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AMERICAN EUROPEAN COMMUNITY ASSOCIATION
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SPEAKING AT A MEETING AT THE UNIVERSITY OF NEW YORK ORGANISED BY THE AMERICAN EUROPEAN COMMUNITY ASSOCIATION ON THURSDAY 6TH JANUARY 1983, THE RT HON ROY JENKINS MP WILL SAY :

" The world is descending into the deepest slump for 50 years. And without a reversal of present policies all the indications are that it will get worse. Deflation is breeding protectionism, and each is feeding upon the other and making the outlook not merely bleak but menacing. If we take no action, present conditions may in a year or two's time make today's ills seem almost benevolent. We shall have thrown away the whole remarkable achievement of the quarter century from 1948 to 1973, which gave the Western world a greater prosperity and unity than it had ever seen before.

In these circumstances there is an immense need for imaginative and constructive statesmanship. Yet little has so far been forthcoming. Western leaders have either turned inwards and concentrated upon the problems of their own countries, with little regard to the repercussive effects of their attempted remedies. Or, on the rare occasions when they have raised their eyes wider, they have lectured others to be more restrictive. "Countries which have overspent and overborrowed must reduce their spending and reduce their borrowing" the British Prime Minister said in November.

Taken in relation to one country, this may sound good disciplinary doctrine. But applied widely across the world, particularly when accompanied by creeping protectionism, it is a recipe for the generation of a second great wave of recession. The further deflation

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of overseas markets can spell nothing but further economic trouble. Accompanied, as it may be, by the financial dominoes beginning to knock each other over, it could lead to a hitherto unprecedented disaster. The interests of the world economy as a whole, and of the United States and the European Community as economically crucial parts of the world, are the same: to reject deflation and protectionism and to work together for expansion of world trade and the revival of growth in our domestic economies.

I believe that this is the moment for the main trading countries jointly to proclaim a change of course. The world was catapulted into slump by the two great oil crises, and by the restrictive monetary policies with which governments sought to contain the inflationary consequences. The slump has been made worse by wildly fluctuating exchange rates which have discouraged the growth of investment and trade. It is nonsense to pretend that these fluctuations reflect reality. They do nothing of the sort. How can they when the yen has been depressed while Japanese exports have been sweeping the world? It is no longer trade patterns which set exchange rates. It is, perversely, exchange rates which set trade patterns. This danger is intensified as a result of the over-extended positions of many private banks because of their in itself desirable lending to heavily indebted countries. They are now naturally less willing or able to continue to lend and the supply of finance necessary to lubricate the wheels of trade is being withdrawn.

But circumstances are changing, and as they do so a window of opportunity for effective concerted action emerges. The oil price has stabilised and is far more likely to fall than to rise significantly in the foreseeable future. The rate of inflation is declining around the world and interest rates have at least temporarily come down. As world-wide concern about unemployment mounts, circumstances have become propitious for an international initiative to save

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the world from the disaster which continued adherence to previous policies will bring. Opinion is, I believe, turning here in the United States. Monetary targets are effectively abandoned. There are increasing numbers, including some in influential places, who see the fight against inflation, while in itself necessary, as an inadequate exclusive goal of economic policy. Concern is also rising in Germany as unemployment goes over two million even there. We should seize this moment, now at the beginning of 1983, to halt the Gadarene rush towards protection and launch instead a carefully ~~worked-out~~, responsible, but above all coordinated strategy for expansion of the world economy.

Such coördinated action will be required on three fronts :

First, joint expansion. If countries are successfully to expand, it is highly desirable that they should do so together. Otherwise, if one country makes a solitary "dash for growth", its expansion is likely to be abruptly ended by balance of payment difficulties and the inflationary pressures which follow from a collapsing exchange rate. Coordinated expansion is far more easily sustainable. It was planned for at the Bonn Economic Summit in July 1978, in which, as President of the European Commission, I participated together with the heads of government of the seven Summit nations. There, following previous expansionary moves by both the United States and Britain, Japan undertook to raise its growth rate by 1.5%. Germany in turn took action to raise its GNP by 1%. And France, Italy and Canada all undertook to make contributions of their own.

The conventional view is that this exercise was misconceived But this is a superficial view without considering the reason why it did not achieve a sustained drive to its objectives. It was quite simply aborted by the second oil crisis, which ushered in the general move towards restrictive policies and carried us all into the great slump. That lion is no longer in the path, and shows no sign of returning. The rationale of Bonn remains

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valid, and my first proposal is that now there should be a major political effort to revive it. Relatively small adjustments to the fiscal stance of the major countries involved could produce significant increases in GNP and reductions in unemployment. The world could gradually be led out of recession by imaginative decisions such as Keynes propounded and Roosevelt took.

