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(Acts whose publication is not obligatory)

COUNCIL

COUNCIL RECOMMENDATION

of 10 July 1995

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

(95/326/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 Cannes of 26 and 27 June 1995,

HEREBY RECOMMENDS:

1. Introduction

Since the summer of 1994, when the previous broad guidelines were adopted, economic growth in the Community has become firmly established. However, as the recent foreign exchange turmoil following the decline of the dollar has highlighted, significant risks and important policy issues remain unresolved. In order to ensure that the growth prospects are fully taken advantage of to increase employment and enhance convergence, economic policies must respond to the challenges and opportunities presented by the emerging economic expansion.

The present set of policy guidelines — prepared and adopted according to Article 103 (2) of the Treaty establishing the European Community — will constitute the reference for the conduct of economic polices in the Community and the Member States. It re-affirms both the objectives proposed in the earlier versions and the conclucions on fighting unemployment reached by the European Council, notably those of the Essen meeting which recommended five years where action had to be intensified. Full implementation of these guidelines will make possible a strengthening of convergence and a realization of the good growth and employment prospects, thus achieving significant reductions in the rate of unemployment, thereby also contributing to the alleviation of the problem of social exclusion.

Two policy concerns should be given prominence in the present environment. First, there is the possibility that the favourable impact of economic growth could give rise to 'adjustment neglect'. This may take the form of a weakening commitment, induced by the cyclical improvement of the budget deficit, to resolve in a durable manner the structural fiscal imbalances, or, as employment begins to recover, it may be reflected in a reluctance to initiate and implement those measures which are necessary to remove labour market imperfections. It is essential that either type of 'adjustment neglect' should be vigorously resisted.

Secondly, some of the recent exchange-rate changes have not only contributed to greater risks of inflation dispersion. They have also contributed to disturbances in the operation of the internal market and thus threaten the beneficial achievements of economic integration. Those exchange-rate changes which do not correspond to fundamentals will have detrimental effects for all the Member States.

It is clear that, in order to minimize the occurrence of such episodes, creating the conditions for exchange-rate stability reflecting economic fundamentals must become a key priority of economic polices in the Community.

The present guidelines re-affirm the policy objectives set in the December 1993 and July 1994 guidelines: it is essential for the Community and the Member States to turn the present recovery into strong, sustainable, non-inflationary medium-term growth which respects the environment. Such growth is important in order to reduce unemployment substantially and to make possible the achievement of the necessary degree of convergence to facilitate the transition to stage III of EMU. Achievement of these 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.

An essential complement of this framework must be provided by structual reforms aimed at fostering the competitiveness of the economies of the Member States and at improving the functioning of their labour markets. The policies necessary for sustaining long-term growth, increasing employment, and strengthening convergence are mutually consistent.

2. Economic Policy Guidelines

Price and exchange rate stability

Substantial progress in reducing inflation in the Community and the Member States has been made since the beginning of the decade. Nine Member States are now expected on the basis of the spring forecasts published by the Commission to see a rate of inflation in the range of between 2 and 3 per cent in 1996, consistent with the objective of the 1993 and 1994 guidelines, with a further two Member States forecast to experience rates of inflation just above this range next year.

Further progress towards price stability must be made. This means, above all, enlarging substantially the group of Member States where inflation performance is in line with the 1994 guidelines. Those Member States that are currently expected to experience rates of inflation between 2 and 3 per cent should maintain a policy aimed at preventing any resurgence of inflationary pressures and at progressing towards or going below 2 %. Other countries need to increase their efforts, in some cases substantially, if they are to meet the guidelines.

Exchange-rate changes could have important implications for inflation convergence. Thus, in most Member States which have experienced currency appreciations, inflation convergence is expected to strengthen. In these Member States wage trends are expected in most cases to develop broadly in line with the objective of price stability too. However, it will be necessary to ensure that wage developments do not lead to reductions in investment profitability, particularly in the export-oriented sectors. On the other hand, in the Member States which have experienced currency depreciations, price tensions have increased as well as the risk of an acceleration of inflation. In these countries utmost caution is needed. In particular, in the context of strong economic growth, it will be important to prevent increases in import prices from generating a vicious circle of price and wage inflation. Otherwise, the achieved creadibility of moving towards a stability-oriented policy framework would be rapidly lost.

The combination of the marked depreciation of the dollar, of unresolved structural problems, of uncertain fiscal and inflation prospects and of other uncertainties in some Member States has led to substantial exchange-rate instability within the Community. Exchange-rate changes exceeding those which are warranted by the differentials in the rates of inflation are detrimental to all Member States; in those where currencies have appreciated, growth prospects, while still generally favourable, have been reduced, while in those where currencies have depreciated inflation prospects will increase and call for additional efforts if medium-term inflation objectives are to be achieved. Moreover, the proper functioning of the internal market has been disturbed as business decisions may be made on the basis of misaligned exchange rates, thereby providing false incentives to special interest groups.

By making further progress towards price stability, Member States will improve the prospects for lasting exchange-rate stability, which will, in its turn, help price stability. In this respect, a key role will be played by budgetary policy and by the credibility of fiscal consolidation commitments. Exchange-rate stability will also

contribute to reaping the full benefits of the internal market and to improving resource allocation within the Community. 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 and, where appropriate, its exchange-rate mechanism.

