Growth and employment in the framework of EMU: economic policy for broad guidelines for 1998

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OBJECTIVE: This communication replaces the traditional annual economic report and for the first time (in view of the introduction of the euro) takes the form of general reflections on growth and employment in the framework of EMU. It also aims to prepare for the Broad Economic Policy Guidelines which will be submitted in June 1998. SUBSTANCE: Essentially, the report recommends pursuing a macroeconomic and structural policy concentrating on convergence and aiming to take advantage of the current phase of recovery. It concentrates on analysing the current situation and advocates measures such as pay moderation, more structural reforms and improving the operation of job markets. (1) Economic situation: although inflation rates and budget deficits have been strikingly reduced in recent years, the results in terms of growth and employment are disappointing. The cause is the lack of firmness in establishing appropriate economic policies. The Commission considers that the conditions are now right for sustainable, job-creating growth. Inflation has reached historically low levels and is controlled in almost all the Member States, and the profitability of investments has reached the level of the 1960s. However, there are still weaknesses in the area of internal demand. The other positive factors include interest rates (historically low) and signs of confidence in industry and consumers. The Commission stresses, however, that although the situation is improving, there must be no relaxation of effort. In the short term, monetary stability and market confidence must be preserved. In the medium term, the recovery must be translated into a process of strong and sustained growth. (2) The employment challenge: during the last 24 years the Community's performance in terms of increased productivity has been satisfactory (an average increase of 2% per year compared with 0.7% in the USA and 1.9% in Japan). However, this economic performance has not improved the rate of employment: there were 18 m unemployment people in the EU in 1997 (10.7% of the labour force) with an employment rate of 60% (74% in Japan and the USA). What is needed to increase this employment rate and reach the level of the 1960s (67% of the labour force) is: - greater the 'employability' of the labour force, in particular by raising their level of qualifications, - greater productivity by promoting technological development. (3) Beneficial effects of EMU: the strategy advocated by the Broad Economic Policy Guidelines and shared by all the Member States is based on three major factors: - a stability-oriented monetary policy, - sustained efforts to consolidate public finances, - nominal wage trends consistent with the price stability objective. Establishing EMU should reinforce this consensus as the euro should rule out exchange rate turbulence and establish an area of stability and low inflation which will encourage investment and thus employment. (4) Structural policies for growth and employment: to improve the functioning of the job market, the EU has developed a two-point strategy: coordinated application of the Broad Economic Policy Guidelines in the framework of EMU stability and gradual introduction of employment guidelines in each Member State. The Commission considers that a significant increase in the labour content of growth will be obtained by: - slowing down the process of labour by capital substitution; in this context, the wage distribution must be widened downwards; the report considers that to obtain a tangible result, a fall in the wage cost of low-skilled activities by about 20-30% must be envisaged together with an equivalent reduction in unemployment benefit (to avoid the 'poverty trap'); it is, however, difficult to apply this reduction in the EU (as was done in the USA) without concluding pragmatic selective agreements between the two sides of industry, including entry level wages for the long-term unemployed; it is also important to reduce non-labour costs: this reduction will not be truly effective unless it is targeted at specific categories of the working population at the bottom of the pay scale: young people and the long-term unemployed with few qualifications; this reduction should also be accompanied by effective education and training measures and be based on new forms of partnership in the private sector; the Commission therefore considers that steps should be taken to associate productivity with wage reduction, as a part of the normal process of

collective bargaining and tax reform; - reduction in working time: the Commission considers that a pure and simple reduction in working time is not the answer; on the contrary, it may have a damaging effect on enterprises (in terms of productivity) and therefore on employment; however, a negotiated reduction of working time can have undeniable advantages; the report therefore suggests exploring the possibilities of a selective reduction of working time and also stresses the possible advantages of voluntary part-time working which would enable new forms of employment to be created.