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COMMISSION OF THE EUROPEAN COMMUNITIES

Statement by Mr Raymond BARRE to the European Parliament

on the economic situation of the Community
at the beginning of 1972

Luxembourg, 18 January 1972

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The year which has just closed was economically and financially a time of trial for the Community.

The ink was scarcely dry on the Council's Resolution concerning the phased establishment of a Community economic and monetary union when the exchange relationships within the Community were thrown into disarray. Some fundamental matters having been up to then left on one side or only very sketchily tackled, the Member States found themselves unable to take a common line against disrupting factors from abroad. The common agricultural policy was once again affected, so true it is that the machinery devised for its operation presupposes a sufficient measure of economic and monetary integration.

When the international crisis reached its peak on 15 August, the monetary and commercial uncertainties it raised added to the existing difficulties of the Community. They acted as a deterrent to industry's plans for capital spending just at a time when the Community was in any case in a period of slackening growth, accompanied by continuing inflationary stresses.

The Washington Agreements in mid-December to some extent allayed disquiet. The introduction of new rates of exchange is calculated to reduce monetary insecurity, and the dropping of the surcharge and the discriminatory measures the United States had adopted or was planning to adopt serves to lessen the risk of a trade war.

And now, as the new year opens, what are the economic prospects, internationally and for the Community ?

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The movement of the international economy in 1972 will be largely governed by the monetary situation that develops following the Washington Agreements.

Hailed initially with such enthusiasm, the Washington Agreements are now being viewed with considerable misgiving. We should be careful not to overstate their implications either way.

The Ministers of the Group of Ten were out to settle the international monetary crisis quickly, because a quick settlement was in the interests of all. The countries which had floated their currencies were in a more and more difficult economic situation ; the countries which had sought to protect their economies by controls were compelled by force of circumstances to make those controls more and more stringent. Exchange distortions were becoming alarming ; the risk of trade reprisals was growing. There was no time to be lost in ending the chaos. Such was the main reason for the Agreements of 18 December.

In fairness, they have their good side. They do away with floating exchange rates : by authorizing, on either side of the new fixed parities which the Central Banks are henceforth to maintain, fluctuation margins of 2,25 %, they introduce a measure of flexibility that is reasonable in the present circumstances but smaller than that which was previously advocated in some quarters.

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By opening up the way to commercial negotiations, after the abolition of the surcharge, they serve to dispel the spectre of unilateral protection measures.

Over and above this, they are the first evidence of international consultation on decisions which admittedly come within the exclusive sovereignty of the nation states but have to take account of the common interest.

However, it would be a mistake - and a dangerous mistake - to imagine that the Washington Agreements solve all the problems raised by the international monetary crisis. It is sufficient to read the last paragraph of the communique published after the Group of Ten meeting to realize precisely what has still to be discussed and to be done. Apart from these questions, which relate to the reform of the international monetary system and which call for the protracted discussions, three subjects are of major importance in the short term.

The first concerns the return to a degree of dollar convertibility. Everybody knows that in this regard the United States cannot be asked to undertake commitments which it would be unable to fulfil ; even so, measures should be taken to enable the International Monetary Fund operations to be carried out smoothly and to ensure, in specific cases, limited dollar convertibility.

The second is the problem of financing the deficit on the United States balance of payments. It is difficult to believe that the realignment of exchange rates will lead quickly to the restoration of equilibrium in this particular field, although it is true that a reflux of capital to the United States in the coming months is expected to help towards reducing the country's deficit. But nobody knows how marked this reflux will be. It is therefore not unlikely that in the months ahead the question of financing the US deficit will arise again. How is it to be resolved ? By the accumulation of further dollar balances in the Central Banks or by the usual methods

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employed in international credit ? The question is important and still an open one.

Thirdly, nobody disputes the fact that short-term capital movements have over the past few years had a disruptive effect within the international monetary system, either when they have been generated by differences in interest rates between Europe and the United States or when they have been motivated by expectations of capital gains from parity changes. What is urgently required is that the problems inherent in such movementsshould form the subject of a concerted policy at international level ; otherwise the maintenance of stable exchange-rate relationships in the world economy is liable to be threatened from time to time, since the slightest tension or the slightest rumour may set up speculative pressures the strength of which will be proportionate to the extent of the migrant capital.

