Mr. Gundelach's speech (An EEC View Point) to the ABP Conference on THE INFLATION/EMPLOYMENT CRISIS - BUSINESS, TRADE UNIONS AND GOVERNMENT STRATEGIES Wednesday 24th March, 1976 2.30 p.m. (Sheraton Hotel, Brussels)

The recent years' upheavals on the international economic scene cannot but make us reexamine the economic decision-making process. Even some of the accepted economic theories may have to be reconsidered. However, I believe that the major problems lie in the political economic decision-making process, in particular in its adjustment to changed economic environment. On the outside, international cooperation must be radically strengthened. It is not good enough to discuss or negotiate trade, energy or monetary affairs in rather watertight compartments. The so-called social partners must be drawn closer to the decision-making process. Our fundamental problem - full employment without intolerable inflation - cannot be achieved without international cooperation on what matters: the basic economic strategy. Such a strategy can manifestly no longer be built exclusively on classical measures, hence the need for broader participation.

One of the major reasons why economic policy decisions have become more difficult is due to the de facto alignment of the business cycles in the western industrialized world. This alignment has been particularly pronounced in the economic upswing in 1972-73 and in the following recession which we now seem to be on our way to overcoming. We are all well aware of the extremities brought about by the fact that every country expanded economically at the same time which for instance led to the unacceptable inflation. On top of this high inflation due to an overheated economy, the energy price increase added considerably to the inflationary fire.

As we have seen, the reaction to this was one of a severe economic contraction. While the energy price increase was a very serious element in bringing about the high inflation, its balance of payments effects was a larger factor in bringing about the recession. Thus, the fact that the western industrialized world has been able to overcome the balance of payments effects of the oil price increase is only due to the serious contraction - which in itself was partly induced by the oil price increase - resulting in laying idle a large part of our productive capacity with

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consequent large unemployment problems. This price is obviously too high, and the way in which a new unstable equilibrium has been brought about bears the sign of economic mismanagement. While the inflation has been very persistent, as one would expect with the cyclical development we have had, it is now showing the decline which economic downturns normally bring about.

The fact that the industrialized countries have been able - at a cost - to overcome the balance of payments problems does not, however, mean that these problems have been overcome internationally. For the time being the problems have been pushed on to the developing countries, whose present enormous balance of payments problems could to some extent hamper the recovery.

It is an old truth that people's psychological reactions to business cycle swings tend to enforce those swings. Thus, when we have an upswing followed by increased inflation there is a tendency to save less. On the contrary, when there is a downturn the public becomes more prudent and tends to save more. This observation has not least been underlined during the last two years where uncertainty in connection with the oil price increase together with the general downturn brought about a very nervous climate with subsequent big increases in savings. It is obvious that the real impact of these psychological reactions has made the task of implementing counter-active economic policy extremely difficult.

Another psychological element which adds to the uncertainty of improvements in the employment situation is that the decreased job security has brought about a stability in the work force resulting in large productivity gains. This will cause a continued unemployment problem during the first phase of the coming upswing, a problem which might be confused with structural unemployment.

It is quite obvious that it is of utmost importance that such business cycle swings as we have seen recently and which have been approaching uncontrollable levels are avoided. If we cannot avoid these, our whole economic system will come under an intolerable strain.

In the course of the last few years some of the traditional economic truths have come under heavy strain. One of the problems is that of extreme currency changes. It used to be accepted that balance of payments problems could be solved through devaluations. The recent experiences of the UK and Italy seem to contradict this, and the devaluations have in any case made the inflation problem much worse. Apart from the internal problems arising from rapid devaluations, our most recent experiences have again made it clear that they also bring the basis for our economic system in danger. This is so because the nervousness related to currency crises in connection with their effects on international competition brings out the protectionistic tendencies in our societies. The nineteen thirties showed us the effects resulting from the prevalence of protectionism. Fortunately, we have during the recent downturn been able to contain the protectionist elements within fairly reasonable limits, but the currency crises could easily have been the element leading to a serious set-back in our striving towards a free exchange of goods, which is the backbone of the prosperity of the western world.

While currency adjustments might have been the correct medicine to apply in a world where the dollar provided a large stable basis, the change in the relative strength of the world's economies has underlined the interdependence of the economies and has also widened the responsibility for maintaining a stable economic system. It is thus clear that European countries cannot to the same extent as earlier solve economic problems among themselves through currency adjustments without severe economic repercussions, but must put much more emphasis on avoiding internal economic mismanagement.

