Chapter 4
The position of individual member countries

The global energy constraint with its repercussions for the Community as a whole obviously affects the possibilities for economic growth in any individual country within the Community. All except the UK are net oil importers and are hit directly by the balance-of-payments cost of the high world oil price. All are affected in some degree by the slowdown of export markets in other energy-deficit parts of the world. Given the high level of mutual trade, the probability of recession in any one member country of the Community is reinforced by the fact of recession in others. Whereas, before 1973, intra-Community trade in manufactures grew 4-5% a year faster than exports to the rest of the world, since 1973 it has grown *slower* than exports to the rest of the world.

Although the environment since 1973 has been unfavourable, any single country in the Community might have been able to improve its share of external markets at the expense of other countries and thereby avoid the worst of the recession. An individual member country can gain (or lose) on the intra-Community market as well as on the external market. Even the largest member country is small in world terms so that adverse repercussions from a rise in its own market share (which may depress growth elsewhere) are comparatively trivial. For all these reasons growth in individual member countries may depend as much or more on trading gains or losses relative to other countries as on growth in the world economy. However important the impact of the high oil price, the energy constraint is less binding on member countries individually than it is on them collectively.

In this chapter we examine trading performance and growth of income in individual member countries, relying on the analytical relationship between the balance of payments and the level of income discussed in the previous chapter. Following that analysis we regard increases in a country's net borrowing, exports or energy supply as being helpful to growth in internal income and increases in the energy coefficient or the ratio of non-oil imports to income as tending to reduce growth of income.

4.1 The background: 1965-73

Before looking at the incidence of recession since 1973 it is useful to review trends in the balance of payments and growth of income of member countries during the preceding period (here taken from 1965 so as to exclude adjustments during the first years after the formation of the EEC).

The rate of growth of total real income in member countries was fairly uniform. Apart from the UK where growth averaged 3% a year, the growth rate ranged between 4½% in Germany and Denmark and 5½% in France and Ireland with Italy, the Netherlands and Belgium half way between. This was not entirely a matter of labour supply since considerable migration of labour between countries was necessary to accommodate growth of production.

The uniformity of growth rates between 1965 and 1973 appears the more remarkable when we examine changes in the balance of payments of individual countries. Here considerable variety is evident (see Table 4.1). While most countries improved their net balances on food and raw materials, Italy suffered a major deterioration as it lost out under the Common Agricultural Policy, biased in favour of temperate rather than Mediterranean products. (Denmark, whose food surplus fell relative to income, was not then a member of the Community and had the harder job of exporting in the open world market.)

Most countries suffered some increase in net fuel deficits although development of natural gas enabled the Netherlands to reduce its deficit. Table 4.1 suggests that there were also differences between member countries in the fastest-growing branch of external trade, manufactures.

Export performance in manufactures was indeed extraordinarily varied with growth rates ranging from 5% a year in the UK to around 7% in Denmark, the Netherlands and Germany, 9% in Italy and Belgium, 10% in France and no less than 14% in Ireland (where exports were growing from almost nothing). Growth rates of import penetration also varied considerably, from zero in the Netherlands and Denmark where the level of penetration was already high, to 2% in Ireland and 4% in Belgium where the level was also high and

Table 4.1 Changes in the balance of payments of member countries, 1965-73

	Changes in net balances as percentages of total income					Growth rates, % per year			1965 ratio of manuf. exports to manuf. imports (%)
	Food and raw mats.	Fuels	Manufs.	Services and transfers	Current balance	Exports of manufs.	Ratio of manuf. imports to income	Total real income	
Germany	+1.9	−0.7	+2.4	−0.8	+2.8	7.2	1.5	4.3	171
France	+1.2	−0.2	−1.1	−0.7	−0.8	10.1	7.5	5.4	141
Italy	−1.7	−0.6	−1.2	−1.7	−5.1	8.9	8.3	5.0	191
Netherlands	+1.3	+0.7	+3.4	−1.2	+4.3	7.3	0.0	5.2	78
Belgium	+2.4	−0.3	+1.2	−0.5	+2.9	8.7	3.9	5.0	130
United Kingdom	+1.4	−0.5	−3.8	+1.3	−1.6	4.9	8.5	2.9	190
Ireland	+2.2	+0.4	+2.9	−3.8	+1.7	14.2	2.0	5.5	33
Denmark	−2.0	+0.5	+1.7	+0.3	+0.4	6.9	0.2	4.5	53
EEC average*	+1.1	−0.4	−0.4	−0.5	−0.2	7.5	4.5	4.4	144

