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Western Europe's Economic Security

by Wolfgang Hager, Florence*

"Economic security" has become a fashionable but rather loose label covering the new uncertainties in the world economy. Dr. Hager makes an attempt at a narrower definition of the concept on the basis of which he analyses the threats to Western Europe's security which result from its economic dependence on the outside world.

To most people economic security relates to oil and raw material supplies. More broadly, the term reflects the growing instability of the world trading system and the world economy in general. Behind it is the realisation that the West, and especially the United States, has lost control over events in both the industrial and the Third worlds.

Perceptions of what constitutes a threat to security are shaped, not only by objective criteria, but by the (often) rising standards of what constitutes normal stability. A similar process has occurred with regard to social security in the last hundred years. But for a useful discussion of our predicament, economic security (which means *external* economic security) should take a narrow point of reference, i. e. the other dimension of external security, the politico-military one. The latter is concerned with essentially three threats: to life, to territory, and, since the French Revolution, to the preferred political order. Independence is another goal, which may or may not gain the status of a security concern.

Except for the threat to territory, threats to economic security can closely parallel those familiar from traditional foreign and security policy. For marginal third-world countries, and for marginal groups in most third-world countries, external economic forces can constitute a threat to life — of this more below. A country's independence is circumscribed, almost by definition, when it engages in external economic exchanges; some third-world countries, and even countries like Canada, regard e. g. foreign direct investment as a threat to national sovereignty and

hence to national security. More narrowly, Western European *political* independence is effectively threatened by e. g. O.A.P.E.C., as is potentially Britain's economic independence via O.A.P.E.C. sterling holdings.

But for Western Europe, the most relevant and profound threat posed by the external economic environment is to what politicians and pundits call "political stability". Behind this frequently used term lies a fear which is widely shared by elites if rarely spelled out in detail. Basically, it is a conviction that democracy is a fair-weather instrument. The non-recourse to force as an instrument of social control, "freedom", the adherence of conflicting social groups to institutionalised methods of bargaining depend, in this view, on a passive consensus born of contentment. Once this consensus breaks down, i. e. in adverse economic conditions, authoritarian forms of government, under whatever label, will become a necessity. Behind this view are, of course, collective memories of popular front and fascist regimes which became almost universal in the Europe of the 'thirties. A narrow definition of national economic (in)security could therefore read: (the absence of) changes in external economic parameters which cause the breakdown of the preferred socio-economic system.

Security Implications of the Energy Issue

The relevance of such a narrow definition can best be demonstrated with respect to the oil/energy issue. A sharp curtailment of oil supplies because of some political or military event might disrupt industry and life styles quite dramatically for a few months. The population, however, would in all probability show

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great tolerance, i. e. bear the hardships without blaming "the system", just as they would react to a blockade by a hostile power. If anything, the capacity of the political system to act forcefully might be temporarily enhanced, as indeed it was in war time democracies forty years ago.

By contrast, a slow decline in OPEC production in the eighties – as forecast by the CIA, Exxon and the International Energy Agency in Paris – might pose more dangerous problems for the political stability of Western Europe. It would constitute a constraint on growth, both directly and indirectly, i. e. via the inflationary and balance-of-payments effects. There would be a fall in personal consumption in most countries, again both directly (to pay the inevitably higher energy prices) and indirectly, because of lower growth.

According to the OECD, the direct and indirect income loss suffered because of the 1979/80 oil price rises alone amounts to US \$ 400 bn, equivalent of the GNP of Italy and Belgium together.

Moreover, accelerated adjustment to a high-cost, scarce-energy economy means both a rise in unemployment (frictional unemployment) and an expenditure of capital which does not result in higher output. For like anti-pollution expenditure, expenditure on energy-efficient plant or added-on equipment like heat exchangers, removes a constraint on growth but does not increase output *per se*.

A Worrying Scenario

This scenario is a great deal more worrying than a short-term disaster, although the latter may involve, say, a six-months decline in output by 10 % and the former, say, 10 % *growth foregone* over a six-year period. But a slow and steady erosion of the ability of democratic governments to be successful in general, and of the resources available for specific policy tasks in particular, allows time for resentment to grow, and, as importantly, for consensus to be replaced by the formation of competing and radical political forces which promote alternative forms of governance.