The recent experiences suggest that while currency adjustments may in the short run be able to sustain a national economic expansion, contrary to international economic development, such a policy is in the long run not possible, as the inflationary level will soon reach an unmanageable rate. Recent economic experience has thus with extraordinary force underlined that economic problems are not solved on a national level but must be solved through internationally coordinated policies. This obviously applies fully to all the European economies, but increasingly also to the American economy.

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The point made is underlined by the mere fact that for each exporter there must be an importer. Attempts to push the balance of payments problems on to one's trading partners can only give rise to repercussions and protectionistic tendencies.

It has also become more and more clear that the structural changes involved in rapid economic growth require more attention than hitherto. I shall revert to this problem. The special structural problems created in connection with the energy price increase, i.e. those related to development of alternative energy resources and to exporting in order to compensate for the loss in terms of trade, have increased the general structural problems somewhat. In order to solve these problems it has become more and more clear that a continuous dialogue between the social partners is necessary not least in order to widen the understanding of the underlying economic realities, so as to avoid disruptive runaway inflation. In this connection agreement on incomes policies in accordance with the overall productivity increases in the economy is essential.

While I do underline the importance of incomes policies and dialogues between the social partners, I am nevertheless convinced that no such dialogue about immediate problems can replace the seeking of not only national but international consensus on a new economic strategy.

We know for example very well that it is not so difficult to carry out incomes policies when there is little need for them, i.e. when we find ourselves at the bottom of the business cycle. On the other hand, when incomes policies are really needed to avoid runaway inflation, i.e. at the top of the business cycle, then these policies are extremely difficult to carry through. Even if we had the full commitments to such policies by unions and employers' organizations, it is fairly obvious that these organizations do not have the necessary control over their members in a tight labour market. We must therefore not be satisfied with attacking the symptoms of our economic problems, but we must consider the basis of the problems.

The background for a successful outcome of social partner dialogues and incomes policies is therefore a stable economic development. How do we then create a more stable economic environment than we have seen for some time?

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As I mentioned before, the alignment of the business cycles in the western world has made economic policy making a much more difficult task. This is so because errors in the policy making in one country are not offset by a counterdevelopment in another country but even reinforced. I do think we must admit that the long lag which exists between an economic intervention and the time when the result of this intervention shows up as changes in employment and economic activity makes economic policy a very difficult task for politicians. The politicians are for the most part very much geared to the situation existing at any given point in time and somewhat less to the events which are likely to happen in 6 or 12 months' time. There is therefore always a great risk that if careful analyses are not undertaken, the political decisions may worsen rather than offset the swings in the business cycle.

My first recommendation for creating a sound economic environment is then that economic policy decisions must be internationally coordinated. After some initial difficulties the value of establishing economic guidelines within the Common Market is becoming more recognized. However, the results are until now far from satisfactory as events show. Whilst the carrying out of this work on a Community basis must be our first responsibility, economic guidelines must also increasingly be coordinated with the US, Canada and Japan. With the weight now carried by the oil producing countries, these should also be brought into the picture.

Europe's problems cannot be solved by empty talk about monetary and economic union. It is a necessity for the Common Market to bring order in its own economic house. If this cannot be done, Europe will not be counted for much when it comes to settling international economic affairs. The primary task is to undertake a policy of economic convergence among the Member States.

As far as the international aspects are concerned, I am not thinking of the creation of new institutions, as the economic policies are not carried out by international institutions. But I am thinking of coordination of the major monetary and financial policy guidelines.

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My second recommendation is that, in view of the mentioned difficulties concerning the correct timing of economic policy decisions, we should seek to adopt some more or less automatic guidelines concerning monetary expansion, and even similar measures could be undertaken concerning financial policy. Such guidelines should be geared to decrease the cyclical variations in monetary expansion and the variations in expansionary and contractionary budgetary and financial policies. The overall expansionary effect should be closely connected with the increase which can reasonably be expected in production - that is growth. While such a policy should not take away the responsibility of the governments in relation to economic policy - they would, indeed, have to decide on the guidelines - it would have advantages in as much as the business cycle swings could become less drastic.

National economic policies must be much more geared to maintain stable currencies than has been the case recently. In relation to the US and other industrialized countries the present system of floating should be maintained and controlled so that exchange rate adjustments are geared to reflect changes in competitive positions, while speculative tendencies should be forcefully counteracted.

