HOW ECONOMIC INSTABILITIES ARISE IN SOUTHERN EUROPE AND PROSPECTS FOR THE FUTURE

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Discussion about economic instability has been restricted mainly to Westein Europe and the United States, and its relevance to countries which face problems of a structural and an institutional nature characteristic of their own area is questionable. But at a time when much discussion is held about a united Europe, it is imperative to look also at the less advanced nations that are struggling to accelerate their rate of growth under institutional and structural backgrounds that are different from those of the rest of the community.

The problem of explaining economic instability in the context of a growing economy requires comparisons to be made among different countries. The present study examines some important features relevant to economic growth and stability in the South European countries. More specfically, the countries examined are Greece, Portugal, Spain and Turkey and the period covered in from 1960 to 1974. The study is believed to provide an overall perspective of economic instability in these countries and to allow us to make comparisons and draw conclusions about the specific problems these countries face.

The reason for examing these four south European countries is that there are some basis features of economic structure and the degree of economics development which they all have in common. However, although the four countries have, to a certain extent, similar social and economic institutions, policy objectives and temperament, each one has its own individual problems and they are in many ways independent of each other.

In discussions of economic problems in individual countries, comparisons are frequently made with experiences of an earlier period.
Thus, data referring to the period under consideration, such as the volume and the rate of growth of GDP, the level of industrial production and its respective growth rate, and the evolution of prices and unemployment, are compared with the corresponding data for a previous period. The differences are then taken to represent the peculiarities of the period under consideration. Unfortunately, such a method cannot

be followed here because comparable statistics are not available for the period prior to 1960. Nevertheless, the basic features of the countries concerned are easily recognized.

To start with, the economies of these countries are market economies where the private sectors are large, and where consumers and firms act under continuous economic changes. The public sector, which however is not very large, may then intervene by the means of economic policy.

Morever, the economies may interact with each other through international trade and capital movements. Although not all of them are closely linked by trade, they all hope to join the EEC in the near future. All four economies have suffered from unemployment and underemployment of the concealed form, arising mainly from large agricultural sectors. Inflationary conditions have also been experienced so that rising price levels have been taken as a natural phenomenon in the countries concerned. However, inflation seems to have had an adverse impact on the growth of these economies. Thus, the overall climate of uncertainty and speculation that prevailed so affected business attitudes that investment patterns deteriorated and the misallocation of resources was increased. Politically the four countries also appear to have similarities. All of them, for the whole or part of the period under consideration, were under a military regime, and this might have important connotations on growth and stability. Another characteristic of the area is that the agricultural sectors are relatively large.

However, the share of primary production to domestic product of industries declined in Greece from 22.05 per cent in 1960 to 20.27 per cent in 1972, with a corresponding increase in manufacturing from 18.42 per cent to 21.97 per cent. In Portugal the decline in the share of primary production from 28.13 per cent to 18.00 per cent was accompanied by an increase in the share of manufacturing from 32.70 per cent in 1960 to 37.63 per cent in 1973. In Spain the decline in the share of the agricultural sector was accompanied mainly by an increase in the share of services, while in Turkey the share of the primary production fell from 44.5 per cent in 1963 to 30.4 per cent in 1973 and manufacturing increased from 15.4 per cent to 23.25 per cent. In sum there undoubtedly was a high economic progress during the period in all the South European countres.

Output and productivity rose very quicly, investment increased considerably, and trade rose much faster than ever before. Thus, over the period, the average rates of growth (7.58 per cent in Greece, 6.50 per cent in Portugal, 7.14 per cent in Spain, and 6.31 per cent in Turkey) were much higher than those of the highly developed countries of Europe and of the U.S.A.[01].

1. The rate of growth in these countries was 4.82 per cent in Belgium, 3.67 per cent in Sweden, 2.68 per cent in U.K., 4.66 per cent in Germany, 4.87 per cent in Italy. 5.72 per cent in France, and 4.30 per cent in the United States.

Finally, growth proceeded without any serious interference from periodic waves of recession.

In fact, the period was subject only to minor recessions, hardly noticeable on a trend chart. It thus becomes apparent that cyclical flutuations in Southern Europe cannot be described as those that are more common in the industrial countries and, particularly, in the U.S.A. South European countries have shown little or no tendency to fall into a cummulative process of depressions, but recessions appear rather as periods of stagnation in an otherwise steady process of expansion. Nevertheless, the fact that economic fluctuations in Southern Europe have been less violent than those of the advanced economies cannot be a justification for disregarding the problem of business cycles.

It is true that spells of relative stagnation, reflected by a slow rate of growth cannot well be regarded as business cycles, and cases of negative annual growth rates, that is, real contractions, have not occurred during the period under consideration except in one case. However, there is a cyclical element in the sense that growth does not follow a smooth path but fluctuates around that path. In this sense, variations in the anual rates of growth are evidence of economic instability.

In the present study instability is defined as the irregularity of the yearly rate of growth of real GDP. But as well as looking at GDP we shall also examine its main components in order to evaluate the contribution of each one to GDP instability. Some important measures such as industrial production, unemployment, and prices will also be examined. We may then compare the sources of irregularities in the instability that the various countries experienced during the period[21].

In the following sections, each country's yearly percentage rate of growth of GDP is subdivided into changes in its expenditure components, where changes are expressed as percentages of the preceding year's GDP at constant 1970 prices. These percentages are expressed annually and as an average for the entire period under consideration. The mean deviation of the annual percentage rates of growth of the various measures around their respective average rate of growth is also estimated. The rations of the mean deviations to the respective average rates of growth may then be used for measuring instability. This method, apart from having the advantage of being simple, enables us to observe the relative importance of the yearly changes in the GDP components for total GDP. Finally, the method can be used for making comparisons between corresponding changes in the. various countries.

Obviously, economic instability can be analyzed in deep details which cover even small aspects of the economic activity for very short periods. Thus, quarterly data would give a better idea of instability but unfortunately such data do not exist for any of the countries that are considered. Moreover, the available statistical informa-

2. It has been shown that the determinants of growth are numerous and that they vary in importance from time to time and from place to place [1,21.

tion is neither sufficient nor very reliable. It is therefore likely that the margin of error will be large and this should be kept in mind throughout this study.
However, all the countries are members of the OECD and this enabled us to use comparative statistics that made the description of their growth and instability possible»[1].

Variation in the Output

Gross Domestic Product has been chosen as the measure of output because it is an embracing concept and statistical data can be found for comparative purposes. Indrustrial production on the other hand may give too optimistic a picture in economies that have been steadily increasing their degree of industrialization. Nevertheless, industrial production will be examined as well because it is the only measure for which the available data is expressed on a monthly or quarterly basis:

In Southern Europe the outstanding characteristic of economic development between 1960 and 1974 has been the rapidity rather than the instability of the growth of total output. Thus, from 1962 to 1974 the real GDP of the four countries under consideration increased by approximately 6.97 per cent on the average and the deviations from this were rather limited. Thus, we notice that even in 1974, a year that is deemed to be of a rather recessionary character for most of the individual countries, the total rate of growth was 1 per cent.

However, such aggregates may give too favourable an impression of the cyclical experience as the movements are influenced by differences in the timing of the cycle in each country, and by the fact that the movements of the aggregate figures may be heavily influenced by those countries that have experienced a more rapid rate of growth. But in all the countries real **GDP** has not fallen since 1960, except in Greece where the decline in 1974 was 3.6 per cent. Comparisons, however, are not possible on a peak to trough basis simply because of the unavailability of quarterly data. On the other hand, yearly data tend in general to undrestimate fluctuations, as changes in economic activity over the year tend to flatten out.

Table I gives an idea of the instability of growth in the selected South European countries. The table shows the annual rate of increase in GDP expressed as a percentage of the previous year's value. As can be seen, the irregularities in the growth rates of GDP refer mainly to accelerations or decelerations in these rates. Even so, the variation in these rates is quite considerable for some of the countries, such as Greece and Turkey, and less pronounced for others, such as Portugal. If, on the other hand, cyclical fluctuations are defined as regular interruptions of the growth in total output, in the sense of absolute declines, no business cycle can be identified. However, as was said, this may be due to the shortcoming of annual data and its inability to show absolute declines of relatively short duration, and it does not neces-

3. The analysis in the study is based on OECD, National Accounts 1960-1971 and 1962-1973. However in some cases data was obtained from the IMF, International Financial Statistics, and the U.N. Statistical Yearbook and Monthly Bulletin of Statistics.