Quite apart from these specific problems, a more general, if not more fundamental, observation is called for : the realignment of currencies which has just been carried out will not in itself be sufficient to give the international monetary system a greater degree of equilibrium. The efficacy of parity changes depends on the stabilization policies adopted in the countries concerned and, in the present case, on that followed by the country which is suffering from a fundamental disequilibrium in its balance of payments. On top of this, alterations of exchange rates have only a limited influence when the disequilibrium in the balance of payments is bound up with structural factors and attributable in some degree to exceptional, extra-economic factors. It is for this reason that certain difficulties will doubtless continue to be experienced in international monetary relations. Thus in the years ahead management of the international monetary system is likely to

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demand unremitting attention and close cooperation between national and international monetary authorities.

In such cooperation the present Community, and in the very near future the enlarged Community, can play a leading part.

Despite the internal difficulties which it has experienced during the past few months and which are due to concrete factors rather than to a lack of the will to cooperate within the Community, the Six have maintained throughout the recent international negotiations the attitude which was adopted by the Council last September and with which the United Kingdom has constantly associated itself.

The Washington Agreements clearly represent a success for this attitude, since the currency realignment embraces the dollar, as desired by the Community, and has been accompanied by abolition of the surcharge.

The Community has, however, contributed to the achievement of these Agreements by accepting sacrifices which cannot be underestimated. The extent to which the Six have agreed to revalue their currencies against the dollar is considerable. They have done so in an economic situation which cannot be said to be propitious to such parity changes. They have thus given United States exports an advantage which is all the greater in view of the Community's substantial deficit on trade with that country over the last few years. The United States trade balance will be further strengthened by these revaluations. At the same time, there is nothing to suggest that there will be any lessening of the large-scale outflows of long-term capital which for some ten years now have been a major factor in the external disequilibrium of the United States.

For all these different reasons, the Community will have to make sure during the present trade negotiations with the United

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States that it safeguards its essential interests and enters into subsequent negotiations only on the basis of reciprocal advantages and multilateral concessions.

It is in the context of the situation arising out of the Washington Agreements that the proposals just submitted by the Commission to the Council on the organization of monetary and financial relations within the Community must be viewed.

These proposals are aimed, on the one hand, at the establishment of the Community's own exchange system and, on the other hand, at the setting-up of a concerted policy with regard to excessive inflows of capital.

The Commission's first proposal is designed to eliminate the drawbacks to the functioning and development of the Community which would result from fluctuation margins as wide as those henceforth authorized at the international level, but also to put an end to the discrimination against Community currencies in favour of the dollar, which would be perpetuated by the adoption of such margins within the Community. The Commission has recommended that the maximum margin by which the spot rates of any two Community currencies may differ should be fixed temporarily at 2 %. A certain flexibility - which is necessary after the radical disturbances which have afflicted exchange markets in recent months - would thus be introduced for a transitional period in intra-Community monetary relations. When this period expires, the maximum spot differential between two Community currencies would be reduced to 1,5 %.

The Commission is asking the Council to request the Central Banks in the Community to intervene on the exchange market in Community currencies and not merely in dollars. It suggests that they should be allowed to hold Community currencies as well as the various reserve assets in their reserves, thus opening up the

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way for the Community countries to harmonize their currency-reserve policies. Finally, with the aim of ensuring implementation of these measures, it recommends the use of the most efficient technical methods and the establishment of a European Monetary Cooperation Fund, whose operations would be expressed in a European unit of account determined by a certain gold weight. In the present circumstances the Fund method offers certain advantages over the other potential methods of coordinating Central Bank interventions and harmonizing policies on reserves, because the Fund provides a means of establishing greater solidarity among the Community's Central Banks and introducing better management of the dollar reserves held by the Community countries.

As to the concerted policy regarding massive inflows of capital from abroad, the Commission's view is that, with the international monetary situation still rather unsteady, it is impossible to protect exchange rates inside the Community and safeguard a Community exchange system without such a policy.

In accordance with the concept which it has always upheld, that of keeping progress in the monetary field in step with progress in the aligning of economic policies, the Commission again stresses the need for closer coordination of the Member States' economic and monetary policies.

There is nothing particularly new in the Commission's proposals : since February 1968, when, speaking on its behalf, I first asked the Conference of Ministers of Finance at their meeting in Rome to organize the Community currencies on an interdependent basis, the Commission has never ceased to advocate such measures and to work for their achievement. From meeting to meeting, from committee to committee, either these proposals were considered too bold and were set aside for a later date, or it was said that they were too modest and must go very much further. But the fact is that the Community has gone little further except in intention.

