MINISTERO DEL BILANCIO E DELLA PROGRAMMAZIONE ECONOMICA

NATIONAL ECONOMIC POLICIES AND POSITIVE ADJUSTMENT AMONG INTERDEPENDENT ECONOMIES

edited by Paolo Guerrieri

ISTITUTO POLIGRAFICO E ZECCA DELLLO STATO
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INTRODUCTION

by **P. Guerrieri**

The performance of the international economic system in the 1970s was very disappointing, in sharp contrast with the brilliant results achieved in the first twenty years after World War II. The negative records of economic trends at the national and global level in this period are well known and need not be recalled here. This period has aptly been called the " crisis of the seventies " to underline the deep changes, for the most part irreversible, in the growth mechanism on which the post–war experience had been based, and the breakdown of the balance of international economic relations that had been developed and consolidated in that period (1).

The failure of the rules of the game which regulated the former system led to growing uncertainty and instability at international level, to a multiplication of destabilizing actions on the part of the major industrial countries, to increasing conflicts between different economic areas and within each of them. Examples of such trends abound: currency crises have become a recurrent fact; protectionism, in new and old forms, is growing in the industrial area; conflicts between blocs and countries over international trade are intensifying; the increased average size of current account surpluses and deficits generates enormous problems with regards to how to transfer and redistribuite huge real and financial resources.

A series of developments and changes in relations among the various countries underscores above all the international dimension and origins of the crisis of the seventies. Over the past decade interdependence among countries and groups of countries has increased enormously, not only through a deepening of the pre–existing economic ties of the leading industrial nations, but also through an extension of the area of mutual dependence to include a growing number of less developed countries (LDCs) (2). *This network of ties (interdependence) took on decisive importance for all the major countries precisely because of the economic events of the seventies and heavily conditioned each country's national economic policy.*

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(1) See P. Guerrieri and G. Luciani, *L'Italia e il nuovo ordine economico internazionale*, Milan, Etas Libri, 1979, ch. 1.

(2) G. Sautter and L. de Mautort, *La concurrence industrielle à l'echelle mondiale*, CEPII, La Documentation Francaise, 1978.

In this sense we can say that both the sensitivity and vulnerability of each country to external factor have been increased. Sensitivity involves the degree to which the condition in one country is affected by events occurring elsewhere. Vulnerability involves the degree to which a country is capable of overriding the effects of events occurring elsewhere (3). *Therefore in recent years each major country has been unable to avoid being influenced by outside occurrences and has been unable to reverse the influence of outside occurrences except at very high cost to itself.*

Moreover, as the importance of the forces of global interdependence grow, there was no parallel development of institutions, rules and agreements to ensure the manageability of the system. Developments over the past decade, which I will deal with in detail later, confirm that the initiatives taken have indeed produced an exactly opposite effect. In fact, it would not be exaggerated to say that the international economic conditions prevailing at the beginning of the 1980s are in a state of quasi–anarchy. The disarray in international economic relations highlights the fact that the national governments' ability to manage global international factors has decreased in inverse ratio to the increase in importance of such factors (4).

The major countries' economic policies in the 70's have to a great extent aggravated or been responsible for the current crisis in management at the international level. Governments have generally adopted policies serving exclusively national interests and have acted in accordance with traditional codes of conduct which are for the most part inadequate to solve the problems posed by the forces of global interdependence (5).

A good example to illustrate this inadequacy is represented by macroeconomic policies adopted by all major countries after the first oil crisis.

The redistribution of resources at the international level as a result of the increases in the price of oil and the stagnation of domestic demand have accentuated the role played by foreign markets and international demand in influencing the nature and the intensity of the major nations' domestic growth paths. In response all countries have adopted a policy of maximizing net exports, tending toward a neo–mercantilist behavior (6). *If all countries act in the same way, pursuing an aggressive commercial policy, attempting to relaunch domestic activity by increasing exports and decreasing imports to the detriment of their trading partners, at macro aggregate level these policies will*

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(3) R. O. Keohane and J. S. Nye, *Power and Interdependence: World Politics in Transition*, Boston, Little Brown, 1977.

(4) R. Bryant, *Money and Monetary Policy in Interdependent Nations*, Washington D. C., Brookings Institution, 1980.

(5) C. Allsopp, « The Management of the World Economy », in W. Beckerman (ed.), *Slow Growth in Britain*, Oxford, 1979.

(6) H. O. Schmitt, « Mercantilism: a Modern Argument », in *The Manchester School*, n. 2, 1979.

almost certainly be inconsistent and the end result self–defeating (7), *as has been proved in recent years. Without forms of coordination and concertation of international effective demand the vast majority end up as losers. This stems from the fact that the abandonment of fixed exchange rates in favour of a flexible system not only has not eliminated, as many expected, the transmission mechanism of demand impulses from country to country, but has instead, as proved by recent events, made it in many ways more effective. Differences in domestic demand from country to country, amplified by the transmission mechanism, have thus influenced the process of readjustment of current account imbalances in a much more significant way than variations of real exchange rates* (8). *The degree of interdependence of domestic demand trends has thus increased and with it the degree of interdependence of national economic policies* (9). *In the past years many proposals to neutralize the oil deficits without resorting to beggar–my–neighbour policies have been put forward in order to find a way of effectively managing this interdependence* (10). *As is well–known, these proposals have remained a dead letter. Economic nationalism has prevailed making it impossible to agree on forms of concertation and coordination of the major countries' economic policies at the international level, and even at more restricted levels, such as the European Community* (11).

The conflict within the industrialized world to corner a bigger share of a stagnate international market — with all this means in terms of more markedly neo–protectionist policies, a widening of the area of "managed trade", intensification of the struggle to secure primary resources — is bound to worsen as the medium–term growth prospects of world income decline. And this is the result of the economic policies pursued by almost all the major industrial countries, with only rare exceptions, since the second oil crisis and the more recent "dollar shock".

The fixing of rigid targets for monetary aggregates, the return to the rules of financial orthodoxy in terms of balanced public budgets, reliance on the allocative capacities of the domestic and international market based on the conviction that redistribution of resources is favoured by a relative stagnation of effective demand — these are the basic elements of a common line of economic policy that has taken hold in the major industrial countries, notably in the USA, albeit with significant differentiations from country to country. Restraint of medium–term growth by means of a restrictive monetary policy,

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(7) R. Mundell, *International Economics*, New York, Macmillan, 1968.

(8) N. Kaldor, « The Effect of Devaluations on Trade in Manufactures », in *Further Essays on Applied Economics*, London, Duckworth, 1978.

(9) Bank of International Settlements, *Annual Report*, 1978 and 1979.

(10) OECD, *Economic Oytlook*, July 1974 and 1978; Economic Commission for Europe, *Economic Survey of Europe*, Genova, 1977 and 1978.

(11) L. Izzo and L. Spaventa, « Macroeconomic Policies for Growth and Stability: The European Perspective », in *Weltwirtschaftliches Archiv*, 1981.

based on the monetarist prescription of controlling the expansion of the stock of money, is seen as a panacea for contrasting inflation and reducing the oil deficit (12). *But it is a shortsighted strategy based on national solutions, inconsistent with each other, therefore inadequate to the new international context, and will probably not bring the hoped for results. With regards to the first goal, the fight against inflation, the equilibrium of international system which is most likely to evolve is an ex–post deflationary adjustment of quantities, while inflationary pressure stemming from external cost pushes will persist. At the same time, a slowdown in growth certainly does not favor positive adjustment to the new relative prices. It penalizes industrial investments for this purpose and the accumulation process in general. Moreover because of the transmission mechanism afore mentioned, if the monetarist recipe is followed by all the major countries, the cumulative effects will be even more disastrous* (13).

With regards to the second goal, that of neutralizing the negative effects of the oil deficit and the energy constraint, growth in the major industrial countries would have to settle at such low levels that strongly destabilizing internal and international tensions would inevitably arise. In the 1970s energy consumption as a proportion of total domestic spending declined thanks mainly to the forms of energy saving encouraged by high oil prices and the relative stagnation of investments in energy intensive sectors (14). *But this is not enough to justify the optimism now in vogue of those who take for granted that the balance of power has now turned in favor of the consuming countries and that the oil constraint can be eliminated by slowing down the rate of growth. It is still true that faster expansion of world income in the medium term will be possible only if more rapid progress is made in developing energy–saving techniques and new sources of supply of energy. But this can be achieved only through greater accumulation and industrial restructuring. Therefore, an alternative economic policy at the international level will have to be found which penalizes the single areas and the world economy less in terms of growth. The major countries will have to evolve a policy aimed at avoiding drastic confrontations with the oil–producing countries, at favoring greater participation of the latter in the management of the international monetary system and at developing new forms of cooperation in the exchange of manufactured goods and raw materials. This means that in the short term the major problem for policy at international level will continue to be that of how to deal with the importing countries' current account deficits. The magnitude of the current account imbalances of the 1970s accentuated the role of financial mechanisms*

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(12) T. Balogh, « Oil Recycling: The Need for a New Lending Facility? », in *Lloyds Bank Review*, July 1980.

(13) « World Trade and Finance: Prospects for the 1980s », in Cambridge Economic Policy Review, Dec. 1980, vol. 6, n. 3.

(14) OCDE, *Perspectives Economiques*, December 1981.

in the process of real adjustment. Access to international sources of credit greatly influenced the way in which a country attempted to adjust its economy in response to the external shocks.

After the first oil crisis the industrialized countries managed a quick return to surplus positions, thus shifting the major burden of the oil deficit into the non–oil developing countries. The oil surplus was recycled through the international private credit markets, with private banks playing a preeminent role while the part played by the official international agencies was only marginal. Credit was distributed according to the allocative criteria of the private banks and this meant limiting the circle of potential borrowers to a small number of newly industrialzing countries (NICs) which because of the favorable dynamics of their exports could offer the greatest guarantees of financial solvency (15). *The NICs were able to finance their growth by increasing their indebtedness to dangerously high levels. Instead, the middle and low income LDCs were obliged to drastically cut back their imports and consequently their growth rates in order to reduce their external deficits. These countries were excluded from the international credit markets managed by the private banks and could resort to official loans only to a very limited extent* (16). *Their indebtedness has in fact changed very little with respect to the 60s.*

The second oil crisis made it clear that new solutions would have to be found to the problems posed by the structural surpluses of the OPEC countries, since the deep division at world level between saving and investment centres has been consolidated. The most important goal is of course real adjustment on the part of the consuming countries. But in the short term it is just as important to find solutions to the problem of financing and sharing the burden of the oil deficit of the importing countries. The way in which this is done will be decisive in determining the nature and the forms of medium–term adjustment of these countries' productive structures. Important changes in the present system of international financing are needed. There are a number of factors which seem to indicate that it can no longer continue in its present form: today the possibilities of recycling the oil surpluses through the private international credit market are more limited. The major banks operating in the Euromarkets are heavily in debt. The oil countries are less willing to deposit their surpluses in such markets. The risks of insolvency of certain debtor countries have increased with the enormous accumulation of indebtedness over the past few years. If the difficulties in managing international financial flows increase, the worst repercussions will undoubtedly be felt by the LDCs in terms of a strong penalization of their growth potential. But the negative effects would

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(15) C. Davis, « Financing Third World Debt », *Chatham House Papers*, n. 4, London, Royal Institute of International Affairs, 1979.

(16) World Development Bank, *Annual Report*, 1981.

eventually be felt by the industrialized countries too because in recent years the LDCs have become important purchasers of the industrial countries' exports (17). *Many aspects of the situation are alarming. But the solution does not lie, as many have recently suggested, in a simple return to a more rigid adherence to the rules of financial orthodoxy. In other words, a drastic reduction in the flow of credits to the LDCs is not the answer. Again to preserve monetary and financial stability, some means must be found to ensure consistency among national policies. This means to minimize conflicts over the distribution of the economic costs of real adjustment processes* (18). *In order to attenuate the above-mentioned risks certain changes, possibly very deep ones, are certainly needed in the working of financial intermediation at the international level. It is necessary to ensure greater balance and diversification of the sources of international credit, with a bigger role for the official organizations, favoring certain trends already underway. But this is not enough to guarantee greater stability to the credit markets and to pursue the consistency objective. The financial aspects and the problems of real adjustment are closely interrelated. In order to avoid the risks of insolvency of single countries or entire areas something must be done to help the LDCs continue to expand their industrialization since their financial solidity depends largely on their development prospects over the next few years* (19). *The industrial countries could do much in this direction by incurring deficits on an appropriate scale, foregoing excessively rapid adjustments, thus offering the LDCs better opportunities in terms of aid and export credit on the one hand and markets for their exports on the other. This would open the way for growth capable of guaranteeing noteworthy advantages to the industrial world too.*

Just as decisive from the point of view of real adjustment to the external oil shocks is a redistribution at the international level of industrial activities by major countries. In the 1970s both the volume and the composition of fixed industrial investment changed in all the major industrial countries. On the one hand, fixed industrial investment as a percentage of GNP has declined. On the other, the pattern of investment has changed. The share of investments to increase mechanization in various sectors has increased, with a strong acceleration of the process of intensification of plant stock, while the share of investments capable of extending production capacity and creating new jobs has declined (20). *These changes in the characteristics of the accumulation process*

(17) S. Mukherzee, *Restructuring of Industrial Economies and Trade with Developing Countries*, Geneva, ILO, 1978; OECD, *The Impact of the Newly Industrializing Countries on Production and Trade in Manufactures*, Paris, 1979.

(18) B. Cohen, *Organizing the World's Money: The Political Economy of Monetary Reform*, New York, Basic Books, 1977.

(19) World Development Bank, *Annual Report*, 1981.

(20) EEC, « L'evoluzione delle strutture settoriali delle economie europee dopo la crisi petrolifera », in *Economia Europea*, 1979.

are in a way effects of the " general disproportion crisis " which hit the entire industrial world in the 70s. The exogenous shocks produces by changes in the prices of some primary commodities and factors of production have brought about radical changes in relative prices which have affected different sectors to varying degrees, depending on the difference in input and labor coefficients. Consequently, the sectors hardest hit by the variations in relative prices are those which depend heavily on oil and those exposed to competition from the NICs. A basis tenet of economic theory is that of minimization of costs. Changes in the relative prices thus oblige firms to modify their production processes, since at the new relative prices certain productions are no longer economic. Wide and deep restructuring has therefore to take place, but this happened only in part and only in a few countries. The fall in accumulation rates has in many cases hindered the required productive adaptations. Thus, in many industrial countries government industrial policy has been prevalently defensive, aimed mainly at shoring up industries and firms in crisis and postponing positive adjustments (21). *This happened through a strong increase in state intervention in the production and accumulation processes. Public transfers in various forms have become one of the most important channels for sustaining firms, giving life to open or masked mechanism of neo-protectionism which only exacerbate the tensions among the industrial countries. The common characteristics of the phenomena mentioned so far must not obscure the significant differences which have marked the productive restructuring processes in the major industrial countries. Some countries, notably Japan, Germany and France, have been able to go further in adapting their industrial sectors to the new terms of trade, at the same time accentuating a strategy of accelerated internationalization of certain sectors* (22). *It is thus foreseeable that in the 80s the hierarchy of the major industrial' economies will tend to be reinforced in relation to the differences in the relative weight in the various national industries of the advanced technological sectors on the one hand and of the services necessary to control the processes of territorial and sectoral decentralization of important production in the NIC on the other* (23).

To conclude this brief introduction it can be pointed out that over the last few years the international economic system has undergone deep qualitative changes, whose results are still difficult to predict. But what arouses even more concern is that many structural problems produced by economic events of the 70s have not yet been resolved. The industrialized countries' vulnerability to external shocks is still very high, just as the state of international monetary relations continues to generate dangerous jolts. Contrary to what happened

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(21) V. Curzon Price, *Industrial Policies in the European Community*, London, Macmillan, 1981
(22) C. Stoffaes, *La Grande Menace Industrielle*, Paris, Calmann–Levy, 1978.
(23) S. Mukherzee, *op. cit.*

in the postwar period when growing integration had been a powerful vehicle for growth, the growing interdependence of the international system has increased its fragility and potential instability at the outset of the 1980s. In such circumstances it is very difficult to say if, when and how a new stable equilibrium might be reached in the international system. Current behaviors in international areas show signs of working in the direction of a strengthening of economic nationalism. But it would be a very serious mistake to think that national solutions might offer adequate responses. No country is or can be independent, and all must in some way manage their interdependence. This is the real challenge of the 80s, which all major countries must face in formulating their medium term economic policies.

I. – THE EXPERIENCES OF THE MEDIUM-TERM ECONOMIC POLICIES IN THE MAJOR INDUSTRIALIZED COUNTRIES IN THE 70's.

1. – INDUSTRIAL POLICY IN FRANCE: CHANGES AND CONTINUITY

by **Christian Stoffäes**

The principles and goals of the Giscard–Barre industrial policy.

Bearing in mind France's longstanding protectionist tradition, its past difficulty making adjustments, its taste for structural stability and its inclination towards state interventionism and nationalization, many foreign observers have been favourably surprised by the new direction of the industrial policy the Giscard d'Estaing–Raymond Barre governments decided on after the oil crisis began.

As a matter of fact, the crisis led to a certain liberalization and loosening up of State intervention in the economy and to new forms of intervention aimed at encouraging structural change and not at protecting existing structures as a certain number of industrialized nations had done after 1974.

Strengthening some market mechanisms.

The control of industrial prices instituted after the Second War for some of the hardship industries like steel, grain, energy, and what was pursued and perfected afterwards especially in 1953 and 1958 in order to fight inflation (" moderation contracts " which were extended to all branches) was abolished in 1978. It was rightly thought that price control that had positive short term effects, could have too great negative effects in the long run entailing a *de facto* formation of cartels in controlled industries through the table of official prices, and a penalization of innovative companies etc. Price decontrolling was extended to a certain number of other non–industrial branches in 1978 and 1979.

The mechanisms of competition were strengthened with the creation of the Competition Commission, a semi–jurisdictional body, and the pledge to take action against industries in cartels and against attempts to prevent free competition.

Similarly, a series of administrative simplification measures were taken to release the regulative restrictions weighing on some companies especially in the realm of: the creation of new companies; the decentralization of aid to industry; various old protection legislation; administrative limitation of measures allowing firing for economic reasons (which had been severely applied in 1975–1976) in order to allow for quicker adjustment and to prevent penalizing companies affected by excess capacity.

France maintained and strengthened its international commitments in terms of free trade. The application of measures to organize trade remained limited expecially in the textile steel (multifiber agreement, Davignon plan) area and were taken in the context of the Common Market and the GATT.

Aids for Industrial Re–Conversion.

The government refused to commit itself to a process of massive comprehensive support to companies affected by the crisis of making structural plant changes.

Thus, even important companies in sectors like the textile industry, ship repairs, etc. were re–structured through the mechanism of bankruptcy. Likewise, bankruptcy legislation and judicial rulings were modernized.

There were few exceptions to this overall refusal to intervene defensively. A new organism, the CIASI (International Commission for Reorganizing Industrial Structures) was created in 1974 to come to the aid of small and medium–sized companies in trouble. It was able to limit its field of action, under the form of susbsidies and state loans, to very limited cases or prospects for real, long–lasting re–organization and improvement depending on existing market conditions; and its actions barely exceeded a few hundred million francs per year.

In the steel industry that suffured faced with an overproduction crisis with very high output and with a certain number of decaying plants, the State took measures aiming to alleviate the burden of financial changes without even depriving the bearers of obligations or creditors involved (with the creation of the Loan Fund for the Steel Industry) the companies paid back their creditors using a juridical mechanism like one provided by a judicial ruling. The new trend with the task of shutting down the unproductive factories, and modernizing equipment and restructuring the industry based on agreements about specialization and integration moving towards endorsement which resulted in the loss of 50,000 jobs from 1977 to 1981. Socially important preretreat measures and measures to help labour mobility along with this industrial operative measure which led to the signing of an important social protection pact.

In the shipbuilding industry massive aid was continued but policies to renovate the shipyards were also begun. This is an important exception which must be viewed as being closely connected to the very general character of measures providing aid to shipyards in all industrial countries and to the general character of the repercussions this brought about on world competition just as it had on the breadth of this industry's crisis following the 1973 oil crisis.

In public services as well, there were restructuring measures which resulted in new planning contracts signed with the SNCF, Air France, the Coal Mines of France; an increase in prices relative to costs; and abolishing activities that were not profitable. All these measures tended to re–establish the autonomy and industrial responsibility of the national state companies.

New procedures were established to go along with these regional reconversions. Regional policy in the Sixties was mainly conceived of as a way of slowing down the de–population rate in agricultural and mining regions, of limiting the growth of the dense Parisian population, of attracting investment towards the West and South–West, far from the European industrial centers. The regional actions taken after the crisis involved, above all, giving aid to the major industrial areas affected by the difficulties afflicting the steel, shipbuilding and textile industries (the North, Lorraine, the estuaries and the Vosges). By creating special Funds, they aim at industrial renewal (FSAI) and at attracting new investments in these regions (3 billion Francs through loans and subsidies).

The same thing occurred for unemployment compensation procedures, especially for economic firings and for youth unemployment which were all improved and modernized thanks to three–way negotiations between the social partners and the State.

Re–inforcing industrial structures.

Some companies' financial health and self–financing improved noticeably from 1977 to 1980 thanks to both the slow down in wage increases and to price decontrol. Productive investment which had stagnated from 1974 to 1978, recovered noticeably in 1979–1980. On the other hand, important measures were taken to improve the companies' own funds including: tax measures to reduce income tax within the limits of a fixed ceiling; regulating the total sum that private parties can invest in the stock market (the Monory law); tax aids for investment; the possibility of making a deduction for a portion of the investment made during a given year; the creation of publicly held loans granted by the Treasury to certain industries (in the form of the lowest level credit). The priorities of the 1950's and 1960's in allocating financial resources to housing, transportation infrastructures, and agriculture, thus were in the process of being re-ordered to work to the advantage of financing industry.

Specific measures for the development and financing of small and medium-sized business were also taken. The existence of the national agency for small-business formation and the creation of the mutual guarantee fund permit launching new business. Following the Mayoux Report, measures are under study for the decentralization of the banking system to favor investment in small and medium-sized businesses, as well as the creation of a plant-and-equipment fund for those enterprises. The IDI is going ahead with its policy of investment in high-performance companies potentially capable of achieving significant market breakthroughs but lacking in funds of their own. This state agency, created in 1970, has become one of the most important business banks operating on the French market (in terms of investment flow, not assets).

In addition, steps — and decisive ones — were taken to facilitate redeployment, the redirection of industrial exports towards capital goods industries and toward high growth rate developing countries. Credit insurance, provided by COFACE, guarantees against economic risks, and bilateral loans to developing countries have fostered a remarkable growth of French capital goods exports overseas, though traditionally this has been a sector of minor importance.

Finally, the state has moved to modernize those branches of industry characterized by old-fashioned structures, insufficiently concentrated or protected by out-dated legislation, such as wood and paper processing, tanneries, food processing, and so on.

Aid for launching new industries.

New measures aimed at encouraging renovation of the nation's industrial fabric have been adopted since 1978. The introduction of financial assistance for innovation (repayable if the venture proves successful) and of an automatic bonus for innovation have made it possible to assist medium-sized firms in undertaking high-risk advanced-technology projects. This aid is administered in decentralized fashion by the newly created ANVAR (*Agence Nationale pour la Valorisation de la Recherche* — national agency for applying research). A network of technological supervision and technical assistance, together with tax incentives for risk-capital companies, also foster technological improvement among small and medium-sized businesses. Special efforts were made to encourage the adoption of micro-electronics in industry, with the creation in 1979 of an agency to promote computer use, the " Agence pour le développement de l'informatique ". Similarly, the Agency for energy savings has been generously funded to carry out its task of impressing on the business community the importance of high energy costs and fostering the needed investments.

Reforms are under study to promote effective communication of the findings of public research organizations, both in basic research (CNRS, universities) and applied research, to private industry. The government is also studying tax incentives for industrial R&D spending in the private sector similar to those in effect in other industrialized nations. Also worthy of note are the significant measures adopted by the ministry of education to bring the educational system more into line with the needs of industry — the development of apprenticeship and of combined work–study programs; training periods for teachers in industry; introduction of computer sciences in schools; and so on.

A new and highly dynamic energy policy has been introduced, relying especially heavily on state–owned companies in the energy sector and on newly formed government agencies. In part this policy consists of massive alternative energy projects, particularly nuclear power generation (5,000 to 6,000 megawatts of new capacity in P.W.R. installed annually since 1975, which represents 50 percent of projected 1985 electricity requirements and 20 percent of total energy needs, and 30 percent in 1990, while oil's share in overall energy consumption should fall from 55 percent to some 30 percent in the course of the decade). Companion investments have been made in the nuclear fuel cycle (COGEMA), but there has also been significant investment in solar energy (a Commission for Solar Energy has been formed) and in a return to coal. The other aspect of the policy is an effort to decrease the economy's energy–intensity (higher prices for gasoline and for other forms of energy; research programs; investment assistance and regulatory measures by the Agency for energy savings). And finally, there has been an effort to diversify and improve the security of foreign sources of energy (state–to–state contracts; diversification of sources of supply to such countries as Mexico, Norway, the Soviet Union and Poland).

Also, the government undertook a massive program of re–equipment and modernization of communication infrastructures in the telecommunications field (where backwardness in equipment was an important factor) and in railroads (the promotion of high–speed lines). The growth of public productive investment compensated to some extent for the relative stagnation of private productive investment between 1974 and 1978 and hence helped mitigate the crisis of the capital goods industries.

As far as actions aimed at particular branches of the economy are concerned, there has been a highly significant change in government policies for major technological projects. Whereas in the 1960s such projects were conceived essentially in a perspective of national independence with respect to American technology without excessive concern for production costs, in the 1970s and particularly after 1976 we saw a growing trend toward policies aimed at international competitiveness and commercial viability. The government's " projects " policy has evolved toward a " businesses " policy. In this way the technological capital built up could be successfully exploited in international markets, often with remarkable success, giving France an enviable position, often enough second after the United States (and sometimes the leadership) in most high–technology industries.

This holds especially in the nuclear energy field, where the French industry has moved from the graphite–gas line to the " Gallicized " P.V.R.–Westinghouse line and where France holds undisputed world leadership in the nuclear fuel–cycle industry (Eurodif fuel enrichment, reprocessing, the Super–Phénix breederreactor). Other areas of French high–technology success include alternative energy development (offshore oil drilling, solar photovoltaic cells); civil aviation (development of the Concorde, movement from that project to the Airbus project, the SNECMA–General Electric CFM–56 engine, helicopters and business jets); space (the successful launch of the Ariane, satellites for telecommunication and direct television); computers (the CII Honeywell–Bull merger in 1975, the development of data–processing and peri–informatics services); telecommunications, following the massive public re–equipment program (development of electronic communications and the real–time system). Some of these programs (Airbus, Eurodif, Ariane, etc.) were carried out in cooperation with one or more European partners, but often on French initiative and under French industrial leadership.

Finally, to foster the flowering of new industries and stimulate the major industrial groups to diversify into growth sectors and the industries of the future, a new procedure was set up in the form of development contracts. Inaugurated between 1975 and 1978 in the mini–computer and peri–informatics industries, in scientific and medical instruments, and in electronic components, this approach was institutionalized in 1979 with the creation of a new government body, the CODIS (*Comité pour le développement des Industries Stratégiques* — Committee for the development of strategic industries), and the initiation of programs in industries of the future such as robots, the automated office, mass–consumer electronics, biotechnology, offshore technology, energy–efficient and energy–saving machinery and equipment, and so on, oriented toward the more dynamic companies. In fact, however, in developing these new technologies businesses will not be able to count on the government as a client as heavily as in the past, when government purchases were instrumental in the successes achieved in such sectors as aerospace, nuclear power, electronics, and so on. Robots, biotechnologies and the like will not have government agencies and ministries as their principal clients, and that is why new procedures are needed to develop these industries of the future.

The doctrine of redeployment.

The doctrine of adaptation thus gradually came to be a consistent element in industrial policy: it implies a reformulation and a reordering of priorities of the traditional aims of industrial policy — which were never entirely free of contradictions — and, as a logical consequence, the identification of non–priorities.

The phase of industrial recovery and reconstruction (1948–1958) set as its top–priority goal the elimination of productive bottlenecks (infrastructures and basic industries) that could brake industrial growth. The phase of Europeanization of industry (1958–1973), by contrast, witnessed the diversification and multiplication of the objectives of state intervention in the economy. Maintain optimal growth, improve the quality of life, distribute economic activity more equitably in geographic terms so as to halt the depopulation of the countryside, protect national independence through major technology projects, soften the impact of structural change in the labor market (agriculture, railroads, steel, etc.) — these were the top priorities, often formulated implicitly rather than explicitly and set forth without determining their relative importance with respect to one another. The sustained high growth rate (itself a function of the significant productivity lag which the economy had to make up for) undoubtedly played a role, with the resources it made available, in this burgeoning of objectives.

From today's perspective, of course, all these goals — employment, growth, quality of life, national independence — appear as consequences of French competitiveness in the international arena. And this does not mean a downgrading or subordination of such objectives, implying that they will be neglected from now on. Rather, it means recognition of the fact that in the present stage of development of France in the world economy, full employment and economic growth can only be achieved and maintained by a competitive industry capable of relieving the burden of external constraints.

The broad outline of French industrial policy traced herein clearly shows that much still remains to be done to coordinate and make consistent the utilization of industrial policy tools, institutions, and funding. These have accumulated in the form of successive layers of sedimentation over the past three decades of numerous programs' life, and they tend to give rise to a self-interested clientele whose existence jeopardizes their very effectiveness. A re-examination of these bodies is indispensable, and for several years now the government has been moving in this direction. Below are mentioned several fields in which this effort should be pursued.

– The financial resources devoted to industrial policy action are divided more or less equally into " horizontal " across-the-board measures of a general nature (aid for exports, for regional investments, for research, etc.) and measures aimed at particular branches or industries (aerospace, shipbuilding, steel, computers, farming and food processing, etc.). The amounts involved are relatively modest (some 20 billion francs per year in loans and grants), considering that total annual expenditure on state economic intervention amounts to some 150 billion francs (of which practically one third goes for special social secutiry privileges for particular categories: farmers, railroad workers, miners, sailors; nearly another third is spent on infrastructures and on the state-owned companies in energy, transportation, and communication; and the remainder on housing and agriculture). Is this spending breakdown really consistent with the assignment of primacy to industry? Can industry today keep on letting itself be milked by the other parts of the economy as it has for the past twenty years? In the event, what is needed is perhaps not so much an increase in the volume of assistance to industry as a decrease in the volume of other state economic intervention, the cost of which is always ultimately borne by the industrial sector. And it is the latter which represents the key interface of the French economy with the outside world, the contact point for international competitiveness.

