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Can governments manage the economy?



Jim Tomlinson
Preface by Bryan Gould

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Preface

Bryan Gould

Jim Tomlinson provides us in this short study with a valuable antidote against the pessimism which sometimes grips the labour movement. All too often, we are told that a Labour government in Britain would be powerless to run the economy in the interests of working people because the globalisation of capital markets and the operations of multinationals render 'socialism in one country' impossible.

This is a counsel of despair. If we are to postpone socialist reforms until we have left governments throughout Europe and can co-ordinate reflation with them, we shall wait forever. The truth is that, while international co-operation with like-minded governments would be very helpful, there is much that can be done by a socialist government in this country to improve our economic performance and bring about socialist reforms.

Jim Tomlinson shows that the supposed obstacles to national economic policy making are much less serious than is commonly supposed. International capital movements on a substantial scale are by no means new; and while multinationals have great power, they are not irrational and will in the end respond to market conditions (which are very much within the control of national governments) just like any other economic actor.

These points are corroborated by the comparative study which Jim Tomlinson makes of the experience of the Wilson

government in this country, the Socialist government in France and the present government of Sweden. The crucial point of difference which he establishes between the failures of the first two and the success of the last is that Wilson and Mitterand allowed their real economy objectives to be subordinated to the monetary measures invented by the financial establishment (so that they spent a great deal of time and effort in propping up the exchange rate), whereas the Swedes were prepared to frame their interest rate and exchange rate policies in the interests of working people rather than of the bankers.

The lessons for the labour movement are clear. A Labour government which is hard headed enough to ignore the pressures and blandishments in favour of financial orthodoxy can achieve a great deal in promoting full employment and raising the living standards—in terms of both personal consumption and public services—of working people. This Fabian pamphlet will help to give us the courage to do precisely that.

Introduction

Perhaps the most striking feature of the development of the advanced capitalist economies in the middle third of the twentieth century was the rise of national economic management. Though there was no single form to the development, nor one accompanying politics, in almost all these countries the national economy was regulated in order to obtain some mixture of employment, growth, inflation and balance of payments goals.

Since the collapse of the post-war boom in the early 1970s there has been a growing chorus saying that the days of national economic management are over. One version of this thesis sees it in terms of the displacement of one economic ideology by another—Keynesianism by monetarism. More compelling is the version that focusses on changing structures of the world economy, which are said to undermine the conditions of existence of national economic management—for example, the internationalisation of capital.

National economic management is of key political importance. On the right the demise of such management can be welcomed as a liberating return to "realism"; this attitude has been taken by the current Conservative government, especially, of course, in its attitude to employment policy. For the left the alleged demise is much more problematic. There are those who have always been suspicious of any 'national' policy on the grounds of a vague internationalism. They welcome this alleged demise of the conditions for national economic management as laying the basis for an international economic policy approach, especially focussing on a co-ordinated reflation of the West European economy.

Allowing for the moment that indeed it is true that the days of national economic management are over, the road to a co-ordinated European economic policy looks very hard. On the one hand it would require as a *political*

condition that pro-reflation governments were simultaneously in place in the major Western European countries. This seems a long shot under current political conditions. In addition, from the purely British point of view, a co-ordinated reflation would be likely to pose severe problems for the British balance of payments: putting some or all of the over three million unemployed back to work would substantially increase the demand for imports. This is not to be interpreted as "anti-European-ism", rather as realism about what can be delivered by European (EC) wide strategies.

An alternative view from the left would be that the demise of national economic management would be a serious blow to the electoral prospects of the left, because successful economic management is a key aspect of successful government and hence electoral support. This is perhaps especially so for left governments, because their always difficult relations to capitalism make them particularly prone to accusations of economic mismanagement.

If it is true that national economic management is a thing of the past the political consequences are enormous. It would mean that much of the traditional approach of left governments to the economy would have to be abandoned. It is far from clear that there is a non-utopian alternative which could offer reasonable prospects of managing the economy at a multinational level.

Given this background, the purpose of

this pamphlet is to examine how far the conditions for successful national economic management have indeed been eroded. It first of all examines those changes in economic structure which are said to have undermined such management. Then it looks at three countries as case studies. First at Britain and France, where the experiences of

the mid-1970s and early 1980s respectively have been used to argue that national economic management is no longer viable. The third country, Sweden, is used to examine how far these structural changes in the world economy can be offset by appropriate policy measures.

