

LOOKING AHEAD TO 1970: THE PROSPECTS FOR THE EUROPEAN ECONOMIC COMMUNITY

Claudio Segré

One economy or six economies?

When I first heard that I would have the honour of forecasting before this distinguished audience the future of the European Economic Community, I was not only very flattered but also very worried. Should I present a sort of "State of the Community Message"--which might not satisfy your legitimate curiosity for hard facts--or should I engage in crystal-ball gazing into the economic future of Belgium, France, Germany, Italy, Luxembourg and the Netherlands, which would, unfairly, involve for me six times as much work as for my fellow-speakers today?

As I actually sat down to prepare for this talk I found that I had been racking my brain needlessly: it is impossible to use just one of the two approaches in preference to the other. They have to be used simultaneously and I ask you to bear with me for a moment while I tell you why. First of all, the E.E.C. is today an economic entity whose own distinctive features and problems largely overshadow the problems and differences of the component parts. Secondly, even for six hardened bachelors (or spinsters) like the Community countries, the strange "ménage à six" which they have been practicing now for eight and a half years has become much more than a simple affair: all of them are now convinced that they are about to enter--with greater or lesser enthusiasm--married life. Thirdly and finally, as the wedding arrangements have now become definite and detailed, the need to adapt rapidly to the new situation has become foremost in the minds of the Six and is going to be a major if not the major element in determining their future economic policies and thus the shape of their development.

The wide publicity accorded to the institutional difficulties of the Community has tended to obscure the fact that, bumping along from crisis to

crisis and from marathon session to marathon session, the Six have nevertheless taken three months ago, on May 11, some decisive steps. The completion of the customs union for both industrial and agricultural goods has been finally set for the 1st July, 1968: the uncertainty which has plagued for so long both businessmen and farmers is now removed and a market of over 180 million consumers has become for them a reality close at hand rather than a nebulous prospect. The arrangements for common financing of the farm policy, which revolve around the sum--considerable by our standards--of 1.5 billion dollars p.a. have now been finalized and this by itself gives an indication of the scope and seriousness of the commitments entered into.

In the climate of greater confidence created by these agreements, ways have been devised for breaking the deadlock in the Kennedy-round negotiations, at least as far as the E.E.C. is concerned.

With these major hurdles out of the way, no one can doubt that the stage is set for further development of the Community as an economic reality, but it is still a dimly lit stage. Moreover, as you legitimately want to know something about the plot of the play in which you may yourselves have to act, I must now come to grips with economic forecasting in the proper sense of the word. I shall therefore sketch out the very broad lines of the evolution which, in my personal view, lies ahead of us; then, on the basis of the recently published "Medium-term Economic Policy Program" for the Community, I shall present a series of projections which indicate the limits within which the more relevant and interesting economic magnitudes might settle by 1970. Finally I shall try to analyze the policy issues upon which depends how things will actually turn out.

Looking ten years ahead from now, what kind of an economic environment may we expect to find in the E.E.C? Will the functioning of the newly formed European entity resemble closely that of the present-day American economy? These kinds of questions can only be answered in qualitative--not in quantitative terms by referring to present trends and taking into account the impact of the integration process.

To begin with fundamentals, I cannot foresee any basic shift in the balance of power in the economy: essentially a private enterprise regime, with its own laws and conditions of successful operation--but no doubt with a higher degree of concentration among enterprises within and across present national borders--will continue to prevail. At the same time the role of the State in steering the economy to given goals will, as it is already now, be more important than in the United States. Likewise, the composition and utilization of the Gross National Product will be substantially different from what it now is in the U.S.: public investment, particularly in social infrastructure which is still badly underdeveloped, will be relatively larger. Internal transfers will also become more important, because of the further development of social security, of pension schemes, of family allowances; private consumption will be proportionately lower, but this will be partly compensated by free or subsidized public services.

As the rate of economic expansion will tend to flag because of the slower increase in available manpower, private investment will need to continue at a sustained level in order to stimulate increased productivity. The threat to stability presented by these conflicting requirements will prompt the development of new policy instruments, among which a more rational approach to the problem of income distribution: such an "incomes policy" ought to be facilitated by a trend towards less fragmented, less politically-

mind, more economically sophisticated labour unions. I also expect that fiscal policy will be able to play a greater role, with a thorough overhaul of the present tax systems: turnover taxes will converge towards a general system of "value-added" tax, a greater harmony in the level and structure of taxation will exist throughout the Community and governments will be empowered to use their taxing and spending powers in a more flexible way.