* Calculated from totals for member countries.

7½-8½% in France, Italy and the UK where the level was comparatively low. Germany which had a low level of manufactured-import penetration nevertheless experienced little increase in import penetration between 1965 and 1973.

Differences between countries in the growth of manufactured exports and import ratios were largely offsetting. To make the comparison fair, allowance needs to be made for absolute differences in the magnitude of exports and imports, e.g. by multiplying the growth rate of the import ratio by the ratio of imports to exports. On this basis, Ireland, the Netherlands, Denmark, Germany and Belgium achieved the highest 'excess' export growth. All in the event improved their balance on manufactures as a percentage of income. In France and Italy the growth of exports exceeded the (weighted) growth of the import ratio by about 4½% per year, not quite enough to match income growth rates, so that net exports fell relative to income. In the UK growth of exports was almost fully cancelled out by growth of the import ratio; since income rose 3% per year the balance on manufactured trade deteriorated rapidly.

A glance at Table 4.1 will show that differences in performance of member countries in various branches of trade up to 1973 did not in general cancel out. Thus, for example, the Netherlands performed relatively well, and Italy relatively badly, in all branches of trade. Processes of trade adjustment were not very effective. Instead, comparative uniformity of income growth rates was achieved with the aid of large changes in the pattern of net external lending and borrowing. By 1973 the Netherlands had a financial surplus equal to 4¾% of its income, Belgium a 3¾% surplus and Germany a 1½% surplus. France was in balance. Other countries (Italy, the UK, Ireland and Denmark) were net borrowers at the rate of 1½-2% of their income. The case of Italy is particularly striking since in the course of eight years its external financial balance switched from a 3½% surplus to a 1½% deficit.

It seems probable, therefore, that the uniformity of growth rates in the Community up to 1973 owed quite a lot to financial policies of governments geared to regulating, and if necessary sustaining, economic growth rather than to achieving financial balance *per se*. Irrespective of the oil crisis, such policies might have been hard to continue after 1973. Italy and the UK were already running into pressure, in the form of rising interest rates and falling exchange rates, to limit their net borrowing at the expense of internal growth.

At this point the whole pattern of trade and external finance began to change profoundly under the impact of the increase in the world price of oil.

4.2 Recession since 1973

Table 4.2 shows that up to 1981 member countries of the Community had experienced a deterioration in their balances of trade in fuels by 3% of income as compared with the situation in 1973. The deterioration amounted to 5-6% of income in Ireland, Italy, Belgium and Denmark and 3½-4% of income in France and Germany. The Netherlands with its natural gas suffered only a small deterioration equal to 1½% of income while the UK, rescued by North Sea oil, improved its oil balance by nearly 3% of income.

The worsening of fuel balances was partly offset in most countries by improved balances on food and raw materials. The UK and Italy registered particularly marked improvements. Balances on manufactures improved substantially in Italy and Denmark but deteriorated sharply in Belgium and Ireland. Most countries suffered a deterioration in services and transfers. Overall, current balances were in much larger deficit in 1981 than they had been in 1973 (with the notable exception of the UK whose current balance improved by *more* than the turnround in its energy balance). The level of current deficits in 1981 relative to income ranged