1. How has the economy changed?

The belief that the scope for national economic management has declined is usually based on some combination of one or more of three features of the modern advanced capitalist economies: the growing dependence of those economies on international trade; the internationalisation of financial markets with massive flows of capital in and out of countries; the growth of multinationals. Before discussing the impact of each of these, it is useful to put recent changes in some historical perspective.

Views of changes in the possibilities of economic management often depend on trends since 1945. A different picture emerges if a longer time span is considered. Broadly speaking, in the decades before 1914 international economic integration was growing apace. This was then reversed by the First World War and the succeeding depression of the inter-war period,

capped by the impact of the Second World War. Since 1945 integration has again grown apace, but from much lower levels than existed in 1914.

This pattern is most readily demonstratable in quantitative terms for trade openness. Table 1 shows how the ratio of trade to national income has fluctuated for three countries through the twentieth century. It reveals that for

Table 1
Ratio of Trade to GDP (%)

	Britain	France	Sweden
1905-14	48.6	-	40.3
1965-75	35.2	28.6	42.1
1982-85	46.5	39.0	55.1

1905-14 and 1965-75 for Britain and Sweden, S Grassman, Long-Term Trends in Openness of National Economies, Oxford Economic Papers (1980). 1982-5 for all countries, and all French calculations—own calculations, on same basis as Grassman.

Britain at least, the economy is no more dependent on foreign trade in 1982-85 than in 1905-14.

One reason why these figures do not show a strong trend (if any) towards more openness is that each country has over the twentieth century seen a large rise in the share of output taken both by government and by services. As both of these are much less internationally traded than manufactures, their growth in share of output has reduced the vulnerability of total output to external forces. Another way of saying this is that international trade in manufactures has grown very rapidly, and increasingly dominates overall trade, but manufacture's share in domestic output has fallen in almost all advanced countries.

Whilst trade/income ratios give a reasonably straightforward measure of trade openness, vulnerability to flows of capital is much more problematic to measure. Grassman uses the net capital flows (measured as the residual of the current account balance) relative to national income. Over a short period this is clearly a dubious procedure—financial openness is seen to fluctuate with the trade balance. But for long periods this measure may be reasonable, and it shows a *fall* in the importance of capital flows in all major capitalist countries (see Table 2: the higher the ratio, the greater the openness to capital flows).

This long-run pattern is less surprising if one thinks of the scale of capital flows before the First World War—especially for Britain with its Empire, formal and informal. These reached the unparalleled level of 10 per cent of national income in peak years, 6-7 per cent over the years 1900-13. If ever a

world capital market existed, then it was in this period.

Pointing out these long-run trends is important to correct the view that large-scale capital flows are a recent phenomena. But it cannot tell us about the forces that motivate such movement. In a neo-classical world a perfect international capital market would be characterised by a single interest rate (allowing for risk): a small national government could borrow as much as it liked at the going rate of interest, or at worst pay a slightly higher figure to compensate for perceived increased risk. But like most neo-classical stories this one seems implausible; experience shows that capital flows are dictated by subjective judgements, and that countries can rapidly lose the confidence of international investors (as will be discussed below).

In addition to the scale of foreign investment, there is the question of the volatility of such flows. Obviously if funds move with great rapidity and in an unpredictable manner, this poses serious difficulties for national economic management. It is impossible to measure, but it is almost certainly the case that such flows are today more volatile than in the past. However, this is not necessarily caused by the same developments as the long-term trend in international capital markets. Some part of this increased volatility is probably due to features of the international economic environment such as floating exchange rates which may be temporary developments. This point is returned to in the conclusions.