TABLE 1

Annual Rates of Growth of Real GDP

Year	Greece	Portugal	Spain	Turkey
1960-61	11.03	5.50	11.80	n.a.
	3.42	6.70	9.30	n.a.
1962-63	7.72	5.90	8.80	9.40
1963-64	9.09	6.60	6.20	4.10
1964-65	8.73	7.50	7.20	2.60
1965-66	6.70	4.10	8.30	11.70
1966-67	6.00	7.50	4.30	4.50
1967-68	7.60	9.70	5.70	6.70
1968-69	9.30	2.20	7.80	5.30
1969-70	8.50	7.90	6.00	4.70
1970-71	7.10	5.80	4.30	9.50
1971-72	10.30	8.70	9.60	6.70
1972-73	7.30	7.60	7.40	T 4.60
1973-74	−3.60	4.34	5.00	8.00
Average	7.08	6.43	7.26	6.48
Mean Deviation	T 2.26	1.54	1.82	2.18

Source: OECD National Accounts

sarily mean that there was a complete absence of such declines in the countries under consideration.

What is more probable is that cyclical movements were concentrated on a rather limited number of branches of industry and that even if such branches have quite considerable weights on total GDP, their combined effects are shown only to a very limited extent. But the specific cycles of various branches of industry cannot be examined in the pressent study.

The agricultural sector in the countries concerned is relatively large, hence, fluctuations in agricultural output have been significant factors in variations of the annual growth rates. But crop fluctuations are mainly determined by random factors that have little, if any, relation to short-term demand, so, to eliminate this factor figure I shows the growth of GDP together with GDP minus gross value added arising in the agricultural sector. As can be seen there is a certain degree of synchronization of the variations in the growth rates among the individual countries.

Thus, it can be said that the poorest performances were around 1967,1971 and 1974. But any measure of the yearly instability of GDP gives only a limited picture of fluctuations. It may be more interesting to examine the timing and amplitudes of the variations in the components of GDP, to see what differences it is possible to find among countries, as well as to what extent variations in the growth of the components cancel or reinforce each other. However, as a preliminary we will look at industrial production for which data are available for periods shorter than one year.

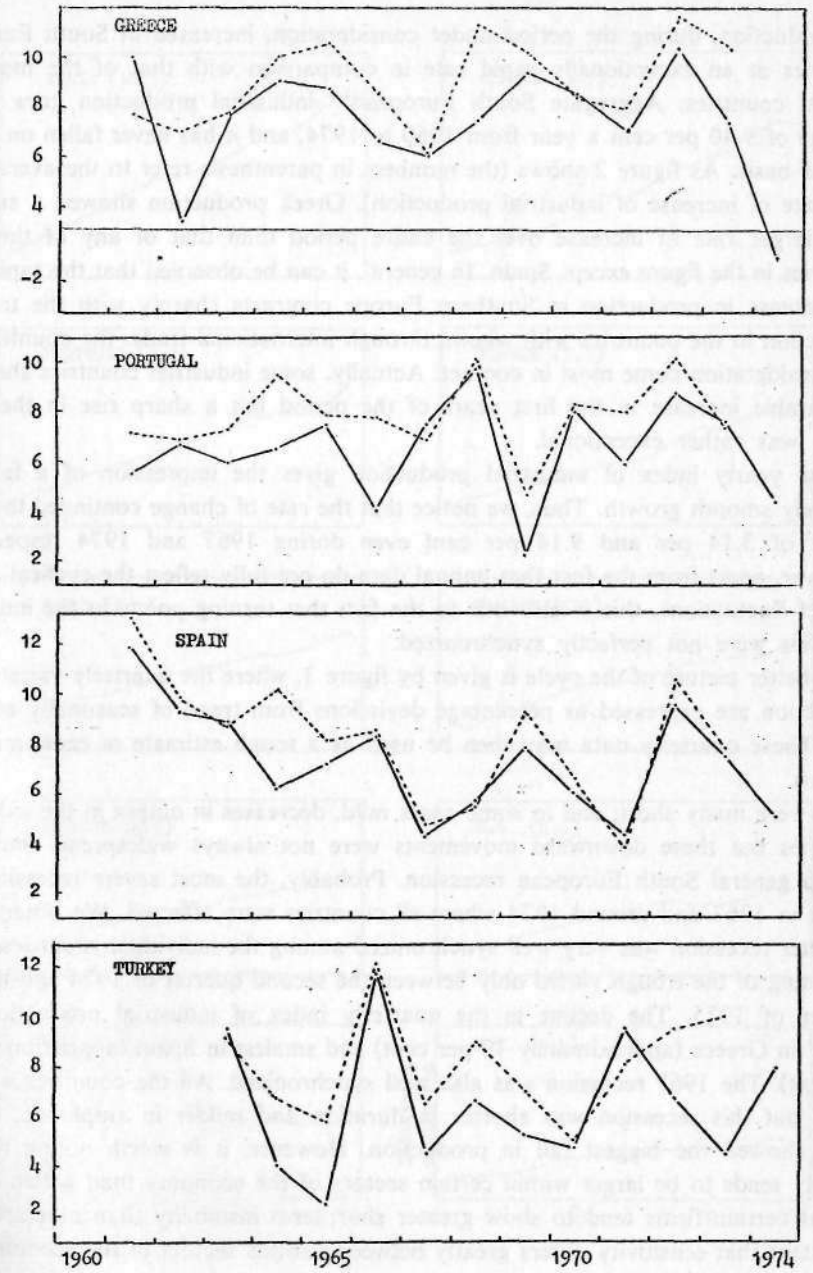

FIGURE I. Annual changes of real GDP and real non-agricultural GDP expressed as percentage of previous year.
GDP., Non-Agricultural GDP.

Industrial Production

Production, during the period under consideration, increased in South European countries at an exceptionally rapid rate in comparison with that of the major industrial countries. Aggregate South European[4] industrial production grew by an average of 9.40 per cent a year from 1960 to 1974, and it has never fallen on a year to year basis. As figure 2 shows (the numbers in parenthesis refer to the average annual rate of increase of industrial production), Greek production showed a substantially larger rate of increase over the entire period than that of any of the other countries in the figure except Spain. In general, it can be observed that the rapidity of the increase in production in Southern Europe contrasts sharply with the trend of production in the countries with whom, through international trade, the countries under consideration come most in contact. Actually, some industrial countries showed a comparable increase in the first years of the period but a sharp rise in the entire period was rather exceptional.

The yearly index of industrial production gives the impression of a fast and relatively smooth growth. Thus, we notice that the rate of change continued to rise at a rate of 3.14 per and 9.14 per cent even during 1967 and 1974 respectively. However, apart from the fact that annual data do not fully reflect the cyclical impact of brief fluctuations, this is also due to the fact that turning points in the individual countries were not perfectly synchronized.

A better picture of the cycle is given by figure 3, where the quarterly variations in production are expressed as percentage deviations from trend of seasonally adjusted data. These quarterly data may then be used as a rough estimate of economic fluctuations.

There were many short, and in some cases mild, decreases in output in the individual countries but these downward movements were not always widespread enough to form a general South European recession. Probably, the most severe recessions occurred in 1967 and around 1974 where all countries were affected. We observe that the latter recession was very well synchronized among the individual countries. Thus, the timing of the trough varied only between the second quarter of 1974 and the first quarter of 1975. The decline in the quarterly index of industrial production was largest in Greece (approximately 19 per cent) and smalest in Spain (approximately 13 per cent). The 1967 recession was also well synchronized. All the countries were affected but this recession was shorter in duration and milder in amplitude. Greece again showed the biggest fall in production. However, it is worth noting that instability tends to be larger within certain sectors of the economy than within others, or that certain firms tend to show greater short-term instability than others. But to the extent that sensitivity differs greatly between various sectors of the economy, dif-

