european community
BACKGROUND INFORMATION

EUROPEAN COMMUNITY INFORMATION SERVICE
2100 M Street NW, Washington DC 20037 Telephone (202) 872-8350
New York Office: 277 Park Avenue, New York NY 10017 Telephone (212) 371-3804

BACKGROUND NOTE

No. 28 /1973

December 11, 1973

EC BATTLES INFLATION

Inflation still jeopardizes the European Community's progress toward full economic and monetary union, according to the EC Commission's third annual report on the Community's economic situation. Therefore, the report said, the battle against inflation must be given the highest priority among the Community's economic objectives. The report, the first to encompass the enlarged Community, was adopted by the Council of Ministers on November 9 and will be sent to Member States' legislatures for consideration during budgetary debates.

As inflation becomes more engrained in the Community, the erosion of purchasing power jams the Community's economic and monetary steering machinery. The resulting social, economic, and political consequences include: mis-allocation of resources; distortions in regions, industries and occupational groups; reduced effectiveness of public services (health, education, transport, and environmental protection, etc.); distortions of income and capital distribution, social unrest, and demands for higher incomes.

If inflation were allowed to go unchecked, the Commission said, it could result in new differences between Member States in cost and price trends and bring about divergent policies which could undercut the progress made so far toward economic integration.

Calling on Member States to pursue economic policies geared to curb inflation, the Commission stressed the need for coordinated action on both Community and national levels.

Concurring with the Commission's report, the Council of Ministers on Finance and Economics met, December 3-4 in Brussels, and adopted a set of guidelines for Member States to follow in taking anti-inflationary measures.

<u>SDR's Double in Three Years</u>

Inflation is worldwide, the Commission noted in reviewing the general economic situation. Rapid growth in the booming industrialized nations has gone hand in hand with strong inflationary trends, aggravated by monetary disorders, commodity speculation, and supply problems which have skyrocketed raw material and food prices.

In recent years, there has been a sharp increase in the money supply in industrialized countries. Gross monetary reserves of the central banks, as estimated by the International Monetary Fund, have risen from 77.8 billion Special Drawing Rights (SDR) during early 1970 to 150 billion SDR in mid-1973. Moreover, the report said, the large quantities of international liquidities, held by banks and multinational corporations, pose a severe threat to monetary stability.

World trade has expanded rapidly since the beginning of 1973. The Commission estimates that it will increase in volume by about 13 per cent over the whole year.

Raw material prices, since 1972, have been driven upward by the expansion of world demand, speculative restocking, teaming up by exporters and producers, deliberate production cutbacks to freeze price levels, supply difficulties and shortages, and finally, the devaluation of the dollar and the pound. Export prices of manufactured products were also shot up by generalized inflation, especially in countries whose currencies have depreciated.

The economic situation in the Community for the first half of 1973, the report found, was one of rapid growth, a high degree of plant capacity utilization, and long delays in deliveries. The Common Market's internal demand continued to strengthen as a sharp increase in disposable incomes -- and, in some countries a weakened propensity to save-- stimulated private consumption.

Growth of intra-Community trade, boosted by the first 20 per cent tariff reduction between the Community and its three new members (Britain, Denmark, and Ireland) continued to accelerate. Exports to third countries also went up, as the leveling off of exports to the United States was offset by sales to other European and developing countries.

<u>Anti-Inflation Measures</u>

The Commission did, however, find a slight deterioration in the Community's trade balance. Strong internal demand has stimulated imports, but supply shortages have reduced exports. Of the "Nine," only the Netherlands and Germany increased their exports. While noting an increase in employment and the labor shortage, especially for skilled workers, the Commission pointed out that unemployment is still higher than in earlier periods of economic boom. Furthermore, Italy and Ireland still face heavy structural unemployment.

Although Germany, Denmark, Belgium, and Luxembourg have restrained public investment, overall EC public expenditures have continued to grow, primarily due to high salaries. The Commission saw no repercussions from higher interest rates or new credit restrictions.

Furthermore, despite EC anti-inflationary measures, overall price increases gained momentum in the first half of this year. The rate of increase jumped from a range of between 5.5 per cent (Italy) to 8 per cent (Ireland) in 1972 to a range of between 6 per cent (Luxembourg) to 11 per cent (Italy) in 1973 (see annex). The report said producer and wholesale prices of industrial products were rising faster than consumer prices.

