

# COMMISSION OF THE EUROPEAN COMMUNITIES

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## THE ECONOMIC SITUATION IN THE COMMUNITY

The present document comprises a working paper for the Council of 18 November 1974, on the actions to be undertaken to meet the structural problems of the economies, resulting from the present economic situation in the Community.

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## THE ECONOMIC SITUATION IN THE COMMUNITY

### I. Initial position

1. The Community and world economic situation is full of dangers and uncertainties, as regards both the short-term factors and the medium-term outlook.

The position in the Community has deteriorated in the past year; the disparities between the Member States have become greater.

Inflation continues serious: consumer prices in 1974 show a yearly rate of increase of between 15 and 20% in Italy, Ireland, Britain and Denmark and between 10 and 15% in France, Belgium, Luxembourg and the Netherlands, with only Germany keeping to about 7%.

World economic activity is declining: the expected upturn in the United States has not yet developed, and is not likely to do so until mid-1975.

Economic activity in the Community is slowing down: it does still seem possible that things will pick up in 1975, but a fall in industrial production, with its implications for employment, can no longer be ruled out. At the end of the summer, the number of unemployed in the Community exceeded three million.

Many problems facing the Community can only be tackled on a medium-term basis. There are still major uncertainties with regard to the movement of oil prices, the capacity of the oil-producing countries to import goods and services from the industrialized countries, and the stability of the credit system. This means that it is difficult to seize the situation in the short term. Some basic tendencies are, however, already discernible. These tendencies, for the large part applicable throughout the Community, do however disguise certain divergencies between countries; these are partly due to previous developments.

2. In the medium term a number of changes need to be effected.

The rise in oil prices must be offset by additional exports of goods and services. In the longer term, these efforts will be facilitated by having recourse to European energy resources.

The apparatus of production must be restructured so as:

- . to develop new sources of energy;
- . to take account of the change in world demand, which will be directed more to capital goods;
- . to make possible the internal adjustments necessitated by scarcer and dearer raw materials.

The deterioration in the terms of trade is a drain on the economies of the Community, which is bound to lead to a diminution in the amounts of goods available to meet internal requirements.

The necessary restrictions cannot be imposed at a stroke without involving intolerable and, moreover, inequitably distributed, social tensions - the more so as the burden for the Community as a whole works out differently for the different Member States and on some of them even bears very heavily. In any case, the oil-producing countries are not in a position to expend their extra earnings speedily and completely on extra imports. The organisation of new mechanisms for economic co-operation which includes the industrialised countries, the oil-producing countries and the developing countries will necessarily take time.

The Community will consequently be saddled for several years with substantial current-account balance-of-payments deficits. These have to be covered by foreign indebtedness; indebtedness by reason of oil deficits alone is calculated as amounting within the next five years to over 60,000 million dollars.<sup>1</sup> This overall figure masks major differences, ranging from a substantial surplus in the case of Germany to sizeable financing requirements in the case of other countries.

With such indebtedness it will be possible to stagger the burdens of adjustment, but not to avoid the sacrifices altogether. Moreover, the indebtedness carries considerable additional costs owing to the interest payments required.

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(1) Not counting interest payments.

3. The Community will therefore have in the medium term to release the economic means needed:

- . to offset the deteriorating terms of trade;
- . to pay the interest on the foreign debt;
- . to effect the increasing investment necessary to indigenous energy production, conversions of industry and the maintenance of employment.

The overall cost for the Community in real terms could amount to over 4 per cent of Gross National Product. This figure takes into account adjustments in the terms of trade, debt charges and the additional increase in investment. It represents an average for the Community as a whole; for certain member countries it would be considerably higher. This adjustment evidently does not have to occur immediately, but should be spread out over a number of years.

As it is necessary to avoid damaging investment, indeed on the contrary it is necessary to stimulate it, the necessary sacrifices will have to be borne by public and private consumption.

There are many difficulties in constraining beyond a certain point government expenditures, (one only has to consider expenditures of a social character); in these circumstances, the sacrifice must largely be borne by private consumption, the growth of which must, therefore, be slower.