Speech after solemn speech has been made in the last few months on the need to resume progress towards an Economic and Monetary Union as soon as the international currency situation returns to normal. In an international context that gives the Community an exceptional opportunity to organize and strengthen cooperation in the monetary field among its present and future members, the Commission sets before the Member States a proposal to achieve definite progress that is economically sensible, technically feasible and politically acceptable. The coming months will show whether the Economic and Monetary Union programme which the Community has decided to carry out merits a different fate from the one embodied in the well-know quotation, slightly amended for the purpose : "Talk constantly of it, but never think of it".

I should now like to look at the present economic position of the Community and outline the forecasts we can reasonably make now at the start of the year. Here again, whilst avoiding over-optimism we must take care not to be over-pessimistic.

First let us review the state of the Community economy in 1971.

Economic expansion slowed down in the Community during 1971, from spring onwards, the exceptionally mild winter of 1970-71 having made it possible to achieve high production levels at the beginning of the year. For the Community as a whole, the gross internal product increased in volume by 3,5 % in 1971, as against 5,6 % the year before.

The trend of economic activity varied somewhat from country to country, with a fairly rapid growth rate in France, where the gross national product showed a rise of some 5,5 % ; a revival of economic activity in Italy towards the end of the year, during which the gross national product increased by only 1 % in volume ; a

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continuous decline of the expansion in Germany and the Benelux countries from the second quarter onwards, the gross national product increasing by 3 % in volume in Germany, 4 % in the Netherlands, 3,5 % in Belgium ; a stand-still in Luxembourg, where the rate of growth was no more than 0,5 % owing to the drop in demand on the world steel market.

Fewer new jobs, more unemployment, and fewer unfilled jobs are features common to all the Community countries. Yet we cannot assess the trend of the situation without bearing in mind that all the member countries have hitherto been experiencing overemployment and overheating ; in some of them the structural problems besetting the labour market have been obscured by this fact.

Prices and costs have continued to shoot up everywhere. Germany and Italy alone show a slight slowing-down of the wage increase during the second half of 1971.

Wages rose by an annual rate of about 11 % in France and nearly 12 % in Belgium. In the Netherlands they climbed steeply again after the relative standstill in the first half of the year.

For the Community as a whole, consumer'prices increased by about 5 % in 1971. It is interesting in this connection to recall that during the previous slackening of economic activity in 1967, the gross Community product had increased by 3,2 % in volume, whereas the rise in consumer prices was then only 2,5 %. In West Germany, consumer prices advanced by 5,8 % between December 1970 and December 1971. In France the price rise was nearly 6 %, in Italy 5 %, in the Netherlands 8,5 %, in Belgium more than 5,5 %, and in Luxembourg 5 %.

Turning to intra-Community trade, we find that the growth rate weakened perceptibly (an increase of 12 to 13 % by value in 1971, as against 18 % the year before). Exports to non-member countries increased by only 3-4 % volume, while imports levelled off in the second half of the year ; the surplus on the trade balance improved, largely through better terms of trade.

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Lastly, businesses showed less inclination towards capital spending in nearly all the Member countries.

Looking ahead in 1972, we expect to see a faster growth of the gross national product in the United States (5 to 6 % in real terms) and the United Kingdom will achieve more rapid growth rate than in previous years (3 to 3,5 %), whereas the Community will go through a consolidating phase ; its gross product might increase by 2,5 to 3 % in volume.

In spite of a certain slowing-down of wage and production cost increases, costs and prices will still show a high rate of increase.

In West Germany, the prospects for the months immediately ahead do not hold out any hope of a recovery in economic activity. Admittedly the international structure of trade relations is more favourable to German exports today than it was during most of 1971 ; but on the other hand, there will be less capital investment by firms and consumer expenditure may record a slower pace of expansion. All in all, the growth rate of the gross national product should be about 1,5 % in real terms, even assuming that the Government takes limited fiscal or budgetary steps in the first half of the year to start things moving again. The main problem from the point of view of short-term economic policy is choosing the right moment and the extent of the boost to be given to economic activity. In this connection care should be taken to ensure that stimulating the economy does not trigger off further wage rises and step up the already soaring rate of consumer price increases.

In France, it appears that economic activity may be able to continue at the pace observed in recent months. It is true that the Washington Agreements have partly wiped out the exchange advantage that French exports have enjoyed since May 1971, but their expansion does not seem likely to be too seriously affected by this ; a bigger

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impediment might well be the low growth rate of the German economy. Household consumption should still increase fairly quickly. The capital spending and a possible upward revision of private enterprise investment projects, particularly in response to the measures recently taken by the French Government, should contribute to a satisfactory growth rate. It is not too much to expect the gross national product to expand by 4,5 % to 5 % in real terms. The first concern of the economic policy, however, must be to steady the rise of costs and prices, especially since a certain slowing-down can be seen in this field in Germany and Italy. Thus a premature or overenthusiastic revival of domestic demand might add to the inflationary stresses without bringing any basic solution to the unemployment problems, which in France appear to be due far more to structures than to the economic short-term situation.

