

CHECK AGAINST DELIVERY

"DOES GOVERNMENT REALLY MATTER IN ECONOMIC POLICY ?"

**SPEECH BY
GASTON E. THORN
PRESIDENT OF THE COMMISSION
OF THE EUROPEAN COMMUNITIES**

AT TALLOIRES, 1 SEPTEMBER 1983

Groupe de Talloires

Mr President, ladies and gentlemen,

Thank you for providing me with the opportunity of contributing to your colloquium.

The subject of your colloquium "Do we really live in a crucial period, and if so why?" is one that is close to my heart.

Of course, every politician wants to feel that the problems he is wrestling with are crucial and that he may be able by his actions to guide the future development of the world.

But for the future of the European Community, this time is certainly crucial. Despite the almost unbelievable achievements of the past 25 years; despite the consolidation into one Community of ten Member States; despite the desire of two more to join; the economic crisis in which we find ourselves has put a question mark over all the Community's achievements to date; and nowhere more so than over the role to be played by its institutions in the development of economic policy.

./. .

The situation in which the European Community finds itself today is that we have come through the 30 most prosperous years in history, which made us better off than ever before. But then we hit high unemployment; high inflation; and economic stagnation. This has led us to a crisis of self doubt. We are scared that the competitiveness of European industry, the creativity of European entrepreneurs, the dynamism of European society, and the growth potential of Europe in the world economy is going to let us down.

What a paradox it is, to have suffered such a loss of confidence after such a period of prosperity!

Faced with this situation we are in doubt as to what government and the Community institutions should be trying to do. Should they increase their interventions to try and promote recovery? Or should they fall back, withdrawing from the marketplace, limiting their interventions, to give recovery a chance?

The debate on the role of government in economic policy is poignant because for so long we thought that we had the answer to it. It seems ages since someone said "We are all Keynesians now". And indeed, it is 50 years since Keynes published the General Theory and we came to believe that the question had been answered once and for all.

./.
.....

Those specialized in business would not expect one more specialized in state-craft - an "accomplished generalist" as you have been kind enough to call me - would not expect me to be excessively rigorous or discursive in my economic analysis. So let me be quite brief.

What have we learned since the 1930s on the best ways to increase economic activity?

I have always understood that Keynes said governments could help the economy out of a slump by pulling down interest rates (by expanding the money supply) or by restoring the confidence of investors through fiscal policy.

Those who felt convinced of this certainly had the upper hand in management of the post-war economies. They grew ever more confident as their economies went from strength to strength. Do you remember the standard economic issue of the 60s? Are full employment, stable prices, balance of payments equilibrium and rapid growth compatible? The answer seemed clear of course; thanks to economic fine tuning, the magic square was obtainable. If governments missed one or two of their targets, it was because they did not devote enough resources to planning, did not employ enough economists and only made forecasts of growth rates to 2 decimal places instead of 3.

Don't let's forget. Those were good times economically. And if some people were critical, it was not so much that their living standards were falling as that they wanted them to rise still faster ... just 15 years ago ...

Then it all blew up! inflation; oil shortages; stagnation and falling investment; sharp competition from the Pacific; controversy among economists.

But were we right to be surprised, that economic policy should have hit a bad patch after such a spectacular and prolonged spell of success? Economic text books don't normally talk about it, but every politician knows, that there have been few enough decades this century where there was not some big event of world importance which could be expected to overthrow the plans, not only of the best prepared economic policy makers, but of a few others as well.

In the teens there was the First World War; in the 20s reparations and hyperinflation; in the 30s the depression and the rise of the dictators; in the 40s the Second World War. None of those was what you might call a "normal" economic period.

And if the 50s and 60s were an era of unparalleled prosperity, it must be recalled that they were also a period of remarkable stability in the major Western economies. The US lay in the sunshine until the cloud of Vietnam rolled over, while Europe experienced a drive for stability through unification. The achievement of those days in European consolidation seems almost unbelievable in retrospect.