Something of this sort is implicit in many a politician's speech warning of the consequences of unemployment and slow growth for political stability. The experience of the recession of the mid-seventies has shown, however, that the social level of tolerance for both unemployment and a fall in real wages is far greater than previously supposed. In fact, that period was characterised by centrist voting patterns (producing in most countries weak coalition or minority

governments) with centrist policies being advocated or tolerated by parties such as the PCI in Italy.

Nevertheless, much of this support was given in a spirit which could be summed up in the sentence: let's try it your way one more time. A failure of conventional policies to deliver the goods might lead to a backlash – not in all countries, of course, but in those whose economic performance is already at the margin of the politically tolerable. The Mediterranean countries and perhaps Great Britain seem the most likely candidates. And any fundamental challenge from the Left (perceived as more dangerous because it already has a potentially alternative economic programme) would be met by a response of the Right. None of this is certain or even particularly probable, but simply a risk, which is what all security debates are normally about.

There has been an indirect price to pay, in terms of economic security, for the weak centrist governments of the 'seventies. Timely adjustments of policy, e. g. in the energy field, were postponed, as were overdue efforts by governments to redesign budgets to meet the tasks of the future. Scarce tax resources remain locked in uses, such as agricultural support and a plethora of other subsidies, which leave the states, or the European Community, little cash for tackling the problems of the 'eighties. The half-hearted attempts by the Federal Republic and other countries to create strategic raw material reserves are but one example.

Interdependence with the Third World

Although our subject is Western Europe, a word must be said about the Third World. For them, economic security can mean not merely system destabilisation, but loss of life. Most cases of massive starvation cannot be linked directly, at least in a short-term analysis, to the international economic environment, but rather to natural calamities coupled with inappropriate domestic policies. One important exception to this was the fundamental shift in world food security brought about by the Nixon administration. Where before countries had been encouraged to rely on cheap imports from the US and on ample stocks held in that country, the decision to run down these stocks (after 1969) led both to substantially higher prices and absolute scarcities, e. g. in the Indian subcontinent, in the early 'seventies. The world has taken almost a decade to begin replacing the former US contribution to world food security by an international scheme.

While international aid schemes can be a response to massive and geographically concentrated food

shortages, they are of little relevance to the dispersed problems of people living in deep poverty on the margin of even prosperous developing countries. Many of the urban poor, especially, live on heavily subsidised food. When economic conditions are adverse, the ability of governments to provide such subsidies is jeopardised – indeed the IMF sometimes makes such a reduction a condition for credits. Since many of these countries depend on the strength of the world economy, notably as it affects price and quantity of their commodity earnings, the prospect of the OECD world living in what may amount to a permanent recession becomes a matter of life-and-death for the many millions living on the margin of even the so-called resource-rich third-world countries.

Stagnating Mining Investment

More directly relevant to Western European security are the political consequences. The OECD secretariat, in discussing the consequences of what it considers otherwise desirable restrictive economic policies to cope with inflation and energy problems in the West, notes that this is “bound to make life more difficult for the developing countries . . . We must be concerned lest the required adjustments tax the fragile economic and social and political systems of these countries beyond breaking point”. From the standpoint of Western Europe, this presents, in the first instance, a problem of politico-military security. But as the example of Iran (a victim, however, of a perverse economic success rather than poverty) shows, political change in a context of resentment may mean a massive reduction of interdependence with the West, even at great economic cost for those who initiate the break. Moreover, a prolonged period of political instability directly and indirectly threatens the operation of Western mining interests, or at least discourages expenditure which assures future supplies.

The orderly expansion of the industrial raw-material base of the world economy is, however, perhaps the least important security issue related to raw materials. Political events or political acts which reduce exploration and development expenditures in the Third World may, in time, have inflationary effects and thus further complicate the task of economic management. Many such influences, taken together, may, however, constitute a threat to economic security.

The inflationary effect arises in at least two ways. First, to the extent that new mining investment moves to so-called safe areas in preference to technically lower-cost locations, prices will inevitably be higher.

Moreover, industrialised raw material producers are usually much better at assuring remunerative, i. e. high prices for their exports. Secondly, to the extent that the supply-demand balance remains tighter than with a broadly based resource development, prices will again tend to be higher. The latter effect will be particularly pronounced in (relative) boom conditions, when they are least desirable.