Until recently the growth of multinational enterprise was seen very much as a feature of the post-war world. The

Table 2
Openness to Capital Flows

	Britain	France	Sweden
1905-14	6.61	—	2.01
1965-75	1.17	1.59	1.02
1982-86	1.10	0.99	1.48

Sources as Table 1.

capital flows of the pre-1939, and especially pre-1914 world, were seen as overwhelmingly portfolio investments, held by individuals or institutions at arms length from the entity invested in. But recent work has emphasised that such a view is erroneous, and has arisen partly from the greater measurement of typical portfolio investments in government debt. Dunning has recently summarised current knowledge on the pre-1914 period in this area thus: "There is also little doubt that, from the viewpoint of some home and host countries, foreign direct investment, both as a channel for the transfer of resources between countries, and as a means of controlling the use of these and complementary local inputs, played a no less important role than it has done since the mid-1950s, and a far greater one than it did in the inter-war period" (in M Casson (ed) *The Growth of International Business*, Allen and Unwin, 1985).

The overall picture of the world economy conjured up by these trends is

not one of unprecedented economic integration arising anew in the 1970s and 1980s. Whilst strongly integrative forces are no doubt at work, there are both offsetting trends (growth of the public sector) and substantial ambiguities about the appropriate measurement of these trends.

Of course, before 1914 national economic management was hardly on the political agenda, so any clash between such management and the integration of the world economy was muted (though a country like Argentina's frequent departures from the gold standard suggests such clashes were far from unheard of). It is only with the mass unemployment of the 1920s and 1930s that economic management becomes a central political issue. Nevertheless, it is a misleading perspective on the prospects for national economic management to see these developments as wholly new, creating newly unfavourable circumstances.

2. Is economic management still possible?

Whilst changes in the structure of the world economy are less fundamental than many have suggested, do they nevertheless make national economic management less credible? This chapter examines the three developments sketched out above to see if they present insuperable obstacles to managing national economies—growing openness to trade; greater internationalisation of financial markets; and the growth of multinational companies.

That national economic management is rendered more problematic the greater the openness of the economy to international trade has been recognised from the beginnings of such management. In broad terms this openness would appear to inhibit such management in two

ways. Firstly, it exposes the economy to external shocks—summed up in the old saw that "when America sneezes, Britain catches cold", and recently amply demonstrated by the impact of the two oil price shocks. Secondly, greater openness reduces the impact of

domestic policy instruments on the national economy; for example, if the government stimulates the economy, this may raise imports rather than domestic output and incomes.

Both these aspects are old commonplaces of basic macroeconomics. But what needs to be stressed is that such openness to trade, whilst a constraint on national economic management, is not of the same character, and not so serious, as the internationalisation of capital markets and the growth of multinationals discussed below. Unlike these other elements, there is an essentially passive, non-reactive character to the trade constraint. External shocks (such as the two oil shocks at the beginning and end of the 1970s) are not *aimed* at inhibiting the functioning of national economic management. Whilst they may cut across such management, they do not interact with such management in the sense of involving a strategic game between the 'shockers' and the managers of the affected national economies. Equally, in the case of imports substituting for domestic output this is an 'unintended consequence' of the relative competitiveness of domestic and foreign output, not usually part of a deliberate attempt to reduce or offset the aims of national economic management.

In addition, trade openness is not simply a structural feature of the world economy, a feature whose effects are beyond the reach of policy—governments can act to manage their effects. The oil shocks, for example, may pose difficult problems for all those countries with substantial oil imports. But they do not necessarily imply a rise in inflation or unemployment ie a failure of policy measured by the two most important indices. (Other things being equal, it does involve a fall in real incomes in the importing country, because of the change in the terms of trade.) As will be discussed below, some national economies were able to escape the worst consequences of these shocks by effective management.

As regards the sucking-in of imports,

this of course does reduce the impact of domestic stimulation. But this is a serious problem only where domestic capacity is either so fully utilised or inefficient that any domestic stimulus leads directly to serious payments difficulties (assuming offsetting exchange depreciation is not a viable option). In other words, openness to imports will only put a complete bar on domestic management if either the economy is already fully employed, or is suffering from chronic uncompetitiveness. In the first case domestic stimulation is not necessary; in the second there is clearly a policy problem, but not one arising from openness *per se*. If the economy is generally competitive, national economic management is still feasible in an open trading economy.