Sound public finances

Despite the consolidation of economic growth, prospects for the resolution of the fiscal imbalances remain uncertain and fiscal convergence continues to be elusive.

The failure to realize greater progress in budgetary consolidation leads, in many cases, to a situation where fiscal policy is severely constrained by a high and rising burden of interest payments. It also undermines sustainable price- and exchange-rate stability, increases uncertainty about the course of fiscal policy and erodes the credibility of policies. It contributes to an unbalanced policy mix, and it undermines the task of monetary policy. Over the medium term, persistent fiscal imbalances will have adverse implications for economic growth and for employment creation. A sound fiscal position is a positive supply factor as it opens up the possibility for tax reductions and for increases in productive public investment. Indeed the arguments for budgetary consolidation based on growth and employment considerations are at least as important as those based on the need to improve the sustainability of debt positions and nominal convergence. If budget deficits and debt ratios cannot be reduced in a durable manner now, during a period of relatively strong growth, when will they be reduced ?

The clear task confronting virtually all the Member States is to ensure that advantage is taken of all growth opportunities to promote fiscal consolidation by reducing structural deficits. The Member States should aim to bring their budget deficits below 3 per cent of GDP as soon as possible, as a first step towards the medium term goal, as set out in the December 1993 guidelines, of close to balance. In some countries, the structure of the pension system calls for surpluses in the public accounts.

The current estimates suggest that all the Member States, including those where the forecast deficit for this year will be below the 3 per cent mark, ought to exploit any room provided by economic growth higher than in budget plans, or by a decline in interest rates, to accelerate the process of budget consolidation. This is particularly urgent in the countries which have a high debt-to-GDP ratio. In the event that the exchange-rate turbulence lowers economic growth this year, the efforts to achieve the targets of the convergence programmes should not be relaxed.

The forecast for 1996 indicates that, on the basis of the adjustment measures which have been clearly specified so far among those Member States which have set fiscal ceilings in their convergence programmes, the fiscal objectives will not be uniformly met. In several cases adjustment effort is needed to reach the targets set out in convergence programmes. On the basis of Commission forecasts and 'unchanged policy' assumptions, only seven Member States will have deficits below 3 % of GDP. This underlines the high importance of respecting convergence programmes and the need to updated them regularly so that they assist in fulfilling the objectives of the Treaty.

In many countries, remaining expenditure increases should be the preferred approach since, apart from their impact on employment, there are undoubtedly limits to higher taxation and social charges. But the rationalization of the public expenditure and taxation systems can also contribute to economic growth and emloyment creation. In particular, as proposed in the 1994 guidelines, Member States should, where necessary, modify their tax structures in ways which are likely to favour employment and benefit the environment, while public expenditure should be re-allocated away from consumption and in favour of productivity-enhancing spending ; in the latter category, strengthening public investment and investment in human capital should be accorded a priority. In this context as well, non-wage labour costs should be reduced, especially, in some countries, at the lower end of the wage and productivity scale. It is important, however, that the necessary reduction in budget deficits is not endangered, which implies that compensatory additional revenues should be found.

Fiscal difficulties continue to characterize the public finances of several Member States. In Greece, some progress was made in 1994. However, it is essential that fiscal imbalances be reduced much further in order not to inhibit progress towards convergence. Decisive measures are required, especially on the expenditure side, in a multi-annual framework in order to increase confidence in the course of economic polity. In Italy, the fiscal consolidation measures taken over recent years are beginning to bear fruit. These efforts should be continued through the full implementation of the recently announced three-year plan. In the case of Sweden, which is also confronted with a large deficit, a multiannual adjustment fiscal framework has already been adopted ; it is necessary that the adjustment path be adhered to. In Belgium, the high indebtedness necessitates that the fiscal component of the Global Plan be fully implemented and that further progress in reducing the deficit below the 3 per cent of GDP mark be made in order also to achieve a more significant reduction in the debt ratio. In Spain and Portugal, greater efforts are required in the area of fiscal consolidation. Ambitious fiscal objectives are also necessary in the cases of Austria and France. While Finland has not yet prepared a convergence programme, the forecasts suggest that its fiscal objectives are ambitious ; efforts to realize these objectives should be sustained. Denmark, the Netherlands and the United Kingdom should continue with the vigorous implementation of their programmes of

fiscal consolidation in line with their convergence programmes to ensure that their deficit is below 3 % in 1996. Fiscal developments and prospects in Germany, Ireland and Luxembourg suggest, on the basis of the Commission's forecasts, that they will continue to show no excessive deficit. In Ireland, the decline in the debt ratio is projected to continue at a healthy pace, while the state of the public finances in Luxembourg continues to be robust.

Where Member States have to follow stringent budgetary policies to ensure that deficits come below 3 % of GDP, the Community itself should adopt a cautious stance towards the financial perspective established by the European Council in Edinburgh — this perspective sets ceilings and not targets.

