

Großer, Günter

Article — Digitized Version

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Intereconomics

Suggested Citation: Großer, Günter (1979) : A short-lived European recovery, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 14, Iss. 4, pp. 213-214, <https://doi.org/10.1007/BF02924284>

This Version is available at:

<https://hdl.handle.net/10419/139629>

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A Short-lived European Recovery

It is almost an economic tragedy for the West European national economies that the second oil crisis in this decade arose at a moment when for the first time, after the deep recession of 1974/75, there had been a chance of a lasting upswing. Although the stabilisation advancements achieved in 1977 and 1978 could not be considered to be secured already everywhere, a certain stimulation of the propensity to invest and a process of reciprocal cyclical impulses had started reminding of earlier upward phases – at least in its tendency although not intensity.

The strength of the stimulating forces is particularly distinctly shown by the fact that according to current surveys the business climate in the EC-industries was still improving beyond the middle of the year. Just during the months from May onwards, when the brisance of the development on the international mineral oil markets could be perceived more and more clearly, the upward trend was making itself felt again. Regarding the inventories of finished goods as well as the orders on hand the most favourable position for more than five years had been reached. Against this background the entrepreneurs' assessment of the short-term production chances, unchanged since the beginning of the year, is somewhat surprising. This could perhaps be interpreted as a first indication of prudence in view of the development on the oil markets.

West Europe's real GNP has in fact grown distinctly until the middle of this year. Adjusted for losses caused by weather conditions and strikes in a number of countries at the beginning of the year, the current speed of expansion should correspond to an annual rate of 3.5 %. Private consumption contributed considerably to the increase in demand in spite of the dampened expansion of real incomes which resulted from the intensification of the upward trend of prices. Obviously the private households at first reacted to the sudden inflationary impulses by cutting down on savings. Regarding investment in plant and equipment – which anyhow increased only sluggishly – a rapid slowing down was not to be expected, if only in view of the necessary planning and implementation periods.

The effects of the steep increase in oil prices became distinctly visible in the acceleration of the current uptrend of prices. In Western Europe it again reached double-digit annual rates on average, although with major differences from country to country. The strong increase of world market prices of other industrial raw material prices also contributed to this development. Internal impulses originated in several instances from the raising of indirect taxes. As against this, wages have so far hardly induced higher price advances because in nominal terms they have risen generally at a scarcely changed speed. With that the increase in gross real wages has slowed down.

The imported inflation is shown very distinctly in foreign trade. While in 1978 import prices had been stable or even declining in many European countries, this year they surpassed the previous year's level with a rising tendency. The rise of oil prices reached its full extent only in the second half of the year. With the maintenance of the present price level the West Europeans would have to spend more than US \$ 20 bn this year and even 35 bn in 1980 on imports of oversea crude oil. Nevertheless the deficit in the aggregated current account should not approach the magnitudes of 1974 and 1976, since in the past

year Western Europe still achieved a remarkable surplus and exports to the oil exporting countries will rise quickly. More important is, however, that the external disequilibria between the West European economies themselves are at present much smaller. Thus the former deficit countries Italy and France still registered a remarkable surplus in the first half-year, while Germany's current account showed only an insignificant one.

This year Western Europe's further cyclical development will at first still be determined by the present upward tendencies. The production increase should however be slowed down by the oil price-induced dampening of demand which is already making itself felt in private consumption, for a longer-term reduction in the saving ratio can hardly be anticipated. But for an outlook on the year 1980 the decisive question is how in Western Europe the internal adjustment processes to the development on the international mineral oil market will turn out and – in close interrelation with this – which economic policies can be expected. The forecast is rendered more difficult by the fact that under the impact of such a strong external shock the differing economic and social structures of the West European countries assert themselves more strongly.

The internal adjustment process will, in the first place, be concerned with the distribution of the unavoidable reductions of the real incomes. The smoother the process turns out the more probable would be an oil-induced "price-hump" which would vanish after a relatively short time. But the more the different social groups take pains to evade losses the longer the price wave will continue. There are indications that this must be apprehended in various important countries. In several instances domestic policy tensions have certainly exacerbating effects. The indexation of wages, existing most distinctly in Italy, but in other forms e. g. in France, Belgium and Denmark, at present also impedes the internal adjustment process considerably.

Apart from the social conditions the reactions of economic policy play a decisive role for the course of the internal adjustment processes. In this connection an accommodating policy yielding to external inflationary impulses in order to avoid the contractive effects of the oil price increase would be exposed to great risks. On the other hand an economic policy which intends to preclude the revival of a vehement distributional struggle without giving contractive impulses itself, faces difficult decisions. For it requires realistic assumptions about the probably "unavoidable" – and externally digestible – acceleration of the upward trend of prices and wages. Only an intensification of the distributional struggle exceeding this would then cause the economic policy to become restrictive.

Differing successes of the West European national economies regarding the mastering of the redistribution process threaten to initiate an interplay of diverging inflationary expectations, corresponding exchange rate trends, and thus again a more pronounced inflation differential. In this way national economies with weak currencies – whether members of the European Monetary System or not – could easily be forced into a more restrictive economic policy even if they still enjoy a relatively favourable balance of payments position. This, however, would only mean that something takes place under external pressure which a little later would happen anyway as a result of internal pressures – but then in a setting of already far-advanced maldevelopments.

Even in those West European countries where the prerequisites to a mastering of the adjustment processes and the limitation of the oil-induced dampening of demand are more favourable, the cyclical climate would – via export expectations – be noticeably deteriorated through more heavily retarding influences in other national economies. Under these conditions much is to be said for the assumption that next year demand and production will grow but slowly in Western Europe. In 1980 the increase of real GNP will thus on an annual average hardly reach again the rate of 3 % to be expected for 1979 and the hope for a gradual reduction of the high unemployment must be buried for the time being.

Günter Großer