– Of total state aid to industry, support for the industries of the future still receives too modest a proportion. Is this consistent with the priorities implicit in the creation and development of dynamic businesses, innovation and technology, and export-orientation? The challenge of redeployment of resources and competitiveness is essentially a technological challenge, providing that the word " technology " is not used in too narrow a sense. In the broad sense, " technology " comprises not merely the most advanced techniques but the widespread use of high technology in all sectors of the economy, organizational abilities, creativity and imagination, and so on.

– General economic policy actions, through their influence over the general business environment, have the heaviest effects on industry. In the past, many specific industrial policies were conceived to counteract the negative effects of general policy decisions. Instances are aid to the steel industry, which was granted at least in part for the purpose of counterbalancing the impact of prices policy; aid to the food–processing industry to compensate for the negative impact of price supports further back in the pipeline, i.e. farm prices. But can we be sure today — notwithstanding the undeniable progress that has been made, with the freeing of industrial prices from controls, attempts to redirect savings toward industrial investment, and so on — that general policy formulation (tax and social contributions policies, competition in all branches, professional training, etc.) is adequately integrated with the expressed industrial imperative?

– Coordination of state assistance must not be only financial and procedural. It must also be carried out according to criteria for industrial strategy subject to regular re–examination. This requires a new kind of administrative coordination, which could be provided, for instance, by the Ministry of Industry. The general tendency should be to try to increase the relative importance of contracted assistance, which of course demands more careful follow–up and a clear strategy, with respect to automatically distributed credits. This is the primary goal, for instance, of the creation of the CODIS, where the main agencies responsible for managing state aid to industry can meet to coordinate their efforts and focus on strategic sectors.

– Most businesses, and especially small and medium–sized firms, are left out of the process of aid to industry, which in the end goes almost entirely just to a few major industries and branches. To reach those who have so far been left out, massive decentralization of credit packages to regional and departmental administrations is called for. Aid turned over to professional bodies must be subjected to stricter state scrutiny, so as to clearly identify the respective responsibilities of the state and of the various firms. One of the top priorities of redeployment is in fact to strengthen the structure of those medium–sized businesses of proven high performance. France now has large industrial groups capable of carrying out their strategy effectively. Where she is still excessively weak, by contrast, is in those industries dominated by the small and medium–sized firm, such as machine–tools, industrial machinery and equipment, precision machinery, furniture, and so on, where West Germany and Italy, to cite but two, are highly successful. It was with this objective in mind that the recent creation of such agencies as ANVAR, ADI, the Agency for Energy Savings was decided on. Their role is to see to the penetration of innovations throughout the industrial fabric of the nation, but there can be no doubt of the need to come up with new formulas to aid those sectors where small and medium–sized firms dominate.

THE DIRECTION OF CHANGE IN INDUSTRIAL POLICY.

The election of President Mitterrand and of a Socialist and Communist majority in the National Assembly in May and June of 1981 will obviously mean far–reaching changes in the drawing up of industrial policy.

The French constitutional structure gives the administration in office considerable stability and the power to undertake major reforms. There is no doubt that industrial policy, which has become an extremely controversial topic, will undergo significant change with the advent of the new regime. For the moment it is not possible to draw up a detailed inventory of the measures that will be taken, aside from listing the broad policy orientations which will be pursued: energy savings, the nationalization program, decentralization, reconquest of the domestic market, an enhanced role for the unions, and so on.

New styles of thinking emerge: the non–inevitability of the foreign invasion of the domestic market for certain specialty products where French advantages can be developed; an industrial empoyment policy not limited to redeployment of investment or to bailing out ailing businesses but which envisages positive actions, in particular with regard to the connection between training and employment; the increased importance of the public sector and of planning, which will permit more " voluntarist " actions to be undertaken, whereas in the previous liberal framework industrial policy actions were carried on for the most part on the periphery, through exhortations and incentives rather than direct actions.

At the same time, however, it is to be expected that alongside the elements of change there will also be elements of historical continuity. These will involve most especially the role of state agencies in orienting industrial policy choices and the priority accorded to productive investment, innovation, and strategic technologies.

2. – THE EXPERIENCES OF MEDIUM–TERM ECONOMIC POLICIES IN THE FEDERAL REPUBLIC OF GERMANY

by **Georg Grimm**

1. There is a growing interdependence of national economies which renders autonomous economic policy planning difficult in general and even almost impossible in detail. This raises more and more the question whether medium term economic policy planning can be properly organised on an international level. Various international institutions, e.g. the European Community, the OECD, and the IMF, are constantly engaged in strong attempts to guide national policies towards progressive convergence. The most spectacular events for this purpose are the annual Economic Summit meetings of the heads of State or government of the seven leading industrial economies.

2. In market–economies the term " economic planning " stands for nothing more than, firstly, assessing the possible performance of the national economy, and, secondly, for clarifying the government's scope and intentions for running its own — budgetary — affairs and for discretionary actions in the fields of, i.a., monetary, fiscal, social, trade, or regulatory policies.

3. In this sense medium term economic policy orientation has been a matter of course in the Federal Republic of Germany ever since it exists. In fact, until the mid–sixties there was no specific short term economic policy concept. And also today economic policy aims predominantly at attaining greater constance in the operating conditions of the economic agents by making policy intentions better calculable to them for a foreseeable medium time span. A regular annual economic policy report at the end of January and a medium term financial plan in context with the annual Federal budget are major tools for that. In order to safeguard against errors and wishful thinking all such government plans, forecasts, projections, or orientations are completely exposed to competitive independence expert analysis by renowned research institutes, a Council of Economic Experts, and Advisory Boards of university economists.

4. A necessary precondition of successful medium term policy is to avoid sudden short term shifts of irritations with regard to fundamental regulatory principles. Shortsighted accommodative government attitudes

vis à vis individual interests of pressure groups and specific promising or less promising enterprises or sectors of the economy provide the coffin nails of medium term policy.

5. Medium term policy needs constant support by non–accommodating short term policy. In the case of severe external shocks to the economy, like the two oil price hikes of 1973 and 1979, a necessary breathing space for the economy must be clearly limited. To make the economy recuperate as soon as possible does not warrant evading of crucial adjustment needs in critical sectors or regions of the economy or of the level and distribution of incomes. Once a sizeable loss of price stability and of competitiveness has occurred it will cost the nation morefold efforts, harder conflicts, and a lot more time to regain the welfare standard of the years before. In such situations policy makers can, as recent experience in various countries shows, be confronted with a longer term policy dilemma.

6. The way medium as well a short term policies are to be applied and their possible effects depend heavily on the degree of public acceptance. Policy methods and measures that once provided astonishingly certain positive results until about 1970 can now easily prove fruitless. Public responce to policy prescriptions is nowadays governed by scepticism. To explain the need and constraints for policy action sufficiently in advance and convince not only a voting majority of the appropriateness of a choice of policy options has become of crucial importance for successful policy making.

7. Policy makers must respect public sentiment but they must not give in to social and political pressures which will prove detrimental to the economy and the society in total lateron. During the last decade public sentiment has changed considerably with regard to self–responsibility and public welfare schemes, competition and protection, technological progress and nostalgia, labour and comfort, earned income and transfer income. But policy makers must care that the economy keeps functioning satisfactorily in order to provide sufficient goods and income for all. This is only possible if flexibility and efficiency, free trade and capital movements competition and productivity are maintained. Whether an economy works well and for the benefict of all, or badly and ever worse, is indicated reliably by price level stability in the first case and inflation in the latter case.

8. In all industrial economies the government sector has grown conspicuously while the private sector declined correspondingly. As a consequence the welfare system could be extended. But the two oil price shocks made people aware that the attained level of governmental re-

distribution had left the economies more vulnerable to external shocks. In such events the fate of the economy depends heavily on the flexibility of the private sector to respond vividly to the external challenges.

This fact is no longer a dogmatic belief of market economists, it has been experiences at different degrees in all countries. Many of the tools of government intervention are presently not at hand because too ample use had been made of them for the solution of, at hindsight, minor problems.

This explains why many countries find themselves confronted with contradictory phenomena in the economies at the same time now:

– high prices and yet serious losses;

– high labour cost, and yet declining real wages;

– high interest rates, and yet insufficient risk capital;

– high tax levels, and yet enormous government borrowing;

– high unemployment, and yet no funds for job creation available;

– high subsidies, and yet loss of competitiveness.

9. In this situation the constituency for more social, regional, and sectoral protection as well as expansionary government programmes and cheaper money supply is growing. If this protection syndrom were allowed to dominate economic policy, then inflation would soar, world trade would face, and unemployment would explode.

To move the economy out of its present stalemate medium term economic policy has to refrain from any kind of defensive measures like price and wage control, subsidized employment, import barriers, or export subsidies. No constituency ought to be protected against fair competition from anywhere. And alike, no constituency should be granted protection against the effects of inflation, neither by inflation accounting for enterprises nor by indexation schemes for wages. The remedy against inflation is not protection against its pains; economic policy must eliminate inflation. Since inflation is one of the major causes of present day unemployment, the fight against it is the precondition for restoring full–employment and real income growth in the future.

10. Therefore, medium term economic policy must imply reliably:

– that it will down inflation;

– that monetary and fiscal discipline is restored once and for all;

– that the rules of strict market discipline are irrevocable guidelines for all economic agents;

– that private initiative, work, investment, innovation, and economic risk taking can pay off in due time to those who take the efforts.

3. - MEDIUM-TERM ECONOMIC ISSUES AND ECONOMIC PLANNING IN JAPAN

by **Masahiro Sakamoto**

I) Background and contents of the current plan.

1. The new seven years' plan was prepared in 1978 and early 1979. It points out that the economic policy should respond to the three sort of challenges which Japan was judged to face.

Firstly, as the new Japanese economy was shifting to lower growth, how to make the transition smooth was essential for economic management. At that time the Japanese economy had recovered from severe recession after the first oil crisis. There remained, however, a sizable disequilibrium in several sectors which causes sluggishness in the economy. One of the major task of the policy was to bring the economy on a stable growth track and to provide confidence to the entrepreneurs as well as to the consumers.

To accommodate the higher price of energy and to adjust the industrial structure to the advancement of international division of labour were also important policy issues. Furthermore, economic policy had to respond to the new requirement such as people's qualitative aspirations.

How to make use of higher saving to proper resources allocation is of extreme importance in meeting these requirements while reducing external surplus. To reduce the deficit of the public sector was also an important task of the plan.

Secondly, after Japan had caught up with the western advanced countries in terms of per capita income in the late '60s, people's aspirations for quality of life, security in life and new demands became stronger. The prospect that aging of nationals and urbanization in local areas would advance, was judged to make these aspirations even stronger. To meet these demands, improvement of social security system, encouragement of educational and cultural activities, environmental conservation, enrichment of social capital (especially living environmental facilities) and housing were called for.

The third challenge concerned the world situation and the role of Japan. While multipolarization and international interdependence advanced, uncertainty and unstability persisted in the world economy in the form of stagflation, monetary unrest, trade disputes, energy constraints and N–S confrontation. In these circumstances, Japan had to make more effort to endure her own economic security on one hand, but at the same time also contribute to a stable development through intensified cooperation.

2. Against these backgrounds, the current economic plan has three basic directions for economic management in the period (1979–1985). They are (1) rectification of imbalances among economic sectors; (2) industrial restructuring and overcoming of energy constraints and (3) qualitative improvement of national life and the realization of a new welfare society. The plan also has five aims: (1) the attainment of full employment and stabilization of prices; (2) stabilization and enrichment of national life; (3) cooperation in and contribution to the development of the international economy and society; (4) insuring economic security and fostering foundation of further development, and (5) reconstruction of public finance and new monetary responses.

The original 7–year plan (1978–85) contains prospects for economic growth and several other economic indicators. It aims at 5.7 average growth rate during the plan period, and some decline in the unemployment rate to 1.7 percent in 1985 as well as stabilization of prices. The plan assumed a substantial increase for public investment and social security transfer while tax burden and social security contributions should be increased. The plan also stresses the uncertainty of the domestic as well as the international environment, implying that there is a need to examine the plan under changing circumstances and adopted a rolling system. Every year the Economic Council reviews the plan and makes recommendations for economic management from the medium–term point of view.

After the plan was completed, follow–ups have been done in 1980 and 1981. According to the report of the 1981 follow–up which made some amendments for the prospects in 1985, the main differences are higher increase of prices, slightly smaller increase for GNP, a more vigorous picture for the private sector indicating stronger expansion of private investment, with less expansion for the government sector. For other indicators, we have not done substantial changes.

3. After the plan was completed, considerable changes have taken place domestically as well as externally. The second oil crisis exerted a more far–reaching impact on the Japanese as well as on the world economy than originally forecast. Administrative reform has been promoted actively. Japan's role grew more rapid than had been anticipated. Aging is advancing more acutely. Some of them call for a longer–term and comprehensive examination. The Economic Council set up

a committee for a longer–term perspective, whose central issues are how to realize an affluent and dynamic society as well as the role of Japan should play in the world economy from the longer–term point of view. The committee is expected to issue a report on these issues next year. In the following parts, as the recent experiences of medium term policies and future task, mention will be made on the four points, which the latest follow–up report recommended as the most essential for economic management, while taking account of the original plan and recent economic development in Japan. These four points are: rectification of imbalances in the economic sector while maintaining economic dynamism in the private sector; secondly, the reconstruction of public finance; thirdly, maintenance of economic security and the advancement of international cooperation; fourthly, the improvement of people's lives, paying special attention to the problem of aging.

II) Maior economic issues in medium terms.

1. Rectification of imbalances among economic sectors and maintenance of dynamism in the private sector.

The term " Rectification of imbalances among economic sectors " is used in the original as well as in the follow–up study of the plan, although the implication is somewhat different.

As stated before, when the original plan had been drafted in 1978, sluggishness remained in the economy. Imbalances were discerned in labour demand and supply, excess capacity in some industries, and a sizable surplus in the balance of payments. Large deficits also exist in the fiscal balance. The plan aimed to realize appropriate economic growth which would contribute to improve the employment situation, and diminish disequilibrium in some industries. Two hundred forty trillion yen public investments would work not only to improve the quality of life but also to smooth out the implementation of demand management, encouraging domestic demand and reducing external surplus.

In 1978 and 1979, private domestic demand advanced more vigorously than the plan anticipated, which reduced the necessity to increase public investment. The external surplus had been diminished, prices stabilized. The desiderable expansion was realized.

The second oil crisis again brought about the deterioration of the economic condition and the shift to a stable growth has been delayed substantially.

In 1979 and 1980, the Japanese economy suffered from the dilemma which the new oil shock brought about. Prices increased sharply until mid 1980. The balance of payments deteriorated. Depressionary impact triggered by higher oil prices has been intensified since the second quarter of 1980. Economic expansion substantially slowed down around the turn of this year. Particularly, consumer expenditure was very sluggish and new housing diminished, inventory adjustment has been continuing for several quarters.

The government had taken the measure in order to promote price stability and economic recovery by mobilising the fiscal and monetary policies in September last year and in March this year. In the spring of 1981, we judge that we have been able to overcome the economic difficulties produced by the second oil crisis. Prices stabilised since the middle of last year and the balance of payments turned to surplus this spring; domestic demand began to recover also during this time. The GNP of the second quarter this year indicates that the growth rate of the economy as a whole is roughly in line with what we had envisaged in the annual outlook of this January, that means 4.7 percent at our 1975 constant prices. However, we have a number of imbalances in our economy: firstly, the expansion has been mostly lead by external demand, whereas in the domestic demand sluggishness is discernible. We have sectoral difficulty (and some basic material industries such as aluminium, petrochemical and paper) and the imbalance between the big versus medium and small industries and the unbalanced development among the regions. Recently, this October, the government examined the economic outlook programme for this fiscal year. The outlook judges that the Japanese economy is now moving on the stable growth path, although, we have still imbalances we can mitigate this difficulty. As a policy measure, we are carrying out demand management policy as flexible as possible and at the same time the selective policy is to be implemented in order to cope with the sectoral and regional difficulties.

After nearly three years' time span, we are again in a similar situation. Our task is to bring the economy on the stable growth path, while eliminating the imbalances which the oil crisis had exercelebrated. However, in two points the situation is different from that of three years ago.

What we found more deficient is that the constraint becomes stronger in carrying out demand management effectively. As for fiscal policy, because of huge deficits, we cannot use it, except for expansionary purpose only in a limited way. To recover fiscal balance is an indispensable and urgent task for demand management. As for monetary policy, the high interest rate in the international market also prohibits an effective use of policy, because of possible depreciation of the yen, which not only give rise to prices but also increase difficulties of several basic industries. On the other hand, what is more advantageous is that the business sector have increased its capacity to cope with the difficulties. The performance of the Japanese economy in 1979–1981 has been rather satisfactory when we take account of the severe shock of the oil crisis. There are various reasons for this. However, the essential thing is that the business sector has achieved rationalisation of management and improved their dynamics so as to survive under slower growth and even under severe conditions. A large-scale energy saving and active introduction of electronic technology and maintenance of favorable labour-management relationships are good indications of the dynamism in the private economy.

2. The second major issue concerns the public sector. After the first oil crisis the deficit of the government sector grew. While increase of revenue had been decelerating owing to a slower growth after the crisis, expenditures had augmented at a rate not much different from the past. Furthermore, the government expenditures increased fairly fast in 1976–78 in order to stimulate the sluggish economy at the time. The deficit of the central government reached nearly 40 percent of the budget in 1979, which dropped to 26 percent in 1981, however, it still remains at a fairly high level. In the original plan, government expenditures are to grow both in current and investment account. Improvement of social security scheme, educational expenditures, social capital call for an increase of expenditures. Though rationalisation of the government sector is, of course, the prerequisite for the increase of outlays and the fair share of the burden is also a precondition for increase of tax, the original plan envisaged the introduction of a new consumption tax in order to increase revenue. Thus, the tax burden will increase from 19.9 percent in 1978 to 26.5 percent of the national income in 1985. But the situation has changed after the plan was adopted in mid 1979 because the introduction of a new consumption tax encountered strong rejection from the public. Restrictive budgets were compiled in fiscal 1980 and 1981 for the reduction of deficit financing. Difficulty to issue massive government bonds also intensifies this stringency.

Furthermore, since the beginning of this year, Administrative Reform has been proceeded by a strong political initiative of the Suzuki Cabinet. To favour a smaller government has been also popular in other advanced countries. The Administrative Reform Research Council, which was set up this March, issued a preliminary report this summer and the final report will come out next year. In the preliminary report, the Council recommends the reconstruction of public financing without introduction of a new tax as an immediate measure for the fiscal 1982 Budget. It proposes to put zero ceiling on the budget appropriation in the next fiscal year except for the priority areas such as defense, aid and energy.

At the same time, the Council recommends the rationalisation and efficient implementation of the administrative reform implying the reduction of government officials and streamlining and restructuring of governmental organizations.

The stringent budgetary policy has been implemented since 1979 and the deficit financing government bond reduced by Yen 2 trillion for this fiscal year. In the next fiscal year's budget, it will be reduced further. However, twelve trillion yen issue of government bonds still creates a problem, particularly because of the reluctance of private banks to absorb them. Further reduction of the bond issues is not an easy task. The accumulation of government bonds will total Yen 82 trillion at the end of this fiscal year. The Administrative Reform Research Council reexamined the role of the government sector and how public finance should be parallel to the recommendation for the immediate future. With the growing responsibility of Japan in the international field as well as the increasing importance of the role of government in the domestic issues, new requirement for the fiscal policy will be strong in the '80s. The fine tuning of demand management, defense expenditure, energy conservation, increase of aid and the growing needs for the welfare are the requests which would require larger government initiative in any case.

4. - THE UK GOVERNMENT'S APPROACH TO ECONOMIC POLICY

by **Richard Allen**

BACKGROUND.

1. Mr John Pinder's article in this research (" Britain, Industrial Policy and the European Community ") traces " the rise and fall of comprehensive planning " in the UK. Attempts at planning, drawing on the French experience, go back to the 1960s and, in particular, to the establishment of the National Economic Development Council (NEDC) in 1961 and to the National Plan of 1965. The National Plan, however, was short–lives; its targets were rapidly seen to be unattainable and the concept of comprehensive planning lost credibility Subsequent attempts at " planning " — for example, the " industrial strategy " implemented by the last Labour administration — have been more modest in scope. As Mr Pinder notes, the planning process was never taken very far because it was " never closely enough meshed with the realities of economic and industrial policy to have much impact on events ".

2. However, the various planning experiments of the 1960s have left their mark on the economy in various ways. The NEDC still operates as a forum for discussion of economic and industrial problems between members of government, management and trade unions. The tripartite Sector Working Parties, set up in 1976 under the industrial strategy, continue to discuss detailed questions concerning a wide range of industrial sectors. And, as Mr Pinder notes, the Manpower Services Commission, set up in 1974 to implement a comprehensive manpower policy, continues to administer a wide range of employment and training measures, policies on which the present Government places considerable weight. The operations of the Manpower Services Commission, and the important role of Government in the control and planning of the nationalised industries, are examples of the growing emphasis placed in the 1970s on micro economic policies. In this context, one might also mention the growth of direct government assistance for industry, for example, through the National Enterprise Board and the schemes of selective financial assistance under the 1972 Industry Act. But it should be stressed that these employ-

ment and industrial policies were essentially selective, and directed at particular industries or groups, as distinct from comprehensive exercises in economic planning.

THE PRESENT GOVERNMENT'S APPROACH.

3. Elements of this complex system of intervention and support remains under the present Government though, with the exception of employment and training measures and support for the nationalised industries and public corporations, the level of resources being made available are substantially less than under previous administrations. Broadly speaking the Government has attempted to reduce the scale of direct intervention in the economy, consistently with its general approach to economic policy.

4. The Government argues that the UK economy over the past ten years, or more, has experienced two separate problems; a problem of rising inflation and a problem of poor growth, taken both in absolute terms and in relation to our major competitors. Government policy is based upon the belief that the problem of inflation is essentially a monetary phenomenon due to monetary growth and an expansion of total money income far in excess of the productive capacity of the economy. By contrast the problem of slow growth and rising unemployment is seen primarily as a supply side problem resulting from the distortion of markets, excessive use of Government controls and regulations, declining profitability and rising Government spending and taxation. Structural adjustments in the economy have also not been facilitated by the growth of the North Sea oil and gas sector which, along with excessive wage increases, has contributed to the sharp rise in the real exchange rate over the past few years.

5. The output and inflation problems are also related in important ways. It is generally recognised that inflation can damage the long–run performance of the economy by creating uncertainty over future relative prices as well as the general price level, raising interest rates and distorting the tax system. And many of the past attempts to " solve " the problem of slow output growth, for example by the succession of injections of nominal demand into the system, can be seen in retrospect to have exacerbated inflation without achieving any lasting improvement in output. The problems of slow productivity growth, declining industries and outdated skills have remained.

6. With this broad approach in mind, the Government is implementing a policy which has the following main elements:

I) a macro–economic strategy which gives a high priority to reducing inflation;

II) supply–side and other policies designed to improve the efficiency of markets and create a climate in which private enterprise can flourish.

Subsidiary themes, related to (II) are:

III) expansion of the market–oriented sector of the economy by reducing the scale of public sector activities, and exposing the nationalised industries to greater competition;

IV) specific constructive support for industry in limited areas.

7. The Government has rejected the use of formal incomes policy, but regards pay restraint as essential to improving international competitiveness and reducing the employment costs of transition to lower inflation. In this context, the Government is determined to relate the pay of its own employees to what can be afforded in terms of the broad objectives for the growth in total money income and, within that total, the planned growth in public spending.

Macro–economic strategy.

8. The Government's macro–economic strategy is designed to provide a broad framework in which, over a period of years, inflation can be brought down, the major imbalances and structural weaknesses in the economy improved, and the productive performance of the economy raised. Monetary policy is aimed at achieving a steady though not excessive downward pressure on the growth in sterling M3 and other monetary aggregates, taking due account of movements in the exchange rate and other external factors. Fiscal policy is complementary to monetary policy: the levels of public spending and borrowing are designed to be such that the monetary objectives can be achieved at a reasonable level of interest rates.

9. The Government has already made substantial progress in achieving its broad objectives: inflation and wage settlements have been halved since the spring of 1980, the company and personal sectors are now in better balance, and there have been striking improvements during 1981 in productivity, particularly in manufacturing. The other policies outlined below are consistent with, and complementary to, the Government's macro–economic policies.

Improving market efficiency.

10. The Government has taken a number of steps to stimulate the supply side of the economy, by removing unnecessary distortions to market forces and strengthening incentives. These have included:

I) ending controls on pay, prices, dividends and foreign exchange movements;

II) a reduction in the higher marginal rates of income tax, and a lower basic rate; simplification of other taxes (eg capital transfer tax and capital gains tax) to encourage incentives;

III) a battery of measures designed to encourage the creation and growth of small firms, including the Business Starp–Up Scheme and the Loan Guarantee Scheme;

IV) important measures designed to promote greater competition and efficiency both in the private sector and the nationalised industries. The 1980 Competition Act provides new and more effective methods for dealing with restrictions on competition in the private sector and efficiency in the public sector;

V) measures such as the 1980 Employment Act in the field of industrial relations aimed at securing a more appropriate balance between employers and the trade unions. Further legislation is planned in 1982 following the Government's consultation document on Trade Union Immunities;

VI) action to encourage the greater mobility of labour, for example, by encouraging the provision of more rented accomodation for people moving jobs;

VII) action in the field of training (for example, a new Youth Training Scheme which will come into effect in 1983) to improve the quality and adaptability of labour.

Privatisation.

11. In addition to seeking to improve the functioning of the market economy, the Government are attempting both to tighten the financial disciplines on nationalised industries and to open them up to market forces.

12. In the latter area, there are solid successes to report. The Government has sold shareholdings in British Aerospace and Cable and Wireless, returning both industries to the private sector. Enabling legislation

is now on the statute book to sell British Airways and the nationalised ports, and to dispose of shares in British Telecom and British Rail subsidiaries. And the Government intends to take powers to sell a majority shareholding in BNOC's oil-producing business, to privatise BGC's substantial offshore oil assets, and to permit the introduction of private capital into the National Bus Company. The Government have also encouraged the establishment of joint ventures with the private sector. And, in parallel with this, important steps have been taken to open up state industries to competition, in particular by removing a number of statutorily-protected monopolies, eg telecommunications. In addition the Government is making increased use of the Monopolies and Mergers Commission, whose powers were augmented by the Competition Act, to conduct efficiency audits of nationalised industries.

DIRECT ASSISTANCE TO INDUSTRY.

13. Though the Government's main aim has been to provide the appropriate fiscal, monetary and legislative framework in which industry can fluorish, direct assistance to industry has not been ruled out in certain cases.

I) First, the Government inherited the ownership of concerns such as BL and BSC which can only be led back to viability by a combination of Government support and a very tough managerial approach.

II) Secondly, there may be certain specific ways in which the Government can bring a useful influence to bear. In the field of public purchasing, for example, the Government can exercise its purchasing power to strengthen and promote the competitiveness and efficiency of its suppliers. And the Government must also clearly concernitself with the development of those industries whose output is vital to the national defence.

III) In addition, the Government has an important role to play in encouraging innovation and new technology (eg in the field of information) which are not necessarily profitable in themselves, but promote more widespread structural changes in the economy.

14. Finally, as mentioned above, the Government supports and presides over bodies such as NEDC, which bring together representatives of Government, industry and the unions, and attempt to promote a greater understanding of economic problems and of the obstacles to industrial recovery.

Conclusion.

15. Quite apart from its policy towards the nationalised industries, the Government does have a coherent and consistent policy towards industry. This policy is grounded on its broad macro–economic strategy for reducing inflation and creating the necessary framework for a sustained increase in output and employment. It is based on the recognition that ultimately it is the private sector that creates wealth and that the most effective way of encouraging wealth–creation is to ensure that markets operate freely and to maintain a stable monetary framework.

5. - MEDIUM–TERM ECONOMIC POLICY: THE CASE OF THE USA

by **Ciro De Falco**

I would like to address my brief remarks to the first part of the title of this research, i.e., national economic policies. We in the United States have made no effort to " plan " pour economy; judging from what others have learned from such experiences, perhaps we have not lost a great deal.

But before moving on, I wonder whether it would not be appropriate to ask whether there is a common thread, or problem if you will, that ties all these presentations together. If one looks closely at each of these experiences, one finds, it seems to me, the common element to be the problem of how to re–allocate resources, in the face of an internal or external shock, to bring about the required adjustment. As experts, we should be searching for objective criteria which will guide our policymakers in the difficult task of formulating policies designed to bring about the desired economic adjustment in an interdependent world.

The economic policies of the Reagan Administration represent *inter alia* a reaffirmation in the belief that the most reliant indicator in the allocation of resources is the market. The principal objective of President Reagan's Economic Recovery Program is to reduce the size and role of government in the economy and to increase the importance of the market place. The expected benefits of the program will be lower rates of inflation and higher rates of productivity and economic growth. This might be considered long–term planning in the best economic sense.

The President's economic program has four parts:

- lower taxes;
- reduced government expenditures;
- less government regulations;
- steady and predictable non–inflationary growth in the money supply.

Taken together, as they must be to be truly effective, the proposed package of measures is intended as a comprehensive attack on the economy's structural problems. To the extent that the program succeeds, and we fully intend to make it work, we achieve an allocation of resources which maximizes productivity—the only guarantee for non–inflationary, long–term economic growth. Thus, this is not an effort to fine tune the economy in the short run. The results of this program will only be visible in the medium and long run. The best we can hope for in the near term is a drop in inflation which should set the stage for an eventual economic recovery.