4. Turkey is excluded because of unavailability of data.

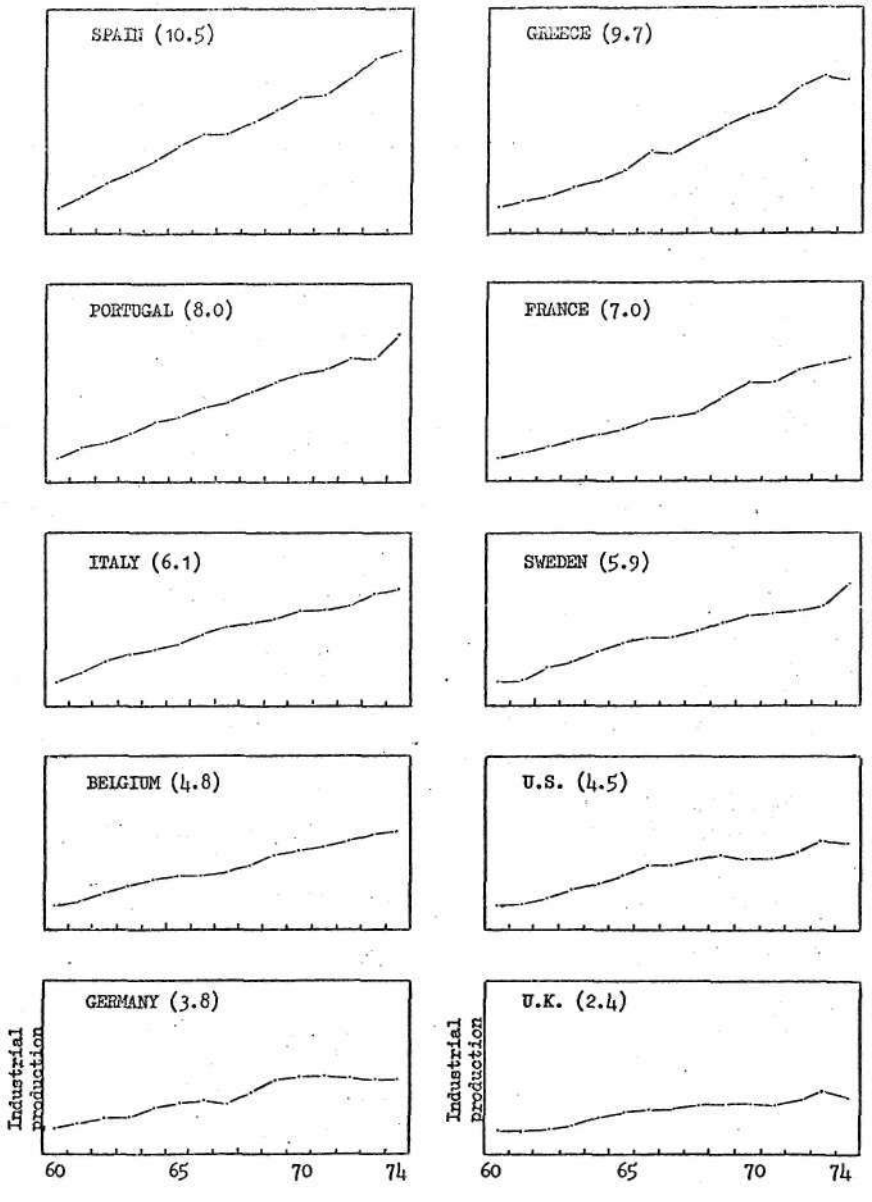

FIGURE 2. The volume of industrial production in various countries 1960-74. (Logarithmic scale, 1960=100).

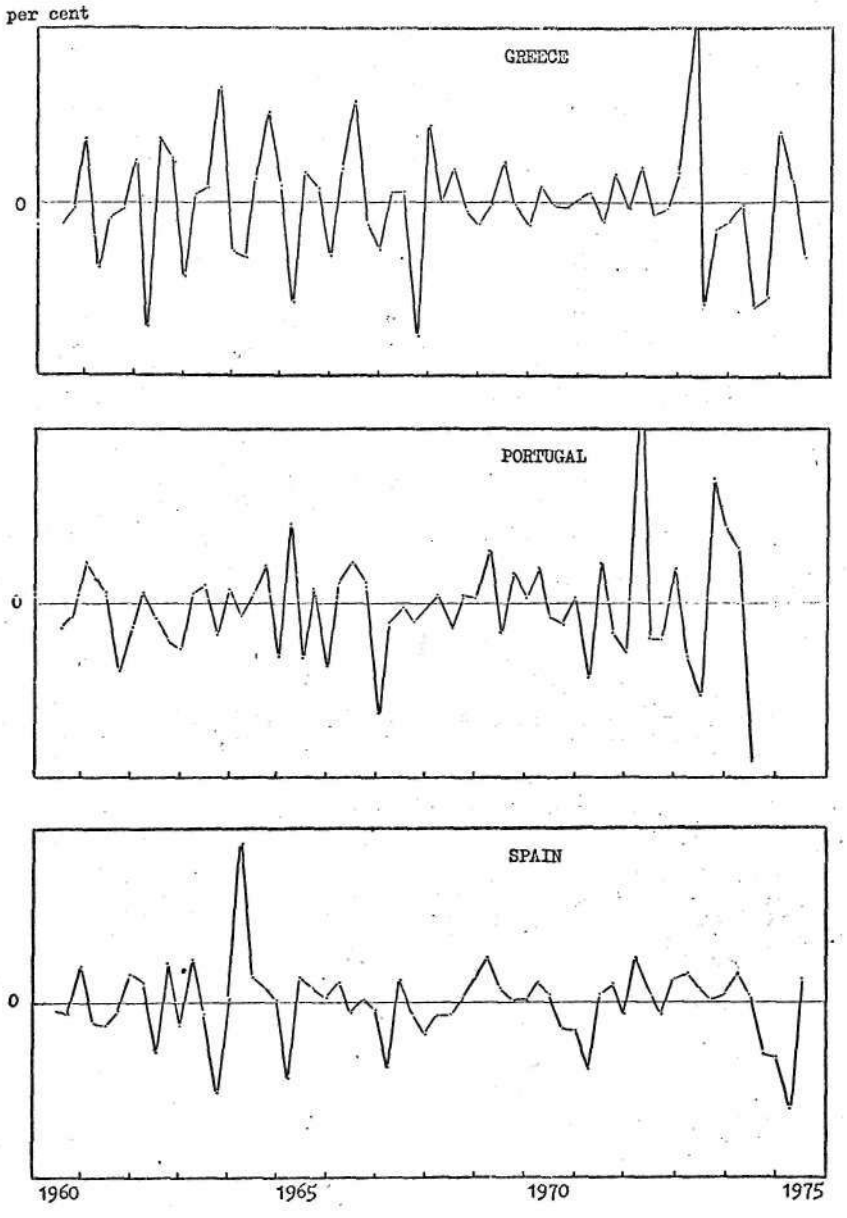

FIGURE 3. Index of Industrial Production. Deviations from trend of seasonally adjusted quarterly data.

ferences in growth patterns between the more cycle-sensitive and the less cycle-sensitive sectors may have affected the overall characteristics of instability.

TABLE 2

Amplitude and Duration of the 1967 and the 1974 recessions[1]

Recession	Greece	Portugal	Spain
		1967	
Peak	11 1967	III 1966	III 1966
Trough	III 1967	I 1967	I 1967
Amplitude	−11.33	−9.59	−4.03
Duration	1	2	1
		1974	
Peak	I 1973	I 1974	II 1974
Trough	III 1974	II 1974	I 1975
Amplitude	−19.26	−15.17	−12.74
Duration	2	1	3

1. Amplitude measured by percentage change in quarterly index of production, and duration measured in quarters.

Consumption

It is often taken for granted that private consumption expenditures are a very stable element of total demand. This becomes apparent if one looks at the percentage variations of total private consumption expenditures around their trend, which are much smaller than the percentage variations of the other demand components. Moreover, experience has shown that general consumer demand does not lead but follows the movements in production of consumer goods; it moves up or down mainly because changes in the rate of production have increased or decreased the current purchasing power of consumers. However, there are three observable sources causing consumer expenditures to lag behind economic activity. Firstly, payments of income normally lag behind the productive operations by which income is generated. Secondly, the spending of income lags behind its receipt[5]. Finally, some allowances must be made for inertia in the adjustment of spending.

A very common way of classifying consumer goods is according to their durability. At the one extreme are durable goods and at the other services which are considered to be consumed instantaneously. In between are those that comprise the semi-durable and non-durable goods. Within these durability groups there are differences in conditions of consumer response as well as of supply that make for dif-

5. Friedman' s permanent income hypothesis [31 is relevant in this respect.

ferences in the degrees of sensitivity to cyclical changes. Food products, for instance, are not likely to respond to changes in economic activity while the consumption of durables is rather flexible. In fact, the role of the latter category has been a matter of considerable controversy in the theory of business cycles, and this to a considerable extent arises from the variety of commodities that is included under this heading. Sales of durables tend to increase faster than the other components of consumption on the upswing, when stocks are comparatively low, and slower on the downswing when at any given level of income stocks are higher. Moreover, some durables are the only class of consumer goods to exhibit some lead as compared to the general business cycle, and such behaviour may be partly explained by the fact that durables may be financed by means other than current income.

TABLE 3

Annual change in consumption expressed as a percentage of the previous year's GDP

Year	Greece	Portugal	Spain	Turkey
1960-61	5.70	8.46	7.73	n.a.
1961-62	4.71	2.36	6.01	n.a.
1962-63	6.29	7.75	7.83	7.54
1963-64	4.87	−0.95	3.04	0.75
1964-65	7.38	3.87	4.84	2.55
1965-66	3.32	1.28	5.14	6.74
1966-67	5.04	0.78	4.38	2.23
1967-68	5.64	19.63	2.95	5.19
1968-69	6.05	1.74	4.80	3.80
1969-70	5.00	6.14	2.68	1.44
1970-71	4.60	7.12	2.08	9.92
1971-72	6.18	2.72	4.66	4.84
1972-73	12.93	6.11	4.34	1.25
1973-74	−8.39	8.94	5.23	n.a.
Average	4.95	5.42	4.69	4.20
Mean Deviation	2.23	3.74	1.25	2.40

Source: OECD. National Accounts

Thus, this type of consumption may show similar business cycle sensitivity to that of certain branches of investment activity so that they are sometimes examined together[6]. Because of the special features of this class of goods, it becomes apparent that in analyzing total consumption, durable goods will have to be separated out for

6. In this study we shall follow the national income accounts and therefore treat durables as a consumption component.

special consideration. However, this will not be pursued here since a breakdwn of consumption expenditures suitable for international comparisons is not available.