De facto, if not formally, a monetary union will exist in the Community, with fixed exchange rates and freedom of movement for long- and short-term capital.

Such a characterization of the internal life of the emerging economic unit leads us to the problem of its relations with third countries. The role of the Community in world trade will go on growing, but the trends in industrial and agricultural imports are likely, at least for some time, to be rather different. Except for tropical products, imports of foodstuffs will gradually decline or stagnate, in spite of a steady decrease in the farm population. The level of protection will remain high, although it might decline if the rise of employment opportunities in other sectors made the social problems of the farmers less intractable.

In industry, however, the movement to freer trade will be accelerated by the success of the Kennedy-round and of further similar moves. All indicators point to the likelihood of an intensification of trade between Europe and the United States with increasing specialization. Industrial imports from the less developed countries and trade relations with the Eastern bloc will also become more significant, but here the limits will be set by European ability to effect smoothly the structural changes which might be necessary. In fact, this may depend to a certain extent upon whether

Britain will, by that time, be a member of the E.E.C., as I think she will.

If you have found this excursion into the future a mixture of wild phantasy and of wishful thinking I can only apologize and try now another tack, that is the projection for the medium-term of present trends and the exploration of the policy problems which such trends are likely to hold in store for us.

The medium-term outlook: some hard facts and their consequences

I have referred already to the "Medium-term Economic Policy Program" for 1966 to 1970 which has recently been published and which is now being debated, with a view to its adoption as a set of guidelines for the Member States and the Community itself. This is the first such step along the road towards European integration and a very important one indeed. A medium-term economic policy is needed in order that all decisions liable to affect economic growth should form an internally consistent and rational whole in relation to the general objectives of the Community, that is as high a growth rate as is compatible with full employment, price stability and balance of payments equilibrium. The idea is to dovetail for maximum efficacy the national and the Community policies, without however, setting quantitative targets, as one might expect in a full-fledged plan: this is why we call this an "economic policy program" which is quite a different matter. But I do not want to get bogged down in semantics and I would rather get on to the actual contents of the program and its relevance to our topic of today.

The quantitative element in the program is provided by medium-term projections, which should help shape decisions and achieve consistency in economic policies. Such projections are based upon a certain number of hard facts and also upon a body of assumptions as to the behaviour of independent economic agents, the development of external uncontrollable factors (like ex-

port demand) and the fundamental decisions of the authorities as to the allocation of resources. By showing the combined effects of all such factors the projections throw light on the difficulties which may be encountered by those responsible for economic policy and thus make them look for ways to steer clear of the rocks.

I would like now to comment on the essential results of these projections, starting from the relatively firm ground of population and employment trends and going on from there to more adventurous and exciting estimates.

In 1970 the Community will have a population of 188 million, somewhat less than the U.S. has today. The effects on the labour force of the comparatively slow growth of overall population (0.8% p.a.) will be compounded with the effects of the changing age structure, the lowering of retirement limits and the raising of the school-leaving age: as a result the available labour force will grow by a very modest rate of 0.4% p.a. and actual employment will grow only slightly more--with the absorption of presently unemployed manpower--by 0.5%. Adding a further dark touch to the picture will be the shortening of the work week and the lengthening of paid holidays, two factors which might, between them, actually eat up all the increase in available manpower. If we wanted to simplify, we could say that the number of hours worked in the Community will hardly increase at all between now and 1970, as we have already taken into account the possible migratory movements which might help relieve the most acute manpower shortages. In fact the situation will vary somewhat from country to country, Germany being the hardest hit and the Netherlands, with its still vigorous population expansion, less likely to feel the pinch. The overall trend in this field does not appear at all conducive to rapid economic growth in the Community, particularly when we compare this trend with the projected estimates for the

United States where, all other things being equal, the demographic evolution would provide by itself almost 2% growth p.a.