Reference has been made by different participants here to the Thatcher Government's experiment with monetarism and what it might imply for the success of the Reagan Administration's program. I maintain that the Thatcher experience is not a good precedent to examine to see what is in store for the U.S. economy. I conclude this for the following reasons:

a) The U.S. economy at the beginning of the Reagan Administration was in much better shape than the British economy at the time Mrs. Thatcher took office. This difference is best indicated by the much smaller relative size of the U.S. Government deficit.

b) The U.S. economy has a larger and more dynamic private sector. Hence tax cuts designed to increase investment and productivity have a better chance of success over the long term.

c) A key element of President Reagan's program is a sizeable reduction in government spending and the elimination of the government deficit. While Mrs. Thatcher also promised to cut spending, the initial Congressional reaction to President Reagan's proposed spending cuts leads one to believe that maybe we will be able to do a little better on this score.

To those who may still be concerned about the economic policy approach of the Administration, particularly as it impacts on other economies through the interest rate mechanism, I would ask what are the alternatives—more stagnation? Recent experience indicates that the trade–off between inflation and unemployment, initially revealed by the Phillips Curve, no longer holds. That a new approach is needed in order to create jobs without igniting inflation. The supplyside theory represents an effort to mesh what seem to be contradictory goals. Someone said that supply–side is a way to " grow inflation out of the economy ". It is a growth–oriented approach.

Finally, I want to say a word about worker participation in management—which has been mentioned in connection with the German case. I realize some foreign observers see the Chrysler case as a beginning of a similar trend in the U.S. I maintain that such an extrapolation is incorrect. The Chrysler " bail out " should be seen as an isolated incident, which would probably not be repeated today. This not only because it is contrary to this Administration's pro–market philosophy, but also because the American labor movement seems opposed to mixing labor and management together.

II. - ECONOMIC INTERDEPENDENCE AND NATIONAL ECONOMIC POLICIES

1. - INCREASING ECONOMIC INTERDEPENDENCE AND NATIONAL ECONOMIC POLICIES

by **Ralph C. Bryant**

In the first part of this paper I will first present a few empirical facts about trends in the economic interdependence of nations, concentrating on the increasing openness of the U.S. economy as an example of this widespread phenomenon. Then I want to present some of my ideas about the consequences of increasing interdependence for national economic policies. In the second part of my remarks, all of may generalizations will be applicable to the United States. But they also apply to the other major industrialized countries. Later on, I will therefore be speaking in general terms rather than about the U.S. economy in particular.

I) Increasing interdependence.

Historical Perspective.

The problems of economic interdependence have again come to the forefront of public attention in the last decade. This renewed interest is partly attributable to the fact that the degree of interdependence increased greatly in the 1960s and 1970s. It is also attributable to a heightened awareness of the phenomenon by political leaders.

If one views economic interdependence from a historical perspective, it is not the recent past that requires explanation. A secular trend toward increasing openness of national economies probably persisted throughout most of the nineteenth century and up to the beginning of World War I. That trend was then interrupted — and in some cases partially reversed — by World War I, the turbulent years of the 1920s, the great depression of the 1930s, and World War II. Writing in the early 1960s, economists such as Simon Kuznets and Raymond Goldsmith were uncertain whether to view the increases in interdependence that had occurred since World War II as a mere recovery from the years of the depression and the war or, alternatively, as a resumption of the long-term trend observed in the nineteenth century. From our vantage point at the beginning of the 1980s, we can better see that the increasing economic interdependence of the last three decades is more likely a resumption of a basic, long-term trend.

The Increasing Openness of the U.S. Economy.

Trade in Goods and Services. In the early postwar period, only 5 percent of the output produced in the United States was exported to the rest of the world. Imports represented an even smaller fraction of total expenditures by American residents. Over the three decades ending in 1980, however, exports and imports grew consistently faster than output.

The trend toward increasing openness of the markets for goods and services in the United States is evident in the aggregative data in *Table 1*. For selected years, that table shows the values of U.S. exports and imports of goods and services and the value of the gross domestic product (GDP). It also gives three measures of the ratio of trade to output. The last of these, based on the average of exports and imports, can be taken as a rough measure of the " foreign trade proportion " for the U.S. economy.

Table 1 – U.S. TRADE IN GOODS AND SERVICES AND THE RATIO OF TRADE TO GROSS DOMESTIC PRODUCT, SELECTED YEARS, 1952–80

	1952	1962	1972	1975	1978	1980
Values in current prices, billions of dollars:						
A) Exports of goods and services	19.1	31.8	77.5	155.0	219.9	339.8
B) Imports of goods and services	16.0	25.5	76.7	128.2	220.4	316.5
C) Gross domestic product	345.7	560.5	1175.0	1531.9	2126.2	2576.5
Ratios (percent)([a])						
D) Exports to gross domestic product..........	5.5	5.7	6.6	10.1	10.3	13.2
E) Imports to gross domestic product	4.6	4.5	6.5	8.4	10.4	12.3
F) Trade to gross domestic product([b]).........	5.1	5.1	6.6	9.2	10.4	12.7

a) Ratios are calculated from unrounded data.
b) Trade is calculated as the arithmetic average of exports of goods and services (line A) and imports of goods and services (line B).

Source: National Income and Product Accounts of the United States, 1929–76: Statistical Tables; Survey of Current Business, July 1981.

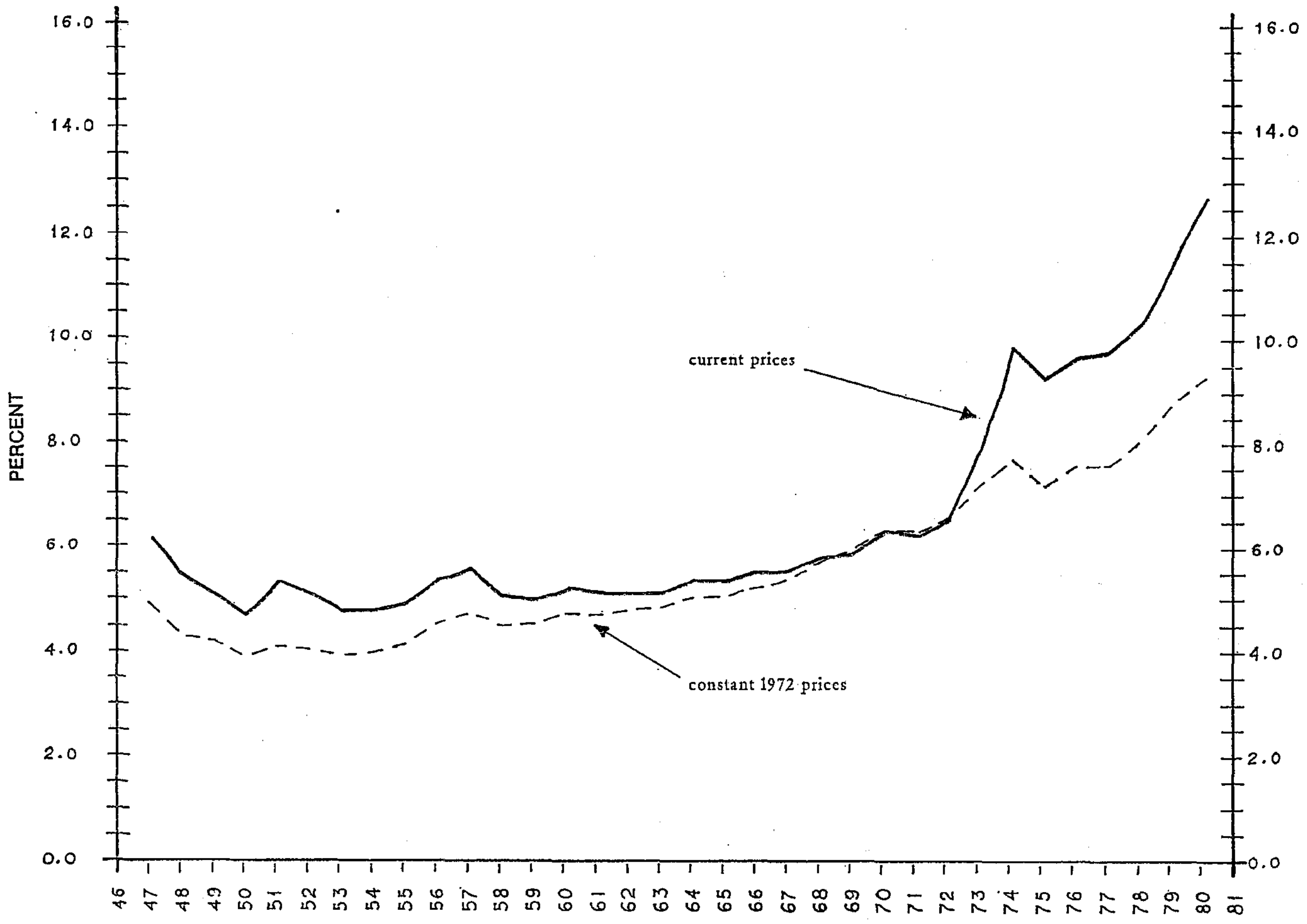
When the numerator and denominator are measured in current prices, measures of the foreign trade proportion can vary because of changes in relative prices as well as changes in the relative importance of traded quantities. Until the 1970s the prices of internationally traded goods rose more slowly than the prices of nontraded goods, and hence more slowly than the average of all prices in the United States. In contrast, during the 1970s the prices of traded goods increased more rapidly than the average level of U.S. prices; this latter trend was attributable in large part to the extraordinary increases in world oil prices in 1973–74 and 1979–80. These differential trends in the prices of traded and nontraded goods had significant influences on the ratios reported in *Table 1*. In particular, the apparent failure of the foreign trade proportion to increase in the 1950s and some part of the especially rapid growth in the 1970s is attributable to changes in relative prices.

Figure 1 plots annual values of the foreign trade proportion in current prices (line F of *Table 1*). The chart also shows the values of the foreign trade proportion with the numerator and the denominator expressed in constant prices. As the second of the two curves makes clear, the price–adjusted ratio of trade to output for the United States has exhibited significant and fairly steady increases throughout the last three decades.

The data in *Table 1* and *Figure 1* are aggregates for total activity in U.S. markets for goods and services. The extent of trade openness is considerably greater in the production of goods alone (output excluding services and structures). In calendar 1980, for example, the current–price values of merchandise exports and merchandise imports were, respectively, 19.8 percent and 22.1 percent of the current–price value of the output of American goods. Even when measured in constant 1972 prices rather than current prices, these ratios of trade to goods output were as high as 13.6 percent for merchandise exports and 10.9 percent for merchandise imports.

For particular sectors of the economy, international transactions have still greater importance. Agricultural exports originating in Arkansas, Illinois, Indiana, Louisiana, North Dakota, and Ohio were 35 percent or more of farm income in those states in 1978. In the three years 1978–80, exports of agricultural products represented more than 24 percent of total farm output. Moreover, exports have accounted for more than 35 percent of total American output in recent years of such agricultural products as wheat, corn, soybeans, grain sorghums, leaf tobacco, milled rice, and hides, skins, and pelts. Manufactured goods exports are especially important to some states; for example, aircraft exports and other exports of manufactures account for some 17 percent of total manufactures shipments originating in the state of Washington. More than a third of total output is exported of such manufactured goods as civilian aircraft, superphosphate fertilizer materials, construction machinery, oilfield machinery, rolling mill machinery, specialized industrial machinery,

Figure 1 – UNITED STATES: RATIO OF TRADE TO GROSS DOMESTIC PRODUCT



Source: United States national income and product accounts.

certain solid state semiconductor devices, audio equipment, and specialized electrical measuring instruments.

Although the proportion fell somewhat from the very high levels of the mid–1970s, petroleum imported into the United States in 1980 still represented toughly two–fifths of total consumption. For particular agricultural products such as bananas and particular minerals such as chromium and diamonds, imports continue to represent essentially the only source of supply. More than one third of the radio and TV receiving sets and virtually two–thirds of the motorcycles and bicycles sold in the United States are manufactured abroad.

Financial Interdependence. As suggested by the data in *Table 1*, the real sectors of the U.S. economy are now significantly linked to economic activity in the rest of the world through current–account transactions in the balance of payments. In several respects, however, the extent of financial interdependence — through actual or potential capital–account transactions in the balance of payments — is even more impressive and has grown even more rapidly over the last three decades.

The most comprehensive data available for the assets and liabilities of U.S. residents vis–a–vis foreign residents are those in the articles on the international investment position of the United States, published each August in the *Survey of Current Business.* For selected years, those data are summarized in *Table 2.*

In the early postwar period, well over half of the external assets of the U.S. economy were owned by the U.S. Government. Over the ensuing years, however, the external assets of private Americans grew much more rapidly than those of the government. By the end of 1980, the official reserve assets of the United States and the other external assets of the federal government were only 15 percent of an economy total of $ 604 billion. The external assets of private U.S. residents were $ 513 billion. Over the 28–year period shown in *Table 2,* these private claims on foreigners grew at an average compound rate of 11.8 percent per year.

The mix of private claims changed significantly during these three decades. In 1952, almost two–thirds of the external assets of private Americans were held as direct investments. Although direct investments grew rapidly and by 1980 were well over $ 200 billion, financial claims increased at a still faster rate. Thus at the end of 1980 direct investments represented less than 42 percent of all private assets abroad.

The most vigorous growth in external assets took place in the claims reported by banking offices in the United States (line A3d in *Table 2*).

Table 2 – The International investment position of the United States, selected years 1952–1980

(Billions of dollars at year end)

	1952	1962	1972	1975	1978	1980
A) *U.S. assets abroad, total*	*59.1*	*96.7*	*199.0*	*295.1*	*547.9*	*603.6*
1. U.S. official reserve assets	24.7	17.2	13.2	16.2	18.7	26.8
2. Other assets of U.S. Government	11.7	19.2	36.1	41.8	54.2	63.5
3. Assets of private U.S. residents	22.7	60.3	149.7	237.1	375.0	513.3
a) Direct investments	14.7	37.3	89.9	124.1	162.7	213.5
b) Foreign securities	4.7	11.9	27.6	34.9	53.4	62.1
c) Claims reported by nonbanks on unaffiliated foreigners	1.8	3.9	11.4	18.3	28.1	33.7
d) Claims reported by banks([a])	1.5	7.3	20.7	59.8	130.8	204.0
B) *Foreign assets in the United States, total*	*20.8*	*46.3*	*161.8*	*220.5*	*370.4*	*480.9*
1. Foreign official assets([b])	([e]) 5	([e]) 14	63.2	86.9	172.9	175.7
2. Other foreign assets in the U.S.	([e]) 16	([e]) 32	98.7	133.6	197.5	305.2
a) Direct investments	3.9	7.6	14.9	27.7	42.5	65.5
b) Securities other than U.S. Treasury securities	n.a.	n.a.	50.7	45.3	53.6	74.0
c) Liabilities reported by U.S. nonbanks to unaffiliated foreigners	n.a.	n.a.	10.7	13.9	14.9	28.6
d) Liabilities reported by U.S. banks to nonofficial foreigners, including U.S. Treasury securities held by nonofficial foreigners ([c])	([e])4.6	([e])9.2	22.4	46.7	86.6	137.1

e: estimated by author.
n. a.: not available.
(*a*) Includes claims on foreigners held in custody by U.S. banks for their domestic customers.
(*b*) Includes U.S. Government securities owned by foreign official institutions and claims of foreign official institutions on U.S. banks.
(*c*) Includes liabilities of U.S. nonbanks to nonofficial foreigners held in custody and reported by U.S. banks.

Source: U.S. Department of Commerce, Bureau of Economic Analysis: *Survey of Current Business* (October 1977, August 1980, August 1981).

Interpretation of the data for the external liabilities of the U.S. economy must take into account the important role of dollar–denominated securities and deposits held in the international reserves of foreign central banks and governments. This "reserve–currency" role of the U.S. dollar explains the segregation in *Table 2* of the assets in the United States of foreign official institutions (line B1) from the other claims of foreigners on the U.S. economy (line B2). As can be seen from the table, foreign official reserve assets held in the United States have been an important component of U.S. external liabilities throughout the postwar period. In 1952 they were one–fourth of the total liabilities of $ 21 billion. At the end of 1980, they were 36 ½ percent of the much larger total of $ 481 billion; in 1978 they had been as high a fraction of the total as 47 percent.

The assets in the United States of foreigners other than foreign official institutions (line B2) are predominantly the liabilities of private American residents. Over the entire period covered in the table, these external liabilities expanded at a compound rate of 11 percent per year, only slightly less rapidly than the external assets of private U.S. residents. Foreign direct investments in the United States at the end of 1980 were about one fifth of the total of $ 305 billion; these direct investments were beginning to attract increasing public attention as the 1970s ended. Holdings by foreigners of U.S. stocks and bonds have always been significant during the postwar years. At some $ 74 billion at the end of 1980, however, these security holdings were a smaller fraction of the total than in the 1950s and 1960s.

As with the asset side of the external balance sheet of the U.S. economy, the fastest growing external liabilities have been those reported by banking offices in the United States (parts of lines B2d and B1).

The data in *Table 2* show that the financial openness of the U.S. economy has steadily increased over the three decades to 1980. This fact is brought out in *Table 3*, where external assets and external liabilities are related to the U.S. gross domestic product. In the early 1950s, external assets other than those of the U.S. Government and total external liabilities were both on the order of 6 percent of the current dollar value of GDP. Two decades later, these ratios had more than doubled. Measured in this way, moreover, financial openness increased substantially further during the 1970s. By 1980, external assets of private U.S. residents were almost 20 percent and external liabilities some 18.7 percent of the value of GDP.

International Activities of American Banks. A few banks in the United States were already significantly involved in some types of international banking by the end of the nineteenth century. For the most part, the

Table 3 – EXTERNAL ASSETS AND LIABILITIES OF THE U.S. ECONOMY IN RELATION TO GROSS DOMESTIC PRODUCT

(Billions of dollars at end year or during the year, except as noted)

	1952	1962	1972	1975	1978	1980
A) External assets of the U. S. economy other than those held by the U.S. Government..........	22.7	60.3	149.7	237.1	375.0	513.3
B) External liabilities of the economy, total	20.8	46.3	161.8	220.5	370.4	480.9
C) U.S. gross domestic product, current prices	345.7	560.5	1175.0	131.9	2126.2	2576.5
D) Ratio of external assets to GDP (A÷C, percent)	6.6	10.8	12.7	15.5	17.6	19.9
E) Ratio of external liabilities to GDP (B÷C, percent)	6.0	8.3	13.8	14.4	17.4	18.7

Source: Table 1 and 2.

international operations of American banks during the first half of this century were closely tied to the ups and downs of U.S. foreign trade.

Beginning in the 1950s, however, international banking activities began to expand especially vigorously and to become less passively associated with the financing of export and import transactions. The growth was rapid both in cross–border banking conducted from U.S. offices and in banking conducted from offices located abroad.

An impression of the current importance of banking conducted from the foreign offices of American banks can be obtained from *Table 4*. As shown in the first column in the table, by 1980 the foreign business of American banks with offices abroad was a very substantial part of their total business. Assets at their foreign offices represented virtually one third of their total balance sheets. Even if one takes into account the numerous domestic banks that had only domestic offices (the second and third columns in the table), the assets at foreign offices of American banks represented some 19 percent of the consolidated balance sheet for the entire group of banks. (1)

(1) The source for the data in *Table 4* is the year–end report of condition (" call report ") filed with the federal regulatory authorities by every bank chartered in the United States. The category of " insured, domestically chartered banks " exludes noninsured banks, banks in U.S. overseas possessions, U.S. agencies and branches of foreign banks, and New York investment company subsidiaries of foreign banks. " Larger " banks are those with total assets of $ 100 million or more. " Smaller " banks are those with total assets less than $ 100 million.

Table 4 demonstrates that a major part of the total business of American banks, and especially of the international business, is conducted by a small number of banks. The 178 U.S.–chartered banks that had foreign offices (branches or subsidiaries) at the end of 1980 accounted for half of the total $ 1527 billion of assets at the domestic offices of all insured, domestically chartered banks, and virtually three–fifths of the $ 1849 billion of the consolidated assets at domestic and foreign offices combined.

Even the statistics in *Table 4*, however, understate the extent to which international banking by American banks is dominated by a few, very large banks. Consider the figures for overseas branches of American banks. At the end of 1980, some 159 banks operated roughly 800 branches in foreign countries and in U.S. overseas possessions. More than 600 of these branches belonged to the largest 22 American banks. Furthermore, the three largest American banks — Bank of America, Citibank, and Chase Manhattan Bank — alone accounted for more than 400 of these branches.

Total assets data reveal a similar pattern of concentration. In December 1980, the 22 largest American banks accounted for 276

Table 4 – Assets at domestic and foreign offices of insured, domestically chartered banks

December 31, 1980

(Billions of dollars, except as noted)

	Insured, Domestically Chartered Banks			
	Larger banks with foreign offices	Banks without foreign offices: Larger banks	Banks without foreign offices: Smaller banks	All banks
A) Total assets at domestic offices of which:	768.7	369.7	388.4	1,526.7
a) Net due from foreign offices	27.1	NA	NA	27.1
B) Total assets at foreign offices of which	353.8	NA	NA	353.8
b) Net due from domestic offices	4.0	NA	NA	4.0
C) Consolitated assets at domestic and foreign offices	1,091.4	NA	NA	1,849.4
Memorandum: Number of banks	178	1,241	13,002	14,421

NA: not applicable.

billion — fully two thirds — of the $ 1091 billion of consolidated domestic and foreign assets of all 178 banks that had foreign offices. Among the top 22 banks themselves, moreover, the totals were distributed unevenly. The top 11 banks accounted for some three fourths of all the assets at foreign offices of American banks and more than half of the consolidated assets at domestic and foreign offices combined. Bank of America, Citibank, and Chase Manhattan Bank alone had $ 287 billion of consolidated domestic and foreign assets, 26 percent of the consolidated assets of all banks with foreign offices.

To put this very high degree of concentration in international banking in perspective, it needs to be remembered that the dominance of Citibank, Bank of America, Chase Manhattan Bank, and a few others such as Morgan Guaranty Trust Company was still more pronounced earlier in the postwar period. The numbers of banks becoming involved in international transactions grew throughout the last three decades. The growth was especially marked during the 1960s, in part because of the restrictions on international lending from domestic offices imposed in the period February 1965 to January 1974 (the Voluntary Foreign Credit Restraint program administered by the Federal Reserve). The fact that as many as 178 American banks were operating foreign offices in December 1980 testifies to the aggressive efforts by many medium-sized banks to secure a share of the rapidly expanding business of international banking.

For the largest American banks, international business is centrally important to their total business. The extent of this importance is probably not widely recognized outside the financial community. Three indications of this importance are shown in *Table 5*. Each of the three columns in the table shows the ratio of a balance-sheet aggregate for foreign offices to the corresponding aggregate for the consolidated balance sheet of foreign and domestic offices combined. The ratios are crude indicators of the relative importance of international business to individual banks and to groupings of banks. (1)

Regardless of whether the judgment is based on deposits, loans, or total assets, the same conclusion emerges. The largest American banks are " American " because they are controlled by American citizens, not because they are primarily engaged in banking with U.S. residents. One

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(1) The data in *Table 5* are drawn from computer tapes containing call-report data for December 1980. Foreign offices of American banks have significant assets and liabilities vis-a-vis U.S. residents, and the domestic offices of American banks have substantial claims on and liabilities to foreigners. If it were possible to include *all* cross-border and cross-currency balance-sheet items as well as all banking relationships with foreigners in the numerator of ratios like those in *Table 5*, the relative importance of international business to American banks would be seen to be even greater than suggested by *Table 5*.

Table 5 – INDICATORS OF THE RELATIVE IMPORTANCE OF INTERNATIONAL BANKING TO THE LARGEST AMERICAN BANKS

December 31, 1980

(Percent)

	Deposits at foreign offices as proportion of consolidated deposits	Loans at foreign offices as proportion of consolidated loans	Total assets at foreign offices as proportion of consolidated total assets
A) *Three largest banks*	*57.3*	*53.2*	*52.6*
1. Bank of America NT&SA	46.1	35.2	44.8
2. Citibank NA	72.9	67.8	63.2
3. Chase Manhattan Bank NA	55.0	57.7	49.6
B) *Eight next largest banks each with consolidated assets in excess of $ 20 billion*	*44.5*	*38.2*	*39.2*
4. Manufactures Hanover Trust Co.	50.2	48.2	45.4
5. Morgan Guaranty Trust Co.	52.0	61.1	50.2
6. Chemical Bank	43.5	39.7	37.9
7. Continental Illinois Nat'l Bank and Trust Co. of Chicago	49.8	28.6	37.1
8. Bankers Trust Co.	51.9	45.7	41.5
9. First National Bank of Chicago	54.7	40.2	46.2
10. Security Pacific National Bank	16.2	14.4	17.5
11. Wells Fargo Bank NA	20.9	12.2	18.5
C) *Top eleven banks* (A + B)	*50.9*	*45.8*	*45.8*
D) *Eleven next largest banks each with consolidated assets in excess of $ 8 billion*	*32.8*	*22.2*	*28.0*
12. Crocker National Bank	23.7	15.3	19.5
13. Marine Midland Bank NA	43.2	32.2	36.8
14. United California Bank	18.0	13.5	16.4
15. Irving Trust Co.	44.7	40.2	38.4
16. Mellon Bank NA	35.5	18.6	28.4
17. First National Bank of Boston	54.5	47.9	49.0
18. Bank of New York	31.6	13.8	26.3
19. National Bank of Detroit	19.6	10.9	18.9
20. Seattle-First National Bank	10.7	11.8	11.6
21. First National Bank in Dallas	31.9	18.6	26.3
22. Republic National Bank of Dallas	37.8	15.7	27.9
E) *Top twenty-two banks* (C + D)	*47.2*	*41.2*	*42.2*
F) *Subtotal for 156 other banks with foreign offices*	*12.3*	*7.8*	*13.0*
G) *All 178 banks with foreign offices*	*35.6*	*30.7*	*32.4*

half or more of the banking activities of Citibank, Chase Manhattan Bank, Morgan Guaranty Trust Company, and the First National Bank of Boston are carried out at foreign offices. The proportion is some 40 percent or more, especially if judged by deposits, for Bank of America, Manufacturers Hanover Trust Company, Chemical Bank, Continental Illinois National Bank, Bankers Trust Company, First National Bank of Chicago, Marine Midland Bank, and Irving Trust Company. Citibank's deep involvement in foreign business is especially striking; 68 percent of its loans and 73 percent of its deposits are on the books of its many foreign offices.

Table 6 presents some summary indicators of the vigorous growth in the international dimensions of banking in the United States and in the overseas activities of American banks. As a point of reference for the international series, the last two rows in the table show figures for the total assets at domestic offices of U.S.–chartered banks and of all commercial banking institutions in the United States.

Over the last three decades as a whole, the U.S. banking sector expanded at a rate of about 8 percent per year (lines E1 and E2). Throughout the postwar period, the international–banking aggregates grew at rates far in excess of the growth in the banking sector itself. As *Table 6* shows, typical annual rates of growth have been 20 percent, or even more (1). It is sometimes argued that the rapid growth of international banking began only in the late 1960s or in the 1970s. The data in *Tables 2* and *6* show that such a view is incorrect.

The very rapid growth of the international–banking aggregates has been causing a gradual but pronounced opening up of the U.S. banking sector to the rest of the world. Three indicators of this increasing openness are presented in *Table 7*. From only 3 percent in the early 1950s, the banks own' dollar liabilities to foreigners had risen by 1979 to more than 7 percent of the total assets of the U.S. banking sector. The banks' own claims on foreigners as a proportion of the sector balance sheet had risen still more dramatically, from less than 1 percent in the early 1950s to 10.3 percent in December 1980. The last line in *Table 7* refers not to the U.S. banking sector itself, but rather to a consolidated balance sheet for the domestic offices and foreign branches of U.S.–chartered banks. For

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(1) The only exceptions to this generalization, the growth of the cross–border assets and liabilities of the U.S. banking sector during the second half of the 1960s and the early 1970s (lines A and B in the table), are more apparent than real. The capital controls in force during 1965–1974 caused banks to expand the balance sheets of their foreign offices at the expense of their domestic offices (compare the unusually fast rates of growth on lines C and D of the table for 1962–72 with the slower growth on lines A and B). But the consolidated claims on foreigners of the domestic and foreign offices combined continued to grow very rapidly — in fact, even faster than in the 1950s.

Table 6 – SUMMARY INDICATORS OF GROWTH IN INTERNATIONAL BANKING – UNITED STATES, 1952–1980

	Outstanding amounts, billions of dollars at end of year				Compound rate of growth percent per annum			
	1952	1962	1972	1980	1952–62	1962–72	1972–80	1952–80
A) Claims of U.S. banking sector on foreigners:								
1. Total reported, including claims held in custody for domestic customers	1.5	7.3	20.7	203.9	17.1	11.0	33.1	19.2
2. Banks own claims	e1.0	e6.2	e15.5	176.8	e17.0	e10.0	e36.0	e20.3
B) Liabilities of U.S. banking sector to foreigners:								
1. Total reported, including custody liabilities	9.3	22.0	61.7	209.0	9.0	10.9	16.5	11.6
2. Banks' own liabilities in dollars	e6.1	e11.7	e25.0	124.8	e7.0	e8.0	e22.0	e11.4
3. Liabilities to private foreigners	4.3	8.0	19.6	116.3	6.4	9.4	24.9	12.5
C) Total assets of foreign offices of U.S.–chartered banks:								
1. Branches	e1.3	e4.3	78.2	369.9	e13.0	e34.0	22.5	e23.0
2. Subsidiaries	n.a.	e1.1	12.7	e75.0	n.a.	e28.0	e25.0	n.a.
D) Consolidated claims on unaffiliated foreigners at domestic offices and foreign branches of U.S.–chartered banks	e1.7	e7.5	e71.5	352.1	e16.0	e25.0	e22.0	e21.0
E) Total assets at domestic offices of:								
1. U.S.–chartered commercial banks	189.6	298.1	740.8	1543.5	4.6	9.5	9.6	7.8
2. All U.S. commercial banking institutions	191.0	302.7	763.6	1710.4	4.7	9.7	10.6	8.1

e: estimated by author.
n.a.: not available.