Looking at table 3 we observe that total consumption did show much smaller fluctuations than did the values of investment and inventories (discussed below). But if we compare consumption with income, the result shows that consumption was more stable than income, a fact that seems to suggest that over the period under consideration savings were the elastic element in economic fluctuations. Actually, the greater the extent to which saving rather than consumption is changed in response to changes in income, the less will be the cumulative effect on expenditure and therefore on income itself. Hence, it is because the saving-income ratio rises in the boom and falls in the slump that fluctuations in consumption are rather moderate. However, this cannot be analyzed very far because of the unavailability of relaiable statistics.

From table 11 we also notice that the consumption part of GDP growth is not the least unstable of the major components in all the countries (e.g. Portugal). This, however can be explained by the very high share of consumption in GDP growth which outweighs the fact that consumption itself is a low variability component. Finally, the analysis indicates that in some cases consumption has varied in a relatively stabilizing way. Thus, to mention an example, GDP in Greece rose by 3.4 per cent in 1962 while total consumption increased by 6.5 per cent. The stabilizing pattern of private consumption in such cases may be attributed partly to the effect of automatic stabilizers on disposable income, and partly to the three factors mentioned at the beginning of this section.

Moreover, in appraising the variability of the consumption component one must also allow for the effect of changes in tax policies.

Investment

Traditionally one of the most volatile elements of demand is investment. However, before we proceed to measure the instability of investment it is worth mentioning that all South European countries devoted a higher proportion of GDP to investment during the period under consideration than they did in any earlier period, and as will be seen, this was a major cause of the accelaration of growth in output and productivity in these countries. Thus, we notice that the ratio of investment to GDP rose in Greece from 0.19 in 1962 to 0.26 in 1972. The ratio rose from 0.16 to 0.20 in Portugal and from 0.18 to 0.21 in Spain. Finally, the ratio in Turkey was 0.15 and 0.17 in 1962 and 1972 respectively. It appears therefore that investment was highest in Greece which was the fastest growing economy during that period, and lowest in the slow-growing Turkey. Thus, there seems to have been a close association between the acceleration of growth and increases in the level of investment.

Table 4 shows that variations in the total value of investment activity were relatively moderate in some cases. Thus, cyclical reactions of total investment have been comparatively small in Turkey, reflected mainly in stagnation rather than

decline during the recessionary years 1965 and 1967. The same can be observed in Spain in 1967. Moreover, we notice that in some cases investment and output moved in opposite directions. Examples are Portugal in 1968 and Turkey in 1971. This, however, can be explained by the fact that investment activity mainly reflects decisions taken in the past. This obviously becomes particularly important for the South European countries where most of the investment relies heavily on imported goods.

TABLE 4

Annual change in investment expressed as a percentage of GDP in the previous year

Year	Greece	Portugal	Spain	Turkey
1960-61	−0.85	0.93	2.96	n.a.
1961-62	−2.05	0.25	2.00	n.a.
1962-63	1.00	2.32	2.04	0.71
1963-64	3.70	0.77	2.75	0.42
1964-65	3.19	1.76	3.11	0.36
1965-66	2.41	3.00	2.37	3.20
1966-67	−0.31	1.13	0.38	1.01
1967-68	4.17	−1.79	0.58	2.15
1968-69	4.12	1.42	2.57	1.09
1969-70	0.63	1.83	0.83	2.33
1970-71	2.47	1.95	−0.34	−0.92
1971-72	4.17	3.96	3.31	2.39
1972-73	2.28	1.58	3.30	1.43
1973-74	−10.09	−0.22	2.57	n.a.
Average	1.06	1.35	2.03	1.29
Mean Deviation	2.57	1.00	0.96	0.92

Source: OECD National Accounts

On the other hand, declining investment was a particular characteristic of the recessions in Greece where investment fluctuated more than GDP. Moreover, since investment is an important component of GDP, it may be concluded that the actual difference between investment and the remaining portion of GDP is even greater than shown in the figures. But we must repeat that annual series are often misleading when used to analyze economic fluctuations since considerable variations may have occurred in the course of the year. Thus, in general, yearly data tend to underestimate the magnitude of fluctuations, and particularly when they refer to such sensitive types of the economic activity as changes in investment.

Moreover, a complete analysis should take into condideration differences between sectors or industries. Information is available for building activity and although incomplete, it can be used to give some idea of the cyclical susceptibility of the industry. Actually, the building industry contains two features that put it in the heart of

the theory of economic fluctuations. The first feature is its large size and the strategic position it therefore holds with regard to production and empoyment in the economy. The second feature is that its fluctuations are very severe. However, it should be noted that only in long cycles are fluctuations in construction severe. On the other hand, in short cycles construction is considered to be a very stable sector of the economy.

So far as can be judged from the available material, non-resindential building activity was not always sensitive to business conditions. Thus, while total investment in Greece fell in 1967 by 1.36 per cent as compared to 1966, non-residential investment increased by 0.68 per cent. Similarly in Portugal total investment fell in 1968 by 9.31 per cent while non-residential investment increased by 11.41 per cent. In Turkey, on the other, hand, total investment fell in 1971 by 4.95 per cent and nonresidential investment by 20.58 per cent. However, in the upswings the situation seems to change a little. Thus, total investment in Greece rose in 1968 by 19.89 per cent while-non-residential investment rose by 35.81 per cent, and in 1972 total investment rose by 17.03 per cent while non-residential investment by 22.62 per cent. Similar movements can be observed in Spain in 1963 and 1969, Portugal in 1966, and in Turkey in 1970. Hence, it appears that in most of the prosperous years non-residential investment increased faster than total investment.

TABLE 5

Residential Construction Indexes for the South European Countries. 1970 = 100

Year	Greece	Portugal	Spain	Turkey
1960	37.55	62.34	71.02	n.a.
1961	40.32	68.97	84.87	n.a.
1962	45.49	68.50	86.98	50.87
1963	45.01	80.57	90.92	53.25
1964	60.27	93.65	102.74	54.80
1965	70.13	103.40	99.52	56.15
1966	77.26	127.99	97.25	68.61
1967	68.47	151.18	86.14	73.00
1968	89.33	84.51	93.31	82.81
1969	106.47	98.90	102.15	88.09
1970	100	100	100	100
1971	115.91	97.72	94.26	95.05
1972	150.24	132.77	n.a.	109.09
1973	n.a.	174.90	n.a.	n.a.

Source: OECD National Accounts

As far as residential construction is concerned, it is believed that it displays a high degree of short- run stability despite its volatility over the cycle as a whole. Part of the explanation lies in the fact that the immediate response to changes in economic

conditions appears in new orders rather than in construction activity as such. However, the actual work of building lags behind the orders and therefore work based on past orders continues through a period when new orders are reduced. Then, provided that the reversal proves temporary, orders withheld will be reinstated, new buildings will be started and activity is therefore not fully affected. Since some projects take two or more years to complete, current activity may be reflecting orders of two years earlier. Thus, short-term variations in the original orders are smoothed out and may not show up at all in activity. Moreover, one should take into account the influence of factors that encouraged house building (particularly in big cities and densely populated areas) during the period under consideration. Hence, one has to take into account that industrial development encouraged immigration to the densely populated areas. Improvements in standards of living were also reflected in improvements in housing and in a decrease in multiple occupation. Finally, in a country like Greece, the housing shortage that followed the Second World War was aggravated by the inflow of refugees from Turkey and Egypt. So, the shortage of houses continued during the 1960's despite the rapid expansion of house building. Therefore, demand increased much faster than the supply of houses and one should expect to see an absence of cyclical reactions and an unbroken expansion of house building throughout the period.

Nevertheless, during the period under consideration, house building had a decisive influence on the instability of total investment. Table 5 for instance, shows that-residential construction fell in Greece during the recessionary years 1963 and 1967. Moreover, the fall in residential construction in 1970 may have led the recession in 1971. Finally, we notice that the rapid increase in non-agricultural GDP in 1968 and 1972 was accompanied in both cases by an increase in residential construction of approximately 30 per cent. Similar observations can be made for the other countries although in some cases (e.g. Portugal in 1968) the synchronization between movements in non-residential building activity and output is less clear. Finally, we notice, that the level of house building that was reached in Spain in 1964 was not reached in any of the subsequent years.

