

INFORMATION

ECONOMIC & FINANCIAL AFFAIRS**ANNUAL REPORT ON THE ECONOMIC SITUATION IN THE COMMUNITY****69/74**

On 18 September 1974, the Commission adopted and forwarded to the Council the fourth Annual Report on the Economic Situation in the Community, in which it describes the current economic situation and proposes economic policy guidelines for 1975.

The Commission is mainly concerned with analysing the negative aspects of three factors : this year again saw no slackening of the pace of inflation and the rise in consumer prices accelerated considerably compared with last year. In addition, Community cohesion is handicapped by serious balance-of-payments disequilibrium. After running a \$1,000 million surplus in 1973, the Community's current account will show a deficit of almost \$20,000 million in 1974. Finally, trends in the Member countries have never before been so divergent. Furthermore, the national economies are also marked by serious disparities as a result of over-employment in a number of industries, while the motor vehicle, textile and building industries are faced with under-employment.

World economic situation

The rate of overall world economic activity eased. In the USA real gross national product fell in the first half of 1974. The upsurge in oil prices increased the pace of world inflation and led to a serious deterioration in the balance of payments of most oil-importing countries. The upward movement of raw material prices came to a halt in mid-year.

Economic situation in the Community in 1974

As a whole, economic activity in the Community continued at a comparatively high level. In 1974 real gross product should grow by about 2.5% (compared with 5.6% in 1973). Balance-of-payments disequilibria and the strains on prices have become more marked in recent months.

Overall domestic demand tended to fall in volume. A certain reluctance to invest on the part of industry has become apparent. The stimuli given to the level of activity by private consumption were relatively slight.

Industrial production in the Community as a whole has stabilised, but the disparities between countries and industries are quite marked. While industrial output in Germany is stationary, production in France and Italy is still growing strongly. Generally speaking, the basic industries (chemicals, iron and steel) are better placed than the construction, motor vehicle and textile industries.

The level of employment remained high, but considerable disparities appeared. Unemployment has recently risen particularly in Denmark, the United Kingdom and Germany.

The annual rate of increase of consumer prices ranged from 7% in Germany to 19% in Italy.

During the first half of the year, Germany enjoyed a record trade surplus. The external deficits of France, Denmark and in particular the United Kingdom and Italy worsened considerably. There are signs, however, that the heavy trade deficits of a number of countries are levelling off. In aggregate, the current account deficit of all the Member States in trade with non-member countries could amount to some \$20,000 million in 1974.

In the Commission's view, the coordination of economic policy at Community levels is inadequate. The measures taken succeeded in halting the intensification of inflationary pressures only in certain countries, namely Germany and the Netherlands.

Outlook for 1975

In all, only a modest improvement in the world economy can be expected although there should be a certain recovery in the United States and Japan. Provided that an appropriate economic policy is pursued throughout the Community, it may be hoped that the disequilibria will be attenuated in 1975 and that the conditions for the growth of Member States' economies will gradually improve.

In 1975 an increase in real gross domestic product of approximately 3.5% is expected for the Community as a whole. This, in turn, is expected to be accompanied by a slight rise in exports and somewhat more buoyant domestic demand, mainly as a result of private investment in Germany and the Netherlands and increased consumption in Germany.

A slight deceleration in the upward movement of prices could well be recorded, but inflation rates will continue to give cause for concern. Furthermore, disparities within the Community will persist. An improvement in the current balance of payments with non-member countries can be expected.

Guidelines for economic policy

In view of the disappointing results achieved in recent years, the fight against inflation must once more be considered the priority objective of Community economic policy. There must be close coordination at Community level in drawing up this policy and backing must be provided in the form of active solidarity from Member States.

All Member countries must restrain the expansion of overall demand to keep it within limits compatible with the growth of production capacity. Demand management must take into account the constraints imposed on various countries by their external positions. Curbs on domestic demand are particularly necessary in countries with large balance-of-payments deficits. Countries enjoying balance-of-payments surpluses should see that domestic demand develops in such a way that the upward movement of costs and prices is held back by further productivity increases.

Budgetary policy in most Member States, with the exception of Germany, will have to avoid any stimulation of domestic demand. Structural budget deficits must be reduced by a programme of strict austerity. The reduction in direct taxes in Denmark and Germany must have as a counterpart more moderate wage demands. The other public authorities will have to align their policies on central government policy.