Table 7 – SUMMARY INDICATORS OF INCREASING OPENNESS OF THE U.S. BANKING SECTOR, 1952–1980

(Percent at end of year)

	1952	1962	1972	1975	1978	1979	1980
F) Ratio of banks' own claims on foreigners to total assets at domestic offices (all commercial banking institutions)	e0.5	e2.0	e2.0	e5.1	e8.6	e8.9	10.3
G) Ratio of banks' own dollar liabilities to foreigners to total assets at domestic offices (qll commercial banking institutions)	e3.2	e3.9	e3.3	e5.1	5.7	7.6	7.3
H) Ratio of banks' consolitated claims on unaffiliated foreigners at domestic offices and foreign branches to total assets at domestic offices (U.S. – chartered banks)	e0.9	e2.5	e9.7	17.4	20.8	21.6	22.8

e: author's estimate.

that group of banks, claims on unaffiliated foreigners represented less than 1 percent of the consolidated balance sheet in 1952; the comparable figure at the end of 1980 was nearly 23 percent!

Table 8 shows several of the international–banking aggregates discussed earlier (end–of–year stocks) in relation to the international trade in goods and services of the U.S. economy (annual flows). As noted in *Table 1* and repeated in the memorandum line in *Table 8*, international trade has itself grown considerably faster than the U.S. gross domestic product, thereby gradually opening up the real sectors of the U.S. economy. But the opening up of the banking sector of the U.S. economy to the rest of the world has occurred at an even faster rate. The external assets of the U.S. banking sector in the early 1950s were only some 5 to 6 percent of the value of international trade; consolidated banking claims on unaffiliated foreigners at the domestic offices and foreign branches of U.S.–chartered banks were only one tenth the value of trade. By the beginning of the 1980s, these two banking magnitudes had risen to, respectively, 54 percent and well over 100 percent of the annual flow of trade. The liabilities of the U.S. banking sector were already a large fraction of U.S. trade early in the postwar period; they increased modestly faster than trade during the 1970s.

Table 8 – UNITED STATES: INTERNATIONAL BANKING MAGNITUDES IN RELATION TO INTERNATIONAL TRADE, 1952–1980

(Ratios expressed as percent)

	1952	1962	1972	1975	1978	1979	1980
J) Banks' own claims on foreigners at end of year (all commercial banking institutions) as a percent of international trade in goods and services ..	e5.7	e21.7	e20.1	e36.4	54.2	49.7	53.9
K) Banks' own dollar liabilities to foreigners (all commercial banking institutions) as a percent of international trade in goods and services	e34.8	e40.9	e32.4	e36.0	35.8	42.7	38.0
L) Banks' consolidated claims on unaffiliated foreigners at domestic offices and foreign branches (U.S.–chartered banks) as a percent of international trade in goods and services ..	e9.7	e26.2	e92.7	118.0	120.9	110.6	107.3
Memorandum:							
International trade in goods and services as a percent of gross domestic product	5.1	5.1	6.6	9.2	10.4	11.6	12.7

International trade in goods and services is defined as the arithmetic average in each period of exports and imports (national–income accounts definition).

The figures in *Tables 1* through *8* are affected by period–to–period variations in the rate of inflation. In the 1950s, the U.S. banking sector and GDP were expanding at rates of 4 ½ to 5 percent a year, with only some 2 percentage points of that growth attributable to inflation. In the decade of the 1970s, the price level in the United States increased at an average annual rate of some 7 to 8 percent. The banking sector and the nominal value of GDP therefore grew at much faster rates in that period — as high as 10 percent per year for the banking sector, with virtually three–fourths of that growth attributable to inflation.

The effect of inflation on the international–banking magnitudes deserves emphasis as a contributing factor to the high rates of growth observed in the 1970s. At the same time, inflation cannot account for the *relative* differences in growth rates between the international–banking aggregates on the one hand and GDP and the size of the banking sector on the other. Nor can variations in the exhange rates of the dollar against foreign currencies account for most of the rapid growth in the international dimension of banking. Exchange–rate valuation effects on the dollar–equivalents of assets and liabilities denominated in foreign currencies are significant factors in explaining changes in the balance sheets of foreigns branches and subsidiaries of American banks. But the secular trends over the entire postwar period, or even over the extended period of floating from 1973–81, are not primarily attributable to exchange–rate valuation effects.

II) National economic policy under conditions of increasing interdependence.

What I have said so far has focused on the U.S. economy. Yet the phenomenon of increasing economic interdependence is a general one. Virtually all the industrial economies have become markedly more open in the last three decades.

Increasing interdependence has far–reaching consequences for the conduct of economic policies by national governments. In my book, *Money and Monetary Policy in Interdependent Nations* (Brookings, 1980), I have tried to grapple with many of the resulting policy issues in a more precise way than is typical of most discussions. I hope I have succeeded in sharpening up what we do and do not know. In the remainder of my remarks I want to share with you some of the more important points that emerge from my analysis in that book.

Alternative Paradigms.

Four alternative approaches can be taken when analyzing national economic policy for an open economy. The first of these may be identified as the nearly closed paradigm. The main features of this paradigm are portrayed schematically in *Figure 2*. Arrows in the diagram indicate the channels of causation or interaction considered to be important; the widths of the arrows suggest the relative importance attributed to the various channels.

As *Figure 2* makes clear, the fact that a particular national economy being studied is part of a larger world economy warrants, at best, secondary analytical attention in this approach. Moreover, to the extent that they are considered, interactions of the home economy with the rest of the world tend to be treated in an ad hoc, piecemeal fashion. An approach based on this national, nearly closed paradigm is thus severely myopic about everything except the " domestic " economy.

In sharp contrast, the small and open economy — represented schematically in *Figure 3* — postulates an economy whose relationships with the rest of the world loom large relative to the size of the economy itself

Figure 2 – THE NEARLY CLOSED PARADIGM

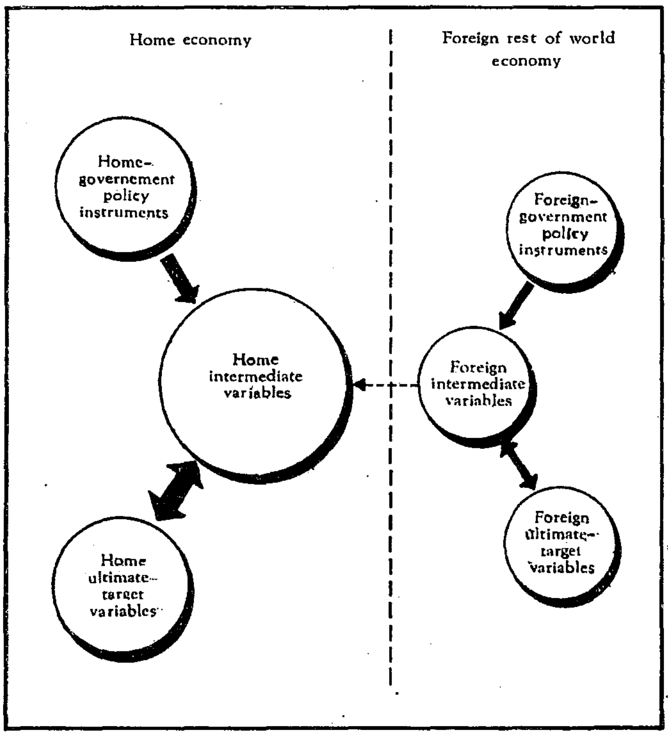
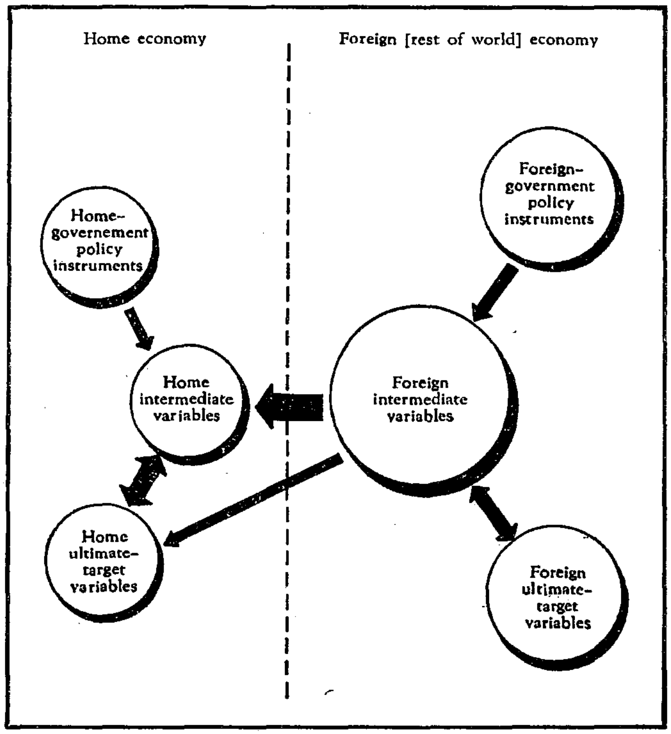


Figure 3 – THE SMALL AND OPEN PARADIGM



but are small relative to the world as a whole. Foreign " exogenous " influences play an enormously important part in influencing many macro-variables in the home economy.

Unlike the nearly closed paradigm, the small and open paradigm does not deemphasize international influences. Yet it still assumes that the international influences run in only one direction. The rest-of-the-world economy plays a large role in driving the national economy; but nothing that happens in the national economy can have any impact on the rest of the world. While the nearly closed paradigm postulates virtual independence, therefore, the small and open economy assumes a large measure of dependence. Neither allows for or attempts to analyze genuine interdependence.

A third approach to the analysis of macroeconomic activity, the supranational paradigm, adopts a global rather than national perspective. As suggested by the schematic diagram in *Figure 4*, the supranational paradigm characterizes economic activity as taking place in a highly integrated world economy. Commodities and financial assets are regarded as very good substitutes everywhere in the world. In fact, the degree of such substitutability and the degree of perfection in the integration of markets is assumed to be sufficiently great to necessitate a world aggregation of macroeconomic variables. At least to a first approximation, the economic phenomena associated with political boundaries and political decisions — with the nation state itself — are ignored.

In different ways, the supranational and the small and open paradigms represent polar extremes. The nearly closed paradigm, given its superficial treatment of the home economy's openness, may also be said to represent an extreme. For nations like those represented at this meeting, therefore, none of the three preceding paradigms are really appropriate for analyzing the problems of national economic policy.

In real life, national policymakers in our countries have to cope with the problem of *intermediate interdependence*. This situation is pictured schematically in *Figure 5*. When policymakers in the home nation take a policy action, some of the effects of that action leak abroad. Nonpolicy disturbances originating in the home economy spill over to some degree into foreign economies. Similarly, when policy actions are taken abroad or when nonpolicy disturbances originate abroad, some significant part of the consequences of those actions or disturbances spill over into the home nation. Yet these spillovers across national borders are far from complete. Home policy actions and nonpolicy disturbances occurring at home still have a markedly greater impact at home than abroad. Policy actions and nonpolicy events originating abroad still have much greater effects in the rest of the world than in the home economy.

Figure 4 – THE SUPRANATIONAL PARADIGM

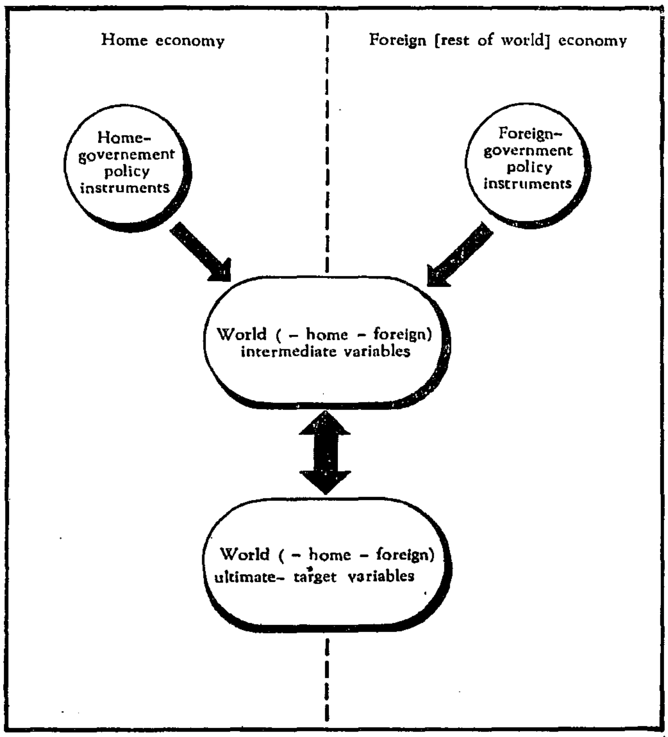
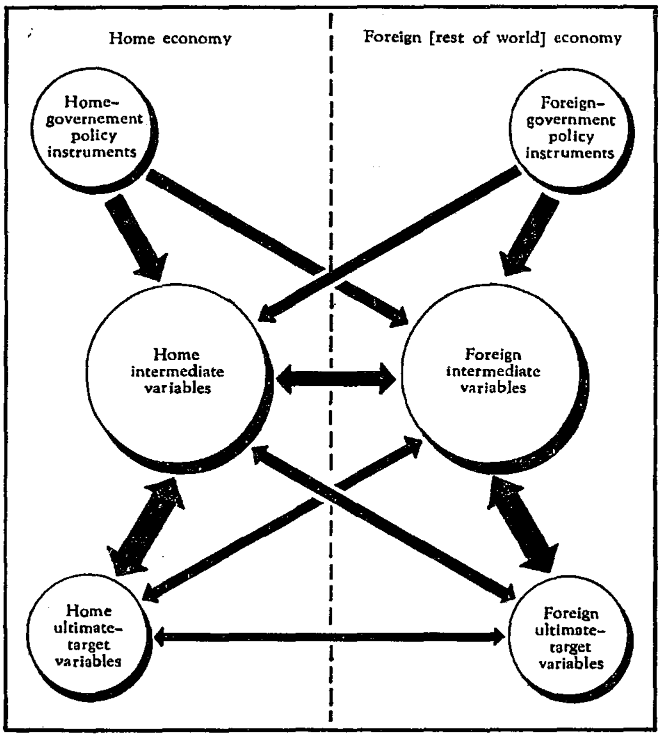


Figure 5 – THE INTERMEDIATE INTERDEPENDENCE PARADIGM



Tension between Political Structure and Economic Structure of the World.

In a situation of intermediate interdependence, national governments — and hence national economic policies — are focused primarily, if not exclusively, on *national* ultimate targets. The national governments have formal sovereignty over national policy instruments. They are free to take independent decisions about the settings on their instruments, and are politically constrained to do so. The *political* organization of the world, in other words, is dominated by nation states.

Increasingly, however, the *economic* organization of the world is in tension with that political structure. The effective domains of economic markets and the geographical borders of governmental jurisdictions are not coterminous!

The study of intermediate interdependence, therefore, is necessarily a study of the interplay between political structure and economic structure. Most analyses of national economic policy ignore or underemphasize the problems generated by this interplay. It is an interesting fact that even our customary use of language is dominated, implicitly, by the political structure. For example, we commonly identify markets with nations — speaking of the " Italian " automobile market, " penetrating the German market, " and so on. It is customary usage to speak of " the domestic economy " or " the national economy. " As one allows for the possibility of a progressively higher degree of noncoincidence between the borders of national governmental jurisdictions and the effective domains of economic markets, however, a progressively larger element of ambiguity creeps into this use of language. One way to bring out this point is to recall the conceptual difference between gross national product and gross domestic product. Gross national product is defined as the income accruing to factors of production owned by residents of a particular nation, regardless of the geographical location of those factors. Gross domestic product is defined as the income accruing to factors of production physically located within the geographical boundaries of a particular nation, regardless of the residency of the owners of those factors of production. Which is the more appropriate concept to use when speaking of " the national economy "? If the national economy is highly open, the two concepts can diverge significantly. More important, at some point concept can comfortably be associated with the phrase " the national economy ". The nation — as a well-defined *political* entity — may still exist. But the national economy — as a clearly defined *economic* entity — will not.

It is an important feature of the intermediate interdependence paradigm that it juxtaposes the politics of nationhood and the economics of integrated markets and thereby encourages an explicit examination of the interplay between them.

De Jure Sovereignty versus De Facto Control.

Each nation's policy authority adjusts the settings on its own policy instruments. Each is formally independent. Each has its own objectives, quite different from the goals of other nations' authorities. Because the policy actions of one nation's authority can have significant impacts on the objectives of the others, however, it is only in a political sense that one can regard each nation's authority as independent.

A careful analysis must therefore take into account the fundamental distinction between *de jure* sovereignty of national economic policy and *de facto* control over national economic developments. The former involves the formal command over policy instruments; the latter involves the ability to influence specified targets by skillful manipulation of the policy instruments.

The distinction between the formal authority to take policy actions and the effective ability to use instruments to achieve targets is a distinction that would be important even for a hypothetical economy completely closed to the rest of the world. Policymakers' knowledge of how an economy functions and how their policy instruments influence the economy is sufficiently uncertain even about the domestic impacts to make a precise control of economic developments impossible. But it becomes *a fortiori* important in an open economy to take into account the fact that formal independence to initiate policy actions does not ensure that instruments will be effective in achieving targets.

Essential Elements of the National Policy Problem.

The basic task to be performed by the policymakers in an individual nation is to use the instruments at their disposal to try to achieve national ultimate targets, given whatever nonpolicy disturbances (domestic and foreign) may occur. All policy presupposes the use of some type of "model." (Models may be implicit and carelessly devised, or explicit and systematic. But an analytical framework of some sort is a logical prerequisite for policy decisions). More precisely, therefore, the task of policy is (1) to choose the least inadequate model available for characterizing the behavior of the economy; (2) to make the best possible projection for all the nonpolicy disturbances that may affect the economy; and then (3) to select that combination of instrument settings judged most likely to bring about the best feasible paths for national target variables.

Because the policymakers in an individual nation are concerned primarily with the welfare of their own national citizens, it might be thought that they need to pay attention only to the evolution of their own economy. In particular, it might be thought that home policymakers could ignore the effects that their policy actions will have abroad and ignore the extent to which foreign policymakers are successful in achieving the objectives of foreign economic policy. The difficulty with this presumption, however, is that these other considerations are irrelevant to the home autorithy only in a proximate sense. If the home policymakers assume that what happens in the rest of the world is " exogenous " from their perspective and if they ignore the consequences of their own actions for the rest of the world, the *indirect* interdependencies in the world economy can cause them to make significant mistakes. Under conditions of interdependence, the world economy behaves as a system; the nation's economy cannot be decoupled from the rest of the system for purposes of analysis or policy control even if it is decoupled for the purpose of appraising national welfare.

A game–theoretic indeterminateness stemming from the interaction of decisions by the home and the foreign authorities may be the most important reason why a single national authority cannot afford to disregard part of the the world economic system and concentrate its analytical attention only on its national subsystem. Home nation projections for " nonpolicy disturbances " affecting the home economy depend on expected policy actions abroad (since policy actions of foreign governments are a nonpolicy disturbance from the perspective of home policymakers). Similarly, the projections of foreign governments for the nonpolicy disturbances affecting their economies depend on their expectations of what the policymakers in the home government will do. In effect, the world economic system has a number of would–be controllers, all simultaneously seeking to control an interdependent system.

Consequences of Increasing Interdependence for Autonomy and Controllability.

When the extent of economic interdependence increases, the " autonomy " of national economic policy is diminished. To speak more precisely, the " multipliers " that link national policy instruments to national economic targets are typically reduced in size and made more uncertain.

The degree of " controllability " that policymakers can exert over the nation's target variables is a broader concept than autonomy. (Controllability depends on autonomy, but it also depends on such factors as the impacts on the nation's economy of nonpolicy disturbances and of the policy actions of foreign governments). Increases in interdependence tend to diminish controllability. As a result, national policy decisions are more difficult to make and more uncertain in their consequences the greater is the openness of the economy. Increasing interdependence undermines the ability of the individual nation's policymakers to achieve national objectives.

III) Interactions among national economic policies.

There is much more that could be said about the ability of a single nation to pursue and achieve its national objectives. (1) For our purposes here, however, it is more pertinent to consider the consequences of increasing interdependence for the interactions among nations' economic policies.

The Non–Independence of Nations' Economic Policies.

Suppose each nation in the world follows the broad approach to policy decisions sketched above, adjusting its own policy instruments in an effort to achieve its own national objectives. With the world economy composed of many nations, it can *seem* to each nation's policymakers that they are acting independently. In fact, however, the actual freedom to take independent policy actions is more restricted than the freedom that seems to exist when each nation's choices are contemplated in isolation.

The constraints on national freedom manifest themselves most obviously in the choice of operating regimes for external monetary policy. Just as the two central banks in a hypothetical world of two nations could not act independently to set one exchange rate at different exogenous levels, N central banks in the actual world economy cannot act independently to set N–1 exchange rates at N exogenous levels. Apart from increases in the world total stock, one nation cannot acquire (spend) outside reserve assets without another nation simultaneously using (receiving) them. Nor can one nation accumulate or run down external reserves in currency–denominated form without generating counterpart changes in external reserve liabilities for another country.

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(1) I have spelled out all the ideas summarized above more precisely, and tried to show how they can be given empirical content in policymaking, in Part 3 of *Money and Monetary Policy in Interdependent Nations.*

Although less obvious, it is equally true that the non-independence of nations' policy actions extends well beyond the choice of exchange-rate and external-reserves policies. A nation's *domestic* monetary and fiscal policies are constrained by the *domestic* policy choices of other nations. To take an important example: the choice by foreign central banks of operating regimes for their domestic monetary policies can have important consequences for the home nation and the decisions of the home central bank. Under conditions of intermediate interdependence in both goods and financial markets, the domestic monetary regimes in foreign nations not only condition the impacts of home monetary-policy actions on the foreign economies, but even the impacts of home actions on the home economy.

If one abandons the myopic national perspective that is typical of each individual nation's approach to policy decisions, the question of " policy flexibility " appears in a quite different light. A global perspective makes it clear that any extra room for maneuver in one nation's macroeconomic policies attributable to the openness of its economy must come at the expense of policy flexibility for other nations. All countries cannot enjoy additional flexibility simultaneously.

All nations can *try* to enjoy additional policy flexibility at the expense of other countries. National targets and policy actions can easily be inconsistent *ex ante*. But somehow, a reconciliation of the inconsistencies must and does take place: some, if not all, *ex ante* national targets and policy actions go unrealized *ex post*.

Exchange-Rate Variability as an Antidote for Interdependence?

Until recently, the conventional wisdom among economists asserted that nations could pursue independent monetary policies if exchange rates were permitted to be perfectly flexible. That proposition is now understood to be analytically incorrect and a misleading guideline for policy decisions. Flexibility of exchange rates cannot insulate an economy.

Under conditions of intermediate interdependence, monetary-policy actions in foreign nations affect financial and real-sector variables in the home nation's economy whatever happens to the exchange rate. Monetary-policy actions taken by the home nation's central bank are not completely bottled up at home regardless of the manner and degree of exchange-rate variability. Analogous conclusions apply to the international consequences of fiscal-policy actions and of nonpolicy disturbances.

Any policy action taken at home gets transmitted in one way or another to foreign output, prices, and employment — and vice versa.

No analytical model of " flexible exchange rates " can be made to yield a complete–insulation outcome without employing implausible simplifying assumptions directly responsible for that result. (1)

It is true that the effects of policy actions and nonpolicy disturbances originating abroad tend to spill over less into a home nation when exchange rates are flexible than when exchange rates are kept from adjusting. If home policymakers wish to buffer their economy against most types of foreign policy actions and against many types of disturbances originating in the real sectors of foreign economies, they should let the home currency appreciate in response to external stimuli that are expansionary and depreciate in response to those that are contractionary. But the buffering tendencies associated with exchange rate variability do not apply to every type of disturbance originating abroad; for example, they do not apply to autonomous portfolio shifts into or out of home–currency assets (by foreigners or home residents). Nor is it always desirable to have the home economy buffered against the rest of the world. In periods dominated by real–sector disturbances *originating in the home economy*, for example, it is in the selfish interest of the home nation to share, to the greatest extent possible, the adverse consequences of those disturbances with the rest of the world.

The idea that exchange rate variability insulates nations' economies is frequently associated with another incorrect idea, that flexible exchange rates unshackle monetary policy from international constraints, freeing the central bank to forget about the balance of payments and to worry merely about domestic goals. The injunction to focus attention on the domestic economy can easily be interpreted to mean that economic developments abroad can be ignored; by implication, flexible exchange rates provide complete insulation.

But there is no meaningful sense, no matter how monetary policy may be conducted, in which a central bank can safely ignore the interdependence of the home economy and the rest of the world. Since the balance of payments is nothing more than an accounting record of the consequences of that interdependence, moreover, there is no meaningful sense in which the home policymakers can safely " forget " about the balance of payments. Events abroad always affect the home economy — sometimes favorably, sometimes unfavorably. The impacts on the

(1) The conventional wisdom of the insulation position evolved during a time when theoretical analysis of international macroeconomics tended to ignore *financial* interdependence. Models that focus exclusively on the current account in the balance of payments and the direct interdependence of real sectors (implicitly or explicitly assuming an absence of all international capital flows except changes in official reserve assets) can yield the complete–insulation outcome.

home economy of central bank actions and of events occurring at home are always conditioned by interdependencies with the rest of the world — sometimes favorably, sometimes unfavorably. Those international influences can be ignored in the same sense that an airplane pilot flying under conditions of low visibility can look merely at his plane's compass and speedometer and choose to ignore the altimeter. If prudent, however, neither pilots nor policymakers behave in that manner.

Implications of Policy Interaction for International Cooperation.

As I stressed a moment ago, when the targets and instrument settings of the various nations in the world economic system are inconsistent *ex ante*, such inconsistencies are necessarily forced into consistency *ex post*. But how? And how do such noncooperative outcomes compare with outcomes that would be possible with cooperative bargaining?

Research on these questions is still in its infancy. But a basic conclusion has emerged from the theoretical analysis done so far: noncooperative decisions can lead to outcomes that are markedly inferior to what would in principle be attainable through cooperation. Analytical support for this conclusion is provided by some control–theory research on decentralized decisionmaking. Further support can be found in economic theory itself. Studies of " market failures " have long since established the result that noncooperative competition can in some circumstances lead to socially suboptimal outcomes. Numerous instances have been identified in which unconstrained maximization by individual economic units, while rational for each individual, can be irrational for all individuals together. (1)

Noncooperative behavior is the norm in the world economy, notwithstanding the theoretical case that each nation could better achieve its national objectives by entering into cooperative agreements. Why? What inhibits national governments from increasing cooperation to a level that would prove mutually beneficial?

One important explanation is that nations' policy authorities do not have a common, agreed model of how the world economy works to use as a basis for cooperative bargaining. Another explanation is that each nation's authority tends to have a biased perception when assessing the *ex ante* tradeoff between loss of national political sovereignty and the potential gains from international cooperation. Perhaps even more im-

(1) For further discussion and detailed references to the literature, see *Money and Monetary Policy in Interdependent Nations*, chap. 25.

portant, however, is a third explanation: the increasing political pluralism that is a pervasive secular trend characteristic of all aspects of international relations in the last three decades.

The single most visible aspect of this secular trend has been the declining political hegemony of the United States. More fundamentally, however, the trend of increasing political pluralism is the development of a situation in which one or a few nations no longer effectively dominate international decisionmaking.

The fact that economic and political power is today diffused more widely among the industrialized Western nations and the Soviet Union than in the 1940s needs no elaboration. It does need to be stressed for some audiences, however, that the diffusion of wealth and power extends well beyond the Soviet Union, Europe, and Japan. Nor is that broader diffusion solely due to the dramatic increase in the political and economic muscle of the oil–exporting countries. It was true in the 1970s, and could well continue to be true in the 1980s, that a number of advanced non–oil developing countries grew more vigorously than the traditional industrial powers.

The trend toward greater political pluralism means that a significantly larger number of nations must be involved in policy decisions affecting the world policy and economy — for virtually any area of policy issues one cares to consider. For reasons spelled out in the literature on game theory, decisionmaking in large groups is more difficult than in smaller groups. As noted above, moreover, game–theoretic indeterminacies are endemic to the interaction of national policies.

The greater international diffusion of economic and political power thus has an important bearing on the ability of the world as a whole to reach cooperative decisions. If only a few nations needed to be involved in critical negotiations, each could easily lern about the probable behavior of the others, including the likelihood of cooperative decisionmaking. The outcome of bargaining would be more likely to be determinate, and the potential value of cooperation could be more readily perceived. If many nations must be involved with none of them dominant, however, any learning process has to be more protracted. Perceptions of the potential mutual benefits of cooperation will be less clear, and the outcomes of bargaining may not be determinate.

The difficulties for collective decisionmaking arising from a large rather than small number of participating nations are exacerbated by the tendency of most nations to perceive themselves as " small " and to assume that their behavior does not significantly affect the rest of the world. Even if each individual nation behaves rationally in the light of its own objectives and even if all nations share some objectives, the tendency to ignore the consequences of one's actions for others can collectively produce a suboptimal outcome for the world as a whole. The larger the group of nations involved, the greater the probability that some nations will act as " free riders, " and hence the *less* likely it is that the group of nations will further their common interests.

IV) Alternatives for coping with interdependence.

Where does my analysis leave international cooperation? From a systemic perspective, what can be done to promote as healthy and stable an evolution of the world economy as possible? National governments, it seems to me, have three broad choices open to them in collectively managing their economic interrelations. The first choice would be to try to go backward, reducing the degree of economic interdependence in the world economy. The second possibility would be a passive course, maintaining governmental institutions and decisionmaking behavior in essentially their present form. The third course would be to try to find mutually acceptable ways to increase cooperative decisionmaking about national macroeconomic policies.

I do not have time here to evaluate the various arguments that can be advanced for and against these broad choices, and I will therefore merely give you a few of my own tentative conclusions.

My own guess is that we will not be able to find low–cost and mutually acceptable ways to " dis–integrate " the world economy. It is of course true that impediments put in the way of movement of goods, assets, and people across national boundaries may permit somewhat more autonomy for national macroeconomic policies and, for good and for ill, may to a greater extent bottle up the consequences of policy actions and nonpolicy disturbances in the nation where they originate. If nations place a very high priority on having the capability to experience divergent macroeconomic outcomes, efforts should be made to devise ingenious impediments to international transactions that yield a large gain in autonomy for as small a sacrifice as possible of the benefits of interdependence. This topic deserves more attention than most economists have given to it. Nonetheless, my own provisional judgment is that dis–integration of the world economy, no matter how ingenious, will prove impossible or excessively costly. Substantial benefits accrue to a nation from interdependence through the more efficient allocation of resources brought about by international trade and capital movements and the resulting ability of the nation's residents to enjoy a higher standard of living. Those benefits may — for most nations at most times probably do — more than offset any disadvantages associated with diminished autonomy and controllability.

