Economic Imbalances and stabilization policy

The experience of European Countries

The first oil crisis posed an unfamiliar dilemma for the European countries. According to the established view at the time unemployment could be combated by means of economic policy such as fiscal and monetary policy. In a similar manner inflation could be dealt with by means of restrictive fiscal and monetary policy. However not both phenomena could be treated by the same means of economic policy at the same time. Dealing with both phenomena simultaneously was not considered possible because if the state aimed at maintaining employment at high levels by means of expansionary policy it would accelerate inflation and would therefore create more constant inflationary expectations.

If on the other hand the state decided to give higher priority in combating inflation it would have to restrain the already curbed demand even further in order to force firms to keep prices down. This restrictive policy would lead to a reduction of production and investments and therefore to a reduction of employment. Unemployment would probably develop to a permanent phenomenon which could not be overcome later on by a rapid expansion of demand.

This dilemma was confronted by various countries according to the political priorities of their governments, the institutions available to them and finally according to economic and social conditions.

Significant factors which had an effect on policy formulation were the balance of payments deficits, the way trade and labour unions were organized, the collective negotiation process, the central bank's autonomy and among other the existence of an organized labour market.

Austria for example managed to have the best results with respect to the goals of the increase of the national product, the reduction of inflation and the curbing of unemployment. The United Kingdom was less successfull Sweden maintained high employment coupled with a high inflation rate. The Federal Republic of Germany experienced a decrease of inflation at a higher degree as compared to the other countries but it also experienced an increase in unemployment.

The answer to the question of how to combat unemployment and inflation simultaneously could be given by means of income policy which restricts the increase of labour costs per unit of product at a level lower than inflation while at the same time expanding demand by means of fiscal and monetary policy

The labour unions therefore have to accept a policy which does not lead to a winding wage and price increase. Thus the government would be able to expand demand and avoid the reduction of employment. This of course presupposes a balance of payments which does not pose serious deficits.

This view as expressed by Scharpf does not reflect the experiences of OECD' countries after 1981. Today the prevailing view accepts that beyond anti-inflationary incomes policy a restrictive fiscal and monetary policy is also required if an effective cure of macroeconomic imbalances is aimed at.

The solution followed in Austria secures satisfactory results, however on a temporary basis only. As observed in Austria itself such a policy contributes to the maintenance of non-competitive industries. Its consequence is ailing industries and a reduction of the economy's competitiveness. Employment remains at the same level by artificial means and the problem of unemployment is postponed for later.

This is why in Spain and Portugal socialist governments made use of a restrictive monetary and fiscal policy along with an anti inflationary incomes policy. Stabilization policy and especially the degree restriction will be imposed upon public expenditures and financing can not be universally homogeneous.

It depends on the special characteristics of the economy especially on the room for maneuvering which is left by the level of inflation, the disposable productive capacity, the existing level of public debt and the balance of payments.

The key to success for dealing with macroeconomic imbalances lies on α) the coordination of fiscal, monetary, exchange and incomes policy, b) an antiinflationary incomes policy and c) the application of selected policy consistently and continuously.

The coordination of policy measures is necessary in order for the application of one measure not to cancel or strengthen to an undesirable degree the outcome from the use of the rest of measures.

For example in many countries the Central Bank applied a restrictive monetary policy. However governments applied expansionary fiscal policy. The result was high interest rates, exchange rates readjustments rapid increase of public debt and malfunctionings in the distribution of resources.

In the United Kingdom the offensive incomes policy on behalf of the labour unions coupled with an eased fiscal and monetary policy in the end of 1978 directed the economic policy of the labour government to partial failure.

Anti-inflationary incomes policy was proved to be an especially effective means of combating stagflation and rising unemployment. As compared to the other policy instruments it exhibits a unique advantage that is it simultaneously curbs domestic demand and restricts the impact of the increase in labour costs on the firms' costs. It contributes therefore to reducing inflation, to the enhancement of business' profits and investments and therefore to the safeguarding employment as well. It also contributes to the reduction of the balance of payments deficits which are due to very high domestic demand. It is finally effective in confronting inflation which is the result of increased demand.

As far as incomes policy is concerned the coordination of various policy instruments presupposes the existence of strong labour unions which are in a position to estimate the macroeconomic impact their stand toward policy instruments might have.

Small organizations restricted to special areas which are always competing each other raising there requirements are in no position to assist on an anti-inflationary incomes policy. Usually labour union organizations which are political party extentions take a negative stand. A small number of large labour unions is therefore required which cover a variety of labour branches and are in a position to discuss wages in central collective negotiations.

The systematic dialogue with labour unions is a prerequisite for the success of antiinflationary incomes policy. This dialogue should be carried out in a wider framework of discussions so that economic policy could be based on a wider social consent. This has been necessary especially since world economic conditions have increased the uncertainty of the course of events as well as the difficulty in making precise forecasts.

An active policy which is instrumental for the maintenance of employment is a policy for the expansion of the labour market by means of providing on the job training, specialization of workers, facilitating the search for work, establishing flexible working hours as well as part time employment.

Investments is a decisive factor not only for combating unemployment but also for confronting the problems related to the balance of payments. Investments depend primarily on profit margins but also on the stability of the course of the economy that is its consistency its continuity and its credibility.

Dealing with macroeconomic imbalances requires finally structural changes. Not enough significance has been attributed to this particular point after the first oil crisis and Scharpf has not emphasized it enough. After 1979 however it was confirmed that difficulties continued and could not be overcome to the degree originally expected. Thus the attention was directed toward market irregularities and malfunctioning. Anti-inflationary incomes policy operates as a mechanism which distributes wealth to the detriment of workers. Real increases remain small as compared to the increases of business profits and therefore the total participation of workers in the national product is reduced. This development is counterbalanced from the moment the cource of the economy allowes substantial real wage and salary increases without inhibiting the propensity to invest as well as the creation of new employment opportunities.

The usual objection toward an anti inflationary incomes policy is that labour unions can not contribute to the increase of the portion of capital when the national product is redistributed due to the stand they take. The improvement of the position of workers must be their principal goal. The labour unions' objection however would not be valid if in considering that the maintenance and further increase of employment is the labour unions movement's priority one realizes that this goal in an open free market economy can not be achieved by other means except by an increase of business profit margins.

The loss of income is nothing else but the workers contribution to a segment of the work force which would otherwise be left without a job.

The result of the international crisis is negative for the workers. They find themselves today under pressure due to necessities which they can not overthrow in the context of the existing social and economic framework. This is why socialist parties as well as labour unions should seek for goals and policy instruments which would stabilize and even change the cource of this negative development. These goals and policy instruments should be such that could not be part of the classical tendency of confrontation about claims for the level of income but would lead to participation in investments, in management and business profits as well as in planning for development and therefore in the process of molding society and social salaries.