The more important consequence of another decade of stagnating mining investment in much of the Third World, however, may be the concentration of supplies on fewer countries, and thus the growing importance of any single one of them. Only in such conditions can short-term supply security become a serious issue. The orders of magnitude suggest that the issue of supply security for certain minerals does fall within our narrow definition of economic security. A much quoted study by the German Economic Research Institute (DIW) has calculated that an annual import shortfall of 30 % for any of ten important minerals and metals (e. g. chromium, manganese, asbestos, tungsten, nickel, aluminium, tin or copper) can cause production shortfalls of between 10 and 28 % and unemployment of several millions. For chromium alone, an essential steel hardener, the figure is set at seven million unemployed.

There is really only one single region which is both politically unstable and has high concentrations of the metals cited: southern Africa, including the mineral-rich “front-line state” Zambia, as well as Namibia, Zimbabwe, and Angola, with Zaire to the north close enough to be drawn into any regional upheaval. The Republic of South Africa alone provides 52 % of the European Community’s manganese (95 % together with Zimbabwe), 31 % of chromium, 42 % of vanadium and 12 % of asbestos (that figure is considerably higher for certain crucial asbestos fibres). Zambia and Zaire together supply some 57 % of the Community’s copper.

National Stockpiling Schemes

It was the situation of southern Africa which more than anything else broke down German resistance against some form of national raw material stockpile. While a central stockpile was ruled out, a co-financed stockpiling scheme, with metal users as agents, is close to being completed. Under the scheme, a rediscount facility from the Bundesbank of some DM 600 mn will be used to buy stocks, amounting to eight month’s supply, of chromium, manganese, vanadium, cobalt and asbestos, which will be additional to working inventories of 1-4 months held by

industry. In the end, the cost will probably be nearer DM 1 bn. The cost of storage and interest is to be shared by industry which, however, stands to make a profit when prices rise in an emergency situation.

The capital cost of the scheme (an investment rather than an expense if it were to be used) is less than 0.1 % of GNP. The potential loss of output, say 10 % of GNP, is one hundred times as large. Thus even without counting the political costs of a major disruption, the scheme makes economic sense if one expects a major disturbance once every hundred years, to make a very crude calculation.

There is, however, a central drawback. Since it is highly unlikely that only German imports would be affected, a serious disturbance in southern Africa would have effects on most of Germany's Western trading partners comparable to those calculated for the Federal Republic. Although few are so heavily specialised in engineering and metal industries, the multiplier effects would spell a very severe world-wide recession. In theory, therefore, it is in Germany's interest that Western Europe should follow the German example. This is the market for 70 % of German exports. The United States and Japan already have effective stockpiling schemes. However, a concerted European approach would drive prices sky-high, and indeed surpass the world's physical production capacity by a wide margin. This problem could have been avoided if the suggestion to constitute a German reserve, made by Dr. Ehrenberg in 1974, had been taken up when world material prices were depressed and the Bundesbank was saddled with embarrassing surpluses in its monetary reserves.

In addition to the new scheme, essentially focused on metal hardeners from southern Africa, the Federal Republic probably maintains substantial stocks of uranium oxide, while the Metallgesellschaft has claims on substantial stocks of copper and other metals, i. a. in the London Metal Exchange's warehouse in Bremen.

The London Metal Exchange is the "stockpile" on which Britain depends, while France instituted a modest national stockpile in 1975. The stocks are valued at some DM 150 mn and are meant to assure a three-months supply, including, however, such large-volume items as copper and tin. Switzerland has by far the largest stockpile, worth some SF 5 bn, but its purpose is to insure survival in wartime conditions and thus the maintenance of a policy of neutrality.

At least in terms of policy, supply interruptions of raw materials, including energy, are among the easier

threats to deal with. Once the risk is identified, it is essentially a question of money and time to design an insurance scheme. Other threats from the international environment are more subtle. They are both difficult to identify and even more difficult to remedy. These twin difficulties have an important secondary effect: forceful action by any single country, and *a fortiori* by several countries, requires consensus. Harmonising different interests is difficult enough. Agreeing on the problem and the solution on merely technical grounds is, however, already a sufficient hurdle which slows down reaction time.

