

Prime Minister

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ECONOMIC DEVELOPMENT, UNEMPLOYMENT AND ECONOMIC POLICY:
A ROAD TO BETTER PERFORMANCE

I Introduction

During recent months it seems to have become more than probable that an international recovery has finally started. In the United States the GNP increased by around 3 per cent in the first quarter of this year, and signs of revival are also detectable in other countries. Inflation is at a ten year low in many countries in the OECD-area.

This does not, however, imply that the main problems of the world economy have been solved. Unemployment is still very high and rising. It is evident that we are confronted with problems which have developed over a long span of time, and which have to be overcome before we can expect to achieve higher economic growth and lower unemployment on a more sustainable basis.

During the decade up to 1973, unemployment averaged some 3 per cent of total labour force in industrialized countries. The rate has since then shown a strong and steady increase, and may - according to a recent OECD

forecast - amount to some 35 million people, corresponding to 9½ per cent of the labor force, by the end of 1984. The situation, however, differs greatly between countries. In Japan the unemployment rate is now about 3 per cent, while it is exceeding 10 per cent in a number of other industrialized countries including the USA, Canada and the United Kingdom. In Norway, unemployment in the first four months of this year was at 3 1/4 per cent of the labour force, when adjusted for seasonal variations.

I am afraid that if we fail to break this trend towards higher unemployment, and do not bring it down to a more acceptable level, we may be faced with a situation which may increasingly affect even the political stability in our societies. Equally serious are the negative effects on the Third World. The opportunities offered by an economic upturn must be used to lead the world economy on to a path of renewed sustainable growth, high enough to reduce unemployment.

In a memorandum of January 1983 to the Secretary General of the OECD, the Norwegian Government called for new initiatives aimed at achieving this. The reactions internationally towards the Norwegian initiative were rather positive. Official reactions and statements by many countries go in the same direction. And the communique from the ministerial meeting in the OECD on 9-10th of May is indeed a step towards the coordinated and differentiated

international strategy that we and many others have advocated. The possible outcome of cooperative efforts are, however, decisively linked to the way in which these ideas will in reality be followed up by such leading countries as the USA, Japan, Germany, the United Kingdom and France.

An important feature of current policy requirements must be to sustain demand in a number of countries, in particular investment demand. It is essential that such policies are implemented in a concerted way by several countries. This does not, however, imply a recommendation for all countries to initiate economic policies in the same way and to the same degree. A differentiated approach is called for, depending on the risk of renewed inflation in individual countries.

An important reason for the poor growth performance of the OECD countries recently is low demand from other parts of the world. The oil-importing developing countries have suffered most from the recent international economic recession. With considerable excess capacity in the OECD area, it would seem beneficial to aim at increasing the flow of financial resources to developing countries beneficial not only to the poorer countries, but to the OECD countries themselves, who will benefit from expanding markets.

It should, therefore, be welcomed that The International Monetary Fund has now decided to increase quotas for financial assistance to developing countries. This development should continue, and the IMF and The World Bank (IBRD) should be encouraged to continue their co-operation with private financial institutions so that potential future financial crises can be avoided.

Such and other measures to increase demand can, however, probably not bring back full employment without being supplemented by other measures. There is a grave risk that traditional expansionary policies may lead to a resurgence of inflation, which may again stop real growth. To avoid such a new downturn, and secure a prolonged period of real growth, the policies must include measures which will

- improve business profitability,
- stimulate productivity, and
- stimulate productive capital formation.

II Causes of increased unemployment

The strong rise in unemployment levels since the early 1970's may indeed give the impression that our ability to achieve set economic and social goals through well designed economic policies has deteriorated dramatically. This may perhaps lead to the thought that politicians today are less able to cope than, were their predecessors during the good

old days of full employment. I will, however, hardly surprise anybody by answering that I think such an explanation is too simplistic. Rather the world has become far more complicated during the later decades.

The economic policies of the first decades after World War II were in reality not particularly sophisticated. Nevertheless, in this period the OECD area achieved high economic growth, low inflation and low unemployment. The good performance was, however, to a large extent the result of a favourable combination of economic and social factors. Let me point to some of them:

- First, I should like to stress the basic importance of the actions taken by the USA to avoid a financial crisis in Europe.
- Secondly, I would mention that in the 1950's and 1960's, economic behavior was still greatly influenced by memories of pre-war and war conditions. Despite low levels of unemployment, and even shortages of labour, wages were not rising much faster than productivity, and wage claims were relatively moderate.
- On the other hand productivity was rising fast, and thus stimulated investment. New technologies, developed during World War II, were applied for peaceful purposes. The rapid transfer of labour from

agriculture to industry facilitated rapid growth of output and productivity in both sectors.