Nor is policy disturbed only by big events. Anyone in the regular business of politics knows that not only can a strategy or a policy be overthrown by a world war, but are subject to upset from day to day by the force of events - someone losing an election, an unforeseen development in public opinion, a chance discovery, someone missing a plane. Such is the nature of politics.

So it is hardly surprising (in retrospect) that something eventually went wrong. And it is a measure of our hubris that we thought that all we would have to do was to adjust our deficit a little here or there, re-programme the computer and off we would go again.

But it did not work. When the crisis hit us, our confidence collapsed. As our belief in demand management diminished, so the advocacy of monetary policy increased. The apparently simple policy of establishing rules or targets for the money supply, and letting everything else go its own way, was more and more urgently pressed upon us. For myself, I must admit that it did not seem to me likely that it would be any more easy to consistently hit a money supply target without major problems arising elsewhere than it had been to consistently hit a full employment target. I don't think anything in our subsequent experience has made me change my mind. Indeed, the press coverage that Mr Volcker gets in his efforts to meet money supply rules shows quite clearly that no one in business doubts the far reaching consequences of his actions. His decisions are political in the fullest sense.

In listening to some of the arguments of the leading economists - and I do not impugn for one moment the brilliance of the arguments that some of them deploy - I am reminded of an anecdote related by Mr Bernard Shaw, who, as well as being what might be described as a romantic socialist, had also the good sense to be something of a sceptic in the face of sophisticated argument.

Mr Shaw relates how he one day came upon a man who was defending his view that the earth was flat. Such an unorthodox view of course provoked furious opposition from his hearers who became more and more excited the more their arguments were resisted.

"We know the earth is round" said one 'because if you sail west from any point and keep going long enough you will come back to where you started".

"Have you ever done it?" asked the flat earther.

"We know the surface of the earth is curved because when you look out to sea the sky appears to meet the sea due to the curvature of the earth" said the other.

"Have you ever looked up a straight stretch of railway line and seen how the parallel tracks appear to meet?" answered the flat earther.

"We know the earth is round, because it casts a circular shadow on the moon during an eclipse" argued a third.

To which the flat earther responded by lifting a dustbin lid and showing how it cast a circular shadow on the ground.

At this point Mr Shaw intervened, to say that in his view the arguments of the flat earther were decisive; but that they proved that the earth was not flat, but cylindrical.

It seems to me that there are a lot of economic policy experts at work proving that the earth is cylindrical.

In other words, what I am saying is that sophisticated arguments which seem to prove that government intervention in economic policy is ineffective, don't derive their credibility from the theoretical arguments used to support them but from the practical failures of recent years.

And the arguments among a lot of economic policy experts seem to me to contain a large measure of unreality. Their discussions seem to me to involve a lot of "Ah, yes, but".

"Ah, yes, but, if you had applied the policy we recommended more fully"

"Ah, yes, but, if you had only kept going longer"

"Ah, yes, but if you did not allow yourselves to be put off by the reactions of bankers"

"Ah, yes, but, you must not allow defeatist industrialists to stop you"

"Ah, yes , but if only you had resisted the temptation to interfere"

Ah, yes, but, public opinion would not stand for a government who just kept going as inflation rose and the balance of payments fell and crisis was all about us. And I am doubtful if it would tolerate forever governments who did nothing while half of our young people are unemployed and our investments and living standards fall.

./. .

Nonetheless, it does seem to me that the useful point that has come out of all the recent debates is the recognition of the importance of expectations - although I still prefer to call that by its more familiar name of "confidence". It seems indeed to have taken economists a long time to spot it. Anyone who has been in business knows - anyone who have even listened to a stock market report knows - that confidence or the lack of it can completely overwhelm "fundamentals".