Capital flows

The second change in the world economy of great importance to national economic management has been the growth of capital flows over the post-1945 period. As already suggested above, what may be important to these flows is not their scale so much as their motives for movement. Thus Michael Stewart argues that capital flows may tend to be deflationary in effect. If a country is deflating its economy, capital will flow in, thus reinforcing the policy by driving up the exchange rate, with its deflationary effects on the trade balance. Conversely, an expansionary policy is likely to lead to capital fleeing the country, reducing the exchange rate and leading to a rise in inflation which will soon force the reversal of expansion (*Controlling the Economic Future*, Wheat-sheaf 1983).

That processes of this kind have taken place in recent years seems indisputable. However, there is a danger of over-generalising from the two cases which seem to show such features—Britain and France. There seems to be a larger menu of policy choice than is suggested by too mechanistic an application of this

asymmetric approach. The British and French cases will be looked at in more detail later (along with the Swedish), but here two general points can be made.

First as Stewart rightly makes clear, international flows of capital do not move automatically in relation to a simple index, as neo-classical accounts tend to suggest. Rather their movement depends on specific forms of calculation regarding the perceived effects of a national government's policy. This involves relatively straightforward elements like interest rates and expected changes in currency value, but also complex assessments of both the economic and political implications of a policy.

Secondly, these calculations are made by a diversity of economic agents, with no single 'master' calculation involved. The "world financial community" as described by Stewart may for some purposes be treated as a single economic agent, but just like the traditional categories of agent called 'capital' and 'labour', treatment in this way can be highly misleading. This is both because under some conditions the "world financial community" may be less important than the domestic financial community, and because the calculations of the "world financial community" are not necessarily unified.

The point of importance in relation to the constraints on national economic management is that international capital flows should be seen not as automatic but as a consequence of the characteristics of the relevant agents and their calculations, both of which may be seen as the object of policy measures. Of course, the scale of capital flows does provide a structure for leverage over national economic policy which would not exist if all national economies were wholly insulated. But it does not thereby involve any necessary consequences.

Multinationals

If financial flows have dominated dis-

ussion of the possibilities of national economic management in the 1980s, multinationals played a similar role in the 1970s. Typical of this argument was Stuart Holland's *The Socialist Challenge* (Quartet, 1975). Here the growth of multinational "mesoeconomic" firms undermines the effectiveness of all the major instruments of macroeconomic policy, as they plan their strategies on a global scale and directly act against any national policies damaging to such strategies.

That multinationals have become more significant over the post-war period hardly seem disputable. What seems much less clear is whether they have led to the scale of loss of national economic sovereignty that Holland and others suggest. Two elements need to be disentangled in assessing this.

First, the long-run consequences of multinational forms of organisation for capital mobility. Multinationals may act to transfer capital from areas of lower to areas of higher returns, and over a long period such sustained movements may clearly damage a country's economic base. But this result cannot be reduced to the effect of multinationality. First, capital will always tend to flow out of countries where returns are poor to those offering higher returns—multinationals may simply ease a process which would exist without them. Furthermore, where there are substantial net capital outflows from an economy this is usually a *consequence* of the failure of national policies to raise efficiency in production, rather than a cause of such failure.

Second, multinationals will have an impact on macroeconomic policy such as management of the exchange rate and credit control. But the impact of multinationals *per se* needs to be disentangled from the general impact of the scale of international transactions. For example, multinationals undoubtedly will speed up/slow down currency transactions in order to benefit from any exchange rate changes, and in so doing make exchange rate controls less useful.

But this would be true of any economic agent engaged in international transactions. Similarly, the availability of credit in 'foreign' centres undercuts monetary policy in a domestic economy. But again such funds can be deployed outside the context of multinational firms.

Clearly, if all multinationals were organised on a global basis, and orders on their behaviour simply travelled from global headquarters to branch plant, the problems for national economic management would be severe. In practice the picture is far from so simple. Many multinationals do *not* pursue global strategies. In addition, they are constrained in pursuing such strategies as they do have by both economic factors (eg the fixity of many of their assets which militates against rapid changes of policy), and organisational ones, the impossibility of running a large organisation as a strict hierarchy in which orders move from top to bottom and are simply and unproblematically implemented. It may also be a mistake to suppose that all economic pressures tend towards global strategies. For example, recent emphasis on 'just-in-time' sourcing of

components in manufacturing may imply some trend towards more use of local suppliers. (Under 'just-in-time' sourcing, long-term, constructive relationships are established with local suppliers in order that large manufacturers can order what they want when they want.)