However, on the assumption that demand will remain at a high and sustained level, we have projected, in spite of these unfavourable demographic factors, a growth rate of the G.N.P. which, at 4.3% p.a., although lower than the realized rates for the two previous five-year periods--respectively 4.9% for 1960-65 and 5.4% for 1955-60--would still represent quite an appreciable performance. Only the German growth rate would show a substantial decrease, while Italy would show the fastest progress. It may be interesting to note that on the strength of these assumptions G.N.P. for the Community as a whole would reach by 1970 almost 300 billion dollars (at official exchange rates and constant prices), while the United States may by that time have forged well ahead of the 800 billion mark.

The relevant questions at this point are of course: can it be done and how? If the contribution of the increase in hours worked is taken as being practically nil, then all the burden is evidently put on an improvement in the productivity of the economy as a whole. Such an improvement must/can stem on the one hand from a better use of the available factors of production within each branch, on the other hand also from a reshuffling of the factors of production from the less productive to the more productive branches of the economy. I shall come back later to this absolutely crucial point, the adoption of policies apt to improve the effectiveness with which factors of production are used and also to stimulate a better allocation of factors among alternative uses: but I would like already to point out some of the structural changes which will work towards the achievement of the projected increase in productivity.

Of the three great sectors--industry, services, and agriculture--industry, which has the highest productivity per capita, is projected to de-

velop at the fastest rate; services would increase at somewhat lower rates throughout the Community and, finally, agriculture would show an average growth rate of only 2%. This last point must be stressed: the share of agriculture in G.N.P. would decline from 7.8% in 1965 to 6.7% in 1970, while agricultural employment would decrease at an average rate of 3% p.a. Thus, it would provide the other sectors with additional manpower to the tune of 1.7 million people over the five-year period, while raising at the same time by a very appreciable proportion product per person employed in agriculture.

This discussion of productivity gives us the occasion of checking the consistency of our projections on the supply side with the hypotheses and the projections which have been formulated for the demand side. There is no need to stress that, in order to raise productivity to the necessary extent, investment, particularly in the industrial sector, must rise more than proportionally to the increase in G.N.P. and this is in fact the working hypothesis which has been adopted. However, public investment is expected to rise even faster, in fact at almost double the rate of growth of G.N.P. Public consumption on the other hand would substantially follow the trend of G.N.P., although with notable differences from country to country: it is not on this side therefore that the extra resources needed for investment can be obtained.

Neither can they be found in the export sector: if one assumes that imports will continue to grow more than proportionally to G.N.P. and that balance of payments equilibrium--and indeed an increase in investment abroad--remain the Community's objectives, then it follows that exports will make an increased claim on resources, rather than make room for the additional demand coming from the investment side.



What remains then? The slackening of the rate of growth of investment in the housing sector is projected to provide some leeway. However, it is quite clear that the burden of adjustment to the new conditions of growth in the years leading up to 1970 must be borne essentially by private consumption. The tendency for this type of expenditure to increase its share of gross domestic product can no longer be maintained without endangering the basis of future growth. In fact the projections necessary to achieve consistency imply not only that this tendency be checked, but also that the share of consumption be rolled back, even if only slightly. This must not sound unduly harsh, if one considers that there would still remain room for a 3.3% average growth in consumption per head, that is a doubling of such consumption over a period of little more than twenty years. Moreover, as I have mentioned earlier, the important progress projected for public investment would also have altogether positive implications for the standard of living of the population, with the increase of "collective consumption" making up for the slower growth of private consumption.

When all this is said, I think that you will agree with me that the maintenance of equilibrium under such conditions of tightness of the labour supply and, at the same time, under the pressure of both additional competition within the Community and the greater competitiveness of third countries, such as the United States, presents a formidable challenge to the E.E.C. for the years to come. The threat to stability deriving from excess demand, allied--as is usually the case--with rising labour costs per unit of output is a first danger that must be mentioned. A risk of disequilibrium might also exist if household savings and corporate savings did not come up to expectations and investment were consequently checked (which would reduce the growth rate) or were financed in an inflationary way, with adverse consequences

on the price level. I shall revert to this problem shortly.

Finally, either of the two phenomena which I just mentioned would be very likely to have a direct incidence on external equilibrium: the comfortable reserve position of the Community makes it possible and indeed desirable that the expansion of imports and reduction of exports may play for a given time a stabilizing role by providing additional flexibility in the event of a strained supply situation. But clearly this cannot go on for very long and that the necessity of maintaining external balance would quickly reassert itself.