Therefore the question facing governments in taking economic policy decisions is how to take these in such a way as to increase confidence, and how to avoid taking decisions or making interventions which undermine confidence. This was very much in our minds at the Williamsburg Summit. Indeed, the need to generate confidence is itself a justification for holding such Summits, even if the detailed policies are worked out elsewhere.

I am quite willing to accept that in the present situation extensive "spend your way out of recession" policies could lead to a collapse of confidence, because enough people believe that such a policy would inevitably lead to increased inflation, deteriorating balance of payments and a general decline in activity.

On the other hand, I find it hard to believe that policies which leave the economy bumping along at the bottom of a recession can be such as to inspire confidence. In order for investment to take place, there must be a real prospect of profits and sales. It seems to me unlikely that recession conditions will promote such expectations. The only policy that can generate confidence amongst investors is a policy that increases the chance of reasonable profit and growing sales.

Therefore the question is not whether or not government should involve itself in economic policy; but how, how far and with what limited aims in view.

./.
.

It is not a question of whether government is there just to make the rules. Government is not only entitled, but to some extent obliged, to take action on its own discretion to influence the economy.

Indeed the suggestion that government can somehow confine itself to simply making the rules is naively simple. When a decision falls on your desk, however carefully the rules have been drawn, they often seem ambiguous and difficult to interpret. Even decisions not to intervene can begin to look interventionist with the complexity of real choices before you.

But in saying this let me make it perfectly clear that I recognize that many government interventions in economic policy making in the past have certainly been marred by excesses. These fall into four broad categories:

- excessive volatility of policy, whether it is hard to adapt to an ever changing situation; whether it is the old problem of stop and go, or favouring competition one day and the benefits of large scale industry the next, policy makers have always been prone to changing their minds; some change is inevitable, but a consistent policy framework needs to be maintained;

- a tendency for intervention to become pervasive; we all know that it is much easier to start intervening than to stop it; and the result has been a growth in the responsibility of government until it accounts for nearly 50% of all expenditure;

- the tendency of government to substitute its own economic wisdom for the market place wisdom of business; this can be through things like restrictive purchasing arrangements - buying only nationally produced computers - or through politicians trying to take commercial decisions better left to others;

- an excess of optimism in the caring society - which might arise from the wrong sort, of welfare. I cannot find it in me to agree that the growth of public concern for the welfare of the less well off is a bad thing; but when we are told that much of the expenditure does not reach the target groups, then we can afford to re-examine our policies.

It is interesting to review Community policy in the light of this criticism.

As regards macroeconomic policy, my colleague Mr Ortoli has strongly urged the Member States to restrict the extent of their intervention; but he has made it very plain that there

./. .

should be a limit to this restriction, urging that if further declines in activity take place, the automatic stabilizers should be allowed to operate and that those Member States who have made most progress in controlling their budgets should use the room for manoeuvre thereby gained to prevent renewed recession. In advocating this, we have sought to achieve a balanced, steady policy which will reinforce the expectation of a sustainable recovery.

Where we have found situations of manifest crisis and have the authority to act - and the most evident of them is in the steel industry - we have been unwilling to abandon the responsibility of government to the vagaries of the market place. In such cases, where the forces at work appear to us to be such that individual firms are unable to withstand them on their own, but where the common good requires the survival of a viable Community industry, government intervention cannot be shirked even in the face of public criticism. There would be far more criticism to be faced if the industry, with its strategically vital output, its skilled labour force and its huge fixed investment, was just allowed to collapse.

On the other hand, we must recognize the difficulties which can arise from excessively interventionist policies. Our own experience with the CAP shows the difficulty that might

arise from generalized price controls, output guarantees and protection from the forces of the international market place. It shows clearly the difficulty of escaping from interventions begun for the best reasons - not because there has been any shortage of critics of the weaknesses of the CAP, but because of the lack of politically practical suggestions as to how to resolve its problems without putting worse ones in their place.