In sum the role of multinationals, separate from the scale of international transactions, seems commonly exaggerated especially in relation to short-run economic management. Over the longer run they may prove central agents in the process of a country's economic decline, but to focus on their role in such a process seems largely to put the cart before the horse.

Finally, it is striking that in recent discussions of the problems of national economic management in Britain in the mid-1970s and France in the early 1980s (returned to in the next chapter) so little is heard of the role of multinationals. Even Holland's account, whilst repeating the arguments of 1975 on multinationals, focusses attention on capital flows as the basis for the recent failure of economic management (*Out of Crisis*, Spokesman, 1983).

3. Britain in the 1970s

The question to be asked in this chapter is how far Britain's experience in the mid-1970s can support the view that single country reflationary economic management is no longer a viable option. Britain is a good example to look at, not only because the events of the 1970s have commonly been used in this way, but also because it clearly is an economy highly integrated into the rest of the world. It has high trade/GNP and capital/GNP ratios, and is also probably the most dominated of all major OECD countries by multinational enterprise. For example, 70 per cent of all those employed in manufacturing are in multinational firms.

The context of the Labour government's attempts to defy the deflationary pressures in 1974 to 1976 has two important

elements, one international, one national. On the international side the context was, of course, the first oil price

shock, the most serious deflationary pressure on the world economy in the post-war period. In January 1974, Britain joined with other major capitalist countries in agreeing not to deflate domestic demand to offset the balance of payments consequences of the oil price rise. But Britain was almost alone in sticking to this pledge.

Second, the election of the Labour government was based on the battle of the previous Heath government with the miners. The importance of this was that the victory of Labour compounded the already very powerful pressure towards a public sector wage explosion, by making it politically very difficult for Labour to resist such claims. Both these factors are important in any judgement of the significance of the subsequent events.

The unsurprising consequence of Britain's 'go it alone' policy was a sharp deterioration in the balance of payments. The deficit on current account rose from 1.4 per cent in 1973 to 4 per cent of GDP in 1974. This led to a fall in the exchange rate which, coupled with a domestic pay explosion, compounded the rapid rise in inflation. But it is important to note that both these problems were already reducing in scale well before the sharp reversal of policy in 1976 when loans were sought from the IMF. The incomes policy introduced in summer 1975 was followed by a sharp fall in the rate of inflation which peaked in August, and the balance of payments improved, albeit slowly, so that in 1975 the current account deficit was down to 1.5 per cent of GDP.

The loss of confidence in sterling in 1976, which precipitated the policy reversal of that year, seems to have been caused by two elements:

- a belief that the Bank of England was eager to encourage a further fall in the £ (it was \$2 in March 1976, compared with \$2.40 a year earlier) —this provided a strong encouragement for anyone to move out of sterling;
- the rise in public expenditure and the

parallel rise in public borrowing which, especially because of the explosion of public sector pay, was the particular form that expansionary budgetary policy took in this period.

The issue of importance here is how things might have been different, even given the international exposure of the economy. Any answer to this must be counterfactual, and hence speculative. It must also take into account that, apart from the level of international integration, there were other features of the British economy that over the short period of a couple of years have to be treated as given:

- Britain's long-standing weak competitive position in international markets;
- the financing of government borrowing through sales of gilt-edged stock to private institutions which gave those institutions very great leverage over government policy;
- the fact that domestic capital markets were completely dominated by private bodies, without trade union or other forms of more public regulation, meant that there was little institutional-cum-political inhibition on capital flight (a point particularly important in relation to Sweden, as discussed below).

Even given these constraints it is possible to argue that a policy of reflation which was coupled with an effective incomes policy, focussed expenditure on areas other than the public sector wage bill and was less ambitious *initially* might have prevented the 'boom and bust' sequence that occurred. Such a course would have depended on a series of political conditions that are fairly remote from the actual situation at the time. Nevertheless, the point here being made is not that such an alternative was readily available, but that it was not available for reasons which have much more to do with the nexus of union/labour rela-

tions, the ideologies and practices of the left, than with international economic integration *per se*.