Table 4.2 Changes in the balance of payments of member countries, 1973-1981e

	Changes in net balances as percentages of total income					Growth rates, % per year			1973 ratio of manuf. exports to manuf. imports (%)
	Food and raw mats.	Fuels	Manufs.	Services and transfers	Current balance	Exports of manufs.	Ratio of manuf. imports to income	Total real income	
Germany	+0.9	−3.6	0.0	−0.6	−3.3	4.0	5.2	1.7	188
France	+0.9	−3.9	+0.9	+1.0	−1.1	5.6	3.2	1.8	112
Italy	+1.7	−6.0	+3.2	+1.0	−0.2	7.7	4.6	1.6	135
Netherlands	−0.1	−1.3	−0.1	−5.0	−6.5	2.8	1.6	1.1	92
Belgium	+0.3	−5.3	−4.5	−0.1	−9.5	1.2	2.2	0.7	126
United Kingdom	+2.9	+2.7	−1.1	−1.4	+3.1	1.6	2.7	0.2	116
Ireland	−0.1	−6.3	−3.1	−0.2	−9.7	9.0	5.3	1.6	53
Denmark	+0.9	−5.0	+5.6	−2.6	−1.2	4.5	−0.7	0.4	63
EEC average	+1.4	−2.9	+0.5	−0.4	−1.4	4.3	3.3	1.3	128

from 1% in France to 1¾% in Germany, Italy and the Netherlands, 2½% in Denmark, 5¾% in Belgium and over 10% in Ireland.

Income growth had been uniformly low, averaging 1½% a year in most member countries and around ½% in the UK, Denmark and Belgium. External borrowing had not been sufficient to prevent general recession.

The slow-down in trade in manufactures

How important was depression of trade in manufactures as a cause of slump in individual member countries? We have already noted the overall reduction of 1¼% in growth of exports of manufactures to the rest of the world and the much sharper 5½% reduction in growth of intra-Community trade in manufactures.

Changes in net balances on manufactures varied between countries. There was a slower average growth in the ratio of imports of manufactures to income. This is likely to have been, at least in part, a consequence rather than a cause of recession since demand for manufactures is usually reduced proportionately more than aggregate income whenever growth slows down. An explicit allowance has to be made for this effect if we are to estimate the importance of changes in trade in manufactures as a cause of recession in each country.

Table 4.3 provides data which may serve as a basis for comparing the effects of trade in manufactures on economic growth in member countries before and after 1973. The figures shown are estimates of the growth rates of internal income which would have been consistent with a constant balance of trade in manufactures relative to income. They are calculated independently for each country, the growth rate of its exports being taken as given. To allow for the cyclical sensitivity of demand for manufactures, the estimates assume that the marginal propensity to import manufac-

Table 4.3 Income growth rates consistent with a constant balance of trade in manufactures as a ratio to income

(% per year)

	1965-73	1973-81e	change, 1973-81e compared with 1965-73
Germany	5.5	1.7	−3.8
France	4.4	2.3	−2.1
Italy	4.3	3.0	−1.3
Netherlands	6.1	1.2	−4.9
Belgium	5.2	0.0	−5.2
United Kingdom	1.2	−0.3	−1.5
Ireland	6.4	1.0	−5.4
Denmark	5.3	2.6	−2.7

Note: Growth rates calculated by adjusting income in the terminal year of each period by an amount sufficient to make the terminal balance on manufactures equal to the same fraction of income as in the initial year. The assumed marginal import propensity is *twice* the actual ratio of manufactured imports to income. The calculations assume given exports to other countries including other EEC members.

Table 4.4 Changes in government deficits and net external borrowing, 1973-81[e]

(changes in net borrowing as a percentage of total income)

	Deterioration in personal and business financial balances	Increase in government deficit	Increase in net external borrowing
Germany	−1.6	5.0	3.4
France	−1.7	2.8	1.1
Italy	0.3	0.0	0.3
Netherlands	1.0	5.5	6.5
Belgium	2.9	6.6	9.5
United Kingdom	−2.0	−1.0	−3.0
Ireland	3.6	6.3	9.6
Denmark	−10.1	11.3	1.2
EEC average	−1.3	2.7	1.4

Note: Positive figures indicate increased borrowing or reduced lending. A minus sign indicates a fall in borrowing or a rise in lending.

tures is in each case twice the average propensity, i.e. the actual ratio of imports to income*.