Although Member State and EC-level inflation curbs have not achieved desired results, the Commission reported some progress in measures carried out under the Community's short-term economic policy. Despite attempts to neutralize the impact of a heavy inflow of foreign capital, the rapid growth of money supply gathered additional speed in the beginning of 1973. Bank lending restrictions and a deceleration of public authority cash transactions did manage to curb this trend in the middle of the year. Short-term measures have also succeeded in raising the cost of credit, discount rates, and interest on savings accounts. Additionally, the influx of short-term capital has been checked, and the internal capital flow has slowed down.

In the field of public finance, the growth of central government expenditure has exceeded the Community's guide limit, adopted by the Council on December 5, 1972. However, in all Common Market countries, except for Italy and Belgium, the net borrowing requirement will be much lower than was initially forecast. The Commission also found that prices were being more closely supervised, especially in Britain, Ireland, and Italy where restraints on the overall expansion of demand are still limited.

The Community's common agricultural policy (CAP) has been a positive force in the fight against inflation, the Commission said. Until mid-September, 1973, duties on beef and veal were cut by 50 per cent, and suspended on calves; import restrictions on potatoes were lifted from December 1972 to February, 1973; butter stocks were cleared at reduced prices; and since May, butter prices have been cut in several Member States.

The Council resolution also pointed out that export restrictions imposed under the CAP on products such as cereals, rice and sugar, whose prices have skyrocketed on the world market, have shielded the consumer against a depletion and higher pricing of these products.

1974 Outlook

With regard to competition, the report said EC price curbing measures would only be felt in the long term. Additionally, Commission proposals for pre-merger controls and for improving intra-Community trade of certain products are currently being considered by the Council.

The Commission expects a continued vigorous economic expansion in the Community and the rest of the industrialized world during 1974. However, anticipating a drop in world trade, due primarily to a slowdown in growth in the United States, Canada, and most European countries, the report predicted a reduction in the Community's third country exports. While the import demand of industrialized countries will slacken, developing countries, which have registered increased foreign exchange reserves, are likely to continue importing at a high level, the report said.

The Commission saw no signs that intra-Community trade growth will level off, especially since tariffs between the original EC-Six and the Three will be cut an additional 20 per cent on January 1, 1974.

The Community's expansion of internal demand should settle down to a calmer pace in 1974. But, the Commission said internal supply will not be sufficient to substantially relieve inflationary pressures. Real gross Community product, according to the report, is likely to grow by 4 1/2 per cent compared to 6 per cent in 1973. Economic activity is expected to accelerate in Italy, stabilize at a high level in France and Ireland, and slacken in the other countries, especially in Germany and Britain. Furthermore, consumer and corporate investment spending will lose little of its buoyancy. The Commission was optimistic about the job situation outlook for 1974, expecting continued expansion and a further decline in average unemployment rates.

EC Action Program

The Council of Ministers' December 4 resolution called on the Community and Member States to take simultaneous and emergency action to combat inflation and maintain a high level of employment in the early months of 1974.

In the field of budgetary expenditure, the Council said Member States should:

- strictly curb the growth in current spending by postponing purchases of goods and services and increases in the number of civil and other public servants
- review business and trade subsidies
- align the rate of public investment expenditure commitments with available capacities, especially in the building and construction industry
- endeavor to finance central government budget deficits with increased medium and long-term borrowing
- speed up tax collection if possible, and refrain from using taxing methods which accentuate the growth of total demand.
- ensure that the management of finances of local authorities and public undertakings, and of social security agencies, contributes to the fight against inflation.

The Council directed Member States to maintain a monetary policy which will help curb price increases, and to work out a concerted policy on interest rates.

To these ends, Member States should undertake one or more of the following types of action:

- quantitatively control monetary aggregates, particularly the volume of credit
- aid productive investment, particularly in the energy sector, and restrain credit stimulating consumption by seeking greater selectivity in the granting of bank credit
- end compensation for the acquisition of internal liquidity from sales of foreign currency by the monetary authorities
- encourage saving by adjusting of the creditor interest rate hierarchy.

To control prices effectively, the Council listed several types of action required, giving Member States the option to choose from among them. They include:

- strict surveillance of the conditions for fixing prices of goods and services, and possibly freezing profit margins
- strict and strengthened application of rules for the posting and disclosure of prices for goods and services
- freezing rates and dues charged in the public services during the first quarter of 1974, at the level reached on December 1, 1973
- strict application of national provisions for controlling price abuses resulting from a controlling position on the market
- initiation of an information campaign with the help of consumer groups concerning the prices for products sold on a large scale to the consumer.

Member States and the Commission were also asked to organize, as soon as possible, regular exchanges of specific and comparative information on price movements in the Member States.