The share of consumption in the Gross National Product must, therefore, progressively decrease in real terms. This must involve adjustments in the medium-term evolution of income and savings.

In principle this could be done in three ways:

- . maintaining the proportion of wages and salaries coupled with a marked increase in saving by those in paid employment;
- . increasing taxation either of private consumption or of all incomes, with corresponding saving by the public authorities;
- . reducing the proportion of wages and salaries in gross national product, with a corresponding increase in self-financing by enterprises.

Actually these possibilities could be used in combination.

4. Growth could be maintained in the medium term, though, due to inevitable frictions in adjusting production methods, the rate recorded hitherto must nevertheless be expected to fall off. It is essential, however, that a lasting solution is found to the balance-of-payments problem. In any event the maintenance of adequate growth depends on structural changes in the Member States' economies, supported or indeed launched by active measures of structural policy.

It would be wrong if structural change was impeded in the interest of keeping low-productivity sectors or enterprises going. Such measures would be at the expense of the growth sectors, which are the ones that must be encouraged.

These changes must inevitably involve major movements of labour from one sector or one occupation to another. Consequently there will be much higher frictional or structural unemployment than before. It must be borne in mind that unemployment is already considerable.

Restructuring will necessitate substantial investment in the fields with a future. This investment must at the same time enable workers rendered redundant in the other sectors to be reabsorbed here. It must

- be in line with the new demand arising out of the change in relative energy prices.

Some of the major growth sectors of the past, will no longer be the engine of economic development they used to be;

- make possible the development of new forms of energy production.

This will be a slow process, requiring to be assisted by systematic measures for economizing on energy;

- meet the new outside demand.

For this purpose efforts must be devoted to securing conversions in industrial production so as to promote the development of the sectors producing the goods (notably capital goods) which are in demand: otherwise the Member States could find their exports being impeded by bottlenecks at the producer stage.

5. The problems which must be faced by the Community following the energy crisis are the more serious and their solution the more difficult owing to the previous existence of serious internal disequilibria.

The persistence of inflationary trends has brought a distortion in the distribution of income and wealth, thus provoking a climate of social friction. At the same time, investment has often been badly directed and marginal enterprises or sectors artificially maintained in existence.

The restructuring and improvements required will be heavier for the countries whose economies have been the most seriously affected.

## II. Outline of medium-term action

1. Despite their seriousness, the problems facing the Community and the Member States are soluble, but require closer solidarity between social groups within countries, between the Member States within the Community and also between the Community and the rest of the world.

2. Solidarity between the social partners is indispensable in order to ensure that the sacrifices which must inevitably be accepted will be fairly shared, whether it involves facing up to the consequences of the energy crisis or to effectively conduct the fight against inflation. A prerequisite for such solidarity is a general consciousness of the magnitude of the problems, but it will not occur unless the initial conditions are taken into account insofar as the structural distribution of income and wealth is too inequitable. The slowing-down in the expansion of consumption will be more easily accepted if there is simultaneously an attempt to improve the quality of life.

3. At the level of the Community, solidarity is required to protect the result of the efforts undertaken in Europe so far to create a single market and which has been the essential impetus for the improvement in the standard of living.

In present conditions, there is a risk that in the absence of common action X the fundamental disequilibria in the Community will bring about a re-establishment of protectionism or recourse to savage deflation.

Beyond this aspect, the development of the Community must be considered a major worry. The Member States find themselves confronting problems of substantially the same character, the solution of which, often difficult at the national level, is to be found in its appropriate context at the Community level; i.e. the effect of economic adjustments on the labour force, financing balance of payment deficits, energy policy, the control of waste, particularly economising energy, competition policy, etc.

4. International cooperation should be actively promoted at the moment in which difficulties can provoke protectionist behaviour. The Community must play an essential role in this field and ensure that its interests are accepted.
5. The fight against inflation must remain one of the major objectives of economic policy.

The margin of manoeuvre between inflation and recession is very narrow, it poses difficult problems of strength and timing for the measures which must be taken in the various member countries.

