7,7	6,8	5,4	4 3/4	4 1/2
DK	3,4	3,7	3,2	2 1/2	2 3/4
D	4,7	5,8	5,3	3 1/2	3 1/2
D+	—	—	—	—	—
GR	19,7	15,0	12,3	11 1/4	10 3/4
E	7,9	8,7	9,0	7 1/4	5 3/4
F	5,0	4,2	4,1	4	4
IRL	4,4	4,4	6,3	6	3 1/4
I	10,5	8,7	5,1	4	4 3/4
L	6,9	5,4	5,1	6	4 1/2
NL	4,1	4,3	4,8	3 1/4	3 1/4
P	18,7	19,0	14,9	9 3/4	8 3/4
UK	9,5	8,9	6,0	3 3/4	4 3/4
Community	7,5	7,2	5,8	4 1/4	4 1/2
Community+	—	—	—	—	—
USA	4,9	5,1	2,4	2	2 1/4
JAP	5,3	4,4	3,2	2	2 3/4

Note: Community+, these aggregates include values for unified Germany.

(1) Based on the forecasts of January 1993 (final).
Unusually high uncertainties surround the winter 1992/93, economic forecasts which are based on the standard assumption of no change in economic policy, implying that projections for 1994 are essentially extrapolations of expected 1993 trends. Actual outcomes for 1993 and, particularly, 1994 might differ substantially from present forecasts if, *inter alia*, economic policies were to be significantly modified.

Source: Commission services.

(i) **Investment in construction at constant prices**

(annual % change)

	1990	1991	1992	1993 (1)	1994 (1)
B	7,1	2,0	3,8	-2 3/4	1 1/4
DK	-4,6	-8,1	-4,5	4 1/2	3 1/2
D	5,3	4,1	4,5	1/2	2
D+	—	—	5,6	1 3/4	3
GR	2,2	-6,4	-3,0	3	5
E	10,8	4,3	-3,4	-3 1/4	1/2
F	2,7	0,6	2,3	1/4	1 3/4
IRL	11,7	-1,4	2,5	3	2
I	2,5	1,2	0,4	-3/4	1/2
L	8,0	7,1	6,0	3 1/4	4
NL	0,6	-2,1	0,0	-1/2	1/2
P	5,3	4,5	2,5	2 3/4	5 3/4
UK	-0,6	-8,4	-1,4	-1 1/2	5 1/2
Community	3,8	0,5	1,0	-1/2	2
Community+	—	—	1,5	-1/4	2 1/4

(j) **Investment in equipment at constant prices**

(annual % change)

	1990	1991	1992	1993 (1)	1994 (1)
B	10,9	-1,9	0,7	-4	1 1/4
DK	3,7	2,8	-12,0	-3/4	4 3/4
D	13,3	9,1	-2,0	-4	1 3/4
D+	—	—	1,3	-1 1/2	3 1/4
GR	7,9	3,3	4,5	6	7 1/2
E	1,4	-2,5	0,2	1/4	2 1/4
F	4,1	-2,5	-4,3	-1 1/4	1 1/2
IRL	7,2	-11,6	0,5	1 1/4	1 1/2
I	3,5	0,7	-0,7	-1 1/2	1 1/4
L	10,9	11,4	3,5	1 3/4	3
NL	7,6	2,6	-0,8	-3/4	1 1/2
P	5,8	1,0	4,8	3 3/4	6
UK	-3,6	-11,9	0,6	-0	3 3/4
Community	4,8	-0,2	-1,5	-1 1/2	2 1/4
Community+	—	—	-0,7	-1	2 1/2

(k) **Gross fixed capital formation at constant prices**

(annual % change)

	1990	1991	1992	1993 (1)	1994 (1)
B	8,4	0,3	2,5	-3 1/4	1 1/4
DK	-0,5	-2,8	-8,3	2	4 1/4
D	8,7	6,5	1,3	-1 3/4	1 3/4
D+	—	—	3,6	1/4	3
GR	4,8	-1,9	0,6	4 1/2	6 1/4
E	6,9	1,6	-2,0	-2	1 1/4
F	3,1	-1,3	-1,5	-3/4	1 3/4
IRL	10,2	-7,2	1,6	2 1/4	1 3/4
I	3,3	0,9	-0,2	-1 1/4	1
L	2,5	9,8	4,5	2 1/4	3 1/4
NL	3,6	0,1	-0,4	-3/4	1
P	5,9	2,8	3,6	3 1/4	5 3/4
UK	-3,1	-9,9	-0,4	-3/4	4 3/4
Community	3,9	-0,0	-0,3	-1	2
Community+	—	—	0,4	-1/2	2 1/2
USA	-2,8	-8,5	5,2	4 1/2	5
JAP	9,5	3,4	-0,7	1	2

(l) **GDP per head (EC=100) at current prices and current PPS**

	1960	1973	1986	1993 (1)	1994 (1)
B	97,5	103,5	103,1	106,7	107,1
DK	115,2	110,1	114,2	107,5	108,4
D	124,3	116,7	119,2	116,3	114,7
D+	—	—	—	—	—
GR	34,4	50,6	50,1	46,8	46,9
E	58,3	76,4	70,6	77,2	77,6
F	107,7	112,7	112,2	113,3	113,5
IRL	57,2	55,5	60,1	72,3	72,8
I	86,6	93,4	102,6	103,8	103,9
L	155,4	138,9	124,9	130,6	130,8
NL	116,8	111,4	104,5	104,0	103,3
P	37,2	54,1	50,7	58,1	58,8
UK	122,6	103,5	101,3	95,2	96,3
Community	100,0	100,0	100,0	100,0	100,0
Community+	—	—	—	—	—
USA	182,6	155,6	146,4	136,8	137,7
JAP	54,1	92,8	105,2	118,1	119,3

Note: Community+, these aggregates include values for unified Germany.

(1) Based on the forecasts of January 1993 (final).
Unusually high uncertainties surround the winter 1992/93, economic forecasts which are based on the standard assumption of no change in economic policy, implying that projections for 1994 are essentially extrapolations of expected 1993 trends. Actual outcomes for 1993 and, particularly, 1994 might differ substantially from present forecasts if, *inter alia*, economic policies were to be significantly modified.

Source: Commission services.