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(Acts whose publication is not obligatory)

COUNCIL

COUNCIL RECOMMENDATION

of 8 July 1996

on the broad guidelines of the economic policies of the Member States and of the Community

(96/431/EC)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 103 (2) thereof,

Having regard to the recommendation from the Commission,

Having regard to the opinion of the Monetary Committee,

Having regard to the conclusions of the European Council in Florence of 21 and 22 June 1996,

HEREBY RECOMMENDS:

1. Main objectives and general guidelines

Contrary to expectations prevailing at the time of the adoption of the 1995 Broad Economic Policy Guidelines, the Community's economy experienced a marked slowdown in economic activity over the last twelve months and a renewed rise in unemployment. Whereas inflation declined broadly as anticipated and price convergence strengthened, progress towards sounder public finances proceeded at an insufficient pace and was made more difficult by the economic downturn.

As a result, the Community did not succeed in making significant progress towards realizing important economic objectives such as those stipulated in Article 2 of the Treaty, namely the promotion of sustainable, non-inflationary growth and a high level of employment. This failure to reduce the gap between aspirations for, and the realization of, economic and social well-being is the major cause of the present less confident mood in the Community.

Nonetheless, the Community enjoys favourable economic fundamentals. Inflation is historically low and still declining, exchange rate tensions have progressively eased, world trade is expanding at a healthy pace, investment profitability has been improving and, in overall terms, is noticeably higher than in the second half of the 1980s. Due to these factors, together with the decline in long-term interest rates and an end to destocking, expectations now centre on a rebound in economic activity in the second half of this year. The opportunities offered by the expected recovery should be fully seized upon to accomplish the necessary degree of convergence in order to ensure a successful transition to Economic and Monetary Union on 1 January 1999.

If the economic challenges facing the Community are to be met, there will need to be a continuation of the current macroeconomic policy strategy, especially in the area of budgetary consolidation, as well as a sustained structural reform. Appropriate initiatives in both the goods and services markets and in the area of labour market reform are needed.

In essence, therefore, the present guidelines corroborate and augment the policy recommendations outlined in previous exercises. If this strategy does not yet seem to deliver satisfactory results in the Community at large, this is because it has been implemented with insufficient vigour and credibility. All parties are therefore encouraged to conduct their economic policies with a view to contributing to the achievement of the objectives of the Community (Article 102a of the Treaty), to demonstrate with action what has been promised for more than two years and to coordinate better their economic policies.

The last mentioned is not only a Treaty obligation (Article 3a) but also a practical obligation made all the more critical by the increased integration of the economies of the Member States.

2. Macroeconomic policy mix conducive to growth, employment and convergence

The Council reaffirms that the achievement of those objectives will continue to require a stable, investment-enhancing, short- and medium-term macroeconomic framework characterized by:

— a stability-oriented monetary policy whose task is not undermined by inappropriate budgetary and wage developments,

— sustained efforts to consolidate the public finances in most Member States consistent with the objectives of their convergence programmes,

— nominal wage trends consistent with the price stability objective; at the same time, real wage developments should be below the increase in productivity in order to strengthen the profitability of employment-creating investment.

The more the stability task of monetary policy is facilitated by appropriate budgetary measures and wage developments, the more monetary conditions, including exchange rates and long-term interest rates, will be favourable to growth and employment.

High and sustained non-inflationary economic growth over the medium term is essential:

(i) to reduce significantly and durably the Community's unacceptably high level of unemployment and to combat the spread of social exclusion;

(ii) to make the necessary improvement in the competitiveness, and in particular the productivity, of the Community economy compatible with the safeguarding, in the context of an open market economy, of the basic social values which characterize the Union; and

(iii) to ensure the lasting success of Economic and Monetary Union.

To reinforce both the credibility of the macro-economic policy framework and the efficiency of the coordination process within the Community, Member States are invited to present updated convergence programmes reflecting a strong political commitment.

The Commission will intensify its dialogue with the social partners on macroeconomic issues. The social dialogue should also be intensified, where possible and according to prevailing traditions, at the national level.

3. Price and exchange-rate stability

The achievement and maintenance of a stable macroeconomic environment is a precondition for achieving sustained medium-term growth. Inflation in the Community on average is expected to fall to 2½ per cent this year. This result should be improved upon next year.

At present, 10 of the Member States already respect the objective established in previous guidelines exercises of a rate of inflation (1) of no more than two to three percent as a step towards price stability; in the United Kingdom inflation is close to three per cent. In the seven countries (Belgium, Germany, France, Luxembourg, the Netherlands, Austria and Finland) where inflation is below two per cent, and in Denmark and Ireland, where it is just above two per cent, the anti-inflation credibility of the monetary policy framework is generally firmly established and the task is to consolidate this performance over the medium term. In Sweden, where inflation has recently come down significantly, and in the United Kingdom, policies should aim at consolidating the results achieved.