Inventory Investment

One characteristic of the period under consideration is that inventories were particularly susceptible to economic fluctuations. Accumulation of inventories represents additions to goods, produced, but not sold, to consumers or other final users. Liquidation, on the other hand, represents the reduction in stocks when sales exceed production. Thus, inventory changes have the same stimulating effect as any other type of investment as long as they are accumulated, but this effect disappears when accumulation ceases and becomes negative when liquidation starts.
Hence, any decline in the rate of accumulation means that the stimulus has been reduced, and any decline in the rate of liquidation means that a stimulus has been provided. Or, to put another way, accumulation reinforces the upswing and liquida-

tion the downswing. Substantial changes in the rate of change may therefore reflect a period of general advance (as in Greece in 1961) or decline (as in Portugal in 1966). But an outstanding characteristic of inventory investment is that it may fluctuate at times when fixed investment remains stable. This can be observed in Portugal during the period 1960-62 and in Spain during the period 1966-68.

The expanation is that short time-horizon of inventory investment allows int to be moved in line with changes in economic activity than fixed investment. Thus, small disturbances in national income which normally will not affect fixed investment may cause fluctuations in inventory invesment. Also, divergencies between the actual and the desired stock can be corrected more quickly and therefore once a cycle has been started it will be completed more rapidly than a cycle in fixed investment. Thus, it would seem that inventory investment can be used as a useful indicator of economic instability and it is unfortunate that the available data do not permit a detailed analysis.

TABLE 6

Annual changes in inventory investment expressed as a percentage of GDP in the previous year

Year	Greece	Portugal	Spain	Turkey
1960-61	3.89	−2.64	1.81	n.a.
1961-62	−1.90	6.81	1.72	n.a.
1962-63	0.81	−8.22	0.24	n.a.
1963-64	1.84	4.65	−0.88	−0.14
1964-65	0.46	1.58	1.47	−0.40
1965-66	−3.72	−10.38	0.69	1.84
1966-67	0.90	4.02	−1.36	−0.84
1967-68	−0.05	1.77	0.13	−0.36
1968-69	−0.57	0.45	0.15	−0.60
1969-70	1.57	−1.06	−0.14	1.25
1970-71	0.08	0.80	−0.02	−0.27
1971-72	−0.04	−1.06	0.48	−0.75
1972-73	5.00	−0.05	0.30	0.60
1973-74	−2.66	2.41	0.63	n.a.
Average	0.40	−0.06	0.37	−0.27
Mean Deviation	1.67	3.29	0.65	0.62

Source: OECD National Accounts

Table 6 shows that during the period studied inventory investment did not contribute much to growth but that as a factor of instability it played an important role. In general, stocks of goods that are nearer to the consumer tend to increase as business improves and to fall as business falls, while those that are nearer to the

source of production show the opposite tendencies. In the cycles of the study period stocks of goods seemed to show positive cycles thereby intensifying fluctuations of consumers' demand in passing them to the producers of goods. Thus, in the boom, producers were trying to satisfy consumer demand, but also to increase stocks. On the other hand, those stocks that have a negative correlation with economic conditions had the opposite effect; that is, they worked towards making production more stable than the volume of consumers' purchases. Such behaviour implies that producers increased their stocks when demand was falling, and therefore maintained employment.

As examples of negative correlation between stocks and economic conditions we may refer to Portugal in 1970 and Turkey in 1971. However, these were exceptions, and changes in stocks had, on the whole, an unstabilizing influence on the economy in the sense that they tended to intensify fluctuations of economic activity. However since the volume of stocks was small, their fluctuations did not pruduce a decisive effect on the cycle.

However, for inventories to make a general impact on economic activity, it is a necessary prerequisite that there should be considerable conformity in inventory movements in the various sectors of the economy. But it is not possible to analyze this because in the statistics inventories are usually treated as an aggregate. Manufacturers' and other's inventories must be available for a number of subcategories since the lag in terms of the process of adjustment involved in each case can be explained by differences in the motives behind inventory policy and in the ability-for reasons of technique, market organization, etc. — to implement these policies. We can also distinguish various classes of stocks and the lag of inventories is to be found in the differences between these classes. Thus, goods in process may vary together with output, but raw materials purchased from domestic suppliers are bound to lag. Obviously, the lat increases in the case of imported raw materials and agricultural goods which may even show inverse movements to the cycle.

Foreign Trade

Since World War II the outstanding feature of the international economy has been the trend towards the restoration of a system of relatively free trade, mainly among the highly industrialized countries.

Mutual trade in goods and services is nowadays very extensive and, as a result, the conditions prevailing within each country or the policies of individual countries have a strong external effect. Thus, reduced demand at home, for instance, means reduced export markets for other countries.

It is a generally accepted fact that imports are significantly related to movements in domestic economic activity; they rise during booms and decline during recessions. When income in a country falls, part of the reduced expenditure will fall on imports. But expenditure on imports creates income for foreign producers. Consider now the

case of a propserous year. A rise in imports represents a leakage from the circular flow of income, while from the point of view of the rest of the world the increase in exports represents an injection into the circular flow of income. Moreover, incomes in the rest of the world will increase further due to the increased exports since a rise in the domestic investment of the various countries will be induced by the prosperity of their export industries and of the consumer goods industries where the proceeds from exports are spent. Hence, it appears that the movement in a country's imports reduces the amplitude of fluctuations in its income and transmits them to the rest of the world. However, here we must take into account changes in the demand for a given country's exports that will come about by changes in the rest of the world's income. In fact, to the extent that this happens, the damping and transmissive effects of the original increase in the country's imports are lessened.

The size of a country's marginal propensity to import is of great importance in this respect since it determines the extent to which imports will increase over the cycle and therefore the strength of their effect in damping the country's fluctuations and transmitting them to the rest of the world. Obviously, the value of the marginal propensity to import depends lergely on the structure of the economy. Thus, it will be smaller for a nearly self-sufficient country than for one that produces a comparatively narrow range of goods and relies heavily on foreign trade for the rest of its needs. This becomes more apparent if a country lacks the industries that produce investment goods, since the demand for those goods fluctuates more widely over the cycle than the demand for consumer goods. Hence, it follows that the marginal propensity to import is expected to be high in countries that specialise in the production of goods of the primary sector.

Although policies towards trade liberalization have been pursued mainly by the industrial countries, this by no means implies that the external relations of the countries in which we are interested form a closed circle. On the contrary, some of them are highly interdependent and it is likely that will become even more so in the near future. There is no doubt that the EEC will provide a great impetus in this direction.

Generally, the less industrialized countries are dependent on the highly advanced economies for export earnings and external trade is of considerable importance to them. Hence, it is mainly through foreign trade that outside influences make themselves felt in the economy, since variations in the volume of imports and exports transmit changes to the country that are brought about by the international business cycle. Moreover, given the important effects that international price movements have on business conditions, they are passed through foreign trade to internal prices. But these countries are too small individually to be able to influence the world economy. Moreover, fluctuations originated domestically are not likely to be synchronized in time since their interrelations are much smaller than those they have with the industrial countries. Thus, it can be said that this causes them to be at the receiving end rather than at the generating end of world economic cycles. Also, because of

TABLE 7

Annual Changes in Imports and Exports expressed as Percentages of GDP in the Previous Year

Year	Greece		Portugal		Spain		Turkey[1]	
	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports
1960-61	0.37	0.97	5.36	−0.48	2.79	0.77	n.a.	n.a.
1961-62	−1.89	0.79	−2.22	3.14	3.00	1.20	n.a.	n.a.
1962-63	1.77	0.76	2.18	0.17	2.53	0.37	0.13	T−0.06
1963-64	2.43	0.15	6.15	10.23	1.58	2.37	−0.31	0.09
1964-65	3.85	1.01	2.60	2.88	3.62	0.27	−0.02	0.08
1965-66	−0.11	3.02	2.33	4.38	2.24	1.67	0.10	0.02
1966-67	1.27	0.42	−1.73	1.07	−0.41	0.18	−0.02	−0.01
1967-68	1.86	−0.12	8.33	−0.98	0.87	2.38	0.10	−0.02
1968-69	2.86	1.39	2.32	0.73	2.27	1.71	−0.03	0.04
1969-70	1.21	1.26	0.28	−0.42	0.92	2.58	−0.01	−0.03
1970-71	1.91	1.16	7.26	2.94	0.03	2.04	−0.11	−0.05
1971-72	3.47	2.59	3.12	4.00	1.64	1.69	0.13	0.06
1972-73	7.00	3.53	2.35	1.25	3.66	2.10	0.04	0.06
1973-74	−4.52	−1.64	10.00	1.16	5.11	0.75	0.16	−0.05
Average	1.53	1.09	3.45	2.15	2.13	1.43	0.16	0.12
Mean Deviation	1.84	0.91	2.83	2.10	1.17	0.72	0.15	0.11

(1) Data for Turkey were taken from UN Monthly Bulletin of Statistics and were deflated by the imports and export price indices respectively. Data for other countries from OECD. National Accounts.

their rather homogeneous range of export products, these countries suffer more from trade fluctuations than the industrial countries.