There is no contradiction between concern to correct the medium term ''full employment deficit'' and a willingness to apply some short-term stimulus in conditions well short of full employment.

Second, monetary stability. Coordinated expansion will not succeed unless exchange rates are given a reasonable stability. If they are allowed to fluctuate wildly and often irrationally, they become the enemy of world trade and of international investment. They also stimulate protectionist forces in those countries whose currencies are forced too high. But we should not be utopian. The economic performance of countries inevitably varies in terms of growth in productivity and comparative inflation. We cannot therefore just proclaim a new regime of fixed exchange rates and expect it to stick. The simple re-establishment of the Bretton Woods system of fixed rates, great though were the benefits which flowed from it, is not a practical option today. Apart from anything else, the United States discovered in 1971 that it could no longer sustain the solar role in this system which it had so honourably discharged for 27 years.

Yet there is mounting disillusionment with freely-floating currencies. Experience of these has not been that they adjust gradually and smoothly, keeping payments in balance. On the contrary, exchange rates have lurched wildly from one extreme to another - in the US/British case from a pound/dollar rate of 1.60 to 2.40 and back again. And not only have they been unstable, but they have shown a capacity to stay well out of line - in terms of relative inflation competitiveness and balance of payments - for long periods. The pound is over-valued by a good 30% compared with its 1975 level. The dollar has been so by about the same amount - although less so today than a month ago. The yen is at least 12% down from its rational level. In Britain's case, the result has been to destroy competitiveness and accelerate de-industrialisation. In the case of the United States, the effect has been to revive long dormant protectionist instincts.

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The markets themselves cannot and do not ensure that currencies adjust to reality so as to keep foreign payments in balance and employment reasonably full. What is required is a system of exchange rates which broadly maintains the competitive position of one economy against another and avoids the short-term fluctuations which are damaging to trade and devastating to investment decisions.

I believe that substantial progress could be made on a trilateral basis between the US, the members of the European Monetary System, which should ever more obviously include Britain, and Japan. Each bloc would define a "target zone" for its currency within which the value would be free to vary. This should, in present circumstances, be wider than the old Bretton Woods margins. Perhaps the 6% margins which the Italian lira has within the EMS would be reasonable. From time to time the central rates would be shifted upwards or downwards according to medium-term changes in relative competitiveness, which would embrace inflation differentials. Monetary policy would be used to keep the rates within the zones. They should not be permitted to go outside in response to speculative movements or short-term factors. Adequate swap agreements, which are not difficult to secure, can iron out disruptive short-term waves, although they cannot - nor should they - obviate the need for responding to a long-term swell of the ocean.

The new tripod would form the basis of a new, stable, but not rigid international monetary system. It would be possible and desirable for other countries strongly dependent on one or other of the blocs to tie their currencies to the dollar, yen or European ECU. To take European examples, the Austrian schilling and the Swedish krone would obviously move in general with the ECU.

<u>Third</u>, finance for the developing world. The risk of a knock-on collapse of the banking system cannot be ignored. It is of course not certain. It should not be exaggerated. But it is there. And increased risks mean that private financial

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lending is being much reduced. If the expansionary strategy outlined above is put into operation, and growth rates in the industrialised world raised as a result by an average annual rate of about 1%, World Bank estimates suggest that large increases in the flows of both official and private finance to developing countries would be needed if general sustained expansion were not to be frustrated by credit constraints. There should be at least a doubling of International Monetary Fund quotas and a fresh issue of Special Drawing Rights - preferably angled in favour of developing countries; and there should be a major extension of "co-financing", which means close cooperation between the official institutions and private banks.

The private banks need sufficient confidence to continue lending on the scale required. This means help with debt servicing for those developing countries whose total exports barely cover their interest charges. It means support for the new $20 billion IMF fund for use in cases like the recent one of Mexico. This is not soft-hearted generosity. It is imaginative self-interest for the Western world such as was spectacularly shown by the United States at the time of the Marshall Plan which led to the most economically successful years in the recorded history of the world. It also led to the most freely accepted period of unchallenged American leadership of the West and of much of the rest of the world as well. That cannot be wholly recreated in its old form. The past can rarely be set upon its throne again. Leadership must now come from both sides of the Atlantic and the United States and the European Community must be careful not to let their trade differences undermine the necessary political partnership.

The first two proposals would provide a context within which expansion could restart - measured, balanced, sustainable expansion - and the third would ensure that it would not run into a barrier of markets blocked by penury. The essentials are more stable currencies and a world of good neighbours.

A far-sighted recognition of interdependence served us far too well in the days of mounting prosperity, which did not start easily, for us to turn our back on it in the harsher circumstances of today. They are the keys which will unlock the gate of escape from the threatening dungeon of deflation and protectionism. They alone can once again give us the realistic prospect of restoring jobs growth and the expansion of trade.''

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