But it was the political context of the Labour government's assumption of power in 1974, coupled with the unprecedented nature of the world depression, which made its position so difficult. In combination with those

features of the British economy noted above, the task was, *as of 1974*, a fairly hopeless one. Nevertheless, the lessons to be drawn from this period are not all the impossibility of national economic management under current international economic relations. This general point is returned to in the final chapter.

4. France in the early 1980s

Like Britain in the mid-1970s, France in the early 1980s had a socialist government which pursued economic policies of a reflationary character, which then had to be reversed. Like the British, the French case has been used to argue against the possibility of a single country reflation (but see Denis MacShane, *French Lessons for Labour*, Fabian Tract 512, 1986). Like the British, the French case is clearly pertinent to the general issue of international dependence; France has high trade/GNP and capital flow/GNP ratios, and though a newcomer, has quickly become an important country for multinational enterprise activity.

Like Britain a few years earlier, the French Socialists came to power in a very adverse international economic context. The French balance of payments had not fully adjusted to the second oil price rise by 1981, and was quickly plunged into the consequences of what we can call the Thatcher-Reagan depression, as these countries responded to the oil price and its consequent rise with their own sharply deflationary policies. The US economy's condition in the first 18 months of the Socialists' rule is indicated by the fact that American industrial production fell by 10 per cent from mid-1981 to the end of 1982.

If the British government of 1974 might be said to have had a naive faith in the sanctity of international agreements in expecting non-deflationary policies in other countries, the French

government seem to have had a similarly naive faith in the reliability of economic forecasts. At the time of the Socialists' accession to power, all the major international and French forecasts suggested an upturn in the world economy in 1982. This failed to materialise, and the policy quickly became one of reflation in a deflationary world.

Secondly, the political context of the Socialists' accession to power was dominated not by the role of unions as in Britain, but by expectations of immediate and substantial increases in social welfare. Whilst fully explicable given the long dominance of the right in France and the manifest inequalities of income, a commitment to greater spending on welfare makes a successful reflation very difficult.

The French policy of reflating in a

deflationary world led inevitably to balance of payments problems, downward pressure on the exchange rate and rising inflation. Even allowing for the inaccurate forecasts of world growth in 1982, the government would have been forced to devalue the franc as part of a reflationary policy. Unfortunately, like the British Labour government of the late 1960s, it resisted devaluation until forced into it, and thus undermined financial confidence.

The focus on social welfare improvements had two implications. It led to a sharp rise in deficits in the social welfare funds and the national budgets. And, via increases in the SMIC (minimum wage), it drove up labour costs, the latter also being hit by a statutory reduction in the working week. As in Britain, both the rapidity and the purposes of the rise in public spending and the budget deficit led to a loss of financial confidence. The rise in labour costs meant a reflation that was not 'supply-side friendly' and therefore did not have the effect on employment that might have come from an alternative package.

Like Britain, France pursued policies which were not congenial to financial opinion, domestically or internationally, and this led to a flight from the currency (though not immediately). However, this did not force the same kind of crisis in France; there was no recourse to the IMF and no specific package of deflation suggested in order to secure funds from an external body. Rather the key element seems to have been the Socialist government's own political calculation that the accumulation of a growing external debt, the counterpart to the balance of payments deficit, could not be allowed to continue. (This partly reflected changes in the political balance within the Socialist coalition.) This point needs to be stressed, because the French government does not seem to have had any problems in financing either its internal or external debt as Britain did in the mid-1970s.

The other important difference to Britain was the role of the trade unions. Where in Britain the unions' role was

central to the government's position, in France unions never had more than a passing role in government decision making. Whilst consultation was radically extended in the first period of Socialist government, there was none over the wage and price freeze which was introduced in June 1982 as part of the first reversal of policy. This reflected the deep-seated weakness of French trade unionism, its low membership (20-25 per cent of the workforce), and its highly schismatic structure and politics. In Britain part of the problem was the politics (in the broadest sense) of a unified and large trade union movement; in France the unions were never very significant actors in the policy-making process.