I also doubt that the second broad choice — that is, passively allowing economic interdependence to increase without trying to adapt national and international institutions to it — will prove politically feasible as time goes on. Difficult though it will be, therefore, I believe the best course is the third one: actively trying to adapt to increasing interdependence, thereby managing it better.

What does it mean to try to cooperate better? I find it useful to distinguish between two broad approaches. The first I term " supranational traffic regulations. " The second approach involves more far-reaching cooperation than a mere reliance on traffic regulations.

It is a superficially appealing idea to imagine nations' policymakers initially agreeing on a covenant defining the environment within which they will interact with each other and then subsequently, while abiding by the covenant, making decisions noncooperatively. Such an approach to international economic cooperation puts exclusive weight on a " rule of law " — so to speak, on traffic regulations.

How much of an insurance policy against the excesses of untrammeled noncooperative behavior can be expected from traffic regulations alone? Is it feasible to design systemic rules that will render any further international cooperation unnecessary? Unfortunately, government officials and economists probably expect too much of systemic rules, while they unduly neglect opportunities for mutually beneficial cooperation of a more fundamental sort.

A basic difficulty with supranational traffic regulations as typically conceived is that they are formulated to deal merely with the external sectors and policies of each nation's economy. Rules for the international monetary system, for example, have been written to pertain primarily to exchange rates and external reserve positions. But from the perspective of a single nation's economic policy decisions, there is no logically valid dividing line between " external " and " domestic " policy decisions. If supranational traffic regulations were written to conform to the realities of non-independence, their scope would have to be extended to the entire range of domestic as well as external macroeconomic policies.

Even if it were economically sensible to try to accomplish so much with supranational traffic regulations, political logic would hopelessly conflict with economic logic. National governments are politically unable to subject their domestic policy actions to supranational regulations and the associated enforcement responsibilities of supranational institutions.

Even if domestic politics would permit national governments to yield some sovereignty over domestic policy actions, there would exist a second basic difficulty with an effort to write a comprehensive rule of law for the world economy. Supranational traffic regulations are incapable of dealing with the most important problems caused by macroeconomic non-independence. One must have a naive view of the role of law to accept the notion that nations can first agree on a covenant articulating rules for acceptable behavior (and proscribing certain types of behavior as unacceptable), and can thereafter make independent decisions within that legal environment without creating serious problems for each other. Laws do not (and cannot) play such an efficacious role in regulating the behavior of individuals within a national society. Nor does a well-functioning legal system for the domestic society obviate the need for positive collective action to supply public goods. Because cooperative decisionmaking about national macroeconomic policies is an international public good, its supply requires discretionary collective action by national governments, not development of a supranational rule of law.

One is thus inevitably driven to the conclusions that it is not possible to devise supranational traffic regulations that are both politically feasible and analytically sound, and not wise to rely upon conformity with agreed traffic regulations as the main form of cooperative behavior among nation states.

You will rightly ask, however, whether it is politically feasible to try to intensify the international "coordination" of national macroeconomic policies. And I must candidly say that I am not sure. There do exist a number of reasons for being pessimistic and cautious. Many economists and government officials believe it would not even be desirable to broaden efforts at cooperation. I believe their arguments are weak. But the political importance of that position is considerable. A large group of other economists and officials maintains that attempts to coordinate, while desirable in principle, are simply not feasible at the current time.

Nonetheless, I see the potential gains from heightened cooperation as great enough, and the opportunities for realizing them sufficiently realistic, to warrant more intensive efforts. The existing degree of economic cooperation among nations' policymakers has probably changed little in the last two decades. Since economic interdependence has grown significantly in that time, an underlying basis for more extensive cooperative efforts has been created on that account alone. The chief reason for not accepting a pessimistic view about cooperation, however, is the failure of the pessimistic view to give adequate emphasis to the potential role of leadership. As critics of the "free rider" explanation of the suboptimal supply of public goods have emphasized, imaginative political entrepreneurship can sometimes circumvent the inability of unorganized groups to act by integrating individual benefits into a collective action. That point has obvious applicability to officials of national governments. If their perceptions of national well-being are not distorted by an excessive preoccupation with political sovereignty and if they are alert to opportunities for gains from coordination, they may be able to exert leadership as international political entrepreneurs.

The outcome of noncooperative intergovernmental behavior is similar to the situation in which each member of a crowd, wishing to see better, rises to his tiptoes to view a passing parade, with the result that all are more uncomfortable but no one sees better than before. The potential contribution of political leadership is analogous to the role of a parade official who, grasping the collective problem and taking the initiative to propose a solution, uses a megaphone to persuade everyone to sit down simultaneously.

I can sum up my views on this last point with a paraphrase of an aphorism attributed to Samuel Butler. To coordinate is like to love. All pragmatic reason may seem to be against it. Yet all healthy instinct is for it.

2. - BRITAIN, INDUSTRIAL POLICY AND THE EUROPEAN COMMUNITY

by **John Pinder**

What is national economic planning in Britain? How much of it will there be in the 1980s? These are difficult questions to answer. With the system of alternating governments from adversary parties, which amplify moderate swings of public opinion into major shifts of governing ideology, economic planning and policy have fluctuated more widely than in other European countries. We now have a Conservative government with a greater abhorrence of planning than any since the war and a Labour opposition committed to a form of national planning protected by import controls and the removal of Britain from the European Community. Reacting against these opposing ideologies, there is the new alliance between Liberals and Social Democrats, whose policy is not yet defined but which has won surprising support in elections and opinion polls in 1981. How can the observer judge whether this laboratory (as it has been called) of political and economic experiment will produce laisser faire, nationalist collectivism or a normal European mixed economy during the next decade, or continuing lurches from one variety to another?

Nobody should claim certainty for his prediction. But behind the zigzag course of policy some steadier trends can be discerned; and these, it can be argued, reflect trends in the contemporary economy to which governments will continue to respond.

The rise and fall of comprehensive planning.

The starting point for the development of postwar British policy was a system of imperative planning which had been superimposed for the war emergency on the most complete tradition of laisser faire capitalism. The working class movement had reacted against that tradition in the nineteenth century by adopting the policy of " nationalisation of the means of production, distribution and exchange ". Little thought had been given, however, to the way in which a collectivist economy would be planned, and the Labour government of 1945, apart from nationalising some basic industries and developing a Keynesian system of demand management, concentrated its main efforts on establishing the welfare state. The Conservative governments of the 1950s aimed to return to laisser faire, with the model of a " robot " economic policy, whose instruments would be confined to the interest rate and the exchange rate. But towards the end of that decade the difference between British and Continental growth rates had become disquietingly apparent (1) and a remedy was sought from what was then the most salient Continental example: the French planning system.

Thus in 1961 the Conservative government established the National Economic Development Council, bringing together Ministers and representatives of employers and trade unions and providing them with an Office to help develop a British planning system. The NEDC produced comprehensive sets of both economic targets (2) and policies for growth (3). NEDC was, however, soon overshadowed by the Department of Economic Affairs which the Labour government, elected in 1964, established to make a stronger system of planning the centrepiece of its economic strategy. The *National Plan* (4) which the DEA produced in 1965 contained, again, both comprehensive targets and policies. But within a year the government chose deflation rather than devaluation to resolve a sterling crisis. The targets of the Plan were seen to be unattainable and it was widely accepted that this " approach to economic policy had lost its credibility for the rest of this decade and probably beyond ". (5) Documents containing sets of figures and policies continued to be produced at intervals, but the figures became forecasts or " alternative assumptions ", not targets, and the policy documents became more modest until the most recent one, in 1975, defined not an industrial strategy but a way in which government, trade unions and employers could cooperate to arrive at one. (6)

The Sector Working Parties which were set up in 1976 under NEDC to work towards this " industrial strategy " have continued to involve employers, trade unionists and officials in discussion of detailed questions of interest to each of nearly two score sectors. But useful though this may be, it is neither planning nor strategy. No planning document has been issued since 1975. Two decades later, it is fashionable to suppose that the planning movement which started in the early 1960s has only been much ado about almost nothing.

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(1) A good example of the resulting literature is PEP, *Growth in the British Economy*, London, Allen and Unwin, 1960, particularly the « league tables » of economic growth from p. 27 onwards.

(2) NEDC, *Growth of the United Kingdom Economy to 1966*, 1962.

(3) NEDC, *Conditions Favourable to Faster Growth*, 1963.

(4) *The National Plan*, Cmnd 2764, HMSO, September 1965.

(5) Samuel Brittan, *Inquest on Planning in Britain*, London, PEP, January 1967, p. 3.

(6) The « planning » documents produced since the *National Plan* were *The Task Ahead* (1969) associated with *Economic Prospects to 1972* (1970); NEDC's *Industrial Review to 1977* (1973); and *An Approach to Industrial Strategy* (1975).

This fashion mistakes the shadow for the substance. The comprehensive target and policy documents were never closely enough meshed with the realities of economic and industrial policy to have much impact on events. But the development of microeconomic policies which started at the same time as the formal planning movement has been much more durable and influential.

Manpower policy in particular has developed enormously since the early 1960s. The NEDC's first planning exercise was soon followed by the *Industrial Training Act* of 1964 which set up Industrial Training Boards; and after rejecting both planning and microeconomic intervention on its return to power in 1970, Mr. Heath's Conservative government established the Manpower Services Commission in 1974 to implement a comprehensive manpower policy. The activities of the MSC were greatly expanded by the Labour government in the mid–1970s; and although the Conservative government which returned in 1979 shows an even greater aversion to microeconomic policies than did Mr. Heath's in 1970, manpower policy has been relatively little affected.

A National Incomes Commission was also established in 1961 with the planning wave that established NEDC; but unlike manpower policies, no less than four generations of policies to influence pay and prices have, with the institutions for implementing them, been planted and uprooted in the last two decades. (7) While doubtless a tragi–comedy for the British, this sequence of incomes policies may seem to be of little concern to the international economy; for labour markets are mostly national or sub–national in extent, so that pay policy, like manpower policy, is for the most part a domestic matter. But industrial policy, corresponding to the international market for industrial products, is a matter of keen international concern; and pay and manpower policies are significant for this because they show the limits of experience within which the course of industrial policy, which is the other main arm of microeconomic policy, must lie. Has industrial policy, like manpower policy, an inexorable tendency to expand? Or is it destined, like pay policy, to be planted and uprooted repeatedly or even, as the present government appears to have intended, to be uprooted once and for all?

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(7) National Incomes Commission established by Conservative government in 1961 and wound up by Lavour in 1964. National Board for Prices and Incomes established by Labour in 1964 and wound up by Conservatives in 1970. Pay Board and Price Commission established by Conservatives in 1973 and the former wound up by Labour in 1974. Incomes policy introduced by Labour in association with Social Contract in 1965 and wound up by Conservatives in 1979, together with Price Commission.

INDUSTRIAL POLICY IN THE LAST TWO DECADES.

Although it has suffered its share of stopping and going, industrial policy has been considerably more stable and resistant to political fluctuations than pay policy. Successive governments have introduced changes in the taxation of companies, but they have shared the intention of encouraging industrial investment. The encouragement of research and development has also been a constant theme. There have been substantial changes in the financing and subsidising of industry by the public sector; but they have been less extreme than the fluctuations of pay policy.

One product of the period of the *National Plan* was the establishment, through the Industrial Reorganisation Act of 1966, of the Industrial Reorganisation Corporation. The corporation was a public sector industrial bank for promoting mergers and rationalisations, believed at the time to be the key to modernisation and success. Among several other mergers, the IRC induced the formation of the British GEC, which has prospered, and British Leyland, which has not. The IRC was wound up by the Heath government in 1970; but the Labour government, through the Industry Act 1975, established the National Enterprise Board as a new public sector industrial bank. The NEB was given a larger capital (over £ 1 billion) than the IRC and a wider remit to invest in British industry in order to improve efficiency. While the promotion of industrial development was its aim, the NEB became involved in supporting, on behalf of the Labour government, major companies that would otherwise have disappeared in the hard times of the mid–1970s. The Conservative government in 1979 removed responsibility for the largest of these, British Leyland and Rolls Royce, from the NEB to the Department of Industry. But it kept the NEB in being, albeit with narrower terms of reference, focussed on the promotion of technology–based industry.

The Conservative government has also continued a number of programmes of subsidies for promoting industrial innovation and employment, although it does not at present plan to renew the majority of these programmes when the funds already allocated to them by the preceding Labour government have been exhausted. Here the most important legislation was the Industry Act 1972, introduced, like the Manpower Services Commission, the Pay Board and the Price Commission, by the Heath government when, after a period of economic difficulties, it espoused a range of microeconomic policies. The most immediate motive was to save Rolls Royce; but the powers which the Act gave the Department of Industry were to be used to aid sectors or enterprises in places where there was high unemployment, and more generally to promote industrial development.

The Industry Act was used by the succeeding Labour government to launch many more programmes of sectoral and selective support. A total of over £ 300 million was allocated to increase efficiency and develop new products in a score of sectors, through grants of up to a quarter of the cost of investment in machinery and buildings or in research and development, and up to one half of consultancy fees. Selective support was allocated for accelerating investment projects (£ 84 million), promoting investments that would benefit the economy (£ 150 million), product and process development (£ 20 million), encouraging awareness and use of microprocessors (£ 55 million) and economy in the use of energy (£ 25 million). Although initially hostile to all such schemes and averse to continuing most of them, the present government has renewed the Microprocessor Awareness Programme and started a new programme to promote information technology.

While the principal aim of industrial policy since the 1960s had been to improve efficiency and promote technological development, the impact of the 1970s on industrial viability and employment led to the use of the instruments of industrial policy for the different purpose of maintaining activities that were, by the criteria of the market, redundant. Thus the NEB was used to rescue lame ducks; Industry Act funds were applied to the same purpose; employment subsidies were provided to save jobs (giving manpower policy an unusually direct effect on international competitiveness); bankrupt industries were taken into public ownership, and large (British Shipbuilders) or even huge (British Leyland, British Steel Corporation) deficits of publicly-owned enterprises were met from public funds.

Some of these interventions have had positive results. Ferranti was restored to profitability and resold by the NEB to the private sector. After painful slimming exercises, a number of presently ailing firms will doubtless become fit again. Although the Conservative government have continued, despite strong reservations, to inject huge sums into BL and BSC and to continue other support for employment, the Conservative campaign for a return of enterprises to viability appears to be having a considerable effect. But in the mid-1970s the subsidisation of threatened firms and jobs was increasing alarmingly, not only in Britain but also in Italy and France; and this prompted the German Federal Republic and the United States, as the industrial powers most hostile to subsidisation, to lead the series of discussions in OECD which resulted in agreement among member governments on the doctrine of positive adjustment. (8)

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(8) OECD, *The Case for Positive Adjustment Policies: A Compendium of OECD Documents 1978/79*, Paris, June 1979.

The doctrine of positive adjustment.

This doctrine approves industrial policies which aim to shift resources out of unviable activities and accepts policies to soften the pain of the transition provided that they do not unduly delay it. It allows the case for a few policies to promote new industrial development: long–term research and development, small and medium firms, and such special objectives as environmental quality and energy conservation. But the doctrine is essentially designed to curtail policies that delay the shift out of unviable activities and to encourage policies that accelerate this shift. Implicitly it assumes that the resources (people, money) will be able to move into new activities generated through macroeconomic policy.

Although the Americans and Germans had led the attack on subsidies which preserve uncompetitive employment, the idea of positive adjustment became widely acceptable among OECD member governments. The cost of the subsidies was clearly getting out of hand; and there was at the same time a swing to the right in many member countries, with an emphasis on monetary not industrial policy. Until the arrival of the Reagan Administration, this swing had been most pronounced in Britain, personified by the election in 1979 of the Thatcher government. This government would have preferred not to have an industrial policy at all; and in so far as any such policy was found to be necessary, it would certainly not wish to stray beyond the limits set by the doctrine of positive adjustment. The same stance has now been adopted by the United States. In the European Community, Germany has been its constant advocate. The Commission of the EC has tended to harden its line against industrial policy which does not conform to the doctrine of positive adjustment. Given another year or two, then, will not the remains of the soft industrial policies of the 1970s be squeezed out of the system, reconciling industrial policy with international interdependence and making the industrialised world safe for a more sophisticated form of the liberal trading order that prevailed in the 1950s and 1960s? The answer is surely no; and a further look at the prospects for policy in Britain may help to explain it.

Industrial policy in the 1980s.

Conservatives in the 1950s wanted to confine economic policy to the use of two instruments, the interest and exchange rates; and they did indeed concentrate on macroeconomic policy. By the end of that decade the Conservative government had lost confidence in the power of macroeconomic policy alone to bring Britain's economic performance to match that of its competitors and in the early 1960s set Britain on the course of microeconomic policies. After six years in opposition, the Conservatives who won the 1970 election were determined to sweep these interventions away, but two years later Mr. Heath responded to economic crisis by returning energetically to microeconomic policies in each of its three main aspects: industry, manpower and pay. After five more years in opposition, the Thatcher government came to power in 1979 again determined to do away with interventions and to concentrate on only one instrument of macroeconomic policy, the money sypply; Mrs. Thatcher and her economic Ministers were, moreover, also determined not to make a U–turn back towards microeconomic policy like Mr. Heath had done.

The aim of this policy is to bring down inflation and then start healthy economic growth. Inflation is still in double figures and unemployment, at levels unknown since the 1930s, still climbing. There have been riots in inner cities, of which the unemployment prevalent among young people is generally regarded as a cause. With between two and three years to the next election, the political constraint on single–minded monetarism begins to be severe. Either it works, in the sense of increasing employment as well as keeping inflation under control, quicker than seems at all likely; or the government overcome their aversion to microeconomic policies with an approach clearly designed to provide many more jobs; or they lose the election. Bad though the condition of the Labour Party may be, the emergence of the alliance of Liberals and Social Democrats as a new potential government adds powerfully to the electoral sanction. It seems probable, for this political reason, that the Conservatives will either strengthen their manpower policy, reverse their attitude of distaste for industrial policy and make their pay policy more effective, or be replaced by a government that will pursue strong policies in these fields. The chance of their avoiding the latter would be significantly improved if they were to regard the branch of microeconomic policy called industrial policy no less favourably than the branch called manpower, or labour market, policy — which would not seem an impossible transition.

These political constraints would not be durable if they ran counter to economic forces. But the rise of microeconomic policies can be justified in both theory and practice. Theoretically, the market imperfections (in the sense of divergences from the assumptions of perfect competition) which are endemic in the contemporary economy can be shown to undermine the effectiveness of macroeconomic policy which is not accompanied by microeconomic policies adequate to deal with the imperfections. In practice, the most successful performers among the major industrial economies, Japan, Germany and France, are also successful exponents of microeconomic policies, and of industrial policy in particular (even if, in Germany, such policy is distributed among a number of policy headings and levels of government, and not usually called industrial policy). It seems likely that policies within the range of those followed by these successful economies, including industrial policy, will be economically more appropriate and hence politically more durable than policies which go beyond that range, whether towards laisser faire or centralised direction.

If the Conservative government moves back towardst he industrial policy pursued by Mr. Heath after 1972, or is replaced by a government in which Liberals and Social Democrats have a determining voice, or by a Labour government similar to those of Mr. Wilson and Mr. Callaghan, Britain's industrial policy will become part of the European mainstream. On the other hand, a Labour government could take Britain out of that mainstream, towards imperative planning in a siege economy. This, too, would be politically unstable because economically inappropriate. A complex advanced economy can hardly be well managed by means of imperative planning; nor can it be extracted from the web of international interdependence without a reversal of its advanced development. Yet if Britain does embark on that experiment, the political timetable might keep its economy isolated from those of the other industrial countries until the end of the 1980s.

This outcome still seems unlikely, however; and it is more fruitful to consider the relationship between normal European industrial policies and international interdependence as far as Britain as well as other European countries are concerned. It is also useful to focus this consideration on the European Community. For the United States is still in the early stages of the experiment which is now rather far advanced in Britain, and hence unlikely in the next two or three years to accept the implications of industrial policy for international cooperation; and Japan, while far advanced in industrial policy, is not ready for such close cooperation as can be envisaged within the Community.

Community industrial policy and positive adjustment.

Of the four larger countries in the European Community, only Germany has avoided widespread subsidisation of firms in difficulties. Britain, France and Italy became deeply involved in this in the 1970s, to an extent that would have threatened the existence of the common market if they had not, with varying degrees of energy and success, begun to withdraw from that policy towards the end of the decade.

The discussion in Germany about possible levies on steel imported from other Community countries shows that the danger remains. Just as withdrawal into a siege economy would reverse the flow of advanced economic development in Britain, so intra–Community protectionism would thwart the development of the member countries' economies. The degree of interdependence within the Community is such that the members must be able to live with each other's industrial policies if they are to maintain the common market on which they all depend. This underlines the arguments in favour of the Commission's efforts to influence member governments to apply the principles of positive adjustment. Apart from sweet reason, the Community has five main instruments which it can use to induce positive adjustment: the external tariff and quotas; its funds (agricultural, regional, social and ECSC); control of subsidies, or " state aids " (articles 92–94 of the EEC Treaty); the instruments of competition policy (articles 85, 86); regulation of prices and production of coal or steel (articles of the ECSC Treaty).

Protection such as the quotas on imports of textiles can be made conditional on national measures to modernise the textile industry or facilitate the transition out of it. Such a condition has to be imposed by the governments themselves in their capacity of members of the Council of Ministers; but this has been shown to be possible, when for example the German government withheld its consent to the imposition of steel import quotas, which other governments wanted, until they agreed to some limitation of subsidies. Positive adjustment in connection with other measures, such as those of trade policy, can, moreover, be encouraged by allocations of Community money from, for example, the regional and social funds; and this has been a part of Community policy for the textile industry. The combination of conditional protection and Community finance could, given the growth of protection against imports from Japan and the Newly Industrialising Countries, become an important lever to secure positive adjustment should the member governments so decide.

In principle, control over state aids gives the Community wide powers to restrict the use of subsidies which do not meet the criteria of positive adjustment. In practice, these powers have been severely limited by the reluctance of governments, represented in the Council, to take the decisions which would enable the Commission to restrict them. The Commission's most important proposals have concerned shipbuilding and steel. But the member governments have failed to agree on the main elements of the proposals for shipbuilding; and the successes of the steel policy have depended more on the Community's powers under the ECSC Treaty and under trade policy than on its powers with respect to state aids. The control over state aids remains, then, an instrument which has not achieved its powerful potential.

The competition policy has been one of the Community's more effective activities; but it has not been used as an instrument of positive adjustment after the fashion of Japanese rationalisation cartels, which allow firms in a sector suffering over–capacity to remain viable by fixing prices and production quotas for a period, provided that they use the period to reduce capacity enough to enable them to remain viable when the cartel is removed. The Commission lost an opportunity to achieve this when it rejected proposals from the synthetic fibres manufacturers for an agreement along such lines, on the grounds that a benefit to consumers (required under article 85) was not evident. But this decision surely neglects the benefit to the consumer of an industry which can perform better in the future because it returns to profitable performance as quickly as possible now. Rationalisation cartels have brought considerable benefit in Japan and the Community could with advantage make them a part of its competition policy.

The steel industry offers a partial illustration of this. Because the ECSC Treaty gives the Community more powers of industrial policy than the EEC Treaty does, the member governments have been able to agree to declare a " manifest crisis " and thus to enforce production quotas and minimum prices on Community firms. This will help a number of them to return to profitability and give them the opportunity to develop competitive production in future. But the rationalisation aspect of this official cartel is missing: the reduction of capacity which is necessary if the Community industry is to become healthy again is left to be decided independently by the firms or governments. If the reduction of capacity decided in this way is not enough, the firms and countries that have reduced capacity will be dragged down by the rest, unless the price and production controls are continued indefinitely, or the countries that have rationalised protect themselves against their Community partners that have not. One might wish the Treaty had provided that price and production controls could be imposed only if accompanied by any necessary measures of rationalisation — in which case one might also wish that the EEC Treaty had provided for similar rationalisation cartels to be applicable to other basic industries. As it is, the only realistic possibility is that member governments will allow the Commission to use the control of state aids to this end, and that the Commission itself will develop the competition policy as an alternative instrument, for use when sectors with over–capacity themselves approach the Commission with a proposal for price–maintenance.

Yet the member governments do not allow the Commission to control state aids in this way; nor do they attach significant positive adjustment conditions to the Community's measures of import protection. There is a political reason for this: at least some member governments do not want to give more power to the Community. But there is an economic reason too: the efficiency promoted by positive adjustment seems illusory if the people displaced from their work by it do not find new work, but remain dependent on welfare benefits, becoming progressively less capable of efficient work. Positive adjustment is unattractive if it further increases already high unemployment.

THE COMMUNITY NEEDS A POSITIVE INDUSTRIAL POLICY.

Without positive adjustment, the Community common market and hence the member countries' wealth will be undermined by creeping protectionism in the form of job-preserving industrial and manpower policies. With positive adjustment, there seems to be no end to rising unemployment. Is there a way through this dilemma?

The answer depends on one's judgment as to the causes of unemployment. If the pressure of cost push against weak prices makes low profitability endemic in the modern economy, then monetary policy alone cannot provide for the investment which is a condition of the creation of new jobs; nor can positive adjustment, which facilitates the destruction of old jobs, be relied upon to replace them by new ones. On the contrary, an industrial policy is needed, which could well be called a positive industrial policy, that is specifically designed to create viable jobs.

One major instrument of such a policy would be an interest rate for industrial investments low enough to offset the general uncertainties that now inhibit it — quite apart from the additional distortion caused for the time being by the very high American interest rates. If applied on the large scale required to have a substantial effect on employment, this would have to be undertaken jointly by the Community countries. Examples of ways in which it might be done can be found in the rediscounting by the Credit National and the Kreditanstalt fur Wiederaufbau of certain types of loans to industry at favourable rates.

There are numerous other forms of positive industrial policy. State enterprises can be authorised to undertake major investment programmes. Where industrial banking is weak, as in Britain, public policy can create industrial or development banks, or encourage the private sector to create them. Research and development can be given bigger fiscal incentives. Innovation can be promoted by sector programmes with the help of financial incentives. Small and medium firms can be offered services and given incentives. Manpower policies can intensify training to meet future needs.

A number of such instruments and programmes have been mentioned above in outlining British experience. Other countries, particularly France, Germany and Japan, can offer many more. The member countries of the EC are more likely to find positive adjustment economically justifiable and politically acceptable if they apply positive industrial policies more fully. This would require understanding on the part of the Community that such policies are not to be discouraged on the grounds that they distort competition.

3. – STRUCTURAL RE-DEPLOYMENT OF THE FRENCH INDUSTRY AFTER THE FIRST OIL CRISIS

by **Christian Stoffäes**

I) Traditions and concepts of industrial policy.

Industrial Policy: A concept that is hard to define.

First of all, we should premise this discussion by noting that industrial policy is a difficult concept to define that does not fit into the major doctrines of the field of economic theory. If we want to avoid having a purely descriptive vision, then industrial policy can only be understood if it is seen in an overall picture. This entails " thinking structurally " about economic policy, that is, being primarily concerned with priority production structures. In this sense, thus, industrial policy should not be defined only as the total amount of State intervention in the market economy in various industries. But actually, it is a global concept, a way of looking at economic policy in its impact on those things which form the basic conditions for prosperity; in the long run, that is, investment, productivity, innovation and international competitivity. In this framework, industrial policy could also be called supply policy as opposed to the policies of increasing demand, which have dominated since the Keynesian revolution, or the " laissez-faire " policies typical of the nineteenth century. In other words, it is not just a branch of economic policy, but it is a way of understanding all of economic policy as a whole.

The concept of industrial policy, in the broadest sense, encompasses both resorting to the mechanisms of the market and specific explicit structural actions, such as industry-level measures, or implicit ones, such as the sometimes perverse effects of state intervention in the structures. At the same time, this differs from planning in which the State regulates the overall functioning of the economy and from absolute Liberalism which is only slightly corrected by special temporary regulation. Thus, the concept of industrial policy differs by its very nature from the uncontrolled free play of market forces. As a matter of fact, it seeks to better link interventionism with the market with practical concern resulting from the restrictions and goals of modern industrial companies.

By doing so, even if abusive or badly coordinated policies risk impeding adaptation, this policy normally has the goal and effect of making it easier for an industry to make a positive adjustment to the new economic order. But industrial policy actually pursues many sometimes contradictory ends: balanced international competitivity in the trade balance; maximum growth; development of new techniques; defending jobs; regional balance; national independence, etc. Sometimes these goals converge; other times they are contradictory; but very rarely are they arranged hierarchically. There are not many ways of having state intervention in industrial policy nor are there many decision centers. That is why industrial policy is difficult to conceptualize: it can not have the formal beauty of some theoretical constructs like a general system of the Keynesian system.

An Old Historical Tradition.

It is quite clear that it is absolutely essential to take historical and socio-cultural factors into account in order to understand industrial policy. Unlike many other Western countries, France has the right to claim the word industrial policy because it is nothing but a current continuation of a long tradition of State intervention in the economy.

France is one of the countries in Europe that became centralized very early. The pre-eminence of royal power very quickly led to the formation of a very powerful centralized administration. We can trace the first overall plan for industrial policy back to Colbert, Louis XIV's prime minister in the seventeenth century. Mercantilism and worries about national defense prevailed in Colbertism and, furthermore, they continued to be part of French industrial policy right up to today. State intervention occurred in sectors tied to arms and arsenals but also in " civilian " sectors such as metallurgy, glassworks, and the textile industry, with the creation of the State manufacturing companies (Gobelins, Saint-Gobain, Sèvres, etc.). In the nineteenth century and, notably, during the Second Empire, the Saint Simonien movement, often inspired by State engineers, played an equally important role in the development of new industry (the steel and railroad industries, etc.).

After a period of stagnation or prolonged weak growth, typical of the late nineteenth century and the beginning of the twentieth century, French industrial growth developed very quickly from 1945 on. The Rural Republic, the agricultural protectionism of the Mélines laws led to the new generations which saw the conditions for renewing a declining France through industrialization. In 1945, more than a third of France's active population worked in agriculture: this figure illustrates well how far behind France was.

The State made it easier to achieve the conditions needed for industrial development through its new educational, infrastructural and financial policy and through its policy of outward Liberalism. But it also intervened in a selective fashion by giving credit to certain industries or by playing a more active role in state companies. The policeman of the stagnated society became the promoter of industrialization.