These estimates imply a fairly uniform performance of member countries (except the UK) in trade in manufactures before 1973. All countries appear to have been less successful since 1973 than they were before. Italy and the UK show the smallest deterioration (1½% a year), although for the UK this represented a shift from a bad performance to a disastrous one with trade in manufactures making a *negative* contribution to growth. France and Denmark appear to have performed not too badly with a deterioration of 2-2½% a year leaving them, like Italy, with a significant positive stimulus from trade in manufactures since 1973. Germany, with a 4% deterioration, and the Netherlands, Belgium and Ireland, with deteriorations in excess of 5% per year, are the countries which have lost most. Belgium's performance since 1973 has been scarcely better than that of the UK.

It appears that for nearly all individual member countries the deterioration of trade in manufactures has been an important contributory factor in the slow-down of economic growth. None of them has in practice been able to compensate for the impact of the high oil price by a higher contribution to growth from trade in manufactures. This is the main reason why the recession has been so uniform and widespread throughout the Community.

The contribution of external borrowing

The other factor which merits closer examination is the increase in net external borrowing by member countries other than the UK and Italy.

*This assumption fits time-series of year-to-year fluctuations in imports of manufactures reasonably well.

In nearly all countries the main reason for higher external borrowing since 1973 has been an expansion of the government deficit. As shown in Table 4.4, the government deficit has increased sharply as a percentage of income in Denmark, the Netherlands, Belgium, Germany and Ireland. All these countries also showed a large rise in net external borrowing, except Denmark where the government deficit was largely offset by a financial surplus in other sectors. In France there was a smaller rise in the government deficit and a correspondingly smaller increase in external borrowing. In Italy the government deficit, already very high in 1973, has not increased as a share of national income and external borrowing has scarcely changed. The UK is the one country in which the government deficit has been reduced; from being an external borrower it has become a net lender.

As already pointed out in Chapter 1, the increase in government deficits does not mean that governments have simply been profligate. On the contrary they have all pushed up tax rates and reduced growth in their expenditure on goods and services. The deficits have been caused by recession as growth of taxable income slowed down while social security and other transfer payments increased.

The effect of higher government deficits (when not offset by increased private saving) has been to cushion recession by making it possible for external current accounts to shift into deficit, reducing the fall in income necessary to accommodate the higher costs of oil imports and the deterioration in trade in manufactures.

The extent to which external borrowing has alleviated recession cannot be measured directly by the size of the increase in borrowing. To assess this we need to know how much lower the level of income would have had to be in the absence of

Table 4.5 The effects of changes in external borrowing, 1973-81[e]

(% per year)

	Growth of income consistent with constant external borrowing as a ratio to income	Actual growth of income	Effect of changes in external borrowing
	(1)	(2)	(3)
Germany	0.6	1.7	+1.1
France	1.5	1.9	+0.4
Italy	1.6	1.6	0.0
Netherlands	–0.1	1.1	+1.2
Belgium	–0.7	0.7	+1.4
United Kingdom	1.1	0.2	–0.9
Ireland	0.2	1.6	+1.4
Denmark	0.0	0.4	+0.4

Note: The method of calculation of (1) is the same as that used for Table 4.3, but adjusting income in the terminal year to yield a current balance equal to the same fraction of income as in the initial year. In addition to the assumed marginal propensity to import manufactures, an allowance is made for marginal imports of other goods and services at the rate of 10% of the adjustment to income. (3) is the difference between (2) and (1).

higher external borrowing. For any one country (i.e. assuming unchanged exports) this depends on the magnitude of the marginal propensity to import. In countries which are very open to foreign trade, a reduction in the external deficit can be obtained by a small fall in income; in less-open economies, the fall in income has to be larger before imports are reduced by the same fraction of income.