Those countries where inflation is expected to be between three and five per cent in 1996 (Spain, Portugal and Italy) should endeavour to reduce inflation further to below three per cent by 1997. Portugal, where inflation has recently fallen to just above three per cent, and Spain should persevere with their existing policies with a view to achieving the desired inflation objective in the near future. In Italy, the conduct of fiscal policy will in essence dictate the pace of progress with regard to the establishment of exchange rate credibility and in anchoring low inflation expectations.

Despite visible progress in Greece over recent years, it is evident that efforts must be continued and enhanced. In this regard, emphasis should be placed in particular on the maintenance of the corrective fiscal policy stance operated over the last two years as well as continuing with the prudent monetary and exchange-rate policies evident since the early 1990s.

As stressed in the previous guidelines, all Member States must continue to treat their exchange-rate policies as a matter of common interest within the framework of the European Monetary System. The exchange rate movements in early 1995 pointed to the need for several Member States to put their overall policy framework on a more credible footing. The policies recommended in the present guidelines will contribute to an appropriate alignment of exchange rates within the Community. They will also make the exchange rates within the EMS more resilient to fluctuations stemming from movements in major third currencies. For countries which are not currently participating in the exchange rate mechanism, these policies would also contribute to creating the conditions for such participation.

(1) As measured by the 12-month average of the annual change in the interim indices of consumer prices.

4. Sound public finances

Some, but only limited, progress towards fiscal consolidation was made last year in the Community. Slippages relative to announced budgetary targets only partially reflected the adverse impact of the growth slowdown. Insufficient credibility of budgetary policies contributed importantly to the currency turbulence in the Spring of 1995, sapped economic confidence and led to doubts in financial markets regarding the likelihood of a successful realization of the Community's single currency goal.

Meanwhile, a large number of countries have taken significant steps to consolidate their public finances in 1996 and, in many cases, also in 1997. Nevertheless, the still unsatisfactory state of the public finances in the Community should lead Member States to review and, where necessary, to strenghten their fiscal consolidation plans. Credible, pre-announced and socially balanced efforts to reduce high budgetary imbalances will allow for a revival in confidence, for the transformation of the expected recovery into a durable, job-creating, medium-term, growth process and for a sound transition to EMU on 1 January 1999.

While the economic conditions are at present less favourable than anticipated at the time of the adoption of the 1995 Guidelines, a further delay in the inevitable consolidation process is not a justifiable option. Any postponement risks provoking an adverse financial market reaction and would aggravate the consolidation task in future years. Progress made in reducing structural budget deficits this year must continue and will reinforce consolidation when cyclical conditions improve. Credible and well-designed reductions in budget deficits create confidence. In that way, they enhance growth prospects, so helping to offset — even in the near term — the impact on demand, provided they are implemented in an appropriate overall policy framework.

On the basis of the adjustment measures decided up until early May 1996, the net borrowing of general government in the Community as a whole is likely to fall to just below 3½ per cent of GDP in 1997, which compares with a deficit of five per cent in 1995. Virtually all Member States should aim at lowering the budget deficit to, at most, three per cent of GDP in 1997, as a step towards the objective of close to balance in the medium term. In this respect, it is encouraging that several countries have recently announced and are implementing substantial measures to redress budgetary imbalances.

As regards the individual Member States, three — Denmark, Ireland and Luxembourg — already respect the three per cent government deficit reference value. Denmark and Ireland should now move towards the achievement of more ambitious medium-term targets, which in the case of Denmark are set out in the latest update of its convergence programme.

Italy needs to introduce significant measures to achieve and improve upon the planned budgetary consolidation which remains the central policy priority. Action should primarily focus on the fight against tax evasion, on greater budgetary discipline of local authorities and on improved efficiency of the public administration. As regards Greece, sustained efforts on a wide range of fronts, most notably reductions in current expenditure, a continuation of the existing privatization initiatives and an expansion of the tax base are all required.

As regards the remaining ten countries, the additional effort needed to respect the three per cent reference value is undoubtedly feasible and should be pursued vigorously. Within this group, several countries (Germany, France, Austria, Finland, Sweden) have this year announced substantial measures or reinforcements with a view to achieving a reduction in their budget deficits to three per cent of GDP or less in 1997. These countries, as with the Netherlands, should resolutely implement their programmes of fiscal consolidation and, if necessary, strenghten them in order to ensure that their objectives are fully met. The Belgian government has made a firm commitment — and already enjoys the necessary support of the Belgian parliament — to specify in its 1997 budget the measures required to bring the budget deficit down to a maximum of three per cent. In the United Kingdom, substantial reductions in the budget deficit are expected to continue over the next two years mainly as a result of planned expenditure restraint. However, to respect the three per cent target for 1997, it is important that action be taken to keep spending to planned levels, both to compensate for the fiscal slippage in 1995 and for an expected less rapid budgetary improvement in the short run which is partly due to lower growth than previously predicted. Finally, in Spain and Portugal, a determined implementation of the budgetary component of the convergence programmes is required.