To a large extent, the public sector in France is the result of two big waves of nationalization; the nationalization of the Popular Front government (affecting the railroad, and the arms and broadcasting industries) and the one in 1946 (affecting electricity, gas, coal mines, air transportation, Renault automobiles, the big Reserve Deposit Banks, etc.). The high state functionaries played an important role in this process in the financial and technical ministers' Plan and in the state and private companies where they pursued their careers. This interpenetration, this multiplication of personal ties which is a bit similar to the one which could be found in Japan, largely explains the relations of mutual trust that the administration and industrial circles maintained, which we run across much less in Anglo–Saxon countries. The concept of administrative guidance, of orchestration and informal mutual persuasion, is still today one of the distinctive features of French industrial policy. Thus, many aspects of industrial policy are informal, and the flow of funds and explicit regulation are not directed towards them; but they are the product of implicit consensus about general trends. A characteristic of the French model of industrial policy, that can be found nowhere else except in Japan, is that the State's technically high–level vocational function has an important role.

The Industrial Policy of Reconstruction and Expansion.

The period of Reconstruction (1946–1958) was the Golden Era for planning. The Five–Year Plan, whicht he local administrations, business and trade union circles cooperated in drawing up, made it possible to set priorities in the allocation of resources. As a priority, public financing, especially that coming from the Marshall Fund, allocated funds for reconstruction and capital investment in the basic industries through loans or subsidies to public ventures (SNC, EDF, the Coal Mines) or to private companies (the steel and building materials industry). The six priority industries are: transportation infrastructures, the production of electricity, coal, steel, cement, and agricultural machinery.

During the period of Expansion (1958–73), France expanded rapidly (with an annual growth rate of about 6 percent, with the second fastest growth rate in the O.E.C.D. after Japan) and had a very high rate of productive investment return. A major change in France's economic structures also took place: with the industrialization and concentration of companies; vocationally–motivated population migration from agriculture to industry; and geographical migration from the countryside to the cities, etc. Up until then, France had been protectionist and now it was opening its frontier barriers to the Common Market: the flow of trade shifted from the Colonial Empire towards Europe. And the share of foreign trade in the GNP went from 10 percent to more than 20 percent in the span of 15 years. Economic policy became more liberal. The Plan lost its role in the detailed determination of investment. The management of public companies became more independent from local government with the creation of planning contracts. Nevertheless, the State played an important role accompanying industrial growth: expanding credit; providing tax reforms which were favourable for investment and industrial concentration (instituting the VAT and the law on mergers); and creating specific infrastructures (in trasportation, communication, energy, education and housing).

Industry–level policy was also important even if here one can no longer truly speak of it as planning. To begin with they exerted an influence on the industries that were either modernizing or in a period of decline to help investment for political and social aims through: agricultural policy in the Common Market; policy concerning the railroad and Coal Mines (subsidies to the CDF and the SNCF); industrial development in the predominantly rural or poor regions, and limiting Paris' growth.

These policies were followed in other industries linked to the reconstruction effort to accumulate capital and increase production capability like the steel and shipbuilding industries (Dunkerque, Fos).

Lastly, the broadest industrial policy activities were motivated by the desire to achieve national independence: limiting dependence on oil supplies vis à vis the " major " supply sources by creating Elf–Aquitane and expanding Total–CFP, developing high technology industries and major plans to limit dependence on American technology by creating state research laboratories (CNRS, CEA, CNES, etc.), private companies (Dessault, CII. Thomson, Matra, CGE, Schneider, etc.). The most favoured technological development industries are, generally speaking, tied to defense concerns at least at the beginning; but they also branch out into civilian applications: nuclear, aeronautic and space technology, professional electronic and computer applications, etc.

II) Structural re–deployment of french industry since 1974.

Economic Problems after 1974.

Since 1974 the French economy has been experiencing its most severe crisis since World War II. The growth rate, which was always constant between 5 and 7 percent from 1950 to 1973, slowed down dramatically with the most pronounced recession periods and stabilized at a slope below 3 percent in the period from 1974 to 1980. The unemployment rate which was below 2 percent in the 1960's when the French economy resorted to hiring immigrant labour, deteriorated around 1974 and reached 9 percent (with 1.8 million unemployed out of an active labour population of 21 million). Inflation from its peak of 15 percent in 1974 could not be reduced and kept below 10 percent for very long in the period from 1975 to 1981. With this plan, it is quite clear that we must make an important effort to adjust to the new economic conditions. But re–gaining full employment will only result from our becoming competitive and not from temporary emergency tricks to boost the economy.

In terms of trying to control the present critical emergency situation, we need to note that our wage purchasing power improved greatly in 1974 and 1975 to the detriment of both company profits and the ability to make further investments. Restrictive monetary policy measures were taken at the end of 1974, but, in about the middle of 1975, these were followed by measures to boost the economy and intended to remedy the increasing underemployment. There was a major deficit in the trade balance of payments in 1976 that led to France's exit from the European " snake " and to setting up a new economic policy which, to begin with, makes it necessary to describe the general impact on industrial structures before tackling specifically structural measures. The appearance of an external restriction, that is, the fact that the trade deficit limited increasing full employment, was the main decisive factor of the new policy established under the leadership of President Giscard d'Estaing and his Prime Minister Raymond Barre (which began in September 1976).

The goal of the new economic policy was to re–establish French industry's international competitivity so that it would be able to adapt to the new conditions of the world economy (the oil increase, new industrial nations, etc.) and so it would decrease the weight of an external constraint that forced slowing down growth.

This new economic policy gave priority to the battle against inflation. This took the form of a macro–economic plan through monetary restriction measures limiting the budget deficit (which was the smallest deficit relative to the GNP among Western countries) and slowing down wage increases to levels in keeping with productivity increases, restoring profits and investment capability to the companies. Defending the Franc or the money markets seemed as much a macro–economic measure to decrease inflation and reduce the petrol bill in terms of dollars as it was a way of imposing major structural changes in industry and forcing it to increase its productivity exacerbating outside competition. This macro–economic policy was completed through structural policy measures aimed at increasing the mobility of production factors and the French economy's ability to make structural adjustment and improve its technological level and international competitivity.

The meaning of the crisis: the adjustment.

France and the world began the 1980's with a certain amount of pessimism about the economic future, which contrasted with the optimism that prevailed at the beginning of the decade of the Seventies.

The oil increase, unemployment, the slowing down of the growth rate, increasing inflation, the disorganization of the international monetary system, etc., apparent reasons for concern, in fact, only made everyone reflect about the profound interlinked structural changes in the world economy that were disturbing the old system of balances. From this point of view, we probably have to date the beginning of the crisis from the end of the 1960's rather than from 1973. There were several different types of main changes to be dealt with:

– geo–economic changes, with the emergence of new industrial nations which, following Japan, disturbed the currents of traditional trade and upset the terms of the former colonial agreement; also with the decline of former major powers in the technological area, England and the United States;

– technological change especially with the change from more extensive, non–oil energy forms, the revolution of the introduction of micro–electronics and computers in industry and the service sector;

– social change with the change in consumption patterns, with the saturation of needs and former markets and changes in attitudes toward work.

Faced with this crisis, the structures had to adapt. A French model for re–deployment had to be invented and had to contribute to creating a new economic order by permitting avoiding the fatal fall back reactions which had distinguished the 1930's crisis.

Thus, in this sense, one can speak of industrial crisis. We are not dealing with a simple temporary situation of risk, but with a new stage in the industrial revolution like those that have already occurred throughout history. These big waves of the industrial revolution challenge the nations that defy change.

The appearance around 1973 of an external constraint besides the energy crisis forced Frnach industry to adapt to ensure that the French national economy would be synchronized with the rest of the world in light of the new face of the world economy. In 1973 France was at the height of its period of expansion; despite investment efforts, its structures still were not comparable to those of the most advanced industrialized nations. Rising inflation in the period from 1969 to 1973 contributed to weakening the economic structures giving the economy the illusion of having a high growth rate when Germany's economy was beginning to slow down from then onwards.

For example, the French balance of trade for industrial equipment showed a deficit which was not the case in the majority of developed nations. On the other hand, the cover–rate was much higher for certain mass employment industries such as those of non–durable consumer goods, clothing, leather goods, food, etc. In a certain way, within the Common Market, France's industrialization seemed to be in a complemenatary relationship to that of more powerful countries like Germany. France changed partners in this complementary relationship shifting towards the South starting at the beginning of the Seventies. France was forced to readapt. While the Sixties had been marked by the Europeanization of French industry, one could say that the changes that occurred in the Southern countries (OPEC, and the newly developed nations) for seven years were what most characterized the changes in French industrial structures.

Or to be more precise the main features of the adaptation in French industry since 1973 were the following:

– a reduction in employment in industry by approximately 400,000 jobs (which would be about 8 percent of industrial labour) which is less than what was seen in Germany and England but sharply contrasted with the large growth in the Sixties (in ten years, one million new jobs were created in industry);

– stagnation or regression of industries producing consumer goods that were labour–intensive or had facilities that were not very concentrated: textiles and clothing leather and shoes, etc., where jobs were cut by 20 percent in seven years, and their foreign cover–rate dropped steadily by 5 points per year. By then, France was a net importer of textiles and clothing with a deficit of about 4 billion Francs (as opposed to a surplus of 4 billion Francs seven years earlier). The impact of the competition from the developing nations in South East Asia, the Mediterranean, etc. was felt as well as that coming from the most advanced nations like Italy or the U.S.A. If the export positions develop in certain specialized, automated, or deluxe special areas (French fashion sells well...) the domestic market is by now covered by more than 50 percent for imports for its most ordinary sectors;

– changes in the intermediaries' capabilities: a lot of heavy industry was forced to suffer from having a too great production capability because of investments made during the expansion period. Competition was also felt coming from Japan and new producer nations (Southern Europe, Eastern Europe, and the Third World) especially in the foreign market. Important reconversion, concentration, boundary adjustments, closures of old factories, etc. all led to the first major change in the Steel industry and foundries, mineral chemistry synthetic fibers, organic chemistry, etc. (see the reconversion that affected PUK, Rhône–Poulenc, BSN, Usinor–Chiers, Sacilor, etc.). These major changes, specializations, disinvestment, diversification, etc. were carried out for the most part by the big industrial conglomerates resulting from the mergers of the 1960's (CGE, St. Gobain, Renault, Peugeot, Elf, etc.);

– the marked development of industrial equipment exports toward new markets in industrializing nations. Thanks especially to the help from the U.S.A. and to the effectiveness of trade diplomacy, the position of our foreign balance of payments was, by then, well on the plus side in machinery, electrical construction, etc. And the deficit continued relative to the U.S.A., the German Federal Republic, Japan and Sweden but there was marked re–deployment considering the weakness of the starting positions. The development of services linked to industry, engineering turn–key factories, engineering for building and public works, consulting and training, etc. was also significant. The complementary relationship with the developing nations thus developed significantly: the French economy paid its oil bill, to a large extent, thanks to its increased exports to the Third World and OPEC countries at a time when trade within the European Economic Community grew very little from 1973 on;

– the confirmed importance of the automobile industry: at a time when the French position continued to be mediocre in many industries producing durable consumer goods (large public electronics, household appliances, etc.), the automobile was considered to be one of the irrefutable successes of the French economy. Between them, Renault and PSA held one third of the European market and were good at being poles for vigorous reconversion in the world–wide upheaval going on at the time. The industries tied to the automobile industry (tires, auto equipment, glass works) also performed well;

– major success achieved in high technology industries. Thanks to the continued effort of industrial policy, France was able to assert its position as an exporter in industries such as business electronics, civil, military, and aeronautics construction; engineering and electron–nuclear equipment; computers, etc. These industries together with others like pharmaceuticals, chemistry, etc. greatly increased their stock and exports directed to the Third World and OPEC countries.

FRANCE'S FOREIGN TRADE LISTED BY PRODUCT (MONEY CAF/FOB)

The most important trends

(Billions of current francs)

	1974	1979	1980
The increase in the energy bill (despite a noticeable reduction in the tonnage of oil imports from 126 to 110 MT from 1979 to 1980)..	— 51.4	— 83.9	— 131.8
A sharp increase in I.A.A. (products made with grain cereals drinks, alcohol)	+ 3.9	+ 4.4	+ 8.8
Maintenance of the automobile's competitive position (despite a particularly difficult European crisis in this sector in 1980 – Europe: + 80 % in French auto exports)	+ 13.1	+ 33.3	+ 28
A very sharp increase in industrial equipment from 1974 to 1979 (which was interrupted in 1980 as a result of the increase, in foreign penetration and the serious export crisis. French competitivity tends to be deteriorating in this sector)	— 0.2	+ 18.5	+ 10.4
of which:			
– applied mechanical machinery	+ 1.3	+ 8.2	+ 5.4
– electrical materials	+ 2.2	+ 5.1	+ 6.2
– applied business electronic machinery	— 1.6	— 0.5	— 3.5
Similarly: sales of military materiel (increased rapidly in 1979 and 1980 – OPEP sales)	—	—	—
A sharp increase in imports of household appliances (The deterioration of our currency is due to French industry's weakness in large state electronics where the cover-rate went back again, from 29 % in 1974 to 20 % in 1980, basically under Japanese pressure)	— 2.4	— 4.6	— 5.5
of which:			
– Major State Electronics..................	— 1.5	— 3.6	— 4.5
– Household Appliances	— 0.9	— 1	— 1
The new deficit resulting from the exchange of textile products (The textile industry had difficulty adapting to changes in the international division of labour. Clothing lost ground to the advantage of Italy and the Third World)....	+ 2.5	— 4.7	— 2.1
of which:			
– clothing	+ 1.9	+ 0.6	+ 0.2
The deficit of the wood paper and pulp industry become striking (The measures taken to reconvert the wood, paper and pulp industry will only be felt in the medium run at the level of foreign trade).........................	— 0.8	— 4.7	— 7

Segue: France's foreign trade listed by product (Money CAF/FOB)

The most important trends

(Billions of current francs)

	1974		1979		1980	
Balance of Payments for Services						
The final overall balance for services increased very rapidly (In addition to money coming from tourist payments, which improved, the main factor in this increase is the clear breakthrough in engineering exports, but especially by big French public works companies especially in the OPEC countries)	+	2.7	+	28	+	34.9
of which:						
– tourism	+	1	+	7	+	9.8
– public works	+	3.4	+	13.4	+	15.8

Foreign trade by country (Money CAF/FOB)

The most important trends

(Billions of current francs)

	1974		1979		1980	
Deterioration of the balance of payments resulting from trade with the major industrialized nations (The deficit with the German Federal Republic is already an old one and basically affects equipment. The worsening of the deficit with the USA affects machinery computers, electronics, and synthetic fibers. The present rise in the dollar will partially brake this in 1981. The increase in the monetary deficit with Japan is disturbing. Imports are speading ton ew sectors, machine tools). Our surplus with Switzerland is increasing and staying the same with the United Kingdom and Italy):						
– German. – Fed. Rep.	—	11	—	11.1	—	16.8
– U.S.A.	—	9	—	14	—	24.6
– Japan	—	2.4	—	4.8	—	7.1
Sharp increase in the surplus balance with third world countries (non–OPEC) (Uur trade with French–speaking Africa showed a clear positive balance but our exports to newly industrialized nations are not yet significant enough)	+	3.8	+	16.1	+	18.1
A relative part that is still a bit weak on the OPEC markets (France is still behind the U.S.A. Japan and Germany and is only at the same level as Italy and Great Britain in terms of exports going to the OPEC countries. The gap between our industrial export and oil imports increased greatly)	—	34.8	—	39.9	—	64.5

DEVELOPMENTS IN FRANCE'S TRADE BALANCE FROM 1974 TO 1980
RESULTS ZONE BY ZONE AND COUNTRY BY COUNTRY CAF/FOB

(Billions of current francs)

	1974	1979	1980
E. E. C. with 9 countries	— 4.1	— 8.7	— 22.5
of which:			
– The German Federal Republic	— 11	— 11.1	— 16.8
– Italy	+ 6.7	+ 1.6	+ 5.8
– Great Britain	+ 3.1	+ 6.4	+ 2
O.E.C.D. *outside the* E.E.C.	— 2.6	— 13.4	— 27.5
of which:			
– U.S.A.	— 9	— 14	— 24.6
– Japan	— 2.4	— 4.8	— 7.1
Countries with a centralized economy	+ 1.6	+ 3.3	— 3
OPEC countries	— 34.8	— 39.9	— 64.5
Fourth World Countries	+ 3.8	+ 16.1	+ 18.1
TOTAL	— 34.4	— 42.4	— 99.4
Agriculture	+ 1.8	— 1.2	+ 3.0
IAA	+ 3.9	4.4	+ 8.8
Energy Products	— 51.4	— 83.8	— 131.7
Industrial goods:			
Intermediate goods	— 6.5	4.7	— 8.1
Business equipment	— 0.1	+ 18.5	+ 10.4
Household appliances	— 2.3	— 4.6	— 5.5
Ground transport implements	+ 13.1	+ 33.3	+ 28
Non–durable consumption goods	+ 4.7	— 4.0	— 6.4
Various	+ 2.4	+ 2.5	+ 2.2
TOTAL apart from energy	+ 17	+ 41.4	+ 32.3
TOTAL	— 34.4	— 42.4	— 99.4

MONEY SPENT IN PAYMENT FOR SERVICES

(Billions of current francs)

	1974		1979		1980	
Services tied to foreign trade	—	3.6	—	0.4	—	2.2
Civil engineering and technical cooperation	+	3.4	+	13.4	+	15.8
Interest, dividends and other income from capital	+	2.3	+	6.8	+	8.7
Wagesand other payment for labour	—	0.2	—	0.6	—	1.4
Fees and Royalties	—	1.2	—	1.6	—	2.4
Trips	+	1	+	7	+	9.8
Other services	+	1.2	+	2.3	+	2.4
Government operations	—	0.3	+	1.6	+	4.3
TOTAL SERVICES	+	2.7	+	28	+	34.9
SUMMARY						
Trade balance FOB/FOB	—	20	—	13.3	—	60.4
Balance for services	+	2.7	+	28	+	34.9
Unilateral transfers	—	10.9	—	17.1	—	18.7
Current Account Balance		29.1	+	4.9	—	32.1

4. INTERNATIONAL COOPERATION AND ECONOMIC POLICY IN THE FEDERAL REPUBLIC OF GERMANY

by **Wolfgang Roth**

It is only natural that changes and upheavals in the world economy will particularly affect a country such as the Federal Republic of Germany, which exports more than one quarter of its gross national product and is, therefore, closely linked to the world economy. Most of the economic problems are due to interdependencies in the world economy: first of all, there was the explosive increase in oil prices which began in 1974, the fight against inflation in many industrial nations, which was for a long time inadequate, and the growing competitiveness of the developing nations and Japan. With the second oil price explosion in 1979, these three factors have ensured a considerable current account deficit since 1979; in 1979 the current account deficit was approximately DM 9,000 million, in 1980 DM 30,000 million and in 1981 it will still be over DM 20,000 million.

The extent of these deficits surprised everyone. To a greater degree than before external economic forces influence decisions with a considerable effect on domestic economic control. Therefore, we must be concerned to restore such freedom of action as has been lost in the domestic sector. This makes the elimination of the current account deficit the most important task today.

Arising from the current account deficit, the depreciation of the Deutsch Mark has also created a stability problem. In the period from January 1980 to April 1981, the Federal Republic of Germany's oil bill increased by DM 7,650 million, due to changes in the exchange rate against the Dollar.

Let it be said in passing, that quantitatively petroleum and mineral oil imports were 10 percent lower in 1980 than in 1979. Net energy imports in 1980 cost DM 64,000 million, which was twice as much as in 1978. Whereas in 1978 2.5 percent of the gross national product were spent on energy imports, this proportion rose in 1980 to 4.5 percent, i.e. a further 2 percent of current domestic production is used to pay for energy imports. These figures serve to highlight the focal point of the problems involved.

The following logical conclusions must be drawn from this situation with regard to economic and financial policy:

1. Energy conservation and substitution are essential in order to reduce our dependence on energy imports, in particular, on petroleum imports.

2. Wages, economic and financial policies must all take into account the fact that there has been a real transfer of income in favour of the petroleum suppliers. In the short term at least, this will lead to a reduction in the distributable national product.

3. Considerable stability problems are produced, because with the oil price increase there is the danger of a growing wave of price increases. An intensified policy of stabilization is required to fight against this danger.

4. Problems arise in employment policy, because, despite the danger of inflation, there are considerable gaps in demand in various sectors of the economy.

5. Adaptation problems require increased investments, if a high level of employment is to be restored.

There are indications that some measures, which are intended to solve problems caused by the world economic situation, create more problems than they solve. The German Bundesbank, which, unlike most other central banking institutes in the world, has a great degree of independence, is trying to fight inflation and finance the current account deficit by means of a policy by which money is kept in short supply and high interest rates are charged. Similarly high interest rates are being charged in the USA. This strategy leads us to ask whether adaptation processes are not more likely to be hindered than hastened. Only increased investments will ensure that the Western economies become less dependent on oil and internationally more competitive. In the same way, new jobs can only be created if investments are increased. However, does a policy of high interest rates not prevent investments?

With regard to the fight against inflation, the policy of keeping money in short supply and charging high interest rates, which has now been followed for more than a year in both the USA and the Federal Republic of Germany, seems to have been placed in doubt. High interest rates result in high costs, which can at least be passed on in those sectors of the market in which competition is limited. Thus, the monetary policy seems not only to slow down investments, but also to have only a slight effect on inflation. Inappropriate economic policy instruments only intensify the crisis, rather than eliminating it.

The international crisis factors are being intensified by problems in the domestic economy. The state has less freedom of action with regard to financial policy than used to be the case, because, on the one hand, the economic crisis has given rise to considerable costs and, on the other hand, the high interest rates have given rise to high tax burdens. In this respect, a finance crisis restricts the application of Keynesian instruments for creating new jobs.

If, in the long term, the real burden on public budgets is greater, due to the high interest rates, than the real increase in public income caused by the government deficits, then the state will find itself in a financing dilemma. Such a policy could only be pursued if the people were prepared to transfer a constantly increasing share of the available income to the state. However, this will certainly not be the case. For some time it has been clear that a higher national deficit does not lead to growth which will eventually finance the deficits.

Quite apart from the high interest rates already mentioned, another reason for the financing dilemma can be found in a structural growth weakness of the advanced industrial economies. This weakness is due to three factors in particular:

– stagnating world trade;

– relative saturation limits restricting growth capabilities, while the supply of commodities remains highly rigid;

– investment decisions, especially in industry and with regard to infrastructure, conflict with environmental policy.

In none of the advanced industrial nations, was it possible to create an expansive economic growth using the traditional Keynesian instruments. Together with a reflationary policy, this led to a great upswing of monetaristic concepts, even in the Federal Republic of Germany. As a rule, these concepts assume that the crisis phenomena are the results of state intervention. A retreat by the state is what is now required. Only such intervention is allowed which will maintain the money supply. This policy of constantly keeping money in short supply is said to be the best means of fighting inflation and the best guarantee for a thorough and independent improvement in the economic supply structure.

The advance of monetarism with its naive belief in the self–healing powers of the market is somewhat striking. We all know that never in history has there been an economy solely directed by market forces. Furthermore, we all know that in the second half of the twentieth century, the economy of all Western industrialized nations is a complex mixed–economy system, in which private industry and state institutions are closely interwoven and with reciprocal influence with regard to performances.

In the Federal Republic of Germany, the Government is the biggest entrepreneur: almost 50 percent of the gross national product passes through its hands and, whether it wants to or not, its financial policies can speed up or slow down economic developments; it can have a decisive influence on the money supply in the economy and on credit costs as a result of its credit policies; it is responsible for ensuring a high level of employment, price stability, adequate economic growth and a balanced current account; with its sectoral and regional structural policies, its research and development policies, it influences the economic dynamics of our society.

This list alone makes it clear how useless the ideological debate was which arose everywhere in the 1970's and which merely had as its point of orientations an unreal market economy idol. Any debate on the problems at hand must pose the question, how and with which instruments and over which period of time the international and national challenges of the 1980's can be overcome. We are, therefore, concerned with the constant search for the most sensible and most appropriate means of influencing economic development. If the traditional economic policy instruments cease to be satisfactory, the alternative is not to have no policy at all or to have a highly primitive policy; instead, the alternative will be to improve and modernize the old instruments in view of the new problems and challenges.

Although, up to now, the idea that an unrestricted class conflict in the Western societies impoverished everyone, employee and employer, government and society, was a central feature of enlightened political thought, monetaristic philosophy would appear to make such a maxim outdated. If market forces are really to be the sole decisive factor with regard to the creation, distribution and use of the national product, this would imply that the integration, power sharing and codetermination of the employees and their trade unions must be eliminated. For, if the production factor work is to be evaluated solely on the basis of shortage criteria, organized representation of employees' interests will become unnecessary. According to the text book wisdom of the monetarists, unemployment arises only when wages are too high as a result of trade union influence or political intervention. Consequently, unemployment is not a weakness of production systems organized according to capitalist criteria, but is the result of incorrect action taken by the employees themselves, in particular, their attempt to bring about a redistribution of the national product to their benefit, by means of organized representation of interests in a way destructive to the system.

The monetarist philosophy claims that the employee is capable only of representing partial interests, is not capable of viewing economic problems from the point of view of society as a whole. Thus, the employee is simply the embodiment of his labour, and is no more than an object in business decisions. Or to use Karl Marx's words, he is simply variable capital.

In two respects, therefore, the economic and social constitution of the Federal Republic of Germany contradicts a number of current trends in the neoconservative concepts which have established themselves in Great Britain and in the United States. On the one hand, we acknowledge the active role of the state in economic and structural policies; on the other hand, however, we believe in the need to integrate employees and trade unions as active and equal partners in economic policy. Furthermore, the state must guarantee free collective bargaining in the same way as it must play a role in attempts for a more just distribution of wealth.

We believe, therefore, that it is in the economic interests of all, that employees and their trade unions be actively involved, and that means above all as a power factor, in these changes which are taking place.

With its often contradictory interests, a society requires an institutionalized framework for settling conflicts, for reaching compromise and consensus. No one should be brow–beaten or overpowered. On the one hand, this includes an autonomous wage–bargaining system, and, on the other hand, political control of economic processes, especially in cases when the existence of this ability to reach compromise and consensus is in danger. However, mass unemployment and inflation are the main dangers to social peace.

Up until the recession of 1974/75 in the Federal Republic of Germany, there was general agreement amongst the major parties with regard to the basic principles and major instruments of economic and financial policy. This basic agreement can be summarized as follows:

Due to the experiences of the economic crises in the past, especially those at the end of the 1920's, and the need to defuse the class conflict by means of a secondary distribution policy, the constant growth of state involvement has ensured that economic and in particular fiscal and financial policies play a major role in the creation, distribution and use of the national product. Financial policy has assumed a highly responsible role with regard to, above all, growth and fullemployment policies. Financial policy serves as an instrument for regulating the scope and form of overall economic demand, both in times of boom and in times of under–utilization of production capacities. The amount and structure of public expenditure must take as their point of orientation the respective demand and supply situations of the overall economy and must adapt in an anti–cyclic manner in each case. Tax revenues and public credits should be used to influence private–sector demand in such a way that the economy develops uniformly. It is the duty of the state and its administrative units to draw up economic and financial policy measures which will contribute to a high level of employment, price stability, constant economic growth and a balanced current account. In addition to financing public investments in infrastructure which will promote growth, government borrowing policy has an important balancing function in economic policy: financial deficits caused by recessions are not eliminated by increased taxation as was the case with traditional financial policy, but rather by using the medium of the capital market. This allows any unused liquidities to be recirculated into the economy, thus reducing any recession or even overcoming it.

In the Federal Republic of Germany, this consensus was recorded in binding form in the Act on Growth and Stability, as well as in the financial reform of the late 1960's by the Grand Coalition.

There can be no doubt that this agreement amongst all the political parties and all the major social groups helped the Federal Republic of Germany in surviving the 1970's relatively well.

The basic principles agreed upon by the Federal Government in 1968 for a sectoral, regional and company–related structural policy, as well as the philosophy of the Act on Growth and Stability, are still relevant today.

1. Sectorally, this structural policy is to facilitate changes in the economic structure and speed up structural changes made necessary for reasons of growth, at the same time avoiding unacceptable social consequences in declining industries.

2. Regionally, this structural policy is to mobilize unused or under–used production factors throughout the Federal Republic of Germany for general economic growth, create more jobs and better working conditions, and eliminate social hardship.

3. With reference to company size, the structural policy is to assist the functionability of our economic structure by promoting the productivity of small and medium–sized enterprises.

Our economy is a mixed economy, in which there is a place for both autonomous market mechanisms and state planning and control. No one wishes to destroy the advantages of the market, yet it is common knowledge that the market can only create the production conditions of our modern industrial societies to a limited extent. Naturally, I am not thinking only of guaranteeing law and order, or ensuring peace or of safeguarding transnational interests.

It is obvious that the state must also compensate for functional disorders in the market. It would be fatal if the faults, imperfections and mistaken developments in state intervention were to cause us to avoid any debates concerning further development of economic and financial policy instruments, with regard to the problems and adequate solutions.

Why then is this agreement amongst the parties and between the two sides of industry in danger, if it has not in fact already been destroyed? The answer, that it is none other than the monetarist approach which has destroyed this consensus, is a tautology. For, the question would then be why were the monetaristic attacks so successful amongst the conservative parties and the employers?

This question can be answered on three levels which will be briefly outlined below:

1. On a national level, the answers given by economic policy makers could not incorporate the international causes of the problems. Our thesis is, therefore, that more international coordination of national economic policies must be achieved.

2. The crises phenomena which have appeared since the first oil price explosion require more social conflict management, on account of the far lower growth rate. Our second thesis is, therefore, that better methods are required to find social solutions to the conflict, as a basis for an economic policy taking as its points of orientation employment and investment.

3. To too great an extent, the crises of the 1970's were dealt with using the instruments of a global economic policy, when a differentiation between the traditional Keynesian instruments towards structural measures would have been better. The third thesis is, therefore, that we require a better structural economic policy, taking adaptation as its point of orientation.

International Cooperation.

Since 1975, the heads of government of the major Western industrialized nations and Japan have met every summer to " plan " the basic principles of a common economic policy. Basilically, however, these remained very general discussions which at least fulfilled one cooperative function: harmonising steps in the struggle against inflation.