Supply: a three-pronged attack

By calling your attention to the risk of the economy suffering from overstrain in the coming years I wanted to stress the fact that skillful management will have to be applied if the growth prospects which I just indicated are to come true. Any economy where resources are fully utilized is in great danger of catching what some people call the "English disease", but the fact is that hardly can we afford a policy of stop-go at a time when we have to carry out a series of structural readaptations which would be tolerable in a period of sustained growth but difficult to push through in a climate of stagnation.

Supply can be discussed under three different headings: improving the quality of the available resources, increasing their mobility, stimulating a better allocation of such resources.

Under the first heading comes the problem of education and the problem of technological development in industry. I may be allowed perhaps to quote from a recent report just two sets of data which illustrate our staggering problems in the field of education: the proportion of the total population in the relevant university age-group graduating each year in the Community

is of barely 4% as compared with 19.6% for the U.S. and 8.2% for the Soviet Union. Even more disquieting is the comparison in the annual output of graduates in science and technology, again as a percentage of the relevant age-groups: the Community comes at the bottom, with 1.1%, as against 3.9% for the U.S. and 4% for the Soviet Union. Thus the output of scientists and engineers in the Community is scarcely equal to one third that of the United States and the Soviet Union, after account is taken of the differences in population and in age-structure. I do not want to bore you by quoting further figures on another worrying aspect of our educational problem, that is the social inequality in opportunities of attending institutions of higher learning. If we consider the tremendous effort which must be carried out in another field--that of vocational training to prepare workers for technologically more complex jobs--then we may well conclude that education is going to hold first rank as a growth industry in the Community for many years to come. Obviously, the tendency for school-leaving age to rise will intensify the labour shortage and we can therefore expect a vigorous immigration policy and measures to encourage more women to seek employment, in order to meet demand in the short run.

I would like to come now to a related field, that of the development and application of new technologies: we are all aware of the tremendous impact of the new science-based industries and of the gap which exists here between the United States and the Old Continent, in which I also include, of course, the United Kingdom. Until recently at least, the gap has not been so much in pure science, although the brain drain to the United States is beginning to be felt; the trouble is rather that pure science in Europe is not being translated into applied technology at a sufficiently rapid pace. Examples of early leadership being lost because of the lack of adequate

management attitudes are numerous. This is where the problem lies and where remedies must be applied: it is not enough that funds earmarked by the public authorities for research should be increased, even more necessary is the selection of fields in which research should be concentrated in order to be as effective as possible, the improvement of communication and cooperation between governments, universities and industry and, above all, the adoption by European management of a longer-range approach to investment in R & D and the utilization of its findings.

The growing awareness of the magnitude of the problem may hopefully stimulate the adoption of an overall strategy for technological development which, however, will bear its fruits only over the years. I think therefore that we shall tide ourselves over the shorter-run problems in two ways: first of all, the trend towards mergers and the formation of joint subsidiaries for the purpose of developing new branches of activity is helping European industry to reach the threshold above which a significant research effort can be undertaken. I think that Governments will then not be stingy, but will encourage such efforts by the appropriate incentives, which have until now been used much too sparingly.

The other avenue of progress is a constructive approach to the technological flow from the United States. Personally, I think that the response to the present gap consisting in the reservation of key sectors to the national industry in an attempt to catch up with the present level of technological development might actually lead to a widening of the gap. I think, again personally, that investment by American firms in the fields where technological progress is fastest will not only continue to be particularly welcome, but will be encouraged. On the other hand, American companies operating in Europe will be under pressure to extend their research

activities also to the Old Continent, with possible incentives from the European governments. The cooperation with local firms and the spread of technology and managerial skills through the training of personnel will, I think blunt much of the recent criticism of the operations of American firms and help avoid the present technological gap from degenerating over the years into a substantial sociological gap.

Let me now come to the second major field where I think our efforts will be concentrated in the coming years, that is the improvement of mobility of resources. The adaptation of the legal and institutional framework within which firms have to operate in the Community has lagged considerably behind the progress towards a full customs union: as a result, the advantages that can be reaped by bringing industrial structures more in line with the new size of the markets are still largely to be realized.