In order to examine the aspect of the transmission of cyclical disturbances via repercussions on fareign trade we must look at variations of exports and imports. Table 7 shows that foreign trade has been subject to considerable fluctuations. Imports have shown a marked decline during recessions but have increased rapidly in subsequent recoveries. Among the countries under consideration, Turkey appears to have been least subject to import variations, while Portugal seems to have been the most severely affected. On the other hand, there seems to have been little correlation between recessions and declines in exports. It must be noted that exports are often considered to be completely unrelated to domestic activity since they depend on the income of other countries. Moreover, an idea why the exports of the South European countries are not so susceptible to the world economic conditions may be gained from an examination of the composition of their export trade. Such an examination reveals that most of the exports consist of agricultural goods whose demand does not depend much on the business cycle. Thus, it appears that imports have played a

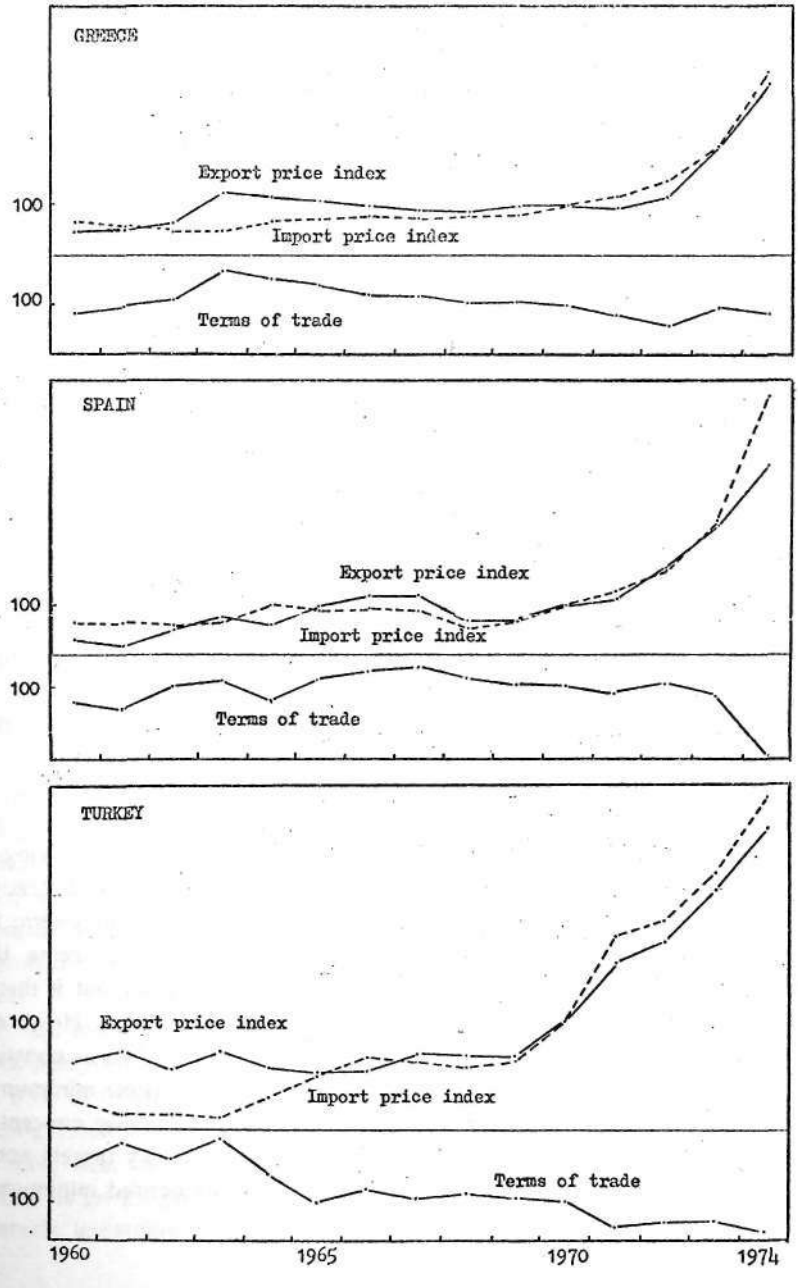

FIGURE 4. Import and export prices and terms of trade, 1970-74 1970=100. Logarithmic scale.

more decisive part than exports in influencing business conditions in the less industrialized countries of Europe.

Changes in export and import price indexes also play an interesting role in the cycle. Changes in the terms of trade affect the balance of payments position of the countries concerned, their productivity, as well as the general conditions upon which economic development depends.

Figure 4 shows that the indexed of export and import prices in the South European countries'[71] moved towards a different direction most years so that their terms of trade with other countries deteriorated. The figure shows that terms of trade moved within a margin of +14.90 and -8.66 per cent for Greece, +7.62 and -32.10 per cent for Spain and +26.60 and -12.98 per cent for Turkey. As can be seen, at the beginning of the period export prices increased more sharply than import prices and therefore the terms of trade moved favourably. The reverse movement is seen after 1963. The outcome was that the price indexes for exports and imports between 1963 and 1974 showed a deterioration in the terms of trade of about 17.9 per cent in the case of Greece, 29.1 per cent in the case of Spain and 36.1 per cent in the case of Turkey. These unfavourable movements in the terms of trade were mainly brought about by the high importation of capital goods, essential for development, and their accompanying increase of prices.

On the other hand, as was mentioned earlier, these countries mainly export agricultural products whose prices remain stable or change very slowly. It must be noted however thyt during the study period there were some structural changes in production, and the economy aimed towards self sufficiency, which were manifested mainly in the increased processing of imported raw materials by domestic industries.

Unemployment

A balance between the supply and the demand for labour depends, among other things, on a rather steady rate of production. In cannot be proved that a steady rate of production will by itself quarantee high employment although the long-term forces of supply and demand will work towards this direction. But it seems that a reasonably steady production is a necessary condition and that without it there will inevitably be the phenomenon of periodic widespread unemployment. However, we cannot say off-hand what percentage of employment should be taken as constituting a balance between the supply and the demand for labour. The feasible minimum level of unemployment in a given country will depend upon the particular concepts and measures of labour force and unemployment used. Moreover, policy targets and possibilities in a given country are also of importance. Also, the desired minimum level

7. Figures for export prices are not available for Portugal and therefore this country is not inluded in the figure.

of unemployment may also depend on the conceived trade-off between the conflicting aims of full employment and price stability. Finally, opinions on what level of unemployment represents the feasible minimum unemployment rate in each country, tend to be strongly influenced by what minimum levels have actually been achieved in the past.

A certain amount of short-run frictional unemployment is a healthy feature of a dynamic economy where there is a continuous flow of new entrants and-re-entrants into the labour force who have to find appropriate job openings. Indeed, in any dynamic economy based on free enterprise such a margin plays an important role in facilitating the starting of new enterprises and the expansion of existing ones. But to the minimum rate of frictional unemployment, some minimum of structural unemployment has also to be added. However, this latter concept refers to unemployment due long-run declines in the demand for certain types of labour which is usually concentrated in specific geographical areas. Such declines in demand along with economic as well as psychological factors can delay the appropriate mobility and can result in long term unemployment even if there is excess demand for labour in other occupations or areas. Finally, the minimum rate of unemployment has to include a certain minimum amount of seasonal unemployment as well.

One of the most difficult problems, therefore, in international comparisons refers to the statistical concepts and measurements of unemployment. Differences in the concepts and particularly in the methods employed for measuring unemployment make international comparisons of the absolute levels of the unemployment percentage strongly misleading[8].

In addition, the statistical information on the countries in which we are interested is not complete and the margin of error is very likely to be large. The coverage of the unemployment series published by different countries differs considerably. Data for Portugal are not available while those for Turkey seem to be extemely unreliable. The avialable unemployment statistics for the other two countries, namely Greece and Spain, are far from being satisfactory: unemployment is not even expressed as a proportion of the total labour force and therefore one must use the figures for comparisons of unemployment levels with caution and in the light of the difficulties noted above.

It can readily be seen that there is a close relation between recessions and levels of unemployment. The figures show that Greece started the period 1960-74 with a high level of unemployment. However, even after a rapid domestic expansion with increasing employment which was accompanied by large scale emigration, there may still have been labour reserves to be drawn upon in 1973 when unemployment reached its lowest point. It is generally recognized that in less industrialized countries, structural unemployment has been and still is and important or even predominant

8. See. A. Maddison |4|.

feature of the labour market. Although the flow of labour from agricultural to urban areas has been large, much of the unemployed, underemployed, or low-productivity employed labour reserve is difficult to move for geographical, psychological, and vocational reasons. Thus, it is doubtful whether such a labour reserve could have found employment if overall demand had simply increased, since although such a policy could be necessary, it would by no means be sufficient. Also there are limits to increasing overall demand in order to avoid inflationary conditions. Thus, special measures to increase capacity and mobility as well as special regional development policies must have played an important role in this respect. On the other hand, we notice that even the limited setback to industrial production in Greece during 1967 was enough to cause an increase in unemployment from 70 to 90 thousand people.

