

# COMMISSION OF THE EUROPEAN COMMUNITIES

THE ECONOMIC SITUATION IN THE COMMUNITY  
AT THE BEGINNING OF 1974

ADDRESS

by Mr Ralf Dahrendorf  
to the  
European Parliament  
Strasbourg  
13 February 1974

In the past year the Members of the European Parliament watched economic developments in the Community very closely. Your Committee on Economic and Monetary Affairs, in particular, rendered a number of very important opinions on policy. My colleague, Vice-President Haferkamp, who asks you to accept his apologies for being absent, has always valued highly these contributions. As you know, Mr Haferkamp is in Washington at the moment, taking part in the energy conference.

It has become a well-established practice to give you, at the beginning of each year, an outline of the economic and financial situation in the Community. Reviewing last year's developments and discussing the outlook for 1974 is no easy matter this time. Never have the clouds lowered so menacingly over Europe as now. The oil crisis has changed the framework for economic development in the member countries and also in most countries outside the Community. It came too late to have much of an impact on the figures for 1973, but in 1974 its effects will have serious implications for production, employment, prices and the payments balances in the Community.

\*

\* \*

In his annual review a year ago, Mr Haferkamp gave you an outline of economic developments in the enlarged Community in 1973 and in particular predicted that economic growth would gather additional momentum. His prediction proved correct.

Real gross Community product rose by 5.7% which was even faster than had been forecast in January 1973. This was the highest rate of growth since 1969. All the Community countries shared in the expansion; real gross national product probably rose by some 7% in Ireland and Luxembourg, by about 6% in France, Belgium and the United Kingdom, by 5½% in Germany and Italy, and by 5% in Denmark.

Only in the Netherlands did growth remain unchanged at 4%.

In 1973 as a whole employment also rose further in the Community. Even so unemployment figures in most member countries are higher than in similar phases of earlier business cycles. Supply and demand on the labour market are not in balance. Indeed for certain categories of workers, the situation has deteriorated; this is particularly true of young people looking for their first jobs. Nor has the drive to combat regional unemployment produced satisfactory results so far. And it would also be a mistake to dismiss as unimportant the fact that towards the end of the year the labour market situation deteriorated in several member countries.

However, what is most disturbing, to my mind, is that 1973 was the sixth successive year of accelerating inflation in the Community. Consumer prices climbed by some 8.5%, the highest rate ever recorded. This overall figure for the Community masks diverging trends in the various countries: the increase ranged from 6% in Luxembourg to 11.5% in Ireland.

The upsurge in prices is part of a general, world-wide movement and is by no means confined to the Community. We have to go back to the time of the war in Korea to find a period when inflation was progressing on such a wide front as in 1973.

The main causes are:

- (i) The upswing of the business cycle coinciding in the main industrialized countries, the result of which was overstrain in the general international economy;
- (ii) The uncertain monetary situation and especially the devaluation of a number of currencies; this encouraged speculative capital movements;
- (iii) Persistent supply difficulties for agricultural and industrial products and fresh bottlenecks emerging during the year. This led to sharp rises in raw material prices.
- (iv) As factors within the Community, I would mention habituation to inflation and the tendency for inflationary behaviour to become ingrained; the efforts of the various economic and social groups to secure higher money incomes and, above all, the fall-off in productivity gains towards the end of the year.

The trend of the Community's external balance was much more unfavourable than previously, reflecting the deterioration in the terms of trade of most member countries. Most of the increase in the Community's official gold and foreign exchange reserves (some 11 000 million EUR, including Special Drawing Rights and the reserve position in the International Monetary Fund) was achieved in the first three months of the year, while towards the end of the year the tendency was downwards.

This was the situation when the oil crisis developed at the end of the year. Its first main effects are a further deterioration in the terms of trade, a fresh wave of cost and price increases in the Community and pressure on some Community currencies; this pressure was felt not only by currencies on an independent float but also by currencies in the Community's exchange rate scheme, the "snake". As you know, the dollar has picked up sharply since November. On 19 January, the French Government decided to suspend for six months obligatory intervention by the Banque de France on the foreign exchange markets, thereby withdrawing from the joint float of the European currencies.

The oil crisis has very serious implications both for our Community and for international economic relations. Unless oil prices fall below the level reached at the end of 1973, the oil-exporting countries will receive very large extra revenues of the order of \$60 000 million in 1974. This will be matched by an equivalent deterioration in the current accounts and a loss of real income in the oil-importing countries. Special problems arise here, particularly as to how the deficits are to be financed and, quite generally and world-wide, as to how the extra oil revenues are to be invested. The oil-importing developing countries are also faced with special difficulties; the additional burden placed on them in the form of higher oil prices is larger than the public development aid they have been receiving in the past few years.

In 1974 the higher cost of oil alone will produce a deterioration of \$ 17 500 million in the trade and services account with non-member countries. As the Community's dependence on oil imports from traditional supplier countries will probably continue for a long time to come, this additional burden may increase still further in the years ahead. The oil crisis therefore quite generally raises the problem of the Community's energy supplies. Oil prices are now higher than the break-even point for other energy sources. But the substitution process calls for immediate and sustained investment and research efforts.

It is very hazardous at the moment to forecast the economic trend for the Community in 1974. But there can be no doubt that we shall be faced with major economic and financial difficulties.

Already the tentative forecasts made last autumn suggested that the economic trend would be less buoyant in all member countries. The oil crisis seems to have accelerated this process while the general uncertainty has increased. Prudent and objective analysis puts the growth in real Community product at between 2 and 3%

.../...

this is assuming that the current labour disputes in the United Kingdom will not entail any unduly heavy losses of production. The improvement in the employment situation recorded in the past few years may be wiped out again by the direct and indirect effects of the oil crisis.