The countries with the highest rates of inflation are at the same time those which suffer from the biggest balance of payment deficits. Restrictive policies continue to be necessary, they meet simultaneously the two objectives of internal and external stability.

The member countries which continue to experience current surpluses must undertake policies which assist deficit Member Countries to reestablish the balance of their economy in real terms. Such policies, however, could be in conflict with the objective of internal stability in surplus countries. These must therefore adapt stimulatory measures in such a way as to avoid creating new inflationary impulses.

In the present world situation there is a serious risk of a slow-down in economic activity and, in consequence, a significant increase in unemployment. It is necessary to avoid an indiscriminate stimulation to total demand which would only result in adding fuel to inflation and eventually recreating under more serious conditions the problems of unemployment and growth. Rather, the response should not only vary according to the situation in each Member State, but also in the individual sectors and regions of these.

This situation implies a common definition of national measures, the extent to which they are imposed and their timing.

6. When deciding what policies to implement, account must be taken of the necessary structural adjustments required anyway to meet the crisis caused by the increase in oil prices and to eliminate the deep causes of inflation.

To a certain extent, the adjustments may take place under the spontaneous influences of market forces. However, these adjustments should be encouraged and facilitated by accompanying policy.

In fact, there is a risk that the necessary medium-term developments will not be taken into account completely by the Market. Thus, the economic agents should be given an overall view of the restructuring requirements. Further, public expenditure should be restricted and the tax structure adapted to respond to the new requirements.

Moreover, the accompanying policy is necessary in order to facilitate social adjustments and to avoid marginal enterprises and declining sectors being maintained in activity to the detriment of economic efficiency.

7. The measures to be taken must be seen in the framework of a long-term view. To this end, the Community will determine the necessary measures on the basis of a medium-term economic policy programme. This programme should be prepared very quickly during the first half of 1975.

8. The following measures could already be envisaged, some being applied to the Community as a whole, the others concerning one or other Member State more particularly:

a) Social actions

- The participation of the social partners in the process of restructuring economies, particularly with regard to the choice of measures to obtain a slowing-down of the expansion in private consumption and to facilitate the movement of labour. This action should not be limited to the national level, but should be continued at the Community level, particularly in the Economic and Social Committee and in direct contacts with the various economic and social groups.
- The rapid examination by the Council of proposals to be submitted by the Commission on essential measures for the participation of workers in management.

- Improvement of the mobility of labour by retraining and vocational training and also by more general actions designed to overcome the difficulties encountered by workers who change jobs: housing, schools etc. In this field the Community could play a role by enlarging the activity of the Social Fund and by an extension of the social actions existing already within the E.C.S.C.
- Improving the social security system in certain States in order to facilitate adjustments and alterations which are rendered inevitable by the economic situation.
- A much faster reform of fiscal and parafiscal systems in certain Member States so that they meet the economic and social requirements - this is an important contribution for the equitable distribution of the sacrifices demanded by the economic situation.

b) Public finances

- An improvement in public finance is necessary to ensure that, particularly in certain countries, expenditures are covered sufficiently and structurally by receipts and also for a more efficient orientation of expenditure. In this context, priority should be given to investments over consumption, taking care, however, that this has economic and social benefits.
- Public authorities should prepare investment lending programmes to be launched in case of need. Coordination at the Community level should take place in the preparation of these programmes, and in assessing their impact on the economy.

c) Structural and Energy Policies

- A systematic slowing-down in energy consumption which should be integrated into a Community programme.
- A battle against all kinds of wastage.
- Stimulation of research and investment in the energy sector and in those sectors responding best to the new requirements of world demand.
- A restructuring and an improvement within the Community of rules and measures on competition and consumer protection.

d) Internal and External financial problems

- The Community instruments on financial solidarity should be used and, if necessary, reinforced during 1975.
- At the international level, the Member States will act together to support the reinforcement of the measures of International Institutions, the IIF and the World Bank. This action should be designed, among other things, to ensure a sufficient aid to the poorest developing countries.

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For the implementation of these actions, the Commission, after consulting the competent Committees, and particularly the Economic Policy Committee, will make the necessary proposals to the Council.