- The liberalization of international trade strengthened competition, further encouraged efficiency and reduced inflation.

- Inflation was kept down also by the relative stability of commodity prices. Oil prices changed little in nominal terms, and fell in real terms. (Before the first oil shock, oil cost two dollars per barrel.)

By hindsight, it is beyond doubt that such factors and circumstances to a large extent explain the excellent performance of growth, employment and price stability during the first decades after World War II.

Towards the end of the 1960's however, ominous changes in the functioning of our economies began to emerge. I should like to point to some of those factors:

- Wage and other nominal income claims got more and more into conflict with the moderation necessary to achieve growth without inflation. One may say that social groups intensified their organized efforts to share between themselves more than 100 per cent of the available resources, with the inflationary consequences which ought to have been expected. That is the old

- story of man - after a number of good years - gradually demanding so much that he undermines his own position.
- Vocational and geographical mobility were more and more resisted, contributing to rigidities within the labour market and to lower productivity growth, which again complicated the fight against inflation.
 - Public sector expenditures, as a portion of GNP, expanded strongly as from the second half of the 1960's in most industrialized countries. This trend continued after 1973, partly as the result of the necessary increase in benefits to the growing number of unemployed. Adding to the rapidly increasing public expenditure were various forms of financial support to industry. The increase in public expenditures reduced the share of resources available for other purposes, particularly investments. Higher taxes, in combination with higher labour costs, reduced real profits, and had a negative effect on the willingness to invest.
 - Low investments have, finally, meant that the stock of real capital has increased at a slower rate than the stock of labour. This is a textbook cause of unemployment.
 - Low growth, and new social patterns also added to the rigidities of the labour market. Unemployment increased

in several countries also because of strong increases in the economically active population, particularly from young people and women seeking employment.

- The prolonged economic stagnation has made it difficult for parts of the labour force to gain work experience. This may, partly, serve as an explanation why increased general demand seems to stimulate employment less and inflation more than in the 1950's and 1960's. The mobility within the labour market has been reduced also by the increasing number of two-income families.

- The prolonged increase in unemployment has contributed to mounting protectionist pressures, particularly in recent years. Selective measures to support industry have preserved excess capacity in various branches, and have thereby prolonged or even aggravated the crisis.

- The two oil price-shocks in 1973/74 and 1979-80 served to re-inforce the effects of the above mentioned factors. Prices and wages accelerated, notably in those countries where a high level of demand was maintained for counter-cyclical purposes.

Thus, it is very important to acknowledge that most, if not all, industrial economies are different now from what they were in the 1950's and the 1960's. Consequently,

economic policies must be different, and we must acknowledge that there are no easy solutions to the problems we face.

It is especially important to accept that the traditional "solution", entailing expansion of real demand, is no longer sufficient to create full employment on a more durable basis, but may, if overdosed, simply result in more inflation. And more inflation would mean a new round of more instability in exchange rates, more uncertainty, higher interest rates, less investment and less employment. Modern inflation is rightly termed stagflation.

III Elements of an economic-political strategy to reduce unemployment

To avoid that increased demand leads to more inflation, we must improve the functioning of the market mechanism. We must re-consider government policies from the point of view of stimulating investment, increasing productivity and reducing the inflationary bias. Even if these are domestic tasks, they would indeed be easier to handle if more countries would move in the same direction simultaneously. Thus significant results could be achieved sooner.

A second major domestic issue is how to secure better conformity between growth of productivity and growth of nominal incomes. In democratic societies the possibilities for the authorities to influence attitudes and behavior of the labour market organizations may indeed

seem rather limited. Some kind of counter-vailing pressures for income moderation are, however, required.

We must also obtain a much better understanding for the fact that the authorities are unable to solve the difficult economic problems by themselves. It is one of the most serious misunderstandings in modern societies that governments have the necessary means to avoid mass unemployment, even if pressure groups create conditions which make full employment impossible. The general public and interest groups must somehow be made to realize that real wage claims that are too high will unavoidably lead to increased unemployment. Thus moderation should be in the enlightened self interest of almost everybody.

Enduring problems in national economies lead to increased frictions in international trade and payments. New barriers to trade and unstable exchange rates create an atmosphere of uncertainty with negative effects on investment. Thus, protectionist measures and excessive competitive devaluations tend to reduce investment in all countries taken together, and thereby to aggravate the international crisis.