The need to generate increased confidence to promote worthwhile investment is well met in my view by the positive interventions of the Community through making rules for a game that we can win. I mean exploiting the potential of our large internal market, thereby ensuring that the full benefits of large scale production are available to European producers. The work undertaken by my colleague, Mr Narjes, in trying to persuade the Council of Ministers to complete the internal market, aims precisely to give European producers these benefits. It is a matter of serious regret that the Council, despite notable progress, has yet to take the vital decisions to make the completion of the internal market into a reality. And the regret is not just on the part of the Commission. It is still more on the part of firms denied the benefits of an extended home market, which could prepare them to take on anyone in the world.

The dependence of the Community on imported energy and its susceptibility to serious damage through energy shortages has been seen only too clearly over the past decade. Therefore the initiative of the Commission to ensure the development of a Community energy strategy, making the fullest use of our own resources and achieving real economies in energy consumption, is a fully justified intervention in the market place.

There is also general recognition that the support of research and development at the pre-production stage is a worthwhile investment for government. If we are to be in a position to compete successfully with our dynamic trade rivals, we cannot afford to confine our research and development activities to the small scale prescribed by the limits of firms or of national resources. European producers must have access to the best and latest in technology.

Further, the process of transferring the results of research into industrial innovation and useful technology is one of fundamental concern to us all. Measures to ensure that the high risks inevitably encountered in the early stages of the innovation process are not allowed to prevent the investment from being made, are again amply justified at a Community level.

Let me remind you of the position that we face in the area of informatics. It is universally recognized that we are in danger of trailing the Japanese and Americans in this field, and that to do so puts us at serious risk with regard to our capacity to produce a whole generation of products. There can be no solution at the level of purely national policy to the problem of recovering lost ground and establishing an industry that is strong enough to vie with world leaders. That is why we have been particularly concerned to make progress in opening the internal market for informatics products, ensuring common European standards and the availability of the whole market to European producers, with the opening of a share at least of public markets to competitive tendering.

At the level of applied research, the ESPRIT programme, in which the Commission is collaborating with a series of major European companies, has been enthusiastically received by the industry. Yet I must tell you that, although the Council in some of its formations has been ready and willing to support these actions, in full recognition of their necessity, in other formations - such as the budget - the pursuit of nationalistic aims has been in grave danger of squeezing out this foundation for our future prosperity. This is the sort of intervention we must maintain and which we cannot allow to be sacrificed on the altar of budgetary doctrine.

Finally, I want to say a word about our policies in the field of employment. The greatest asset of the European Community is its work force. The number of young people entering the Labour market should be a major source of dynamism and inventiveness for our economies. It is a tragedy, on a very large scale, that so much of this vital resource is presently being wasted. Let me remind you that some 40% of our 11 million unemployed are under the age of 25. Our policy, while unable to abolish the scourge of unemployment in the short term, has been to ensure that this period of enforced idleness is, as far as possible, used constructively. Through the interventions of the European/Social Fund, and particularly in its assistance to young people, we are seeking to ensure that the work force is as far as possible prepared so that it can lend the necessary dynamism to the recovery as it develops and can provide the work-force for participation in the productive activities of the future.

Therefore let me sum up my view of the role of the Community institutions and government bodies in economic policy.

Governments cannot do everything. As the effect of their actions on confidence is vital, it seems to me that given the present situation, and present public attitudes, a strict limitation of macroeconomic intervention is unavoidable.

./.
.

But government cannot be satisfied with doing nothing. It is inconceivable that confidence should bloom if it is known that no matter how low the economy sinks, the government will not intervene to try to improve the situation. Well defined, finite interventions are justified now as much or more than ever before.

A government has obligations to its electors which it cannot meet by renouncing its duties. But it must try to meet them in a spirit of realism and caution and, dare I say it, humility, in full recognition that its achievements will be limited and may at any time be swept away by events beyond its control. And it must try to ensure that the public at large and businessmen in particular recognize these limitations and do not blame it for failing to achieve the impossible.