I have mentioned the merger movement which is already underway: I think this movement will gather momentum when an ambitious project at present being discussed finally sees the light. I am referring to the idea of making it possible to set up "European corporations" under a uniform law, which would coexist with present national legislations, but which would be particularly attractive to companies whose activities extend across present borders. Also, we shall have to remove the tax obstacles which at present discourage companies from carrying out the measures of reorganization and streamlining needed to embark in new activities, by merging forces or setting up joint ventures with national or foreign partners. I believe this need is now understood by Governments, and so is the need to improve corporate cash-flow, in order to redress financial structures which would often horrify the average American or British company treasurer. However, in tax matters there seems to be a gulf between understanding a need and carrying out

the necessary measures: political and/or budgetary considerations have their own nasty way of coming up at the last moment and retarding reform. Some fumbling steps in the right direction have already been taken, e.g. to correct the undue emphasis on debt financing, but there is still a long way to go. I would venture to predict, nevertheless, that by 1970 the conditions for mobilizing capital for productive investment will have improved and even that, by that time, the features of a truly European capital market may have taken shape.

Why do I feel confident that action will be taken in the right direction? This brings me to my third point, the forces which are at present working towards a more efficient allocation of resources. Competitive pressures were set up already many years ago by the process of trade liberalization, but they have been enormously increased by the emergence of the Common Market. These pressures have worked so ruthlessly that some companies or even entire sectors have been caught off balance and have either had to quit, or are working painfully their way uphill towards competitiveness. The great problem here is that of declining sectors: as you know, we are very sensitive to social considerations on the Old Continent and hiring and firing have somehow never been considered a matter of every day industrial life. This does not mean that existing structures or unprofitable sectors should be kept artificially alive. On the contrary, the idea is to facilitate the necessary adjustment processes and create favourable conditions for the replacement of declining activities by new ones. A consensus is emerging on the doctrine that state interventions should therefore only be temporary in nature, and that the support which may initially have been granted must be progressively dismantled according to a pre-set timetable.

Another significant advance in a closely related field is the trying

out of new methods in regional development policy: the most interesting experiment, that of setting up what we call "development poles", with an organic group of enterprises that can develop under their own momentum after an initial boost, may prove to be a turning point and I would not be at all surprised if, by 1970, a number of new areas were opened up to industrial development or to tourism by such concentration of efforts.

Last but not least among the influences which will shape our industrial structure in the years ahead I must refer once more to the modification in the tariff structure of the Community and of the other industrialized countries which will result from the present set of negotiations, as well as from the new directions in trade policy towards the less developed countries and the Eastern Bloc. I am afraid I will disappoint you by not giving as a conclusion of this part of my talk any indications as to precisely what developments we may expect in which sectors of industry. The fact is that, beyond a few platitudes, I would have to enter into a series of guesses: the problem is not only that we would have to feed a computer with an extremely large number of variables in order to get accurate results, but rather that there is no way of knowing what particular shape some of the key variables are likely to take. Surely one could work with a model and try out several hypotheses, but in the end the choice between the different hypotheses also remains a matter of personal intuition; as for me, I would rather stick to the analysis of trends which I can already discern clearly, without indulging in guesswork for which I feel certainly no better qualified than my audience.

Reconciling growth with stability: towards a more sophisticated economic policy

I have assumed all through my talk that there is an inherent tendency

in the Community at present for demand to overtax supply. This is, in my opinion, the heritage of a time when economic growth was more rapid and when one could get away with a certain amount of price inflation. Conditions have radically changed and while we will exert all our efforts to improve the conditions of supply in the years to come, we shall have to keep a very close watch lest demand should run away and lead to disequilibria which could not be tolerated for a long time in present conditions. The trouble is that we do not know how to run on an even keel an economy which has reached full employment of resources, and in fact I think that nobody knows. For the long run we have certainly set our sights upon an incomes policy, which simply means that organized labour, employers, and government should together develop a precise view of the average increase in wages and non-wage incomes appropriate to the economic situation and consistent with the aim of price stability. Any guidepost for non-inflationary wage behaviour (and for the behaviour of non-wage incomes) would be based upon the principle that the increase in wages should not outstrip the trend in overall productivity. It is, however, unrealistic to think that it will be possible to apply such guideposts in the Community in the next few years. So we are really left with the old instruments, fiscal policy and monetary policy.

