european community
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BACKGROUND NOTE

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DIFFICULT CHALLENGES AHEAD FOR EUROPEAN COMMUNITY

Washington D.C. -- The most serious problem confronting the European Community in adjusting to the economic and financial consequences of the energy crisis is the total lack of balance between member states economies. Such was the conclusion of the EC Economic Policy Committee's report to the Commission and Council of Ministers on the EC economic situation and medium-term outlook. The report looks at the present state of Europe's economies and tries to evaluate the impact skyrocketing oil and raw material prices will have on the Community over the next five years.

The Community Today

The current EC economic situation is characterized by runaway inflation, a slowdown in economic activity, high unemployment, and heavy foreign trade deficits in all member states except Germany and the Benelux countries. The Community's average rate of inflation during 1974 was 13.2 per cent, ranging from 7 per cent in Germany to between 15 per cent and 20 per cent in Britain, Ireland, Italy, Denmark, France, and Belgium. In December 1974, more than four million workers were unemployed.

The Community's national external deficits and surpluses were already out of kilter when the energy crisis hit, the Committee said. A comparison of external balances in 1973 and 1974 shows that countries with external deficits in 1973, before oil costs skyrocketed more than doubled or even tripled their deficits last year (Italy, Britain, Ireland, and Denmark). Countries in surplus during 1973, either grew stronger,(as did Germany) or returned to a healthy balance.

The economic policies of the member states differ according to the socio-economic structural conditions of each country. The EC countries are faced with different unemployment rates, investment flows, trade patterns, regional problems, etc. Therefore the energy crisis will not have a uniform effect throughout the Community. Its effect on national terms of trade in relation to GNP, for example, will vary according to primary energy sources and industrial output energy needs. Britain and the Netherlands will probably suffer the least, in this respect, due to the recent North Sea oil discoveries. The lack of coordination of these policies on a Community level, the report said, have only aggravated the overall situation further.

Never before has there been such a pressing need for a medium-term economic program to revive the Community's economy, the Committee said. In the coming years, the Community will have to tackle such problems as a faltering rise in the standard of living; the need to speed production of goods for export to oil-producing countries; switching to new sources of energy, and increasing job transfers between industries while coping with higher structural unemployment.

Effects of the Energy Crisis and Outlook for 1978

Since November 1973, crude oil prices have been raised 175 per cent by the Organization of Petroleum Exporting Countries (OPEC). Whether they keep spiraling, freeze, or start to settle down, the Committee anticipates that the price of exported industrial products will go up by an average of 8 per cent annually. Additionally, the price of primary energy sources, such as coal and natural gas, will probably align themselves with petroleum.

The sharp effects these price increases will have on the terms of trade between various world economic areas is already evident. In 1974, the oil exporting countries will receive extra revenues of between $70 billion and $80 billion, with $10-to-15 billion coming from the developing countries. About $60-to-65 billion would come from the industrialized countries -- 2 to 3 per cent of their GNP.

The balance of payments surplus of the OPEC countries rose from $6 billion in 1973 to $58 billion in 1974. Adding the effects of price increases during the second half of 1974, the OPEC surplus will be about $10-to-15 billion higher. Consumer country deficits would go up by the same amount.

In 1978, oil sales should bring extra revenues of between $80 billion and $120 billion to the oil exporting countries, making a five year total of between $380 billion and $600 billion. To what extent these added funds will raise OPEC import demands depends on the level of development of the various OPEC countries. Underpopulated countries such as Kuwait, Libya, the Persian Gulf Emirates, and Saudi Arabia are not expected to be fully able to absorb their new capital. Countries like Algeria, Iraq, Iran, and Venezuela, on the other hand, already have some technical infrastructure and have begun plans for industrializing certain sectors. This should lead to a shift in import needs from consumer to industrial products. These countries are expected to concentrate on developing industries which are: manufacturing plant, machinery, and transport equipment; using locally produced raw materials and basic products, and supplying the farm sector with fertilizers, pesticides, machinery, etc.

Total non-absorbed oil revenue in 1978 could reach $20-to-35 billion in 1974 dollars Between 1974 and 1978, accumulated capital is likely to reach about $200 billion in 1974 dollars, not counting interest.

Direct Effects on the Community

The overall debt for the Community between 1974 and 1978 is estimated to exceed $60 billion if the price of oil is maintained. If prices go up, it could reach $90 billion. This figure does not reflect the wide variations between member states, ranging from a large surplus in Germany to heavy deficits for other countries such as Italy, Britain, Ireland, Denmark, and France. The Community's GNP growth rate for 1973-78 will not reach the 4 to 4.5 percent figure projected during the first half of 1974. North Sea oil discoveries should improve the GNP of Britain and the Netherlands, however. At 1974 prices for instance, the oil revenue is expected to add an average of 0.6 per cent annually to the British GNP growth rate, bringing it near the range originally forecast (3.5 per cent).

At the very best, the Community's energy policy could reduce the share of crude oil in primary energy consumption at the same rate as it went up during 1960-68. At the very least, the EC energy policy could manage to maintain the current level of the share of oil (60 per cent). Crude oil imports will still remain a key EC energy source until 1978.

EC Trade with OPEC countries

The net foreign trade position between the OPEC and EC countries will vary sharply. The Community as a whole will probably be in deficit, but Germany and Britain could achieve a substantial surplus. The proportion of total EC exports going to the OPEC countries should double -- from 4.7 per cent in 1974 and to over 10 per cent in 1978. The annual growth of EC exports to the OPEC nations between 1974 and 1978 is estimated at between 19.2 and 26.4 per cent, depending on oil price movements. EC exports to the rest of the world, on the other hand, should rise by only 8.5 per cent annually. The Community, therefore, will be required to restructure its foreign trade patterns to keep up with the growing OPEC import demands. Industrial sectors, already burdened by new investment needs for energy conversion plans, will be subjected to additional pressures and may run up against production bottlenecks.

Cost to the Community

In real terms, the cost of restoring a feasible equilibrium to Europe's economy will amount to about 3 to 4 per cent of the Community's GNP (2 to 2.5 per cent of the GNP to compensate for deterioration in terms of trade; 0.3 to 0.4 per cent to cover interest payments, and 0.5 to 1 per cent for substitutions and reconversion investments).

Since the EC deficit is divided unequally between the member states, the share of GNP required for each national recovery effort will vary. It can run as high as 20 per cent in Ireland, 9.5 per cent in Britain, and 9 per cent in Italy.

The Committee emphasized that its report is based on a synthesis of preliminary Commission and expert studies and therefore cannot be considered as a definitive scenario for the EC economic situation over the next five years. It will be used to form a basis for further in-depth studies to be made by the Commission in working out proposals for the fourth medium-term EC economic policy program (1976-80).