To avoid protectionism is part of the international challenge to governments. But it should be admitted that it is not always easy to stand up against protectionist pressures, especially when the opposition forces try to gain support from the voters through appeals to short-sighted

national egoism. It is indeed not easy - but not impossible either - to explain why hindrances to imports create more and not less unemployment - in the western world as a whole.

One main reason why the Norwegian government addressed the Secretary General of the OECD in January was just the importance of international linkages. In other words: the economic interdependence between our countries. The OECD has recently published an interesting study, which indicates that the interdependence of the different OECD-countries is even greater than previously assumed.

It is well known, of course, that, when a single country expands demand, a significant proportion of the stimulatory effects "leaks out" to other OECD-countries. The reverse holds true for a contraction of economic policies.

If a number of major countries are initiating demand expansion at the same time, however, the total effect can be unexpectedly large. Each country finds, in addition to the expected expansion of its domestic demand that its exports too are growing sharply. Overheating of the world economy can then arise. Economic developments in the early 1970's stand to illustrate this. The opposite effect, of inducing a downturn, greater than intended, can just as readily occur in times of synchronized deflation. This is what may have happened in the last three years.

Some governments may have underestimated the possible adverse effects of their own restrictive policies through negative effects on the international trade and financial system. All countries would gain from a regime where national policies were modified with regard to the international effects of their national actions and policies.

It is not sufficient that each country individually try to predict the rate of growth, inflation etc. in other countries, and then decide its own policy on that basis. We must become more sophisticated than that. Through international co-operation and coordination we must strive at a more simultaneous decision - making process.

Apart from the economics involved, I will stress that there are important political implications as well. This has something to do with the political cohesion of the western world. It is very important to arrive at some sort of political concensus on common economic and social goals of Western industrial societies. And all countries, notably the larger ones, should acknowledge that the effects on other countries should be taken into consideration whenever they are designing national policies. Cooperation between OECD-countries will be crucial not only from an economical point of view, but for the more general political development as well.

It is, consequently, very important and encouraging that the ministers of the OECD-countries last week agreed,

as I have allready mentioned, on an approach to sustain and to broaden the economic recovery now under way. Among the many important elements, I will emphasize their agreement to take advantage of the decreasing inflation, which makes it possible to undertake financial or monetary growth, in order to promote job creation and higher employment. The ministers also agreed to work for greater exchange rate stability, lower interest rates, the dismantling of trade restrictions, and effective measures to resolve debt problems.

As regards the North-South-dimension the communique stresses the need for increased aid, as well as improved and more stabilized export earnings for the poorer developing countries.

Important and encouraging as this may be, one could, of course, have hoped for a still more specific programme for the OECD-countries. Given the nature of such cooperative efforts, its success now rests with the implementation and follow-up process ahead of us. We must now work hard to ensure that the spirit and guidelines of the OECD-meeting will be realized in the different national policies and international bodies.

The forthcoming summit-meeting in Williamsburg in the end of May, will in this respect be of special importance. If the seven largest industrialized nations could agree to

take concrete steps in the direction which the OECD-countries agreed upon in Paris, they would indeed exert the kind of leadership that our peoples are calling upon.

IV The problem of policy implementation

It would, of course, be utopian to expect that domestic policies of one country could even be formulated primarily with regard to the needs of other countries. I do feel, however, that the time has now come to reach some sort of international commitment: Governments should plan their economic policies with the effects on their partners more in mind. We have to a great degree opened our doors to the free flow of trade, of payments, of capital transactions, to some extent even of labour. But we have not to the same extent developed codes of conduct to guide this far-reaching freedom. The time has come when we can hardly any longer afford a purely national policy approach. The least we can do is to make a maximum effort to avoid plainly contradictory policies.

Thus, the efforts of individual countries to improve economic performance need to be harmonized. This means, however, that governments will have to design policies that may to some extent conflict with views dominating the national scene. It will be a test of the ability of the leadership to succeed in obtaining the necessary general

public support for such international thinking. But we have to try for the simple reason that we will not win the fight against mass unemployment without improved international cooperation.

The picture may, however, easily become one-sided if we do not also take into account considerations of a non-material nature. Western societies have, since World War II, gained from a strong sense of unity of purpose, and a sound faith in the future. There emerged a strong dedication to contribute to the common good, and a general respect for moral norms. Such attitudes facilitated the solution of the common problems. There are, however, disturbing signs that we have now entered a period where the bonds and ties between individuals may have weakened, and where the solidarity with our society as a whole is weaker. There seems to be less respect for the necessary rules of human conduct. Such moral factors may also be parts of the explanation of economic problems. It may even be that a comprehensive policy to solve economic problems must include the combat against these disruptive tendencies.