Table 4.5 shows estimates of the additional growth made possible in each member country by the increase in its own external borrowing between 1973 and 1981. The contribution to growth of income has been of the order of 1% a year in the four countries whose net external borrowing increased sharply (the Netherlands, Belgium, Germany and Ireland). In the UK, on the other hand, the reduction in external borrowing is estimated to have cut growth of income since 1973 by an average of 1% a year.

Thus it appears that external borrowing has been an important offset to recession in several member countries. If the Community is considered as a whole, the gain from higher external borrowing may have been larger since each country which borrows passes on part of the benefit to others in the form of higher demand for their exports. But we must not forget that the increase in borrowing in the Community will also have had repercussions on the world situation; in particular, as explained in Chapter 2, it may have helped to push up the world price of oil.

4.3 Growth prospects in individual member countries

Future growth rates in individual member countries will (in the absence of new policies) depend very much on developments in the world economy and growth in the Community as a whole. As previous chapters have indicated, the general prospect is poor; it seems unlikely that there will be much improvement on the average growth rate realised in the Community since 1973.

Given this context, the crucial variables affecting growth in any one country will be its relative success in trade in manufactures and changes in its external lending or borrowing. Table 4.6 gives some illustrative projections which, it must be emphasised, are extremely tentative. The only firm claim we make for them is that the estimates for different countries are at least mutually consistent and that the implied outcome for the EEC as a whole takes explicit account of the global situation (since it has been constrained to accord with that projected for Western Europe in our world model).

For most countries we expect performance in manufactures to be similar to that in the period since 1973.

Given only modest growth of income and continued energy saving, there should be little further deterioration in fuel balances (as compared with the very large shifts which have taken place since 1973). Against this, most countries seem unlikely to increase their already-high rates of external borrowing.

The countries best placed to expand seem to be Germany, France and Italy and growth rates here may be slightly higher than since 1973. The countries most in danger of experiencing very low or zero growth appear to be the Netherlands, Denmark, Ireland and the UK. The risk for the first is a weak performance in trade in manufactures with rising penetration of imports

Table 4.6 Growth projections, 1981e-85p

(% per year)

	Income growth rate consistent with a constant balance of trade in manufactures as a ratio to income (1)		Effect of changes in food, raw materials, fuels, services, transfers and net external borrowing (2)		Actual or projected growth of income (3)	
	1973-81e	1981e-85p	1973-81e	1981e-85p	1973-81e	1981e-85p
Germany	1.7	2.0	0.0	0.0	1.7	2.0
France	2.3	2.8	–0.4	–0.4	1.9	2.4
Italy	3.0	2.0	–1.4	0.1	1.6	2.1
Netherlands	1.2	0.1	–0.1	–0.1	1.1	0.0
Belgium	0.0	2.3	+0.7	–0.3	0.7	2.0
United Kingdom	–0.3	–3.1	+0.5	+2.7	0.2	–0.4
Ireland	1.0	0.9	+0.6	–0.8	1.6	0.1
Denmark	2.6	1.6	–2.6	–1.2	0.0	0.4
EEC average	1.5	1.2	–0.2	+0.3	1.3	1.5

Note: Projections for 1985 derived from CEPG model of the EEC assuming broadly unchanged policies. See Table 4.3 for the definition of (1); (2) is the residual of (3) less (1).

from outside the Community (although recently its exports have risen too). The problem for Ireland and Denmark is their dependence on the Common Agricultural Policy which has come under pressure for the generosity of its support to farmers in the north of the Community.

The UK's prospects involve different considerations. It can benefit from increases in the price of oil (since it is now a net exporter) and it can afford some deterioration in its external financial balance since it starts with a surplus. The contribution of oil will, however, increase much less fast than in the past few years when North Sea oil fields were coming on stream, and its performance in trade in manufactures is likely to be appalling because of the severe over-valuation of sterling and the contraction of capacity which has taken place in the past two years.