

# INFORMATION

ECONOMIC AND FINANCIAL AFFAIRS

THE COMMISSION EXAMINES THE IMPLICATIONS OF THE ENERGY CRISIS

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The Commission of the European Communities published at the end of January a report which analyzes the impact of the energy crisis on production, employment, prices, the balances of payments and the monetary reserves, thus fulfilling one of the instructions of the Copenhagen summit. It describes therein the effects which could arise from the possible situations of the affected countries and warns against the dangers of unconsidered reactions.

The Council of Ministers accepted the report on 18th February. All delegations declared themselves in agreement with the analysis.

## World implications

On 16th October, the O.P.E.C. member countries decided to scale down their supplies of crude oil and to impose an embargo on the USA and the Netherlands. In the course of 1973 the prices for crude oil were increased by about 180 %. These increases hit most the European countries and Japan, as well as the oil-importing developing countries. However, while the initial fears of a potential shortage diminished, the financial aspects came more to the fore.

These measures taken by the Arab countries involve a substantial change in the terms of trade. The supplier countries will dispose of heavy additional revenues in 1974 of about \$ 60,000 milliard, which involve a corresponding indebtedness vis-à-vis the oil importing countries. Such radical changes in trade and capital movements must be met with united measures of adjustment.

The oil importing developing countries are particularly hard hit, in that they are unable to finance the additional expenditure the increased prices bring from their own resources. The development aid granted to them up to now by the industrialised countries could hardly match the deficit in their balances of payments. This also poses problems for the industrialised countries in finding new ways of affording them aid.

The internal implications in the various countries are no less serious. The increased cost of oil imports will heat up inflation still further, while economic activity and the employment position will be threatened by the worsening of the external trade balance. In that the various countries have different starting points and different priorities in their economic policy (full employment, improvement of the balance of payments), the danger exists of their defensive measures contradicting one another. Protectionist measures could endanger world trade. With the aim of diminishing balance of payments deficits by individual action, the countries could well also be tempted to try to win advantages for themselves by independent monetary measures.

#### Implications for the Community

##### The impact on prices

The increase in prices of crude oil will entail significant price increases in some sectors of the economy. The Commission expects, on the basis of the direct and indirect impact, an additional increase in the general price level of about 3 %. The increase in consumer prices will certainly be somewhat smaller.

##### Impact on production and demand

The impact of the crisis on production will be mitigated by an economy drive and by trying to diversify into other sources of energy. Such measures will depend chiefly on the extent to which oil prices have risen. However, there are limits to any quick substitution for oil, in that in the short term no other sources of energy can be made available for large scale consumption.

On the basis of these suppositions and considering postponements in the area of investments, the Commission expects a slow-down in the growth of production of about 1,5 %. Thus real economic growth in the Community would only reach 2 to 3 % in 1974. The industries most severely affected by the slow-down will be the chemicals and plastic industries, building and construction, textiles, cement, glass, ceramics, tourism, trade and certain other services, rubber and motor vehicle construction.

### Impact on employment

There could be cutbacks in industrial production and a drop in the units of employment of 0,7 %. The Commission does not expect, however, a corresponding increase in unemployment, because in certain sectors the length of the working week can be reduced and the retirement age brought forward. The impact on employment will not be uniform in all sectors of activity. 80 % of the decline in demand for paid work will be concentrated on the building and construction sector, motor vehicle construction and construction of other means of transport, machines, textiles and the chemicals industry and parts of the services sector.

The Commission also counts on a decline in investment activity but points out that too restrictive an economic policy would only further aggravate the employment situation, particularly in industries such as building and construction and mechanical engineering.

### Impact on the payments balances and the monetary reserves

Dearer imported crude oil entails a considerable worsening in the terms of trade. The additional costs will alone amount to an increased burden of \$ 22,000 million to the common balance of payments but this sum will be reduced by the increase in export prices and an improved relationship between the volume of exports and that of imports. The overall effect could be a deterioration of about \$ 17,500 million. This figure corresponds to more than 1,5 % of the gross Community product and to about 17 % of its exports to the rest of the world.

The increased expenditure must be paid for. The Community countries might be forced to borrow heavily on the international capital market. In this context the European countries should seek to harmonize loan emission criteria and to minimize disequilibria in capital movements between the countries. The European countries should also make their capital market attractive for foreign capital.

### Medium-term effects

The present price of crude oil makes it profitable to exploit other sources of energy. However, for this purpose, considerable investments and research work are necessary. In the short term, then, we cannot yet reckon on a new supply of energy from other sources, so that for some time yet the Community will depend upon its traditional suppliers.

The Commission sees, too, a medium-term danger in measures which the governments could take to even out their balance of payments deficits. To change the terms of trade and to restrain economic growth could in the end bring about a return to protectionism and disorder in international trade. Further dangers are to be found in the capital collected by the Arab exporting countries which by its position in the international capital markets could upset trade and monetary relationships.

If a significant reduction in the price of oil were not possible, the effects in the medium-term would depend essentially

- on the effects of the substitution of replacement sources of energy for oil;
- on the possibility of developing the import market of the oil-exporting countries;
- on the transfers and loans which the oil-exporting countries will provide for the less developed countries to enable them to maintain and increase the volume of their imports;
- on the ways of funding the debts which the oil-importing countries will have to incur.

### Conclusions

The adoption by the Community of an overall strategy should enable it to cope with the problems and hazards which it now faces and which, given their scale, cannot be overcome at the national level.

With this in mind, the Commission has already proposed "conservatory" measures, relating to international monetary and trade policy as well as to energy policy. It has also submitted initial proposals designed to ensure closer co-operation with the oil-exporting countries, the energy-importing developing countries and the other industrialised countries.