Other industrialized countries will probably experience an even sharper slowdown in the growth of economic activity. In Japan, for instance, economic growth is likely to be very weak, and the US economy will probably be almost stationary. World trade, which in 1973 grew by 13% in real terms, is also likely to be distinctly less buoyant.

At the same time throughout the Community the outlook for prices is alarming. In no single Community country will prices increase by significantly less than 10%, and in some countries the rate will probably be much higher still.

There is a great danger that different economic policies will be pursued in the various countries. Sensitivity to the problems of employment and inflation indeed varies with the member country, as does dependence on oil imports, and all the member countries' currencies do not react in the same way to changes in the terms of trade and to destabilizing movements of money and capital.

Moreover, in the new situation there is internationally the great risk of a return to protectionism and hence of a disruption of the present system of world trade.

Here, I must emphasize the very high social cost and dangers which such a step backwards would entail for our populations.

It would mean jeopardizing the rise in living standards which we have enjoyed in the past sixteen years as a result of the establishment of the Common Market and the liberalization of world trade. We would run the risk of creating a climate of considerable insecurity for companies' investment decisions as investments policies in the past few years have been largely determined by the availability of a large market.

But in the present situation less investment means more unemployment. Reducing economic policy formulation to the national dimension would considerably increase the danger of beggar-my-neighbour attitudes developing - be it that member countries would devalue their currencies in order to secure a competitive edge on international markets, be it that a strong deflationary policy would be pursued for the same reason. In either case the partner countries would probably sooner or later resort to defensive measures so that in the end the level of employment would fall in all the countries concerned.

Today no single country could really afford the outlay on investment and research needed to develop quickly new energy sources at costs making the operations a paying proposition; such an effort is feasible only when supported by a large market and a common energy policy.

Similarly, in the forthcoming international negotiations with the oil-producing countries, the developing countries and the other industrialized countries the Governments of the European countries can achieve satisfactory results for their populations only if they act jointly.

\*

\* \* \*

The Community must therefore concentrate all its efforts on overcoming the current crisis, for it represents the greatest challenge the Community has yet had to face.

The danger of a breakdown of economic relations in the Community prompted the Commission to present an emergency programme to the Council on 23 January. In this programme it was pointed out that while the dependence of each individual European country on external trade and other external transactions had increased, no matching common policy had been developed to make the whole less vulnerable to destabilizing influences from the outside. There is a great danger that Member States will resort to unilateral measures whose consequences in economic and political terms would be incalculable. This is why the Commission believes that the

./.



Council should issue a statement expressing the intention of the Member States to refrain from any currency devaluation designed to secure competitive advantages and from any measures that restrict trade. The Commission would also like the Member States to consult each other effectively and on a continuous basis on their exchange rate policies and the measures having a direct bearing thereon.

Consultations should be supplemented by the following steps:

- (i) The Community's credit mechanism, adjusted in accordance with the Commission's proposals concerning the increase in the quotas for short-term monetary support, must be brought into operation immediately;
- (ii) The Council should invite the appropriate Community bodies to work out without delay ways and means whereby funds available on the international capital markets can be mobilized in orderly fashion in a European action framework;
- (iii) The Council should invite the Monetary Committee and the Committee of Governors of Central Banks to prepare immediately an opinion on amendment of the rules governing the price at which gold may be transferred between monetary authorities within the Community and at international level.

Further steps have also been taken in the fields of trade and energy. Efforts are being made by the Community to overcome present difficulties through orderly channels, with an approach covering the entire international system. Applied to monetary policy this means that no country is to engage in competitive devaluation or to take other measures which are tantamount to unloading one's own problems on the neighbouring countries.

We should also look carefully into the proposal by the Managing Director of the International Monetary Fund for the creation of new facilities in the IMF to help mitigate the balance of payments disequilibria resulting from the rise in oil prices. This is not, of course, to say that we accept the sudden and disproportionately sharp increase in oil prices. Concerted action, taken worldwide, to avoid a disorderly scramble for



for international credits could also be very helpful in the present situation. The special balance-of-payments problems facing the developing countries should also receive great attention internationally. The task here is to see that the industrialized countries do not cut back their development aid, and to look for ways, through international cooperation, of moving towards a solution of the special balance-of-payments problems experienced by the oil-importing developing countries. All these arrangements would, of course, have to be supplemented by other actions which are part of wider international cooperation and are aimed at finding a lasting solution to the crisis.

The formulation of a common energy policy, the start of the Regional Fund and the transition to the second stage of economic and monetary union must now form the centerpiece of an overall economic policy, but institutional innovation has an important role to play; this policy must be aimed at restoring the conditions for balanced growth in the Community and for sustained full employment.

It is therefore very regrettable that the Member States should have failed so far to reach agreement on any of these key issues, especially the transition to the second stage of economic and monetary union.

You will remember that while agreement as to principle has been reached on the essential proposals for the second stage of economic and monetary union, adoption of the resolution on the implementation of the second stage of the remaining legal instruments has been shelved for the time being owing to disagreement over the Regional Fund. Such a postponement is difficult to understand in the present situation.

With regard to the pooling of reserves, the Council has invited the Monetary Committee, the Committee of Governors of Central Banks and the Board of Governors of the European Monetary Cooperation Fund to draw up a report by 31 March 1974 on technical problems still outstanding, and that is all. Here, too, circumstances call for a speeding up of the decision-making process within the Community.

\*

\*

\*

In view of the difficult situation confronting the Community I should like to repeat to you the Commission's solemn appeal of 31 January on the state of the Community.

Any return to independent national policies in the economic and monetary fields, as in any other field, involves the greatest risks for the Community and hence for the real incomes, jobs and living standards of its population.