While the aim in the Common Market must be fixed exchange rates and eventually a common currency, it will in any circumstances take considerable time before the economic policies can be brought to converge to such an extent that this aim is attainable. In the meantime we must allow for controlled exchange rate adjustments to reflect changes in competitive positions. For Europe such a policy includes the problem of monetary expansion. The problem of strengthening the currency intervention system is a secondary aspect, as the exchange rate problems are the symptoms of badly coordinated economic policies. However, this does certainly not imply that I underestimate the value of the "snake" arrangement. On the contrary, this arrangement is very essential and should as soon as possible be enlarged to include all the Common Market countries under proper Community institutions. However, we must ensure the basic economic policies which can keep the "snake" system intact. In fact a stricter discipline in general economic policy is required.

If we can succeed in providing a more stable less inflationary economic background, we will create a valid basis for tackling what I will call the related aspects: dialogue among social partners, long-term structural

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problems, incomes policies and workers' participation in the company decision-making process. All these aspects are essential in our battle against the present unemployment and inflationary problems, of which some may be of a more persistent character.

My third recommendation is consequently to ensure that employees and employers are being brought in much closer contact with government economic issues so that a better mutual understanding can be brought about. The instability and the recession we have experienced ought to provide the impetus for undertakings along these lines. We must not let a new economic upswing make us forget that we have not solved the basic problems as they are then likely to return with at least as much force as we have so far seen.

The Common Market Commission has brought forward several suggestions as far as the related policies are concerned.

A discussion paper - a so-called "green paper" - on workers' participation in the management of companies was sent out by the Commission last fall. The basic idea of this paper is to provide a framework for a rational discussion about how employers and employees best can be brought together in a discussion on how to solve problems of mutual interest. While many of these interests naturally concern day-to-day problems in the firms, the longer term objectives of employment and expansion cannot escape the interests of both parts. These longer term interests must necessarily be seen in the context of general economic policies. A framework for bringing together the social partners with the responsible political leaders of economic policies has on a Common Market basis been initiated through the so-called Tripartite Conferences. In a Company Statute providing a common legal but optional basis for the Community, the Commission proposes workers' participation on the Boards of Managements.

Concerning the continuing structural problems in a rapidly growing economy, it is clear that the European countries must - like their competitors - give the necessary support to technologically advanced industries, so that new frontiers can be gained as we, in the interest of international cooperation, must let the developing countries get a fair part in the production of industrial goods for which we can provide essential markets. The impetus to the advanced industries - particularly research and development related to such industries - can most rationally be given on a Community basis.

This industrial development policy would also be of importance in overcoming what at the moment seems to be indications of structural unemployment problems. Nevertheless, the solution to the unemployment problems connected with a more and more automated industry will continually lie in expansion of the service sector, including public service. While immediate adjustments in the public service sector can be necessary, there is little doubt that we, in the longer run, will demand more service also from this sector. It is clearly a responsibility for the Community - and the Commission fully for its part accepts the responsibility - to establish whatever programmes of concrete measures to combat unemployment which developments call for. The Tripartite Conference referred to offers a suitable occasion to discuss such measures, but such concrete measures - retraining, cutting working hours, compensations, etc. - will only have their desired effects if they are elements of an overall economic strategy.

As I have mentioned, the developing countries must be allowed to have their share of industrial production. However, we should not forget that we also have distributional problems within the Common Market. I do understand that certain Member Governments are reluctant to go along with the continuous increase in agricultural expenses, question the efficiency of some other expenses and demand budgetary discipline. Nevertheless, if we want the Community to survive, we must accept that we have problems with our geographical distribution of wealth and unemployment, and we must also accept the budgetary consequences for alleviating these problems.

In the Commission's economic policy recommendations we have for some time put emphasis on the necessity of reasonable incomes policies so as to secure employment uninterrupted by large business cycle swings. In this connection I would, however, again underline that the related policies, which include incomes policy and intervention in currency markets, have no chance of surviving if the basic economic policy decisions do not provide a sufficiently stable framework.

It is my hope that our recent experiences have taught us such a lesson that we immediately try to tackle the basic economic problems. We are likely to enter a superficially calmer economic period before the next gale.

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We must use this period for reflections and initiatives which can alleviate the business cycle swings. A coordinated economic policy can, however, hardly be undertaken without engaging the different partners in our society in a dialogue of mutual long-term interests. If we fail to provide a framework for sufficient economic stability, the future strains on our society may become acute and confrontations so violent that basic political and economic values in our society will be endangered.

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