Monetary policy must seek to prevent a continuation of inflation. This implies a strict limit on the increase in the money supply. The compatibility of interest rates must be assured and saving encouraged. Close cooperation between central banks is needed to supervise the Euromarket. A common approach should also be adopted to the refinancing of deficits and the scheme for a Community loan should be implemented as rapidly as possible.

The Community's standard of living will probably be affected. In countries with substantial balance-of-payments deficits, a temporary halt in the rise of the purchasing power of household is inevitable. Nevertheless, it is important that the sacrifices to be made should be fairly distributed among the various sections of the population and that the Member States hardest hit should be able to rely on the active solidarity of their partners.

Social welfare arrangements for the unemployed must be improved. The rules governing unemployment benefits and specific measures to assist the workers concerned must be reviewed and adjusted to the new circumstances.

Member States must pursue active prices policies, based above all on the machinery of effective competition. Regulations governing the display of prices must be more strictly enforced.

It is in the interest of both sides of industry to cooperate in the control of inflationary tendencies and to repair the damage which has been caused to economies. It is urgent that all should be aware of the disastrous consequences of inflation and, in particular, of its cost in social terms.

If the upward movement of prices could be rapidly brought under control in certain countries, public investment programmes should be prepared with a view to immediate implementation should unemployment rise.

These general guidelines will be adapted in greater detail to each of the Member countries.

Conclusions

In 1975 the Community will still be faced with serious problems of economic equilibrium. There must, therefore, be no let-up in the struggle to overcome inflation. If the policy to combat inflation gradually to wipe out the external deficits without causing a serious deterioration in the economic and social situation is to be a real success, all groups in society will have to cooperate actively. This means that there will have to be a fair distribution of sacrifices and burdens.

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CONSUMER PRICES

(% annual growth rates)

	1966-1971 (1)	1972	1973	1974 (2)
Denmark	6,3	6,6	9,3	14,2
Germany	2,9	5,5	6,9	7,3
France	4,5	6,2	7,3	12,5
Ireland	5,9	8,6	11,4	14,8
Italy	3,3	5,7	10,8	15,4
Netherlands	5,4	7,8	8,0	8,8
Belgium	3,6	5,5	7,0	10,0
Luxembourg	3,3	5,2	6,1	8,3
United Kingdom	5,4	7,1	9,2	14,4

Source : SOEC

(1) Average for the period

(2) January - June

	1966-1971 (1)	1972	1973	1974 (2)
Denmark	-5,8	-5,0	-9,4	-8,3
Germany	+15,1	+20,3	+33,0	+29,7 (3)
France	-6,4	-4,5	-6,2	-16,5 (4)
Ireland	-0,17	-0,19	-0,27	-0,29
Italy		-420	-3267	-3941
Netherlands	-4,2	-1,4	-1,8	-1,3 (5)
Belgium)	+1,1	+29,2	+17,6	-14,2 (5)
Luxembourg)				
United Kingdom	-0,99	-1,39	-3,42	-3,58

Source : National Statistics

(1) Average for period

(2) January - June, unless states otherwise

(3) January - July

(4) January - May

(5) January - April

PRODUCTION AND EMPLOYMENT

(% annual growth rates)

	Gross domestic product in real terms				Persons in paid employment			
	1966-1971	1972	1973	1974 (1)	1966-1971	1972	1973	1974 (1)
Denmark	4,6	5,1	3,8	2,0	1,4	2,0	0,4	-1,4
Germany	4,4	3,0	5,3	1,9	0,5	-0,3	0,7	-1,2
France	5,8	5,5	6,0	5,2	1,7	1,5	2,4	1,7
Ireland	4,4	3,2	6,0	3,5	0,8	-0,9	.	.
Italy	5,2	3,2	5,9	5,0	1,2	0,1	1,9	2,0
Netherlands	5,6	4,3	4,7	3,3	1,3	-0,7	0,1	-0,1
Belgium	4,7	5,2	5,7	4,0	1,2	0,5	1,1	0,7
Luxembourg	3,3	4,6	7,4	4,5	1,7	3,7	2,9	1,9
United Kingdom	2,2	2,3	5,6	-0,9	-0,8	-0,7	1,3	-1,1
Community 9	4,4	3,7	5,6	2,7	1,0	0,1	1,4	0,0

Source : SOEC

(1) Estimates by the Commission's departments.