Growing "Europessimism"

These more subtle threats are posed by the interaction of a number of forces, of which the international business cycle, trade, energy, the world credit structure, all require substantial and speedy adjustments, including sacrifices, while social values within our countries tend to develop in the opposite direction. This is at least one strand of reasoning in the OECD's Interfutures Report. This report ends on an upbeat note, stressing the adequacy of conventional policies: free trade, a larger share of resources devoted to investment, industrial policies which speed adjustment rather than delaying it, wages which are differentiated as between sectors and regions with different productivity, etc.

There is a growing mood in Western Europe, shared least of all in Western Germany, which at the OECD is referred to as "Europessimism". Basically, it is a view that the 'eighties pose so many adjustment pressures simultaneously that conventional policies would overtax both the willingness and indeed the ability of our societies to respond.

The starting point is slow growth itself, made probable by a combination of institutional rigidities of which inflation is one symptom. As long as these rigidities are fought with macro-economic policies, our economies will stay well below potential output. Slow growth is made more certain by the energy constraint as already mentioned.

Against this background of slow growth at least three adjustments have to be made. First to high cost and scarce energy itself. The stagnation of automobile markets with their vast employment implications is only one example. Secondly, there is adjustment to new automatic production processes. Although the net implications for labour are uncertain, transitional unemployment can be expected to increase. The micro-chip may also prevent the service sector from

off-setting the secular fall in industrial employment. Thirdly, there is trade competition. Here Europessimism sees the region threatened by a combination of low-wage producers at one end of the market, and by producers like Japan who can achieve very high levels of productivity. This ability to rejuvenate capital stock and thus incorporate technological advance rests, *inter alia*, on a high rate of profit and labour mobility, which for political reasons cannot be matched by Europe. The newly industrialising countries (NICs), approaching a share of 10 % of world markets for manufactures, combine the advantages of green-field technology and low wages. No exchange rate can compensate for these large but narrowly based absolute advantages.

There is growing doubt, except in the Federal Republic (which has the most up-to-date capital stock and production structure and the highest rate of turnover in capital stock), that Western Europe can play the economic game by the old rule without facing

massive unemployment, stagnation, and what the British call "de-industrialisation". The first victim of such a process would be the European Community and with it the greater European free-trade area. For as the Federal Republic would strenuously resist protectionism at the Community level, other member governments would be driven to act unilaterally.

A working, genuine free-trade area accounting for two thirds of the export markets of member states would then have been sacrificed for the idea of an open world economy which on closer examination already largely consists of highly protectionist, planned, and even state-trading entities. By insisting on a policy of unilateral free trade for the Community a little too long, the break-down of both the common external policy and of the Common Market itself will be accelerated. The consequent Balkanisation of Western Europe would put more at risk than the continued existence of democratic and cooperative regimes. Here, economic and political security become inextricably mixed.

ENERGY POLICY

The Internationalization of Energy Supply Structures

by Heinz Jürgen Schürmann, Cologne*

The World Energy Conference will be held in Munich in mid-September. It will have to deal with diverse and complex problems of energy policy, for the seventies have presented tremendous challenges in the energy field¹. The control over oil – with 46 % of the world supply still by far the most important source of energy – has been reorganized and two oil crises have exposed the flow of supplies to severe disruption and political hazards. As far as can be foreseen, the supply is unlikely to keep abreast of the world-wide rise of energy consumption. To replace the oil gradually will therefore be the major task in the energy field in the coming decades. What will be the supply position between now and the year 2000? And which structural changes will have to be effected?

Under physical aspects there is no need for dramatic energy supply scenarios. On a static basis the fossile sources of energy (oil, gas, coal) can be expected to last a good long time if the putative resources are added to the reserves already opened up. On the basis of such putative energy resources and

static consumption the fossile energy materials will last for more than 200 years from today. Energy will however be much dearer in the future, and very speedy

¹ Cf. on details of the development processes and market results, H. J. Schürmann: *Multinationale Energieunternehmen und ihre energiepolitische Beurteilung* (Multinational energy enterprises and their assessment from the point of view of energy policy), Munich 1980.

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