Although the extent, timing and design of consolidation measures need to be tailored to country-specific conditions, some general principles have been identified in previous guidelines exercises. These include:

(i) restraining expenditure increases, as opposed to further increases in the overall tax burden, is widely regarded as a more credible and efficient option.

Among the issues which should be addressed are the need to place pension provisions on a sustainable footing, to curb the rise in health care costs and to reduce distortionary and costly subsidies;

(ii) re-directing, to the greatest extent possible, government spending towards productive activities such as investment in infrastructure, human capital and active labour market measures, while not endangering the necessary reduction in budget deficits;

(iii) improving the efficiency of public services through *inter alia* more flexible management practices, better incentives for public employees, and in some cases increased use of privatization and user-fees to the extent that Member States judge it compatible with their objectives;

(iv) ensuring that a reduction in the overall tax burden, which is desirable in most Member States, is conditional upon initially putting the budget deficit on a firm downward path.

Just like the Member States, the Community as well is called upon to maintain strict budgetary discipline. Therefore, the Community itself should adopt a cautious stance towards the already established financial perspectives — these perspectives set ceilings and not targets.

5. Better functioning of product and service markets

To foster growth, and thus employment, whilst maintaining low inflation, it is essential that action on the macro side is added to by measures aimed at ameliorating the functioning of product and service markets in general and at generating higher competition and a more flexible functioning of the price mechanism in particular. This will essentially require a further reinforcement of competition policies and a curbing of State aids in full respect of the objectives of Article 130a of the Treaty concerning economic and social cohesion.

It is also crucial to exploit fully the internal market potential in an open and competitive environment through the transposition into national law and effective enforcement of single market legislation. In sectors where transposition is lagging behind, a particular effort is needed to present all necessary proposals to national parliaments before the end of 1996.

To enhance the Community's competitiveness, measures aimed at promoting innovation, at favouring the emergence of the information society and at achieving a working environment more conducive to initiative and to the developement of SMEs should be swiftly implemented. Of course, in these areas the individual Member States largely hold the key. However, national actions can be reinforced, where this is appropriate and consistent with these guidelines, through actions at the Community level. The Commission should also pursue its policy to improve competition in EU markets. Finally, to increase the efficiency of environmental policies, they should rely on more market-based instruments, including fiscal ones, both at the national level and — if EU-wide action appears necessary — at the level of the Community.

6. Fostering employment and labour market reforms

More than 2½ years after the publication of the Commission's White Paper on Growth, Competitiveness and Employment and with the Essen employment strategy set in place for some time, the Community finds itself with a dismal employment record over the period in question. Although the expected recovery will lead to renewed job creation and will reverse the current upward trend in unemployment, it is likely that more than 17 million people will still be unemployed in 1997 in the Community. Assuring a sustained and significant improvement in employment requires not only durable high, economic growth and efficient product and service markets, but also a broad range of labour market reforms.

Eliminating existing rigidities as well as ensuring a more efficient operation of labour markets is at the heart of national efforts to ensure both a tension-free and stronger medium-term expansion and a more employment-creating growth pattern. Member States have been making efforts to reform their labour markets. They are encouraged to intensify their actions while ensuring both equity and efficiency in the social protection system. The implementation of policies aimed at improving the occupational and regional mobility of the labour force and at enhancing the efficiency of employment services should reduce bottlenecks which could lead to an early end to the growth process.

Suitable policies should be conducted in order to adapt the whole educational system — including vocational training — both to the needs of markets and to the improvement of human capital, thereby fostering the growth potential of the economy. In this respect, priority should be given to improving the employability of the unemployed, in particular low skilled, inexperienced labour, and to reducing skill mismatches on the labour market by providing training better fitted to the changing needs of the labour market. Attention should also be given to enhancing the employment prospects of young people and women.

Higher employment growth should be fostered by the maintenance of appropriate average wage trends and in some cases by wages that better reflect productivity differentials. Where possible, a reduction in non-wage labour costs should be used to encourage employment. Attention should be given to the incentives to the employment of disadvantaged groups, including the long-term unemployed and low-skilled labour, consistent with these guidelines. Adaptations, in the mutual interest of firms and work forces, of working-time and work organization will also act in this direction. Finally, the promotion of local and regional initiatives in the field of new services containing a high labour-intensive dimension, such as those identified in the Communication from the Commission on a European strategy for encouraging local development and employment initiatives, should also be encouraged.

All the above elements are featured in the Community's common employment strategy, initiated at the Essen European Council and refined subsequently at both the Cannes and Madrid Councils. In this respect, Member States multiannual employment progammes must be pursued if they are to be effective in the area of labour market policy. Furthermore, the Commission will pursue its initiative to mobilize all parties around the top priority of fighting unemployment.

Done at Brussels, 8 July 1996.

For the Council

The President

R. QUINN