The likelihood is that in Italy the recovery heralded at the end of 1971 will proceed relatively satisfactorily. The halt in the sagging trend of investment, the building-up of stocks, the strong upward trend in public expenditure and the rise in wages and salaries expected to occur in the second half of 1972 will help to make the GNP growth an estimated 3 %. The rise in prices should, however, be more rapid than in 1971, mainly because of the introduction of the tax on value added in mid-1972. Nevertheless, the reflation of the economy should remain the priority economic policy objective in 1972.

Where the Netherlands is concerned, the forecasts are less promising ; a small increase in GNP, of the order of 2 % ; a significant decrease in investment in volume ; a marked slowing-down of exports ; a rise in unemployment at a relatively high level ; a steep rise in prices, estimated at 7 %, as a result of a continued upthrust in the wage bill. The trade balance will, however, tend to improve as imports reach a ceiling. It remains a fundamental necessity

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for costs and prices in the Netherlands to become more stable, despite the short-term employment trend, owing to the danger to the country's longer-term growth which a deterioration in its competitive position would represent.

In Belgium, the expansion will continue at a slower rate (2,5-3 %) ; a downturn in investment by firms and a certain weakness in the trend of exports can be predicted, but there should be an appreciable increase in public investment and a further considerable expansion in household consumption. The outlook for the trend in prices and wages remains unsatisfactory. The reflationary measures already put in hand by the Belgian authorities to limit the slowing-down in expansion and its effects on employment will have material repercussions on the national budget. Besides, they will not create the favourable conditions for the required moderation in the rise of costs and prices.

In Luxembourg, the better outlook for exports to non-member countries points towards an improved growth rate, while the rise in consumer prices seems to be declining.

In most of the Community countries, therefore, the economic policy in 1972 will have to sustain economic activity and protect the level of employment by measures selected and applied in such conditions that the incipient recovery of equilibrium in terms of value is in no way jeopardized. Steering a middle course between a satisfactory growth rate and greater stability of the economy promises to be a difficult task everywhere.

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Another difficult year at the international level, and somewhat dull at the domestic level, 1972 will be especially significant for the Community : it will be the final year of the Community of the Six. On 1 January 1973, the enlargement of the Community will become a reality.

Who can deny that things will no longer be the same ? Changes are inevitable. In order that the new members can be absorbed into the enlarged Community without serious difficulty and that the changes to come do not too radically affect the nature of the Community, the structures of incorporation and the economic and financial bases must be sound and the machinery of the Common Market must run smoothly. Thus 1972 should not be a year of stagnation and marking time, but a year of action and progress. Only in this way can be maintained all that has been done so far and only in this way will those,whose future task will be to direct the affairs of the Community within its renewed Institutions, be able to continue to strengthen it andthus fulfil the hope which has for twenty years guided its founders and architects.

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Brussels, 18 January 1972

Summary of an address given by Mr Raymond Barre, Vice-President of the Commission of the European Communities, to the European Parliament in Luxembourg, on the economic situation in the Community at the beginning of 1972 (Luxembourg, 18 January 1972)

In a report on the economic situation in the Community at the close of 1971, Vice-President Barre this morning said to the European Parliament, "The year which has just closed was economically and financially a time of trial for the Community." After an analysis of the Washington Agreements of mid-December, Mr Barre considers that they are virtually the first sign of an international approach to decisions which are, it is true, the exclusive preserve of sovereign nations, but which must reflect the common interest.

He went on to say: "However, it would be a mistake - and a dangerous mistake - to imagine that the Washington Agreements solve all the problems raised by the international monetary crisis. It is sufficient to read the last paragraph of the communiqué published after the Group of Ten meeting, to realize precisely what has still to be discussed and to be done. Apart from these questions, which relate to the reform of the international monetary system and which call for protracted discussions, three subjects are of major importance in the short term." These three subjects are:

(1) The return to a certain degree of dollar convertibility.

(2) The problem of financing the deficit in the United States balance of payments.

(3) Short-term capital movements which in the past few years have had a disruptive effect on the international monetary system.