To increase supplies of products which are lacking in the Community, the Council called on Member States to review the quantitative restrictions currently being applied to imports of certain products with a view to relaxing them. Member States should also facilitate the widest possible use of quotas during the first half of 1974, the Council said.

The Council will assess the results of its Action Program not later than its March meeting, when the economic situation in the Community will be reviewed.

Gross National Product

(% annual rate of growth in real terms)

Country	1965 - 1970	1971	1972	1973[1]
Denmark	4.5	3.7	4.7	5.5
Germany	4.7	2.8	2.9	6.2
France	5.8	5.0	5.4	6.2
Ireland	4.5	3.1	3.0	5.5
Italy	5.9	1.6	3.2	5.2
Netherlands	5.6	4.3	4.2	4.8
Belgium	4.8	3.7	4.9	5.8
Luxembourg	3.6	0.7	3.5	6.8
United Kingdom	2.4	1.6	2.5	6.8
Enlarged Community	4.7	3.0	3.6	6.0

[1] Estimates by the Commission's departments.

Exports

(% change from one year to another in terms of value and in national currencies)

		1971		1972		1973
		1st half	2nd half	1st half	2nd half	1st half
Denmark	World	9.1	7.7	15.2	10.3	14.5
	EEC	6.5	7.8	10.9	16.5	(32.9)
Germany	World	11.7	5.7	7.4	11.7	18.9
	EEC	12.5	6.1	8.3	12.6	19.2
France	World	15.6	18.9	18.7	15.0	(19.0)
	EEC	13.9	19.4	21.1	13.1	(16.6)
Ireland	World	22.6	21.7	13.3	30.5	36.7
	EEC	– 7.3	1.6	10.8	11.7	(18.9)
Italy	World	11.8	14.9	18.0	13.4	6.3
	EEC[1]	17.7	17.5	21.3	14.1	(2.0)[3]
Netherlands[2]	World	16.3	13.1	11.0	15.6	(17.9)
	EEC	17.1	16.9	13.5	10.2	(20.2)
BLEU	World	4.3	4.1	13.0	14.0	(20.4)
	EEC	1.4	6.9	15.5	14.2	(33.1)
United Kingdom	World	10.3	17.5	9.0	3.5	22.8
	EEC	10.2	15.2	10.9	10.2	30.5

[1] Excluding Ireland and Denmark.
[2] Excluding BLEU(Belgium and Luxembourg Economic Union).
[3] January-May.
( ) Estimates.

Gross National Product

(% annual rate of growth in real terms)

Country	1965 - 1970	1971	1972	1973[1]
Denmark	4.5	3.7	4.7	5.5
Germany	4.7	2.8	2.9	6.2
France	5.8	5.0	5.4	6.2
Ireland	4.5	3.1	3.0	5.5
Italy	5.9	1.6	3.2	5.2
Netherlands	5.6	4.3	4.2	4.8
Belgium	4.8	3.7	4.9	5.8
Luxembourg	3.6	0.7	3.5	6.8
United Kingdom	2.4	1.6	2.5	6.8
Enlarged Community	4.7	3.0	3.6	6.0

[1] Estimates by the Commission's departments.

Exports

(% change from one year to another in terms of value and in national currencies)

		1971		1972		1973
		1st half	2nd half	1st half	2nd half	1st half
Denmark	World	9.1	7.7	15.2	10.3	14.5
	EEC	6.5	7.8	10.9	16.5	(32.9)
Germany	World	11.7	5.7	7.4	11.7	18.9
	EEC	12.5	6.1	8.3	12.6	19.2
France	World	15.6	18.9	18.7	15.0	(19.0)
	EEC	13.9	19.4	21.1	13.1	(16.6)
Ireland	World	22.6	21.7	13.3	30.5	36.7
	EEC	– 7.3	1.6	10.8	11.7	(18.9)
Italy	World	11.8	14.9	18.0	13.4	6.3
	EEC [1]	17.7	17.5	21.3	14.1	(2.0)[3]
Netherlands[2]	World	16.3	13.1	11.0	15.6	(17.9)
	EEC	17.1	16.9	13.5	10.2	(20.2)
BLEU	World	4.3	4.1	13.0	14.0	(20.4)
	EEC	1.4	6.9	15.5	14.2	(33.1)
United Kingdom	World	10.3	17.5	9.0	3.5	22.8
	EEC	10.2	15.2	10.9	10.2	30.5

[1] Excluding Ireland and Denmark.
[2] Excluding BLEU (Belgium and Luxembourg Economic Union).
[3] January-May.
( ) Estimates.