The, fact, however, remains that the economic expansion of these countries, during the period under considerations, occurred in conditions which were considerably below what is normally deemed to be full employment of a nation' s labour force.

Prices

The way in which wages, profits and prices are determined or influenced during the cycle is also of importance in our analysis. It is generally recognized that in a typical boom not only output but also prices rise and that in a typical slump both output and prices fall.

But this is the case where there are fluctuations in demand. When, on the other hand, fluctuations arise chiefly from the supply side, we should expect output and prices to move in opposite directions. In any case, whatever the cause of fluctuations, prices are expected to move accordingly.

Figure 5 shows the movements of prices in the South European countries between 1960 and 1974. More specifically the figure shows the annual percentage changes in the consumer price index of the four countries. It can be readily seen that the magnitude and persistence of price rises in the 1970 ' s constitute probably the most outstanding feature of the entire period under consideration. Thus, from 1969 to 1974 the consumer price index rose by 62.30 per cent in Greece, 86,27 in Portugal, 59,72 per cent in Spain and 114.97 per cent in Turkey. Price increases in Greece remained modest in comparison with the other South European countries up to 1963. They progressed more rapidly in 1966, while in the recession year 1967 they fell back to their previous rate of increase. A rapid increase started thereafter. The annual percentage change was a little higher in Portugal at the beginning of the period. There was a slower increase in 1966 while in 1967 a period of rapid price increases began. Spain was the country with the most rapid increases in the 1960's although prices in Turkey increased very rapidly in the second half of the decade. Prices in both countries started to increase rapidly after 1969.

An important feature of the inflation during the period under consideration was the transmission of higher prices. As was said earlier, this transmission of price increases is a result of the higher prices that have to be paid for import goods influencing the prices of goods produced in the country and sold in the domestic markets.

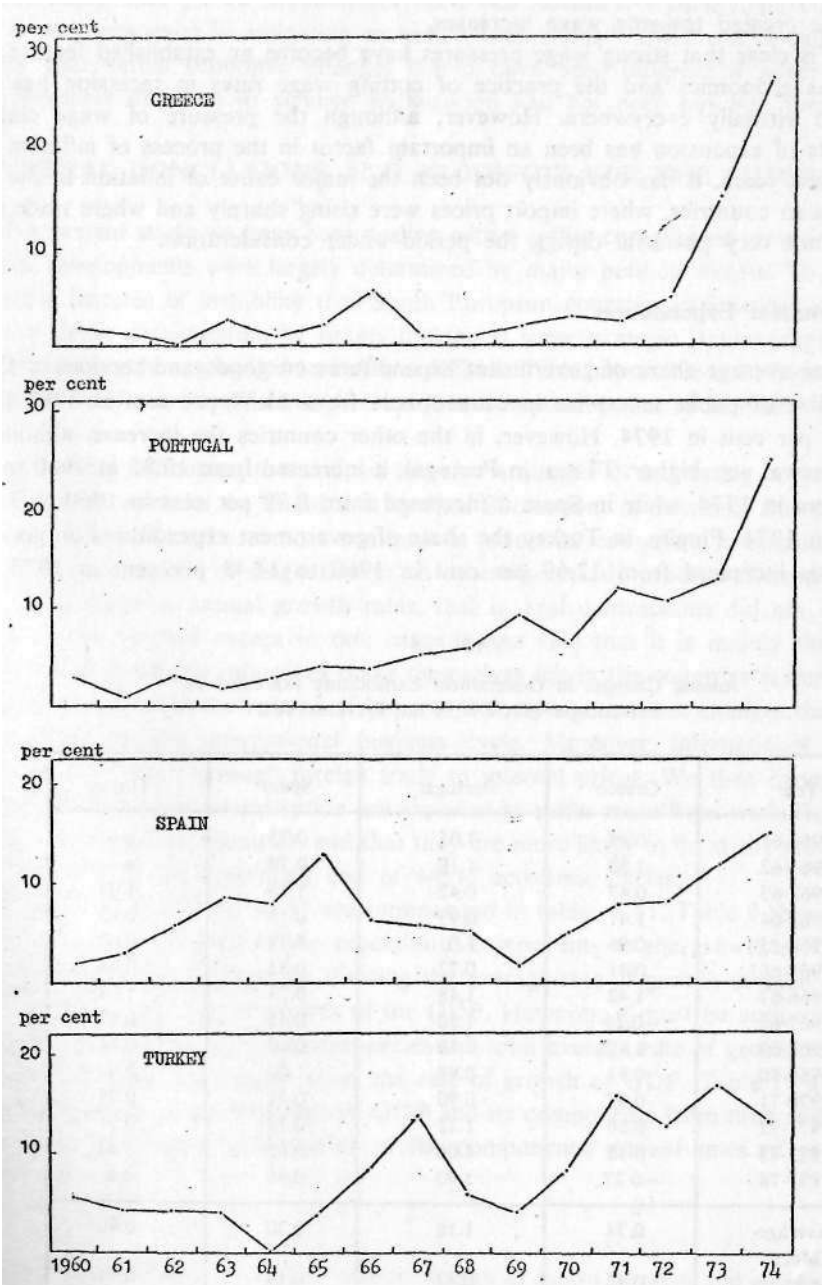

FIGURE 5. Consumer Price Index. Annual Changes.

Moreover, as long as prices are increased and transimitted in such a way, tendencies will be created towards wage increases.

It is clear that strong wage pressures have become an established feature in the various economies and the practice of cutting wage rates in recession has disappeared virtually everywhere. However, although the pressure of wage claims in periods of expansion has been an important factor in the process of inflation in the past few years, it has obviously not been the major cause of inflation in the South European countries, where import prices were rising sharply and where trade unions were not very powerful during the period under consideration.

Government Expenditures

The average share of government expenditures on goods and services in Greece-exclusive of public enterprise investment-rose from 11.34 per cent in 1960 to only 11.59 per cent in 1974. However, in the other countries the increase, although not impressive, was higher. TThus, in Portugal, it increased from 10.85 in 1960 to 14.51 per cent in 1974, while in Spain it increased from 8.79 per cent in 1960 to 9.23 per cent in 1974. Finally, in Turkey the share of government expenditures on goods and services increased from 12.69 per cent in 1960 to 14.41 per cent in 1973.

TABLE 8

Annual Changes in Government Expenditure expressed as Percentages of GDP in the Previous Year

Year	Greece	Portugal	Spain	Turkey
1960-61	0.48	3.05	0.75	n.a.
1961-62	1.50	1.18	0.78	n.a.
1962-63	0.47	0.42	1.15	1.04
1963-64	1.41	0.93	0.15	0.93
1964-65	0.96	1.01	0.79	0.60
1965-66	0.81	0.72	0.31	0.96
1966-67	1.42	1.48	0.73	1.08
1967-68	−0.24	1.20	0.45	0.88
1968-69	1.42	0.49	0.60	0.84
1969-70	0.91	0.99	1.00	0.47
1970-71	0.67	0.90	0.71	0.78
1971-72	0.66	1.22	0.74	0.91
1972-73	0.15	1.06	0.65	1.44
1973-74	−0.27	1.90	0.96	n.a.
Average	0.74	1.18	0.70	0.90
Mean Deviation	0.46	0.42	0.19	0.17

Table 8 shows the rate of change of government expenditures and as can be seen this component of GDP was the least unstable in all four countries. However, this

does not imply that public expenditures must not fluctuate. Acutally, government policy is very important in mitigating economic fluctuations[91] and it can be said with certainty that actual economic changes would have been different if government policy measures designed to achieve stabilization had not been put into force.

GENERAL CONCLUSIONS AND PROSPECTS FOR THE FUTURE

In the present study we have been dealing with a rather complicated period where economic developments were largely determined by major political events. To catch the specific features of instability that South European countries experienced during the period under consideration by simply looking at some strategic factors (expressed in annual and highly aggregated terms) is a difficult if not impossible task. Moreover, the application of more sophisticated techniques is impossible due to unavailability of data.

