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13 May 1974

MEMORANDUM

SUBJECT: Inflation as an Issue in the Domestic  
Politics of Leading Foreign Countries

The rising cost of the things the voter and his family buy in the course of their day-to-day living has become a major political issue in all of the leading industrialized countries outside the Communist systems. The problem has come at a time when practically all industrial countries were already having growing domestic political problems. Failure to cope successfully with the price spiral is further complicating the political scene and has no doubt weakened the position of government leaders.

What follows is an outline of the salient aspects of inflation as a political issue in six countries--among them the US' principal allies.

United Kingdom

Inflation is worse in Britain than in most other industrial nations, and price rises, now running at an annual rate of about 20 percent, underlie many of the political issues facing the country. Public concern about continually rising prices and the unions' persistent wage demands played a significant role in the defeat of the Troy government in the February election.

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The electorate, particularly the working class, is going to be watching to see how soon the new Labor government's "social contract" with the unions breaks down. Under this arrangement, the government has pledged to control prices and rents in exchange for the unions' promise to restrain wages. If Wilson is unable to curb inflation and the unions decide to resort to militant action to get their demands, the Labor leader may not win a majority in the next election.

Wilson's decision on the timing of the next election will in fact depend to some degree on the economic outlook. He is likely to call an early election if he senses that the electorate is beginning to blame him rather than the previous government for the country's economic problems. His government, like all British governments, however, will have difficulty in curbing inflation, in part because of the country's dependence on imported commodities, the prices of which are likely to continue to climb.

France

Inflation is the problem most central to the French election campaign, and control of inflation will be a major factor in the success of the victor's administration. Interest in problems such as unemployment and housing pales next to voters' obsession with inflation. As a package, however, social reforms seem to be running neck-and-neck with inflation in the voters' minds.

In 1973, France experienced an annual inflation rate of 8.5 percent, which placed it in the middle range of the inflation experienced by other EC members. In the first quarter of this year, the rate soared to 17 percent. The increase is related to the oil crisis and is expected to decline in the second quarter. Prior to the energy crisis the economy was booming, wages were increasing more rapidly than prices, and unemployment was at a tolerable level. This prosperity increased demand for expensive domestic programs which the voters now see as necessities.

Opinion polls have shown that the electorate is most concerned about the personal effects of inflation. Their votes in the presidential race will reflect their choice

between the stability necessary for economic growth--Giscard-- and the reform necessary for an improved life for the workers-- Mitterrand. Either man as president will face the immediate challenge of devising a program that will meet the partly contradictory demands of strengthening the economy and reforming the society.

### West Germany

The issue of inflation in West Germany produces an emotional reaction out of proportion to its actual seriousness. Given their country's past experience with inflation and general economic disorder, West Germans--even those who did not actually go through the turbulence of the twenties, the depression years, or the early postwar period--react, or perhaps over-react, to signs of weakness in the national economy.

Inflation in 1974 will probably amount to about 10-11 percent, which will leave West Germany in a slightly better position than some of its West European neighbors. Dissatisfaction with even this rate of inflation, however, to say nothing of fears that it may go even higher, is a serious drain on popular support for the government. No political party that hopes to stay in power can afford to leave the impression that it is not dealing effectively with West Germany's current economic problems.

### Italy

Italy is faced with a multitude of problems, but with consumer prices now rising at an annual rate of 36 percent, inflation is the issue uppermost in the Italian mind. Accordingly, recent Italian governments have singled out inflation as one of the major targets of domestic economic policy. However, the divergent economic philosophies of the coalition partners--the split is essentially between the Socialists and the others--have prevented the government from taking the hard decisions required to deal with the problem.

Inflation is straining the fragile labor peace that has existed during the last year. Labor leaders have given the government a breathing spell by refraining from major

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strike activity and excessive wage demands. Soaring prices, however, have created strong rank-and-file pressure for stronger action. This is reflected in recent settlements in the auto industry. Fiat, for example, is obliged in its latest contract to provide many of the social services that the government has been unable to deliver. A trend in this direction could weaken business support for the center-left coalition and, perhaps, lead some industrialists to conclude that a government including Communists would be no worse for business than the present coalition.

A second echelon of popular concerns revolves around the broad issue of social and economic reform. Government action in this field has not kept pace with rapid economic changes. Although GNP increased faster than that of Western Europe as a whole through most of the postwar period, Italians have had to put up with overcrowded schools and hospitals, an antiquated legal system, a shortage of public housing, a clogged bureaucracy, and an inadequate welfare system. Pressure for change in these areas accounted in part for the launching of the center-left coalition a decade ago. But not much has changed, and reform remains a dominant political issue.

Canada

The dispute over how to deal with inflation brought down Prime Minister Trudeau's government this week. Both the Tories and the New Democrats charged that the Liberals' budget did not go far enough to control inflation. Trudeau, meanwhile, has announced that he will campaign on his budget, which he believes the electorate will recognize as a more sensible approach to the problem of inflation than those offered by the opposition.

The Canadian public is keenly aware of the rise in the cost-of-living, which amounted to 9.1 percent in 1973 and is running at about 11 percent this year. Last month a public opinion poll indicated that 59 percent of the populace believe that inflation is the most important problem facing the country. No other single problem came close to inflation. Unemployment (8 percent) and the energy problem (7 percent) were the second and third most frequently cited problems in the poll.

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Japan

Inflation, which has been running at a rate of about 25 percent per annum, is the concern foremost in the minds of the Japanese electorate. As such, it is an important issue in the campaign now being waged for elections to the Upper House of the national legislature on July 7.

The Japanese have been highly critical of their government for failing to stem inflation. However, they recognize that inflation in part is the result of external circumstances, especially the rising costs of importing energy and other resources, over which Tokyo has no control. Moreover, they do not believe the opposition parties are capable of offering more effective policies to combat inflation.

Thus, although a major concern, inflation is having little effective political impact in Japan. The four opposition parties attempt to exploit inflation as an issue, but their disunity precludes them from effectively capitalizing on it. They have been unable to agree to support joint candidates to successfully challenge the ruling Liberal Democratic Party at the polls. The ruling party is expected to retain its majority position in the coming Upper House elections. As a result Prime Minister Tanaka, whose party also controls the more important Lower House, is likely to remain in office at least through the end of his term in 1975.

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Attached is a quickie response to your talk with George Carver, Maurice Ernst and me last week about inflation as a political issue. The views here are simply those of analysts on the respective country desks in OCI, with a check by OER.

Deputy Director of Current Intelligence

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