Quite apart from these specific problems, a more general, if not more fundamental, observation is called for: the realignment of currencies which has just been carried out cannot in itself be

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sufficient to improve the equilibrium of the international monetary system. The efficacy of parity changes depends on the stabilization measures adopted in the countries concerned, and in the present case, on those taken in the country suffering from a fundamental disturbance in its balance of payments. In addition, alterations to exchange rates have only a limited influence when the disturbance in the balance of payments is linked with structural factors and attributable in some degree to particular extra-economic factors. For this reason, certain difficulties will doubtless continue to be experienced in international monetary relations. Consequently, management of the international monetary system during the years ahead can be expected to call for unremitting attention and close cooperation between national and international monetary authorities.

Mr Barre then drew attention to the contribution which the Community will have to make to this cooperation between national and international monetary authorities. He reminded his listeners of the Community's position in the matter, a position which it has maintained throughout the recent international negotiations, which was confirmed last September by the Council and which Great Britain has all along endorsed. Mr Barre continued:

"The Washington Agreements clearly represent a success for this attitude, since the currency realignment embraces the dollar, as desired by the Community, and has been accompanied by abolition of the surcharge.

"The Community has, however, contributed to the achievement of these Agreements by accepting sacrifices which should not be underestimated. The extent to which the Six have agreed to revalue their currencies against the dollar is considerable. They have done so in an economic situation which cannot be said to be propitious to such parity changes. They are thus giving United States exports an advantage which is all the more remarkable when it is remembered that for some years past the Community has had a substantial deficit on trade with that country. The United States trade balance will be further strengthened by these revaluations. At the same time, there is nothing to suggest that there will be any lessening of the substantial outflows of long-term capital which for some ten years now have been a major factor in the external disequilibrium of the United States.

"For all these different reasons, the Community will have to make sure during the present trade negotiations with the United States that it safeguards its essential interests and enters into subsequent negotiations only on the basis of reciprocal advantages and multilateral concessions."

Mr Barre then criticized the proposals the Commission had just put to the Council on the ways in which monetary and financial relations within the Community should be organized, stating namely on the subject:

"There is nothing particularly new," he said, "in these proposals: since February 1968, when on the Commission's behalf I first asked the Conference of Ministers of Finance at their meeting in Rome to organize mutual monetary support in the Community, the Commission has never ceased to advocate such measures and to work for their adoption. From meeting to meeting, in one committee after another, either these proposals were considered too bold and were set aside for a later date, or it was said that they were too modest and must go very much further. But the fact is that the Community has gone little further except in intention.

"Speech after solemn speech has been made in the last few months on the need to resume progress towards Economic and Monetary Union as soon as the international currency situation returns to normal. In an international context which offers the Community an exceptional opportunity to organize and strengthen cooperation in the monetary field among its present and future members, the Commission is suggesting to the Member States that they take positive steps forward where these are economically sensible, technically feasible and politically acceptable. The coming months will show whether the programme of economic and monetary union which the Community has decided to carry out merits a better fate than the one embodied in the well-known principle: 'Talk constantly of action, but never take it.'"

Having outlined the economic developments of 1971, Mr Barre concluded his address by turning to the outlook:

"Looking ahead in 1972, we expect to see the gross national product growing faster in the United States (5-6% in real terms) and doing better than recently in the United Kingdom (3-3.5%), while the Community will be consolidating its position. Here, our gross product might increase by 2.5 to 3% in volume.

In his conclusion, Vice-President Barre stated:

"In most of the Community countries, therefore, economic policy in 1972 will have to sustain economic activity and protect the level of employment by measures selected and applied in such conditions that the incipient return to equilibrium in terms of value is in no way jeopardized. Steering a middle course between a satisfactory growth rate and greater stability of the economy promises to be a difficult task everywhere.

"The year 1972, a year in which our relations with other countries will still be delicate and the internal situation rather without lustre, will be of particular significance for the Community: it will be the last year of the Community of Six. On 1 January 1973, the enlargement of the Community will have become a reality.

"Who can deny that things will no longer be the same? Changes are inevitable. If the new members are to be absorbed into the enlarged Community without serious difficulty and the changes to come are not to affect its nature too radically, the arrangements for receiving the newcomers must be sound and the mechanisms of the Common Market must function smoothly. And 1972 must not be a year of stagnation and marking time, but a year of action and progress. Only thus can we assure that nothing done so far will be lost, only thus will those who in its refurbished institutions have to direct the affairs of the Community be able to strengthen it further and so fulfil the hope which in the last twenty years has inspired those who founded it and those who are fashioning it."