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INFORMATION MEMO

The economic situation in the Community in 1964

(Summary of a speech by M. Marjolin, Vice-President of the EEC Commission, at a luncheon debate of the "Cercle de l'opinion en 24 heures", Paris, May 29, 1964.)

Discussing the current business situation in Europe, M. Marjolin noted that after many years of expansion combined with stability, certain divergences were now appearing between the aims the EEC was pursuing. "It is not surprising," he said, "that after expansion over a period of five to six years inflationary pressures should emerge. We are coming to a point at which manpower resources are exhausted, at least in the short term. Nor is it surprising that wages should rise more rapidly than productivity when the demand for labour continues after reserves are exhausted.

It is not up to the trade unions to reject unsolicited wage increases. As for the employers, they must aim at the maximum return on the capital invested, otherwise they would not be doing their job.

But even if inflation is a natural phenomenon, this does not make the situation any the less serious, and it is the least favoured sections of the population that suffer most by it."

The most dangerous symptoms

M. Marjolin went on to indicate the most dangerous symptoms of inflation now discernible:

(a) In 1959 the Community's trade balance with the outside world showed a surplus of \$1 000 million. In 1963, after a steady decline, the surplus had become a deficit of \$3 000 million. The latest figures show that for the first quarter of 1964, the deficit was \$1 000 million;

(b) Whereas the six Community countries progressed along parallel lines from 1958 to 1962, wide discrepancies between two groups were now appearing. In 1963 production costs soared in France, Italy and the Netherlands, whereas conditions in Germany were remarkably stable. Belgium, where stability had

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prevailed until 1963, also showed symptoms of inflation towards the end of the year. The result was that intra-Community trade was suffering a profound disturbance.

M. Marjolin then gave figures to illustrate his point.

In the first quarter of 1962 Germany had a surplus of $159 million on trade with the other EEC countries. This surplus rose to $204 million during the first quarter of 1963 and $432 million for the first quarter of 1964. Italy's deficit with the other Common Market countries was $84 million for the first quarter of 1962, $134 million for the first quarter of 1963, and $204 million for the first quarter of 1964.

France, which earned a surplus of $29 million in the first quarter of 1962, showed a deficit of $19 million in the first quarter of 1963, and in the first quarter of 1964 the deficit was running at $62 million.

<u>The answer</u>

M. Marjolin said there were only three possibilities:

(a) Either the situation would continue and the hazard of internal disruption in EEC be accepted;

(b) Or else Germany herself would be caught up in the inflationary movement and her inflation would react on the other members of the Community to aggravate the total external deficit;

(c) Or a vigorous drive against inflation would bring about stability this year or by early 1965. This was the only acceptable way out.

The speaker noted with satisfaction the stabilization programmes now being put into effect in the six countries. They were in themselves a very great step forward. Their main feature was a bold attempt to curb the growth of public spending.

To assess the scope of these efforts in relation to the current situation, M. Marjolin made a distinction between acute inflation and chronic inflation. It was reasonable to say that the symptoms of acute inflation were price increases of 5%, nominal wage increases of 8% or more and an increase of 3% in wage costs per unit of output. Chronic inflation took the form of smaller wage and price increases; but unit costs might rise 2% or more, bringing the threat of reduced industrial investment.

What was being done in France and the Netherlands seemed to have obviated the danger of acute inflation persisting beyond the period they were considering. For Italy, all that could be said was that the action taken or shortly to be taken held out a hope that the country would escape the acute form of the disease. But in all the countries

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the danger of creeping inflation continued and was undermining the Community's position vis-à-vis the outside world. This type of inflation was not new: it had begun some years ago and since then production costs had been climbing steadily. If efforts to stem it were to fail, the inevitable outcome would be a recession, or at best prolonged stagnation.

M. Marjolin believed that anti-inflationary measures were in no way incompatible with the objective of maximum economic growth over several years. Expansion would not be halted as long as EEC goods were competitive with those of the outside world; in other words Community prices must not be allowed to rise faster than those of its competitors.

In this respect, it was noteworthy that while unit costs were rising steadily in the Community, they had remained remarkably stable in the United States and were rising more slowly in Great Britain.

M. Marjolin considered that if the Commission's recommendations were put into effect, they would put a stop not only to acute but also to chronic inflation.

Turning to the problem of incomes policy as an anti-inflationary weapon, he said it was an illusion to imagine that such a policy alone could achieve results: "If overall demand continues to grow, there is no dam - even one accepted by those concerned - that will hold. In 1963, in the Netherlands, the pressure of demand burst the dykes of incomes policy."

Whatever the importance of social problems, it would be against the interest of the lower-paid workers themselves to allow nominal incomes to increase by more than 4 to 5% a year.

"I have never said," continued M. Marjolin, "that wages must not rise faster than productivity. On the contrary, a slightly more rapid increase would induce firms to rationalize and modernize and would help to create working-class savings. However, to ask for more than 4 to 5% in the coming 12 to 18 months would not be reasonable, and it is in the interests of the unions themselves to co-operate in this policy."

As for the industrialists, M. Marjolin said that their profits should not increase faster than the earnings of less favoured groups. It was true that industry was faced with rapidly rising costs, dwindling profit margins and difficulties in obtaining capital. But this did not necessarily apply to sectors in which competition was restricted by agreements. He therefore appealed to the employers' self-discipline to see that real competition prevailed. "I am for company mergers," he added, "which will enable European firms to attain the dimensions of their American counterparts, but I am against cartels."

Replying to the criticism often levelled at the Community's anti-inflationary programme that it restrained public investment at a time when there were arrears to be made up in agricultural, industrial and social infrastructures, M. Marjolin said: "What we must do first is to allay the feverish condition. Then we can establish a programme to run several years in which plenty of room will be given to public investment". As for the criticism of the Commission's recommendation of higher charges for public services, M. Marjolin said: "Save in exceptional cases, the public services must balance their books without subsidies. This does not rule out special advantages for the economically weakest categories. Nor does it rule out subsidies for certain industries, whether national or not, for which it can be argued that a subsidy is the lesser of two evils, though here subsidies must take the form of aid voted by the Parliament."

In conclusion, he said that the Community's long-term objective could only be to attain the position of the United States, where real incomes were twice as high as in the Community. But it was only by arresting inflation that the EEC could avoid recession or stagnation. Failing this, the final objective would become more remote.

In this connection, M. Marjolin pointed out that the American situation did not seem ideal: the Americans had made too many sacrifices in the field of public and social investment for the sake of maximum individual incomes. The European Community would have to find a different balance between private consumption and public spending.