There are two aspects to this shortcoming in the international fight against inflation. On the one hand, there was no adequate control of the international finance markets, following the first oil price crisis. On the other hand, this gradually led to a very extreme policy in the national context of keeping money in short supply and charging high interest rates. The effect of this on employment in the Western industrialized nations was disastrous, especially following the second oil price crisis.

The international money markets pose another unsolved problem in the worldwide fight against inflation; these markets are uncontrolled and, in the present world monetary system, uncontrollable. Since the first oil price crisis, these markets have exploded. The expansion of the international money markets bears no sensible relationship to the development of real trade relations: whereas world trade is virtually stagnating in real terms, international credits are constantly expanding. The grandiose creation of money via credits on the European markets, worth considerably more than 1 billion Dollars, is an inflationary bomb, since, on the one hand, in real economic terms the necessary adaptation processes are being slowed down and, on the other hand, the present international movement of capital is constantly being speeded up or distorted by speculative forces. It must be said by the way, that the OPEC millions are the stimulating force behind this money explosion, but not the decisive cause of it. The OPEC money is in fact nothing other than the fuse in this bomb. The dynamite is the result of the international banking system's ability to multiply the OPEC millions via inter–bank loans. At the same time, the newly created international money is usually used only to pay off earlier obligations.

Of course, these markets have also had a positive side. They made it easier to solve the international balance of payments difficulties, following the first and second oil price crises. The private–sector money markets made sure that the oil millions were so to speak recycled. It is clear that national and international standby measures would not have sufficed to solve the balance of payments problems quite as rapidly. Gradually, however, the everchanging international liquidity situation, which frequently serves to intensify mistaken developments, is becoming more and more destructive because loans are being granted for ever shorter periods.

If national agreements concerning the fight against inflation are to be successful, then it is essential to have an international pact with which to fight inflation. The objective of such a pact which must be signed by the governments of the OECD countries and their central banking institutes, is clear: to limit international liquidity and to reduce speculative reserves to a functionally sensible degree.

These two aims can only be fulfilled if the international loan system can be controlled in the same way as the national systems. The key problem is to limit international inter–bank loans. Naturally, this problem can only be solved by creating an international "central bank". For, it is only in this way that the price function of the exchange rate can be restored. This is because at present, the exchange rate, as the extreme overvaluation of the Deutsch Mark in the past and the absurd undervaluation today have shown, is almost entirely the result of totally subjective, and often enough short–term, political expectations. To an ever greater extent, it is becoming a yardstick which, in the final analysis, will be uncalculable and thus is losing its function as a point of orientation in international money relations.

Thus, the international pact to fight the causes of inflation makes it necessary to reform the international monetary system as soon as possible, in a manner limiting the international formation of loans by a system of rules on an international level. This is not the place for making proposals concerning such a central bank for the international private–sector banks and the national central banking institutes. Nevertheless, we should be aware of the fact that even on a national level anti-inflationary control of the money supply is probably impossible without such an institution.

The second international coordination problem relates to world trade. In comparison to the 1960's and early 70's, world trade growth has become so small that it has ceased to be a dynamic element in the creation of jobs in almost all countries — with the notable exception of Japan. The basic effect of all national measures in this field is to redistribute the gains and losses of a no–profit situation.

At present, the biggest enemy for trade is the wealth of ideas in an ever increasing number of new, conserving crisis subsidies. It seems logical to grant government subsidies to endangered industries. However, this almost always goes wrong because suddenly everyone grants subsidies. Experience has shown that a run of subsidies does not save jobs; the money could have been used to greater effect elsewhere, in a sector where additional jobs could perhaps have been created using public funds.

It is not easy to answer the question as to how one can escape the dilemma of stagnating world trade. A glance at the international situation will show this. The oilexporting countries are wealthy but, with the exception of Algeria and Mexico, cannot transform their wealth immediately and completely into an effective demand within the world economic system. Those developing countries which do not produce petroleum are almost all on the verge of international bankruptcy and, therefore, are buying less and less. Their export revenues are being consumed to an ever greater extent by the costs of petroleum imports. Like the Federal Republic of Germany, the industrialized nations have balance of payments problems and are, consequently, trying out import substitutions which of course restrict world trade.

A solution can only be found to this problematic situation if international finances cease to be used primarily for short-term loans. Instead, they must be used for useful and profitable investments. Proposals, such as the energy subsidiary of the World Bank, point in the right direction.

Social Solution to Conflict.

In the past, the Federal Republic of Germany has enjoyed a relatively peaceful social climate. There were few strikes in the long period of growth following on from the mid 1950's because it was possible to distribute the increase in the national product in a manner satisfactory to all. When, in the mid 1960's, disturbances appeared in the overall economic development, the two sides of industry (social partners) met in crisis management committees (" concerted action groups " (Konzertierte Aktion)). These bodies were fairly successful for as long as all those participating — employers' associations, trade unions and the state — believed they were primarily concerned with eliminating and limiting cyclical and, therefore, mainly temporary disorders.

In the short term, the trade unions appeared to be prepared to forego wage increases in order to allow profits to increase for the purpose of making new investments, but only for as long as they did not believe that the economic policy instruments such as an investment bonus would not be misused to bring about a permanent deterioration in the relative position of the employees with regard to income. However, this impression gradually came about as the employers' associations adopted an evermore ideological position and as the opportunities for the trade unions to find a " class compromise " gradually decreased, on account of the low growth rates and the slight distribution margins.

Basically, the employers and trade unions were now discussing an overall policy with the state which, even when a compromise had been reached through discussion, still did not settle the crisis but left all participants equally dissatisfied. Important issues, such as energy policy requirements, the issue of a general reduction in working hours in order to allow a fairer distribution of work, or the issue of an employment-oriented sectoral structural policy and of a political strategy for industries in crisis remained untouched.

The shortcomings in the solution to the social conflict can be formulated still more bluntly. The trade unions can only organize wage restraint if the employers are prepared to compromise with regard to financing social security and to reducing working hours. Social peace or the organization of a " non–war " on the social level also has its costs. It seems that this understanding is vaining, in the Federal Republic of Germany. It would be more than useful if right now an attempt were to be made to try out new forms of social understanding as a result of which agreement could be reached concerning employment policy, structural and overall economic tasks. Of particular importance is the organization of a social debate in which the decision–making bodies share the responsabilities and in which the participants can themselves analyze their experiences in this interplay and include these in the development of new methods.

The most important thing is to expand the social and economic democracy, to extend the institutional framework for solving these current, difficult problems. In my opinion, we must resist the fatalistic temptation to leave these problems to be solved by an apparently natural logical force. Nothing would be more dangerous than simply to trust in the forces and laws of social systems, whether they be capitalistic or socialist. Instead, we must be conscious of the fact that economic developments can be shaped.

What then would be the shape of such an expanded institutional framework of participation and shared responsibility for the society in the Federal Republic of Germany.

1. Worker co–determination large enterprises, which began in the coal and steel industry, must be continued; i.e. employers and employees must be equally represented on the supervisory boards of Limited Companies.

2. Employees' participation rights are further extended under the terms of the Works Constitution Act (Betriebsverfassungsgesetz) and of the Act on Staff Representation (Personalvertretungsgesetz).

3. In–house co–determination and joint responsibility are extended to a supra–company level: on the one hand, by placing employees' representatives on the selfgoverning bodies of industries i.e. the Chambers of Trade and Commerce and the Chambers of Handicraft on a parity basis; on the other hand, employers, employees and government authorities could meet in bodies in which they are equally represented to one third each, to discuss basic issues concerning structural changes in our economy, raw materials and energy policies and other similar matters, to draw their conclusions and work out proposals with the actual decision–making bodies.

The demand for new institutions for supra–company participation is based on the fact that today we require a large number of preparatory decisions to be reached by the state and industry, which up till now remained in the twilight realm of lobbyists and bureaucrats. It is important to remember that in addition to groups representing traditional interests, new groups have been added and incorporated, such as citizens' action groups or groups of ecologists.

4. Since we require more investment capital than has hitherto been available in order to solve our problems, it is essential to facilitate the accumulation process by ensuring that employees have a share of the production capital. Consequently, the strategy of worker integration must be rounded off with a concept for the creation of property amongst the employees; this however must be in a form which will not lead to the fragmentation of the working class, but will simply not stand in the way of legitimate organizational interests of the workers' movement.

Structural Improvements.

Although the Keynesian instruments were useful, they are not suitable for solving the problems of the 1980's, because there is a need to adapt which cannot be overcome simply by using global demand instruments. We must, for example, save energy rapidly in order to eliminate our current accounts deficit. We must assist small and medium–sized industries in adapting, and directly attack the problems of the labour market.

A whole series of coordinated measures must be taken by a number of decision–making bodies.

This policy, which starts with Keynes and adds to him, is briefly described below:

1. More private and public–sector investments are required to improve the environment, to conserve energy and find petroleum substitutes, and to modernize the economy.

These investments can only be made if they can be financed. The main obstacle to higher investments is the interest rate which, for foreign trade reasons, is maintained at much too high a level. If this interest rate seems unavoidable, and before anything can be done at all, the Bundesbank and the state must lower the interest rate for particularly necessary and overdue investments in the aforementioned areas, for example, by granting interest subsidies or improved depreciation rates. Moreover, the speed at which these investments can be made increases as the trade unions pursue a less offensive nominal wage strategy, i.e.

the more they are concerned with structural improvements and safeguarding incomes on the basis of productivity.

2. It is necessary to concentrate on the focal point of our economic adaptation problems, i.e. guaranteed energy supplies. In the short and middle term, the decisive starting point for finding a solution is in the form of energy conservation and substitution, and particularly in reducing our oil consumption; this means, for example, more rapid expansion of our district heating network, government grants for energy saving industrial plants using oil substitutes, construction of block–heating power stations, utilization of industrial waste heat potential, and updating the Act on Conservation of Heating Energy (Heizenergieeinspargesetz).

In the medium and long term, coal must be given priority in guaranteeing energy supplies, since by refining and gasification, only coal can to any notable extent replace petroleum and natural gas. The Federal Government has drawn up a programme covering a number of years awarding grants for pilot plants.

In the medium and long term, we must also remember that we cannot do without nuclear energy, for electricity generation, district heating and process–heat generation, i.e. the nuclear energy capacities must be expanded, a solution must be found to waste disposal problems, and further grants must be awarded for high–temperature reactors and fast breeders.

3. Employees' qualifications must be improved so that, in the international division of labour, we can keep up with other nations and draw on growth reserves.

To a large extent, the fact has been overlooked that the qualifications of the employees have not been improved to an extent corresponding to the international competitive situation of the Federal Republic of Germany, in particular, to the high export share of the economy as a whole. A certain neglect of professional training in the 1960's and a temporary, partial educational boycott in the 1970's have produced a shortage of specialists limiting growth and thus preventing the creation or availability of parallel jobs for less qualified employees.

Comprehensive financial assistance allowing employees to obtain professional qualifications, either by increasing the number of professional training places in key areas or in the form of in–house qualifications, is perhaps of greater effect as an employment policy than a policy promoting the creation of capital, with equal state involvement. Due to the new bottlenecks, it is all the more necessary financially to burden those companies which do not meet their obligations with regard to training to an adequate degree and to remove some of the financial burdens on those which meet their obligations to a greater degree than is actually required of them.

4. By the mid 1980's at the latest, the labour supply must be reduced by further reducing the working hours. Amongst employers and economic writers, this is the most hotly debated demand. As can be seen from the situation on the job market and from the unemployment figures for the early 1980's, the employment problem cannot be overcome simply by means of economic growth. Unless we again have growth rates such as existed in the early 1950's, a possibility contradicted by the situation and development in world trade as well as in the domestic economy.

Thus the two sides of industry largely determine the time spent working, i.e. one's working life, if we disregard the statutory age limits and the state limits laid down for education. Here is an important area for common sense to be shown by both sides. By the mid 1980's, the two sides of industry should have included in the wage bargaining process a considerable reduction in working hours, because only in this way can we limit unemployment to any extent at all.

5. - THE SECRET OF STRUCTURAL FLEXIBILITY OF THE JAPANESE ECONOMY AND ITS BEARING ON THE INTERNATIONAL ECONOMIC POLICY

by **Nobuyoshi Namiki**

INTRODUCTION.

The performance the Japanese economy exhibited amid the confusion the world economy fell into in the wake of the oil crises has been excellent in its own way.

And it seems that this unique performance of Japanese economy has not been understood duly by Japanese economits not to speak of their foreign counterparts.

This is simply because it is impossible to fully analyse the Japanese economy of the post-oil-crisis period by such method of analysis as to consider the relations among narrowly-defined economic variables which the economics of the post one hundred years has been applying.

The basic characteristics of a society which would not appear in ordinary economic fluctuations is apt to be expressed in a social upheaval such as we experienced after the oil crisis as the depth-psychological phenomenon of an individual which would not appear in his ordinary life cycle could appear in a state of catastrophe. I think the same story could be told about Japan of the post-oil-crisis period, and would like to introduce to you this point as the secret of the structural flexibility of Japanese society.

In the present research which would discuss basic problems of international economic policies in the future, I would like to make clear the dissimilarities between Japan and Western countries which appeared in the adjusting stage subsequent to the oil crisis.

Metaphorically, the adjustment policies which other countries took look like the policy the " north wind " adopted in an Aesop's Fable " the Sun and the North Wind. " As a consequence, the present state of their economies is as bleak as the north wind stricken winter. In contrast, the Japanese economy which carried out adjustment in accordance with different social philosophy and practices is in " Indian summer " so to speak. Though there is no denying a possibility that such relatively good performance may collapse due to violent fluctuations of the world economy, it may safely be said that the Japanese economy is in Indian summer for the present.

I would like first to explain the reasons why there has developed such difference as the one is as bleak as the northwind while the other is warm in Indian summer, and then touch upon the ways the economic policies and programs should be in the 1980s.

1) *Why Economy Bleak in Other Major Countries.*

We are at present confronted with economic problems of various kinds. The most important of them is control of inflation.

Theoretically, control of inflation is quite an easy issue if it is considered as follows.

The ultimate components of prices in a country are only three: import part, wage part and profit part. Among them, the import part cannot but be imported from abroad at international prices and therefore is not controllable by domestic policies. It is only the wage and profit parts which the country can control by policy measures.

Then, it becomes known that there are only three ways for the country to overcome inflation, that is;

1) Control of wage part,
2) Control of profit part, and
3) Simultaneous control of both wage and profit.

Milton Friedman explains indirectly in his book that control of wages is necessary in order to curb a rise in prices. (1)

Corporate profits are only less than 10 percent of national income. They are six percent after taxes. And it is owing to the existence of corporate profits of even this meager margin that business enterprises are enabled to invest, improve productivity and raise wages.

It is, therefore, necessary to hold down a rise in wages in order to counter inflation. The problem is, above all, an artificial hike of wages by big labor unions. So states Friedman.

Perhaps practically all of American economists may agree to these remarks of his.

The possibility of reducing profits as an anti-inflation measure is not made even a subject of discussion. Here is the limit of social philosophy in the present major countries. And there is incidentally a problem of the limit in the methodology of economic analyses.

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(1) Milton & Rose Friedman, *Free to Choose*, 1979, Harcourt Brace Jovanovich Inc., N.Y. Chap. 8.

The limit of social philosophy and that of the methodology are different matters theoretically but closely related actually.

First, as the limit of social philosophy there is pointed out the prevalence of rationalistic human view. Descartes' metaphysics stubbornly attached importance to clearness and distinctiveness for reason. This is a characteristics which cannot be found in the Orient.

The Reformation produced an independent and morally autonomous individual. And this human image went beyond the Protestant area and affected the rest of Western Europe and North America.

For a rational and independent individual, strife for the right (Rudolf von Jhering Der Kampf ums Recht, 1872) was what a citizen had to perform as his duty.

We, Japanese, too can understand these elements intellectually, but find it hard to feel the same way. When I once read a Jhering's book, I felt that if Germany were an ordinary society, Japanese society could not but be said to be backward. I have, needless to say, different ideas about these problems now. Each society has its own cultural characteristics. And this characteristics would have effects of different kinds according to the context of specific states of problems.

I have no intention to discuss in this place further the social philosophies and economic thoughts of Western countries. I, however, would like to point out solely the fact that Carl Gustar Jung has recently analyzed the importance of depth–psychological elements, viz., gnostic elements which have been expelled from academic society in the history of Western ethos after the Reformation but are still alive continuously in the minds of common people. This psychological strata of people made the Vatican to adopt Assumption Mariae as a formal Catholic doctrine in 1951, three centuries after the death of Descartes. (2)

I suspect that social recognition in the Western Hemisphere of the present age does not fit the real aspect of human life. Among those who expound monetarism or rational expectation or those who believe in Neo–Liberalism nowadays, a considerable number of them may be regarding human society too simply. Or, they may be considering that problems could not be solved unless they use a powerful prescription which is made out by a simple way of viewing things.

Now, the United States has been experiencing in 1979, 1980 and 1981 a double–digit inflation as measured in terms of wholesale price index. The rate of economic growth is almost zero, standingat a minus

(2) C. G. Jung, *Antworf auf Hiob*, 1952. In this connection, the problem is how the " sympathy " in Adam Smith's *Theory of Moral Sentiments* will be given a right place in Modern World. The present age takes up his self–love alone and forgets the symphaty.

0.2 percent in 1980 and projected at 1.1. percent for 1981 (according to a government outlook. Private forecasts mostly put it at 2.0 percent or thereabouts). Should U.S. entrepreneurs and labor union leaders behave as mentioned below under such economic condition, what will happen as a consequence?

First, entrepreneures have to ensure profits to their companies lest they should be deprived of their posts by financial institutions which hold the stocks of their companies. They are not allowed to cause the profit–sales ratios to decline.

In U.S. enterprises lately there has been an increase in the reserves for pension funds. In case such reserves reach large amounts they could operate the funds by themselves, but if reserves are of small amounts they entrust their operation with banks. The banks in their turn would purchase stocks and get dividens. There is, therefore, the necessity that dividens be paid constantly. And this would necessitate the entrepreneures to prevent dividens and, therefore, profits from falling.

Next, the leaders of labor unions are not allowed to make the wage–profit relationship unfavorable to wages if they want to hold their posts from which the revenues comparable to those of executives at leading big businesses accrue to them.

Now, should both entrepreneurs and union leaders exert their efforts to attain these goals and be successful, what would be the outcome? It would merely make the two–digit inflation come to stay. It will be the case even if such strong restrictive measures may be taken as Reserve Banks raise prime rates above 20 percent per annum.

Hereupon the implication of the Aesop's Fable "The Sun and the North Wind" would become clear.

In an industrial society of the present age, people wear mantles in the form of too protective social security systems and laborers wear mantles in the form of too large wage hikes. The government, therefore, has to have the people to put off their thick mantles and wear instead thin mantles for the sake of their true health. The means is adoption of restrictive measures.

How are things developing in modern industrial societies? The north–wind policy is unlikely to attain its goal easily. In other words, there is no likelihood that governments may succeed in holding down wages alone. In the United Kingdom the consumer price index (exclusive of food prices) rose as much as 18 percent in 1980, but the rate of increase fell to 12.0 percent in April 1981. Wholesale prices for manufactured goods climbed 16.3 percent in 1980 as compared with the previous year and 10.6 percent higher in April 1981 above a year before. The cause of such decline in the rate of price rise may perhaps be restrictions of both wages and profits. That is the third alternative of the three cases referred to above. And this is the outcome of the north–wind policy.

In the United States wages seem to have been affected in 1979 and profits in 1980. Restrictions of both wages and profits will be necessary in order to place inflation under control in that country too.

At any rate it is inevitable that both management and labor would suffer damages under the north–wind policy which would involve a confrontation between the two rivalling forces. Besides, such a lowering of the rate of inflation which inflicts damages on both sides would inevitably accompany a protracted social tension. Could the economies of developed countries endure increases in unemployment rates and social tensions which will last at least for several years to come? Though I believe they can, I cannot explain the reason as the space is limited. It would, however, inevitably involve a considerable social sacrifice even if they could endure it.

Next, what is the limit in the methodology of economic analyses?

I think economic analyses are something like a doctor's diagnosis of patients. The problem is the diagnosis of the present state of patients. Though results of examinations made ten years, five years or one year before may be helpful, the result of the examination of the present state will naturally become the basis of his diagnosis. Even when physicians examine the same data, skilled doctors would make correct diagnoses while those unexperienced wrong.

What will be the outcome when this is applied to economic analysis.

The characteristics of the economy in every year of the past five or ten years will have to be grasped accurately for each of the years. It is natural that the characteristics lasting for plural years will appear and then disappear. And it will become possible for any observer to grasp the characteristics of the present state of the economy and prescribe necessary policy measures only after he has grasped the characteristics of every past five to ten years.

Natural as it may sound, such a method, however, contradicts with the one which uses an econometric model. It is philosophically nonsense that one estimates a single structure on the basis of time–series data for the past five or ten years. Nor is it sufficient to adjust the constant term and make the model adaptable to the present situation. The model has depicted the same pictures under the same systems and thereby contributed to democratization of learning, but has casted the real aspect away into a black box in the form of an equation system. It, therefore, becomes impossible for us to grasp the characteristics of the ever–changing economy which is necessary to policy formulation, grasp its present state by our mind and attempt policy recommendations based on it. The model fluorishes while economic analysis withers.

We too make simulations with models but attach only secondary importance to their results in forecasting economic trends. We are exerting efforts in grasping the characteristics of the economy in every year, especially the characteristics of its present state, by the use of all conceivable methods.

Though the arguments on epistemological grounds and the concept of truthness that have been proposed are interesting, I will not touch upon them here.

2) *Why the Japanese Economy in "Indian Summer"? — Three causes of the Structural Flexibility of Japanese Society.*

For a cool-headed observer it may look like a miracle that Japanese society has tided over with a fairly comfortable performance the two oil-crises — the one from October 1973 to early 1976 and the other from 1979 to early 1981.

For example, wholesale prices which climbed more than 32 percent from a year before at the time of the 1974 spring labor offensive got stabilized to a rise of 13 percent at the time of the following 1975 Shunto (spring labor offensive to support annual wage negotiations) and further to a meager 1.7 percent rise from a year before for fiscal 1975 as a whole.

The once-prosperous Japanese economy was completely out of order just before the first oil crisis, hit hard for three consecutive years by a mistake of the Bank of Japan to cause excessive liquidity in 1971, lavish spendings on the Japanese Archipelago Rebuilding Plan under the Tanaka Cabinet in 1972 and the oil crisis in 1973. And in the period of wildly rising prices subsequent to the oil crisis Japanese society was in the verge of plunging into a catastrophe which might get uncontrollable if a step was taken in a wrong direction, that is, if people drew their deposits out of banks and rushed to change all of them into goods. In the face of such crisis of the Establishment or rather because it was confronted by such crisis, Japanese society subsequently proceeded promptly to settlement of the situation.

If the characteristics of a society should become explicit only when it is confronted by a crisis, one should explore for the characteristics of Japanese society in this process of its overcoming the oil crisis.

Next, at the time of the second oil shock, the rate of wholesale price increase which stood at a little below 13 percent in fiscal 1980 will slow down to around two percent in fiscal 1981 and consumer prices get stabilized from a little below 8 percent rise to a little below five percent rise in the same period.

The good performance of Japanese economy at the time of the second oil shock is not confined to the aspect of prices. Rates of interest in Japan are lowest among major countries as are symbolized by the official discount rate of 6.25 percent per annum. In the physical aspect as well, private equipment investment and domestic consumption expenditure in fiscal 1981 are expected to grow at the highest rates among major countries, projected to increase six percent and four percent respectively. The rate of economic growth will laso be highest among major countries at five percent.

. According to the OECD's Economic Outlook, private equipment investment in 1981 will decline or flatten out at the best in all countries except Japan. Japan thus surpasses other major countries in the repletion of supply capacity and enjoys lower rates of price upsurges. Consequently, Japanese exports which might have been " squeezing-out exports " in the past have now changed their character to " sucking-in imports " by overseas markets. Unless other countries prevent such sucking-in imports from Japan by barriers of one form or another, Japanese exports will continue to grow at a fairly rapid rate. When world imports grew 1.3 percent in real terms in 1980, Japan's real customs-cleared exports increased a little above 16 percent. Should world imports recover to an increase of around 2.6 percent in 1981, Japanese exports will certainly grow in an extent that its current-account deficit will be wiped out. This will bring about a firm trend in the yen's exchange value in 1982. It may be said in other words that Japan will exhibit a good performance in international trade too. (3)

What events or factors would explain such good performance of Japan which were shocked twice by oil crises? Any argument on the characteristics of Japanese society or on Japanese-style business management which does not answer to this question will have no ground for refutation when it is criticized as insignificant.

What provide support to the structural flexibility of Japanese society are considered to be the following three factors.

The first is intergroup dynamics which is based on the characteristics of the Japanese family system and explains, among others, the existence of fierce competition among enterprises. And it is considered that what is called the characteristics of a vertical society is basically included

(3) Figures for Japan are based on Japan Economic Research Center, *The Seventh Five-year Economic Forecast* published in March, 1981. Those for other countries are based mostly on OECD, *Economic Outlook*, December 1980.

in this intergroup dynamics as well. Besides, the closed or isolated nature which is intrinsic to Japanese families gives rise to strict distinction between their insides and outsides in spite of the existence of the so-called groupistic pattern of behavior, and leads to increasing efforts for self-defence as is symbolized by high saving ratios.

The second is the existence of a system of control by an intermediate boss (leader). This originates from the pattern of production in the form of village-level paddy-field farming, and gives rise to the so-called groupistic pattern of behaviors on the one hand and has an effect that the leaders of subgroups of an organization come to have stronger powers of control over its grass-roots members than the head of the organization has over them on the other.

The third is a Japanese-style incomes policy; or, to be more exact, it may have to be said the influence of Confucian ethics which enabled the Japanese society to apply such Japanese-style incomes policy in an emergency.

Practically all Japanese economists deny the existence of this Japanese-style incomes policy. Certainly there has never existed in Japan such Western-style incomes policy as to contrive adjustment of the relations between profits and wages at the same point of time. Incomes policies adopted in Japan have been of an intertemporal nature. Namely, corporate profits shouldered the cost of adjustment at the time of the first oil crisis, while wages bore the cost at the time of the second crisis. In this way, the proper parts were contended with their lots to restrict values-added at the proper time.

Now, whatever else might be said, the adjustment at the time of the first oil crisis was graver than the one at the time of the second crisis. Therefore, more importance must be attached to the significance of the profit-cut-centered adjustment at that time. At the time of the 1975 " Shunto " the leaders of the business world who felt that the establishment was in danger caused wholesale prices to drop through reduction of corporate in compliance with the precept of Confucian ethics that a ruler should concern himself with the future of the country before the people begin to do so and seek his own pleasure only after the people are assured of their happiness, and held down the rate of wage increase with such decline in wholesale prices as a lever. This fact is clear from statistics and can be substantiated in its subjective intent as well.

An examination of the trend of corporate earnings (excluding financial institutions) according to national income statistics reveals that corporate earnings (when those in fiscal 1973 are set to equal 100) dropped to 80 in fiscal 1974 and 77 in fiscal 1975, stood at 89 both in fiscal 1976 and 1977 and surpassed the level of 1973 at long last in fiscal 1978 rising to 104. This shrinkage of corporate profits caused such slowdown of the rate of WPI rise and subsequent decline of the rate of wage increase as mentioned already. The decline of corporate profits resulted in a decrease of direct tax revenues which in their turn constituted one of the causes for the deficit of public finance which was largest in the world. There is no major country in the world where corporate tax revenues decreased so protractedly and severely as they did in Japan. There should be found the peculiar characteristics of Japan. (4) The share of government expenditure in gross national product grew from 20 percent in 1970 to 27 percent in 1977 due to more a extensive application of welfare policies. However, no means has been adopted to increase revenues commensurately to such a rise in the expenditure. This is the second cause of the deficit of Japan's public finance.

It is a rationale considerably easy to understand that it is hard for a double digit inflation to subside in Western countries which lack the factors that have enabled Japan to apply such incomes policy of the very Japanese style as an intertemporal incomes policy.

As inflation was placed under control and the profitability of investment was assured in this way, investment increased through intergroup dynamics, supply capacity grew and productivity advanced in Japan.

In short, in Japan the supply-side economics meant in substance that inflation has been brought under control. In this respect the order has been reverse in Japan when compared with the United States which wants to try the supply-side economics in order to overcome inflation. Will it be successful in the U.S. where a reverse order will be observed?

Now, the three factors given above are tools which have been prepared in order to shed light on the Japanese economy. They may look like tools which are outside economics. However, one should not set a clear distinction between economic phenomena and other social phenomena. Economic analyses in the future will not be truly practical unless they are truly interdisciplinary.

Now, these three factors will be explained briefly below.

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(4) According to the data by countries on private corporate earnings, there seems to be many countries where earnings decreased in 1974 and 1975 in a row. However, the declines in corporate tax revenues were small. In Japan there is a clearly discernible correspondence with some time-lag between the fall in corporate earnings and the decline in direct corporate tax revenues.

The uniqueness of Japan becomes known when one examines the actual trend of corporate profits in terms of the trend of tax revenues.

When one calculates tentatively the figures in the national accounts which correspond to current profits in corporate accounts, he will obtain such a surprising figure as given below.

Namely, when the figure in fiscal 1973 is set to equal 100, it stood at 48 in fiscal 1974, 42 in fiscal 1975, 60 in fiscal 1976, 55 in fiscal 1977, 83 in fiscal 1978 and 137 in fiscal 1979. Such developments are attributed to the movement of stock valuation adjustment in each year.

A) *Intergroup Dynamics.*

Why is competition among enterprises fierce in Japan which is called a groupistic society and less fierce in West European countries which are said to be individualistic societies? In the age of internationalization in and after the latter half of the 1960s and in the face of the growing possibility of U.S. direct investment in particular, Japan adopted the policy of reorganization of its industrial structure while West European countries upbringing of champion corporations. It may be said in the light of the subsequent developments of events that the upbringing of champion corporations in Western Europe made more progress than the reorganization of the industrial structure in Japan. (5) The progress of reorganization, both national and international, in West Europe in such industrial fields as automobiles, aircraft and computers has been larger than in Japan. (6)

As a consequence, whereas the Japanese industry has shown good performance due to the existence of a large number of competing enterprises, Western Europe generally suffered from the evil of the lack of competition in industry.