Promotion of competitiveness and sustainable growth

Following the proposals of the White Paper on 'Growth, Competitiveness, Employment', Member States are implementing reforms aimed at strenghtening the forces contributing to growth potential and at enhancing the dynamism and competitiveness of the Community economies.

In order to benefit fully from the opportunities offered by the internal market, the transposition of Community directives into national law now stands at 92,4 per cent, the dispersion among the Member States ranging from 86,3 per cent to 98,6 per cent. Progress is required, however, in the areas of insurance, intellectual and industrial property, public procurement, new technologies and services and freedom of movement. Moreover, progress has been slow in the extension of the single market to telecommunication and energy, while the internal market in transport remains incomplete. Furthermore, additional progress is necessary in reinforcing competition rules, reducing State aids, and reducing the role of the public sector. Privatization, to the extent that Member States judge it compatible with their objectives, could further the progress already made in this direction. Several initiatives have been taken at the Community level. Following the recommendation of the Essen Council, a Competitiveness Advisory Group was set up and it prepared a report for the Cannes European Council on the state of Community competitiveness and related issues ; moreover, the Group for Legislative and Administrative Simplification has been established. In order to enhance overall competitiveness, several issues are being reviewed at the Community level, including improving financing for SMEs, enhancing labour market flexibility, and improving the quality of vocational training.

The growth and employment possibilities flowing from efforts to safeguard the environment should be fully exploited. The report to be prepared for the December 1995 European Council by the Ecofin Council on 'the interrelationship between economic growth and the environment and the consequences this has for economic policy' is of particular importance in this respect.

It is essential for the dynamism of the Community economies that investment be stepped up. This relates in particular to investment in education and training and in the infrastructure of the Community, which needs to be developed to match the requirements of the 21st century. The trans-european networks should be realized and the action plan on the information society should be carried through. In addition, for the active promotion of research and development initiatives, greater coordination between Member States' activities is essential. Parallel, coordinated efforts at the level of the Community and of the Member States is an essential building block to realizing the potential for job creation and growth.

Employment and the labour market

The economic recovery, if it progresses as predicted, will absorb the cyclical component of unemployment by 1997. Nevertheless, to continue to reduce unemployment in a significant and progressive manner, it is necessary to achieve a high rate of economic growth over many years and to increase the capacity of that growth to generate jobs. In many Member States, there is a need for stronger differentiation of wages by sectors, geographical areas and qualifications. An essential component of the efforts to achieve the goals is represented by more active and more efficient labour market policies. These must aim at a comprehensive, integrated and coherent effort to bring about structural chance in the fields of the educational systems, labour law, work contracts, contractual negotiation systems and the social security system to improve the functioning of the labour market as a whole.

In the context of the White Paper, the European Council identified in Essen the following five priorities for the Member States to address :

— improving the employment opportunities for the labour force by promoting investment in vocational training,

— increasing the employment intensiveness of growth,

— reducing non-wage labour costs,

— improving the effectiveness of labour-market policies,

— improving measures to help groups which are particularly hard hit by unemployment.

Member States were invited by the European Council meeting in Essen to implement measures adapted to their own specific situation and to prepare multiannual programmes spelling out their policy intentions. It is now important that the Member States rapidly adopt these multiannual programmes. As requested by the European Council in Essen, the Council and the Commission will keep close track of employment trends, will monitor the relevant policies of the Member States and will report annually to the European Council on further progress on the employment market, starting in December 1995.

Various measures have already been taken, but greater and more determined efforts are needed.

Examples of the ways in which active and more efficient labour-market policies contribute to the goal of increasing employment are :

(i) they improve the employment opportunities for the labour force by promoting investment in vocational training, notably in SMEs, and thus raise the quality of human capital which improves competitiveness, potential output and the flexibility of, and opportunities for, the workforce ;

(ii) they increase the employment intensity of growth, without affecting negatively the rate of growth itself, by :

— the social partners examining at the appropriate levels whether employment could be promoted, without endangering competitiveness, through innovative forms of work arrangements such as reorganization and new patterns of working time and new combinations of work and leisure,

— increasing the incentives to employment by reducing non-wage labour costs, especially at the lower end of the wage and productivity scale, without harming other parts of the labour market ; from a macroeconomic point of view this must be achieved in ways which do not compromise the reduction of budgetary deficits or the competitiveness of enterprises. Reforms including, where appropriate, alternative financing sources of social protection systems are therefore required,

— encouraging the development of new employment opportunities and activities especially at the regional and local level, e.g. in the environmental and social service spheres ;

(iii) they promote the employability of people when new jobs become available by :

— improving the effectiveness of labour market policy through enhancing flexibility with respect to professional and geographical mobility (particularly for those workers readily employable),

— improving measures to help groups which are particularly hard hit by unemployment, through special retraining schemes which concentrate on target groups hit by exclusion.

Labour market policies contributing the exploiting these three channels constitute not only an indispensable complement to macroeconomic policies and structural policies in the area of competitiveness but they also contribute to maintaining and reinforcing cohesion and the social consensus inside the Union in the long and difficult process of absorbing unemployment.

Done at Brussels, 10 July 1995.

For the Council

The President

P. SOLBES MIRA