Defeat

The period of French Socialist government was by no means an unmitigated disaster—unemployment, for example, rose much less rapidly in France than in Britain over the same period. Ultimately, however, the Socialists suffered a severe electoral defeat (in 1986), and this obviously prevented them carrying through much of the radical reform package of 1981. Was this the inevitable consequence of ignoring the constraints imposed by the international economic structure?

Setting aside the over-optimistic forecasts of prospective world growth in 1981, it still seems to be true that the consequences of French politics for the exchange rate were not properly appreciated. Again, somewhat parallel to the British Labour government of the mid-1960s, there was a hope that industrial policy could so revive industry as to avoid any devaluation resulting from the reflationary policy. In the longer term such a focus on industrial policy appears much less pie-in-the-sky in France than in Britain; but in the short run, industrial policy cannot be an alternative to macroeconomic measures.

Secondly, and however difficult politically, the French government needed to

go much more slowly on the improvement of publicly-financed welfare benefits if these were not to undermine its reflationary stance. the same can be said about measures which had the effects of sharply raising labour costs at the same time as emphasising employment creation as a policy objective.

Finally, the capacity to borrow abroad does not seem to have been a problem for the French government. In this context one must question the political calculation that a growing external debt was politically insupportable. The French government remained credit-worthy on international financial markets through 1982, which was not true of the British government in 1976.

Overall, the same general points can

be made about France as about Britain. A more (initially) cautious reflation, more 'supply-side friendly' than those actually pursued, might have mitigated the loss of financial confidence which both suffered from, though this does not seem to have been such a compelling constraint in France as in Britain. Both attempted to pursue reflation in an unusually unpropitious international environment; but it cannot be said either that the international conjuncture or the structure of the international economy ruled out a reflationary policy *ab initio*. Much of the problem in both countries lay as much in the internal policies of the ruling group and its allies, as in the external economic environment.

5. Sweden in the 1980s

Sweden, like France and Britain, is highly integrated with the international economy. Trade and capital flows form a substantial ratio to GNP, and multinationals are very significant; relative to its size, Swedish manufacturing industry ranks as one of the most multinational in the world. As is very well known, Sweden combines these characteristics with a highly successful macroeconomic performance, most notably registered in the unemployment figure, which is currently around 3 per cent, and has never risen above 4 per cent in the 1970s and 1980s.

Enormous amounts have been written on the conditions of success of Swedish economic policy. Here the objective is to focus on one short episode, the reflationary period from 1982 and to contrast the success of policy in this period with the relative failures, already discussed, in Britain and France.

The Swedish economy did not escape the pains of the oil shocks of the 1970s. It accumulated a string of current account deficits, which together raised foreign debt to 20 per cent of GDP by

1982. Employment in manufacturing fell by 74,000 between 1970 and 1980, and most job creation was in the public sector, with half a million extra jobs over the same period. The counterpart to this was a growing public sector deficit from 1978, peaking at 13.2 per cent of GDP in 1982.

The strategy launched in 1982 was one of export-led growth, fed by a devaluation of 16 per cent. To accompany this, fiscal policy was mildly deflationary (peaking at a fall in the budget

deficit of 2.2 per cent of GNP in 1984), thus offsetting part of the expansionary consequences of export growth. The objective of the policy was not only to return to a 2 per cent unemployment target, but to shift resources from the government to private sector investment via increased profits. The policy has been a success. Exports rose sharply in response to the devaluation, unemployment fell, and industrial profits rose.

Such a policy success was plainly conditional on a number of features of the Swedish economy. First, devaluation has increased exports partly because of the renowned *quality* of Swedish goods; in Britain especially, such a policy may not be successful, given the poor non-price characteristics of British goods and the seeming inability to compensate for these characteristics by lower prices in many market sectors, where consumers are unwilling to trade off poor quality against cheapness (K Williams et al, *Why Are the British Bad at Manufacturing?* Routledge & Kegan Paul, 1983). This export-led growth, focussed on investment goods, has also no doubt been aided by the sophistication of Swedish technology—Sweden devotes the highest proportion of its national income to research and development in the OECD. In sum, Sweden is in an especially strong position to expand exports, given its very strong manufacturing base.