By the way, the term " collectivism " is suggestive of a communistic monolithic unity. The industrial society of Japan where competition if fierce is not in the least such collectivistic society. It may be " groupism " in English.

In Japan the formation of groups flourishes; and the function of these groups is to compete with other groups. There exist within political parties groups in the name of factions, and they compete fiercely each other in pursuit of the post of party president (prime minister). An examination of the circumstances of the advents of Jimmy Carter, Ronald Reagan or Margaret Thatcher reveals that there is a considerable difference from those within Liberal Democratic Party of Japan. There are factions in a corporation too; and in case one of these factions has contributed more to the performance of the firm than any other faction, the head of such faction will take the post of top executive of the enterprise.

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(5) About the upbringing of champion corporations inWest Europe, refer to Raymond Vernon ed., *Big Business and the State; Changing Relations in Western Europe*, Cambridge Massachusetts, Harvard University Press 1974.

(6) Concentration and integration have been carried out. In the aircraft industry, for example, the number of companies in the United Kingdom has been reduced from four early in 1960 to one, in France from six to three, and in West Germany from five to one. In other minor European countries there has existed only one company from the outset. Furthermore, these companies have been tied up for production of European airbus. Reorganization has also progressed at a rapid pace in such industries as computor and automobile.

Now, an organization in the name of enterprise in Japan which consists of rivalling subgroups (factions) competes fiercely with other enterprises. And this feeling of strong rivalry has made the reorganization of the industrial structure in and after the latter part of the 1960s smaller in scale than expected.

The fierceness of such competition among enterprises naturally makes it difficult for them to have resort to formation of cartels. The number of cartels now in existence in Japan is unknown since the number of illegal cartels is not clear. They are hardly larger in number than those in Western countries. And even if they are supposed to be more, they may be hardly effective actually due to violations of the rules.

The existence of the Major Industry Control Law and Industrial Association Law of April, 1931, may give a strong impression that the prewar Japan was a country where cartels flourished. The enforcement of these laws, however, placed emphasis on the latter law which was oriented mostly toward medium- and small-scale enterprises and big businesses seldom affected. Namely, the Japanese economy has left large room for competition among firms throughout the pre- and post-war periods. What factors have been responsible for this development?

I suppose it has been the result of the effects which the characteristics of Japanese family system, viz., the characteristics of the iye-type family system has had on important social systems or structures.

What is referred to here as " the iye-type family system " is said to have made its advent after the Kamakura Period (800 years ago) in the Kanto District and after the Muromachi Period (600 years ago) in the Kansai District, and according to F.L.K. Hsu (7) and Chie Nakane (8) has such characteristics as given below.

It is an authoritarian system in which the family head has a strong authority, and has a hierarchical character too as is symbolized by primogeniture. It contains a nonconsanguineous element as is symbolized by inheritance by an adopted child and is of a rational and object-pursuit type and strongly self-reliant (isolating).

Hsu argues that when such characteristics of a family casts a reflection on the social system it becomes the so-called " iemoto " (the main branch of a family). An " iemoto " in the Edo Period may have played as a social system a role comparable to a corporate enterprise of today.

Strong self-reliance and isolation would give rise to a distinction between the insides and outsides. And these insides are quite authoritarian and hierarchical in substance, and made Japan a vertical society in a word.

(7) F. L. K. Hsu, *Clan, Cast, Club and Iemoto*, 1979, Baifukan, Tokyo.
(8) Chie Nakane, *Human Relations in Vertical Society*, 1967, Kodansha Gendaishinsho.

In short, such an iye–type familiity system influenced Japanese society in following two ways.

The first is the formation of a purposeful and authoritarian group.

The second is that if there is nothing but his home for an individual to go by in life and this home too is self–reliant and isolating, the Japanese people cannot but be an existence which is essentially isolated and lonely. Religion (gods) may give a help to such individuals in attaining spiritual enlightenment and peace. In case, however, such religion has become a religion for the sake of merely observing funeral service, the alternative will be the formation of a faction in which the people flock together around a powerful boss in their daily life.

The formation of a group as a pertinent unit of competition which was cited first was neutralized by introduction of such ideologies as the principle of corporate family. This, however, does not imply that this principle is the essence of Japanese–way business management as the invention of the family–state idea in the Meiji Era did not mean that the essence of Meiji State possessed the entity of family state.

Since the self–reliance and isolatedness of households add to those of enterprises and strengthen their competition with other enterprises, Japanese enterprises are weak in their solidarity with the outside world. Namely, here exists as well the relations between the insides and outsides. And it is hard for Japanese labor unions of big enterprises which have a characteristics of enterprise union to conceive of solidarity with laborers in medium and small enterprises.

The fact that the blue–collar workers of these days do not devote themselves so fully to the corporations they work for has been testified by the results of questionnaire surveys. (9) And a fact that such an excellent enterprise as Oki Electric Industry Company dared to dismiss its employees by designation after the oil crisis may bespeak the failure of an optimistic myth.

It is for the sake of competition with other groups and never for the sake of cooperation or concord with them that enterprises as such units of competition form a group under the leadership of a financial institution. If there come strong protests from overseas industries, these Japanese enterprises will naturally form a national group this time and confront them.

Since such formation of groups is contrived as a powerful means of competition, it is expressed in such an English word as " intergroup dynamics " which has been coined in Japan.

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(9) Refer to the result of a questionnaire survey appearing in R. M. Marsh and Hiroshi Man'nari, *Modernization and Japanese Factories* (1977, University of Tokyo Press).

B) *System of Control by Intermediate Boss (Leaders).*

For example, when President Zenko Suzuki of Liberal Democratic Party asked a dietman belonging to the Tanaka Faction of the same party to do something for him, the dietman will agree to do so but at the same time ask President Suzuki to inform it to Mr. Nikaido who is the caretaker of his faction and to seek his consent. And President Suzuki will certainly accept his request and make a telephone call to Mr. Nikaido at once.

On this occasion President Suzuki will never make such a statement which is right in a certain sense viz. " Now that I who is the president of the party asked you to do this thing and you have accepted to do so, I believe the affairs has been settled and that there is no need for me to seek the consent of some other person. "

What this episode implies is that in Japan the leaders of sub-groups in an organization may have stronger control over grass-roots members of such organization than the head of the organization.

What is the reason for such situation? It may be attributed to the practice of a village-level paddy-field farming lasting since the Yayoi Era (2,000 years ago). More strictly, the traces of paddy-field farming becomes known from the remains in large villages in low, swampy places which developed in the Yayoi Era, but there is no knowing what sort of social relations existed there. Concerning the more recent Nara Period on which the literature is available, the pattern of the family system at that time becomes known from the family registers stored in Shosoin. It is also considered that group work must have been conducted in water control, rice-planting and harvesting on the grounds that there is perceived the existence of artificially-irrigated paddy fields in addition to rainwater-irrigated fields. Such group work centering around water control continued unchanged even after the ancient farming pattern changed to a classical-pattern farming and further to a feudal-age style farming. The continuation of this group paddy-field farming for quite a long time has given to our national traits a characteristics of so-called " groupism. " The extent of this grouping, however, is that of a grouping attendant on water control and of a grouping which could be limited within the extent of banner-flying processions in overseas travels which are sponsored by agricultural cooperatives, and, therefore, is not so large in scale. In other word, groupism of this sort is not so large in the extent of grouping and apt to become rather mutually bashful with other groups of similar kinds or even antagonistic against them.

This groupism shows a tendency later to associate with the groupism of the iye-type family system.

Since the production base in the lower reaches has not undergone so big changes even if there have been successive changes in ruling classes, the power of regional or sub-group leaders to control grass-roots members has been maintained as it was fairly strong.

Now, such strong regional leaders' power to control grass-roots members has been succeeded in the present age as a structure of control by an intermediate boss. The most conspicuous case this mechanism exerts social influence may be an annual spring labor offensive for higher wages.

There does not exist in the Shunto of this country such a rigid institutional condition as a wage contract which stipulated a slide rule. People is talking about a change from the present practice to base the demands for higher wages on the rate of price rise in the preceding year to the one to base them on a price rise in the current year. Even in that event, however, it is unlikely that demands for higher wages will come to be based so strictly on the rate of price rise. This is because union leaders of this country attach importance to the consistency of their demands with the state of the economy (10) and behave with good sense and entrepreneurs on their part have regard for the views of union leaders. Namely, there is room for fairly flexible negotiations between management and labor. The reason why union leaders are able to conduct such flexible negotiations is that they have a perspective that grass-roots members are so lenient as to accept a compromise they have made in such negotiations. Without such flexibility there will be a shift even in this country to a wage contract with a provision which bases wage increases fairly rigidly on the rate of price rise.

Notwithstanding the fact that the real wage increase at the time of the 1980 spring labor offensive was so small as the family budget suffered a deficit every month thereafter, there has been perceived practically no sign of unrest in the labor camp and even a state of tranquility maintained under such structure of control by intermediate leaders. Should such conditions be repeated, however, the authority of intermediate leaders cannot but be shaken even in Japan.

It is because the management took this point into consideration that a wage hike of more than four percent in real terms was carried out in the 1981 Shunto. This percentage of a little above four percent corresponds to a three-percent decline in the rate of rise in the consumer price index and a one-percent hike of wage rates.

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(10) " The consistency with the economy " may mean that wage rates are fixed on the basis of their relationship with the rate of economic growth, the price level and the performance of exports and imports which would become the premises. The problem, however, is whether an agreement could be reached on these premises. This way of arguing, therefore, is only shifting the point at issue.

C) *Japanese–style Incomes Policy (The Effect of Confucian Ethics).*

The concept of Japanese–style incomes policy has been contrived with the aim to explain the reality of Japanese society having an eye to what actually arose in Japan. This concept explains the reason why the top executives of Japanese society who felt that they were confronted with a crisis of the Establishment were contended with the reduction of corporate profits without causing an increase in costs to be fully reflected in a price rise.

I think it is the effect of Confucian ethics which exists in Contemporary Japan. Needless to say, the Confucian ethics I mention here does not mean such metaphysical doctrine by which our ancesters in the Edo Era attempted to understand all phenomena ranging from cosmos to personal matters. It is unlikely that such special dissertations on Confucianism as the teachings of Chu–tzu and the studies of Chinese classics or classical sentences have had an effect on the managerial stratum of Modern Japan in their own way.

Ei'ichi Shibusawa who was the most important fixer connecting the political world with business world in Japan of the Meiji Era and established a large number of modern enterprises wrote in his later years a book entitled " Rongo Kogi " (a lecture on the Analects of Confucius). This is comparable with a Rockefeller's authorship of " A Lecture on the Bible. " Shibusawa states in the preface of the book that the nation–building by the Meiji government and the laying of the foundation of the Meiji economy were mostly based on the introduction of European styles and that the teaching of Confucius was treasured up in memory as a guiding motto for individual life.

Now, when I make reference to the effect of Confucian ethics, the element which I want to express by it is the point which somewhat differs from the emphasis of the significance as a guiding motto for individual's life of Shibusawa type. It is the contention of the principle of moral government which could be found in the Book on Administration of Confucian Analects and the argument for making moral king which was made clear later by Mencius. And in the light of the actual achievements in Japan, it is the precept of " concerning oneself with the future of the country before the people begin to do so, and seeking one's own pleasure only after the people are assured of their happiness " of Yozan–Uesugi type.

The personal element which propelled Japan's modernization after the Meiji Restoration was " samurais " (worriers) in the Edo Era, and not the people who belonged to agriculture, manufacture or commerce. Though there were cases in which the people belonging to commerce formed "Zaibatsu" (big business concerns), those were only solitary cases where they could adapt themselves successfully to the progress of the new age. And in many cases they were forced to fall; and the latter instances were ordinary cases. It is needless to say that the education and culture of the samurai class who played active part in the aspect of man power in the modernization of this country after the Meiji Period were Confucian. Since an overwhelming majority of students in government– and privately–run schools in the initial period were of the ex–samurai class and they supported the official and business worlds in the subsequent period, it is certain that Confucian ethics formed their backbones.

In this regard, the influence of practical ethics (Sekimon Shingaku: Doctrine of Mind) which nurtured the minds of those belonging to commerce upon Japanese society after the Meiji Period may not have been so large. The significance of the discussions which R.N. Bellah took this something like Protestant ethics in M. Weber's theory may need further examination. (11) It may be the teaching of Sontoku Ninomiya that one should live within his means and be dilligent which was supported by "Hotokukai" (Association for Moral and Economic Teachings of Sontoku Ninomiya established in 1906) which has exerted stronger influence than practial ethics has on popular ethics after the Meiji Era.

After the end of the World War I, Zaibatsu contributed money to Hotokukai as a measure to counter the thought problem, many people joined it from Social Policy Study Association, and the Ministry of Education assisted it in propagation by publishing a story on Ninomiya in a textbook on morals or erecting a bronze statue of his. Sontoku Ninomiya invested his originalities based upon Confucianism.

The problem is to make clear the circumstances how such way of thinking or feeling is exerting influence on Contemporary Japan.

In this regard, the fact that Mr. Masa'atsu Yasuoka, a noted scholar of Chinese classics, now gathers many audiences from the business and political worlds may explain the circumstances a Confucianistic sense is still alive in Japan. It is also suspected that the Confucianistic element which has permeated into popular ethics is being reproduced and exerting influence continuously in our society. The concept of concern in advance and happiness later which was cited previously is one of its examples. It is rather wondered to what extent the Western elements

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(11) R. N. Bellah, *Tokugawa Religion* (1956). Bellah though that what correspondend to Protestantism in Weber might be practical ethics (Sekimon Shingaku) in Japan. I am, however, skeptical of it for the reason mentioned in the text.

which were introduced after the Meiji Era have been adopted into Japan except universal knowledge and technologies of natural science and engineering. It is true that our life style has changed conspicuously since the Meiji Era. These changes, however, have been brought about mostly by changes in hardwares and in a comparatively lesser extent by changes in softwares.

Though I have already touched from time to time upon the contributions which the three factors which have so far been explained have made to the solution of the problems of Japanese society after the oil crisis, I will try further their general summarization in this place.

First, at the time of the first oil crisis those in the main stream of the business world of this country made a choice of reducing the profits of corporate enterprises rather than cutting salaries of their employees because they became aware of the crisis of Establishment. This enabled the stabilization of WPI and lowering of the rate of wage hike at the time of the 1975 Shunto. The same things were repeated in 1976 too, bringing safely to a close the economic adjustment in the wake of the first oil crisis. (12)

Since this started from the reduction of corporate profits, it could be said to have followed the concept of " concern in advance and happiness later "; and this is the reason why they are said to have been influenced by Confucian ethics. Such a thing will be never dreamed of by entrepreneures in Western Hemisphere. If motivated by Western–style concept, they will contrive for maintaining sales–profit ratios high and this will induce laborers' efforts to maintain profit–wage relations unchanged only to cause inflation to continue forever as a consequence under zero growth rate.

It is Thatcher's effort that is aimed at beating her country out of such situation by an iron arm.

Now, what has arisen in Japan after the second oil shock?

When the increase in the nation's import bills resultant from the rise in petroleum prices is divided by GNP, the quotient is the same 3.3 percent for both the first and second oil shocks.

Even if, however, the degrees of economic shock were equal, there was all the difference in the degrees of psychological shock. This is

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(12) " The Long–Term Vision of the Industrial Structure in Fiscal 1974 " made public by the Industrial Structure Council gives in page 28 the policy targets for the period from fiscal 1974 to 1976 which comes under the medium–term adjustment policy. The compatibility of these targets with the actual results may be said to have been excellent from the international standard. (The author took responsibility for the work of establishing these targets.)

This work determined in its basic story the contents of subsequent long– and medium–term projections of Japanese economy made thereafter by government and private institutions.

because it was the second time and also because the rate of price rise was lower since the nations of the world adopted restrictive measures in precaution against inflation as it was the case with West Germany at the time of the first oil crisis.

Entrepreneures of this country, therefore, did not consider this time that it was necessary to save the situation by cutting back their profits. Rather, they considered contrariwise that they should earn more profits, increase investment and add to competitiveness. This was to display intergroup dynamics. When management took such a way of thinking, labor could not but take their turn to shoulder the cost of adjustment by moderation of wage demands due partly to weaker power relationship. This resulted in a minus growth of real wages. Such was the significance of the 1980 Shunto. Should such event be repeated, however, intermediate leaders must be deprived of their posts in their organizations even in Japan. In the 1981 Shunto, therefore, negotiations were settled in such a manner as to compensate labor for this loss in real wages as already mentioned. It may be said to have been the outcome of social consensus. The adoption in Japan of an intertemporal incomes policy was enabled in this way by the existence of these three elements, which will continue their existence throughout the 1980s? Perhaps this will be a plus for Japan. How will it be in and after the 1990s.

3) *Japan's Economy and International Economic Policy in the Post-Oil-Crisis Period.*

Japan's current-account balance of international payments after the oil crisis has been nearly in equilibrium with a cumulative surplus of $ 3.3 billion in the eight years from fiscal 1973 through 1980. In contrast, the long-term capital balance suffered a deficit every year with the cumulative deficit in the same period reaching $ 35.7 billion; and as a consequence, the deficit of the basic balance amounted to $ 32.4 billion in a cumulative total.

What is meant by these figures is that the international payments position has been a constraint which could not be disregarded in formulation of domestic and international economic policies in Japan.

Relations between Japan's international payments position and its domestic economic policies will be examined below.

First, in the period of medium-term adjustment lasting from fiscal 1974 to 1976 Japan strived desparately for normalizing mutual relations among price, wage and profit. This problem was almost solved as expected thanks to the structural flexibility of Japanese society. During this period Japan was too much occupied with domestic issues to consider international economic problems. Thanks, however, to its desperate application of adjustment measures, the rate of economic growth slowed down, prices became stable and the current-account balance of international payments came to equilibrium in fiscal 1975 and registered a surplus of $ 4.7 billion in fiscal 1976.

There were two causes for the improvement of the balance of payments position in fiscal 1976. Firstly, it was because North American and European countries which reduced their stocks of goods in 1974 and 1975 in a row replenished the stocks all at once. Their purchases of residential houses, passenger cars, furniture and electrical home appliances and investments in equipment and inventories suddenly turned to an increase; and economies grew at the highest rates in the post-oil-crisis period in many countries under the leadership of the United States. It was natural that Japanese exports advanced. The second is the stabilization of prices in Japan.

The policy recommendations which economists from Japan, North America and Western Europe made on November 4, 1976, at the end of tripartite meeting in Washington, D.C., that the U.S., Japan and West Germany should play a role of locomotive to pull all other advanced nations out of their economic plights seems to have been a timely present from the Brookings Institution which sponsored the conference to Mr. Jimmy Carter whose election as U.S. President became certain on the previous day. I remember that as a participant in this meeting I wondered with interest if the United States would put this recommendation into practice. After taking his post as President, Mr. Carter cancelled a considerable number of the public pledges he made about economic stimulation during his electioneering campaign. Perhaps he might have been right.

People are surprisingly unaware of the fact that Japan enforced a "locomotive" policy. Japan adopted a positive fiscal policy issuing more deficit-covering bonds in fiscal 1977 and 1978 with the improvement of the international payments position and the price stabilization of fiscal 1976 as a background. The Japanese government had been issuing deficit-covering bonds for some time for the reason already explained. On this occasion, however, deficit-covering bonds were issued additionally in order to implement a positive fiscal policy. Out of the 5.3 percent economic growth in fiscal 1977, government spendings accounted for 1.8 percent which brought the rate of contribution to 33.8 percent; and out of the 5.2 percent growth in fiscal 1978, government spendings accounted for 1.7 percent, bringing the rate of contribution to 32.4 percent. In contrast, in fiscal 1976 government spendings accounted for only 0.15 percent out of the 5.1 percent growth, bringing the contribution rate to 3.0 percent.

In fiscal 1977 the surplus of the current–account balance of international payments increased to $ 14 billion. This expansion of the current surplus caused the yen's exchange rate to rise and Japanese real exports to flatten out in fiscal 1978. The yen's exchange rate of Y 201 to the U.S. dollar in fiscal 1978 was higher than in fiscal 1980 (Y 217).

The Japanese economy in fiscal 1979 and 1980 was affected by the second oil crisis. The current balance of international payments swung to deficits of $ 13.9 billion and $ 7.3 billion respectively. Nevertheless, economic adjustment within the country progressed comparatively smoothly as already mentioned.

Next, let us look at the changes in Japan's trade structure before and after the oil crisis.

The United States clearly declined in relative importance as a Japanese export market. Though the share of European Community increased somewhat, other advanced countries declined in importance as well. As a consequence the share of advanced countries dropped from 54.6 percent of Japan's total exports before the oil crisis to 47.1 percent after the crisis. The share of developing world in Japanese exports grew from 40.3 percent to 46.2 percent since Japan's exports to the Middle and Near East rose sharply and exports to other developing nations also increased at comparatively rapid rates. Exports to centrally–planned economies also rose from 5.1 percent to 6.7 percent of the total exports. Though there is a sharp increase of OPEC's imports from Japan as a reason for the better performance of Japanese exports to the developing and centrally–planned economies than that of its exports to developed economies, one could cite additionally the more rapid economic growth in these countries than in advanced countries.

In the commodity–wise distribution of Japanese exports, machinery and equipment alone increased their share. Among general machinery, electronically–operative machinery added to the share substantially. Among electrical machinery, the shares of newly–developed electronic apparatus increased more rapidly than those of TV, radios and tape–recorders. Among trasport equipment, motor vehicles rose in importance notably. Among precision instruments, electronized goods also increased the share rapidly. In short, Japanese exports owe its success to electronization.

It is worthy of notice that iron and steel has been losing in the share. Chemical goods also have been sluggish. The decline in the share of textile and other light industrial goods is conspicuous.

Table 1 – Regional Distribution of Japanese Exports before and after the Oil Crisis

(in percent)

	Average for 1970–1972	Average for 1977–1979
U.S.A.	30.9	25.2
European Community	10.2	11.5
Australia & New Zealand / South African Republics	5.0	4.2
Others	8.5	6.2
Avanced countries, total ...	54.6	47.1
Southeast Asia	23.9	23.5
Middle and Near East	3.6	10.8
Latin America	6.5	7.0
Others	6.3	4.9
Developing Countries, total ...	40.3	46.2
Centrally–planned economies	5.1	6.7
Grand Total ...	100.0	100.0

Source: Ministry of International Trade and Industry, *White Paper on International Trade 1980.*

Table 2 – Commodity–wise Distribution of Japanese Exports before and after the Oil Crisis

(in percent)

	Average for 1970–1972	Average for 1977–1979
Foods	2.8	1.1
Textile & its products	11.4	5.2
Chemicals	6.3	5.5
Nonmetallic mineral products	1.7	1.4
Metal and its products	18.6	17.2
(of which, iron & steel)	14.0	13.0
Machinery and equipment	49.8	62.4
(of which, general machinery)	10.5	13.8
(of which, electrical machinery)	14.6	16.4
(of which, transport equipment)	21.2	27.4
Motor vehicles	9.1	15.6
Ships	7.8	7.1
(of which, precision instruments)	3.5	4.8
Others	9.4	7.2
Total ...	100.0	100.0

Source: MITI, *White Paper on International Trade, 1980.*

Table 3 – Regional Distribution of Japanese Imports before and after the Oil Crisis

(in percent)

	Average for 1970–1972	Average for 1977–1979
U.S.A.	26.4	18.3
European Community	5.9	6.8
Australia & New Zealand South African Republics	11.4	8.5
Advanced countries, total ...	53.3	39.8
Southeast Asia	17.1	22.5
Middle and Near East	14.2	27.1
Latin America	6.7	4.1
Developing countries, total ...	41.8	55.4
Centrally-planned economies	4.9	4.8
Grand Total ...	100.0	100.0

Source: Ministry of International Trade and Industry, *White Paper on International Trade, 1980*.

Table 4 – Commodity-wise Distribution of Japanese Imports before and after the Oil Crisis

(in percent)

	Average for 1970–1972	Average for 1977–1979
Foods	14.7	13.7
Crude materials	32.7	19.9
Mineral fuels	23.2	41.3
(of which, crude oil)	14.8	30.9
Chemicals	5.1	4.6
Machinery and equipment	11.7	7.6
Miscellaneous manufactures	12.6	12.9
Total ...	100.0	100.0

Source: MITI, *White Paper on International Trade, 1980*.

In exports, Japan's adaptability to the changing situation is fairly high with respect to both markets and commodities.

In imports, the relative weight of oil–producing countries has been growing remarkably; and the share of advanced countries has been falling that much. The European Community, however, has been increasing the share in Japanese imports as well as in its exports.

In the commodity–wise distribution of Japanese imports, crude petroleum has increased the share from 14.8 percent to 30.9 percent while other commodities have been compelled to lose in the shares that much. It should be noted, however, that the share of foods has hardly declined and that manufactured goods of various kinds have not lost much in the share. On the other hand, the share of crude materials dropped from 32.7 percent to 19.9 percent. This is attributed to the fact that the Japanese industrial structure has been changing in a direction toward economization of raw materials. When calculated in real terms, conservation of energy will naturally become clear.

The share of manufactured imports in the nation's total imports excluding mineral fuels has grown from 38.3 percent of the pre–oil–crisis period to 42.8 percent of late. This computation does not include the increase in the share of processed foods. It may be said, therefore, that an increase in the share of manufactured imports in Japan's total imports has become an unquestionable trend. It should be noted that the share of miscellaneous manufactures among others has grown from 12.6 percent to 12.9 percent.

We must here touch upon the problem of trade frictions Japan confronts with.

The shift of industries from advanced countries to latecomer countries has been taking place far more easily in the post–World–War–II period than before the war. This is proved by the fact that newly industrializing countries (NICs) have been propelling industrialization at a rapid pace. And Japan itself was a NIC twenty years ago.

The central issue of international economic policies under such conditions will naturally become the problem of industrial adjustment. The industrial adjustment problem consists of two parts. The one is industrial switchover or rationalization in advanced countries and the other is voluntary export restraints in late–comer nations. The object of voluntary export restraint is to give industrially–advanced countries the time to convert their industries to other industrial lines or rationalize them. And an international rule to contrive reconciliation of the interests of the two parties concerning such industrial adjustment should have been the safeguard clause of the General Agreement on Tariffs and Trade (GATT). The revision of the GATT's Article IXX, however, was not carried out in the Tokyo Round. There exists, therefore, no viable international rule to solve the current trade frictions.

Japan was blamed repeatedly in the past on a charge of having caused trade frictions in respect of various kinds of goods. However, it has so far worked out case–by–case compromises on them. Being a people who apply Confucian ethics to solution of their domestic economic issues, the Japanese are believed to be taking fairly flexible attitudes in solution of international economic problems too. The problem lies rather on the side of a country which demands Japan to exercise self–restraints.

Could Western countries carry out strictly the conversion or rationalization of their industries while they are forcing Japan to restrain its exports? Could they put into practice the positive adjustment policies ("PAPs") which the OECD advocates? Under the present condition, the possibility may be rather large that they may manage the situation with negative adjustment policies (NAPs).

This is because the problem of economic or industrial policies has already ceased to be the problem of policy techniques and is now becoming the problem of social philosophy which lies at their back. And the "north–wind" policy which is based on the philosophy of power does not seem to be effective policy. It is, however, also a fact that there does not exist other possibilities in Western countries at present. The problem is that much serious, therefore.

4) *Conclusions — The Way the Government's Medium–Range Outlook Should Be.*

In the latter half of the 1980s real development of energy sources which substitute petroleum will be placed on the right track and the upsurge of crude oil prices will slow down at the same time. And some advanced countries will see an improvement of their international payments positions. This implies that aid flows to non–oil–producing LDCs will increase. In short, if the world economy tides over the first half of the 1980s, it will begin to improve from the latter half of the decade.

We may need to have a medium– and long–range outlook about international political issues, Islamic religious reform in the Middle and Near East, possibilities of technological breakthroughs, problem of ideological changes, problem of making the large government smaller, social issues of various kinds, problems of changes in economic systems and changes in industrial structure, etc. The JERC has been striving to make projections on these problems.

And there is no doubt that all of other advanced countries too need to have an outlook of their own on these issues.

The problem, however, is who should make such forecasts.

In Japan the government still makes such projections. It is, however, difficult for governments to publish figures about foreign exchange rates, the rate of wage increase and the like. This gives rise to such strange thing as their projections make no mention of these variables. There are, therefore, such countries as France which has changed the system so that the government does not make such projection by itself but a government-affiliated thinktank does it.

When I was in the government in 1968 as director of the international trade research division at the Ministry of International Trade and Industry, I made a projection of the world trade matrix for the period from 1970 to 1980 and predicted an increase in Japanese surplus in its trade with the U.S. and an appreciation of the yen's exchange value due to an expansion of the surplus of its current-account balance of international payments. Though they were confidential materials, my predictions leaked to the press. As the Japanese government was protested to by the U.S. government against these predictions, I was placed in an awkward position. The projection was first-rate as an academic product, and the government could not dispose of it all the more for that reason.

I believe there has been no change in the fundamental circumstances since then. Any prediction the Government makes is subject to diplomatic and political constraints of various forms. Therefore, it may be difficult for the Government to make projections which are not only helpful but also near to the truth. It is, therefore, considered that private research institutions which are able to go into things which are hard for the Government to deal with should make such projections voluntarily. Fortunately, there are in Japan a considerable number of private research institutions which make such projection. There are, however, many instances that projections they make are not substantial because of financial constraints since no public assistance is given to such work.

There are, in addition, many problems in the methodology of forecasting. It seems to be difficult to penetrate into economic phenomena with the method of quantitative analysis now available. Forecasting is a prediction of human behaviors. Experimental psychology, however, deals with only simple phenomena which have no bearing on human reality and, therefore, is not helpful at all. No philosophers are able to fully grasp human being in daily life. According to Martin Heideggar (Sein und Zeit), daily life is nothing but the Verfallen of Existenz. (13) Economic theories too have the big limits of their own. Thus, economic predictions would be required to conduct an interdisciplinary synthesizing work concerning human society. By the way, whatever elements should be synthesized?

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(13) Economic policies may need to be based on social philosophy, or more generally on philosophy; and philosophy, in its turn, may need to be able to position rightly the domain of economic value in human life. No attempt is being made to attain these goals: at present. And this may be one important defect of the human society of the present age.