Despite these difficulties, the analysis revealed a number of interesting points. Using the available material we found that cyclical fluctuations in Southern Europe are much less violent than those most common in industrial countries. Recessions appeared rather as periods of stagnation in an otherwise steady process of expansion, and cases of negative annual growth rates, that is, real contractions did not occur during the study period except in one case. It was said that it is mainly through foreign trade that outside influences make themselves felt in the countries under consideration. Variations in the volume of imports and exports transmit changes that are brought about by the international business cycle. Moreover, international price movements are passed through foreign trade to internal prices. We then concluded that the countries under consideration are expected to suffer more from trade fluctuations than the industrial countries, and that they are more likely to be at the receiving end rather than at the generating end of world economic cycles.

The main findings of the study are summarized in tables 9-11. Table 9 shows the relative contribution of each of the expenditure components to the growth of GDP. These contributions were found by dividing the average rate of growth of each component by the average rate of growth of the GDP. However, it must be noticed, that due to roundings and statistical discrepancies the total average rate of growth of the components does not necessarily equal the rate of growth of GDP. Table 10 shows the deviations of the rates of change of GDP and its components from their average. Finally table 11 shows the variation of the components' annual rates of growth

9. The government can influence the economy through its actions of taxing and spending and through manipulations of the money supply, credit conditions and interest rate. However, whether the government should attempt such a policy of economic control on a regular basis is still open to dispute. The majority of economists would argue that it should attempt to do so, but there are some that contend that small fluctuations are a healthful phenomenon 15,6,71.

divided by the components' average rate of growth. All figures for Turkey, except on imports and exports, refer to the period 1962-73.

TABLE 9

Contribution of Expenditure Components to the growth of GDP. Period 1960-74

Components	Greece	Portugal	Spain	Turkey
Private consumption	0.70	0.84	0.65	0.65
Government consumption	0.10	0.18	0.10	0.14
Gross fixed capital formation	0.15	0.21	0.28	0.20
Inventory Investment	0.06	−0.01	0.05	−0.04
Exports	0.15	0.33	0.20	0.02
Imports	−0.22	−0.54	−0.29	−0.02

TABLE 10

Variation of GDP and its expenditure components Period 1960-74

Components	Greece	Portugal	Spain	Turkey
Private consumption	2.23	3.74	1.25	2.40
Government consumption	0.46	0.42	0.19	0.17
Gross fixed capital formation	2.57	1.00	0.96	0.92
Inventory Investment	1.67	3.29	0.65	0.62
Exports	0.91	2.10	0.72	0.11
Imports	1.84	2.83	1.17	0.15
Gross domestic product	2.26	1.54	1.82	2.18

TABLE 11

Fluctuations of the GDP and its expenditure components. Period 1960-74

Components	Greece	Portugal	Spain	Turkey
Private consumption	0.45	0.69	0.27	0.57
Government consumption	0.62	0.35	0.27	0.19
Gross fixed capital formation	2.42	0.74	0.47	0.71
Inventory Investment	4.17	54.83	1.76	2.29
Exports	0.83	0.98	0.50	0.92
Imports	1.20	0.82	0.55	0.94
Gross domestic product	0.32	0.24	0.25	0.34

The situation for the future is expected to change for the worse. In trying to predict how the situation is expected to change in the future, one has to take into ac-

count the forthcoming association with the European Economic Community and the repercussions that such an association may have on economic stabilization. Thus, a question that arises is whether the association with the EEC will affect the size and extent of cyclical fluctuations within each country.

The idea behind economic integration is to achieve an improved allocation of resources. However, such an improvement is based on the assumption that allocation is not distorted by fiscal mechanisms within each one of the member countries. Thus, fiscal harmonization is required if economic integration is to achieve its objective. Indeed, one of the basic principles of the Rome Treaty was that all tariffs and restrictions upon factor movements will disappear within the union.

Under these circumstances one may expect integration to help the union as a whole since dependence on non-member countries will be lessened. This will reduce the vulnerability of the Community to cyclical changes in non-member countries and particularly the U.S.A., which, as experience has shown, is the major source of international instability.

However, this is only part of the story. After the abolition of tariffs consumers will enjoy an increase in real income. This will probably result in higher imports, causing the average propensity to import to increase. If, on the other hand, we assume that the removal of tariffs is followed by tax increases so as to compensate for the lost revenue, real income remains unchanged. However, still the consumption of imports is expected to increases, at the expense of domestically produced goods. The implication of this is that the economies will be more exposed to foreign trade and therefore the vulnerability of each country in question to economic conditions in any other union member will be increased.

The comparative price reduction in imports will be greater the higher the level of tariffs before integration takes place. This implies that stability conditions will deteriorate more in the South European countries which are highly protectionist as compared to the other countries which are highly potectionist as compared to the other countries of the Community. Moreover, the impact of changes in economic conditions elsewhere in the union will be higher for the South European countries because, generally, less advanced countries are more vulnerable.

Let us see now whether the association with the EEC will affect the efficacy of countercyclical fiscal policy measures. It was said above that all EEC countries have to adopt similar tax structures for all the major forms of taxation. Moreover, country members will not be allowed to make any substantial structural changes unilaterally, However, once this is done, the ability of each individual country to use its fiscal policy instruments for domestic stabilization policy is seriously affected. To this extent, the two objectives, namely optimum allocation and stabilization, are conflicting.

The association with the EEC requires the adoption of a net value-added tax at all stages of production upon the principle of origin. This obviously implies that all member countries should adopt similar tax rates, and this imposes restrictions on an independent fiscal policy. Similar restrictions for unilateral tax changes can be ex-

plained in terms of the corporate income tax. It is well Tknown that the high elasticity of the corporate income tax is mainly due to its high base elasticity, which implies that corporate taxation for macroeconomic policy goals must be done through changes in the tax base. Depreciation allowances, investment allowances, and loss carry over provisions are among the major policy measures in this respect. However, once a country becomes a member of the union, significant unilateral changes may distort the location of new plant and equipment, and therefore will not be allowed. To this extent, the effectiveness of the corporate income tax in attaining stabilization goals will be eliminated considerably.

These are only two examples of the restrictions the association with the EEC will impose on independent tax policy. However, given that the main reason for forming an economic union is to attain optimal allocation of resources, the members will have to harmonize the structure of their expenditure policies as well. Changes or differences in the provision of government services may be allowed, provided that they are offset by changes or differences in the tax burden. Thus, this allows for discretionary countercyclical policy by any member by making use of the balanced budget multiplier. However, it must be noted that this is based on the assumption that both fiscal benefits and burdens are similar.

Alhough this may be feasible in theory, in practice it will be impossible to adopt equal tax and expenditure changes without influencing the existing pattern of fiscal incidence. The overall conclusion " is, therefore, that fiscal harmonization implies limitations upon unilateral changes in taxation and expenditure, which in turn imposes restrictions on the use of these instruments for attaining stabilization policy objectives.

Moreover, to the extent that discretionary fiscal policy is feasible, its efficacy to control economic conditions within the country in question is expected to be reduced. This can be explained in terms of the multiplier thery. After the removal of tariffs we shall expect the marginal propensity to import to increase in the countries under consideration. Assuming now that the marginal propensity to save remains unchanged, the value of the multiplier reduces. This has the following implications. Firstly, the reduction of the multiplier will be stabilizing as long as fluctuations arise within the borders of the country in question. Secondly, having a lower multiplier implies that the effectiveness of countercyclical fiscal policy is reduced. Thus, in total, taking into account that economic fluctuations in the South European countries arise mainly from abroad, we may conclude that the reduction of the multiplier will be rather destabilizing. On the other hand, the association with the EEC will result to a coordination of fiscal policy which in turn will lead to an increased efficiency of countercyclical measures, provided that economic fluctuations are general. The improved efficiency will be for the community as a whole, while the efficacy of economic policy for any particular country will be reduced.

The foregoing discussion suggests that in the future stabilization policies should preferably operate through the automatic stabilizers rather than through discretionary

fiscal actions. The imposition of withholding income tax at the source, as the one that was suggested, will contribute to stabilization both by curtailing evasion and therefore increasing revenue, and by increasing the response of tax collections to income changes. On the other hand, to the extent that country members follow the suggested approach of splitting income for married couples, the degree of progression of the income tax will be reduced (provided that these countries, do not already follow this approach).

As far as indirect taxes are concerned, the replacement of specific taxes by an *ad valorem* value added tax will be definitely, an improvement, particularly for those countries that have many specific taxes in their tax system. However, as was said above, the value added tax will require equal or near equal tax rates. Given the fact that South European countries have high rates of indirect taxes, the rates to be adopted after the association with the EEC are going to be lower than the ones already existing. This implies that the degree of built-in flexibility of indirect taxes will be reduced.

Thus,, in general, the association with the EEC will not only make South European countries more vulnerable to economic fluctuations, but also the efficacy of their countercyclical fiscal policy measures will be reduced. Without going into details we can say that the efficacy of monetary policy is also expected to be reduced since restrictions on capital movements will be abolished. Hence, in discussions about the merits and demerits of a possible association with the EEC the conflict between allocation and stabilization objectives must not be disregarded.

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