As far as public expenditure is concerned, it is apparent that two main problems will have to be tackled in the near future: such expenditure must be contained within the limits of what is economically feasible and the necessary funds will have to be mustered without effectively shutting off the capital market to private borrowers. In fact, it is hard to escape the conclusion, that, although the burden of taxation is already quite considerable in most of the Community countries, the public investment programs



which are at present being considered cannot be realized unless taxation is raised. Moreover this must be done in a way that will affect industrial investment and savings as little as possible.

If we now turn to monetary policy, we shall readily recognize that in the recent past the difficulties besetting almost all the member countries have forced the authorities to lean too heavily on monetary policy as a means of maintaining internal equilibrium. This has entailed unduly heavy pressure on industrial investment; national capital markets have been weakened and international capital movements disturbed.

I should like to dwell a moment, before closing on this point which I think may be of interest to you. People speak often today of "shortage of capital": what is actually meant is--I think--that markets are unable to satisfy demand, except in steeply rising costs.

The facts are well known. In Germany the bond market has slipped badly in the course of the past two years, and the authorities have had to call a truce to new issues for awhile. In the Netherlands, too, investors were obviously holding off from the market for quite some time. In Belgium, the difficulties that had plagued the bond market for some time showed no signs of abating in 1965. In France and Italy, the situation was certainly more favorable than elsewhere, but it must be remembered that this was a period of relatively slack economic activity; even then, interest rates had to be raised appreciably in France.

Now it is true that there has been a reduction in the propensity of individuals to place money at long-term and that the profit squeeze has increased the companies' needs for external finance. It is also likely that the U.S. balance of payments measures have contributed to the tightening of the international capital market.

Yet savings have remained at a high level in the Community throughout this period and the causes of the unsettled market conditions must, therefore, be found elsewhere.

With regard to Germany, one need only note that increased investment expenditure by the State and local authorities, coupled with tax cuts, was bound to lead to a greater call on capital markets. In the Netherlands, the pattern was very much the same, and in Belgium too the fundamental problem was the precarious state of the public finances.

However, in Germany and the Netherlands particularly, one must also look closely to the effects of the monetary authorities' policies. In Germany it was, of course, the announcement of the 25% withholding tax that set off in the spring of 1964 the decline in the bond market, and the situation was made progressively worse by the introduction of restrictive monetary measures for anti-cyclical purposes. It would also appear that the monetary authorities deliberately favored a rise in the cost of long-term capital in order to curb the growth of public expenditure. In the Netherlands, the tightening of liquidity by the Central Bank also had direct repercussions on the market for long-term loans, on which the cost of capital reached unprecedented levels.

Are such hardships necessary and what can be done to remedy them? As an anti-cyclical instrument it is unlikely that this increase in cost actually caused companies to cut back or postpone their investment programmes, and in any case this would not have been desirable for the longer term.

Furthermore, the technique of trying to limit the public authorities' recourse to the market by increasing the cost of capital seems difficult to reconcile with any rational conception of economic policy.

Another detrimental effect was that the sudden drop in the prices of

fixed-interest securities came as a blow to savers, who are now hesitant about committing themselves.

Finally, at a time when the restoration of equilibrium in international payments required a decrease in the level of European interest rates relative to the United States, the existing differences were actually widened.

One may therefore ask whether the role that instruments of monetary policy can play should not now be reconsidered, particularly in countries where the link between action on liquidity and the trend in long-term interest rates is so direct. When monetary instruments are relied upon almost exclusively and fiscal policy, in the wide sense, does little to keep the balance--or is even an independent cause of imbalance--it becomes more and more obvious not only that the desired results are not achieved but also that the difficulties of one country tend to "infect" other markets too.

Closer international coordination could improve to a certain extent the situation, but what is really needed is an improvement in the economic "policy-mix" even if this means bringing into picture unpopular and politically embarrassing measures.

"The need for such action is becoming increasingly evident, as the impact of certain instruments weakens with the progressive integration of the economics": this sentence is a quotation from the 8th Annual Report of the Monetary Committee, which is the meeting point of high officials from both the Central Banks and the Treasuries of the member countries. That such an assembly would take it upon itself to issue such a warning augurs well, I think, for the future and encourages us to look ahead to the coming years without too much fear that the hopes raised by our achievements up to date should be dashed by our inability to keep excessive ambitions in check.