Secondly, the devaluation worked because it was not followed by a wage explosion in Sweden. The reasons for this are highly significant. Partly it was because the Swedish unions accepted a fall in real wages in return for employment maintenance by government labour market programmes. Partly it was because of the acceptance by the unions of the need to raise industrial profits in order to raise investment. This was made palatable by a substantial move towards the socialisation of investment through the introduction of the famous and controversial wage-earner funds, which vested a growing proportion of company shares in union-dominated pension funds.

In this way Sweden was able to pursue a reflationary policy which did not have to be rapidly reversed as in Britain or France. It worked despite Sweden's deep enmeshing into the world economy.

What the Swedish example shows is the interdependence of industrial, macroeconomic and 'social' policies. Under current conditions a successful industrial base pushes out the constraints on macroeconomic policy enormously. But it does not guarantee macroeconomic success, which also requires a capacity to gain a wide consensus for policies, or to impose them on an authoritarian basis. In Sweden, as in Norway and to a lesser degree, Austria, such consensus has been achieved by a 'corporatist' agreement between unions, employers and government. (This is not the only path to macroeconomic success, but the other major examples—Japan and Switzerland—have achieved their goals partly either by authoritarian government or forced emigration, which hardly make them examples to be followed.)

Part of this corporatist arrangement rests on the existence of a unified, well-resourced and ideologically sophisticated trade union movement. It also rests on a recognition that macroeconomic policy making cannot be treated as separate from political issues such as the control of investment and the wage structure.

Finally, it is important to note that whilst policy was changed in 1982 following a period of accumulating fiscal deficits, this change of direction was not forced on the Swedish government by any loss of confidence and capital flight. Sweden was easily able to finance a growing external debt at the end of the 1970s and beginning of the 1980s. Domestic capital was increasingly under the control of pension funds which made them politically different animals from private investors in Britain or France. This is another area where successful macroeconomic policy is linked to broader policy objectives, in this case the socialisation of investments.

6. Conclusions

This pamphlet has attempted to assess how far changes in the structure of the international economy have undermined the possibility of national economic management. The broad conclusion is that whilst such structural changes have rendered such management more difficult, it has by no means confined national economic management to the "dustbin of history".

Openness to trade, to financial flows and the rise of multinationals do not automatically render national economic management impossible. The first and third of these in particular render an efficient manufacturing base all the more important. Trade openness is manageable as long as there are possibilities of export promotion/import substitution to offset adverse external payments position. The scope of multinational enterprises has the same implication. They help canalise foreign investment flows, though overall "the reallocation of resources brought about by multinational enterprise activity is... extremely marginal compared to that caused by the underlying changes in international cost and demand conditions to which multinational enterprises and others respond" (M Swedenborg, "Sweden" in J Dunning (ed) *Multinational Enterprise, Economic Structure and International Competitiveness*, Wiley, 1985). "Underlying cost and demand conditions" are not beyond national government control.

Capital flows have been highlighted in much recent discussion of the problems of national economic management. This emphasis is probably correct, especially for Britain. But as the examples above have shown, the degree of financial confidence is by no means an automatic consequence of a particular government policy—witness recent gyrations in confidence in the US dollar. Rather it relates to both the structure of domestic capital markets (including how closely they are integrated with international markets), and to the calculations employed by

financial markets in responding to government policy. The policy implication is partly the obvious one, to emphasise the need for a degree of caution in policy so as not to lose such confidence. But there are more radical measures which can reduce the leverage of such markets over state policy, and here France in a small way and Sweden much more radically show what is possible.

Until the 1980s France was reasonably successful in insulating domestic credit policies from policies designed to influence international capital flows. Credit ceilings operated via both public and private financial institutions were used to guide domestic investment levels. Exchange controls were also employed to help exchange rate policy. However, there has been some retreat from this since 1985, despite the nationalisation of much of the remaining private financial sector during the Socialists' period of office.

In Sweden, whilst exchange controls have been used, seemingly the most important element in insulating the capital market from the vagaries of international financial confidence has been the dominance of politically-regulated investing institutions (especially pension funds) which have been a very effective barrier against capital flight. Recently Sweden has, with many countries, moved to 'liberalise' parts of its financial markets, but has been careful to try and combine this with continued dependence of domestic investment funds on domestic sources.

As suggested in the general discussion of openness above, it is important to dis-

tinguish long-run trends in capital mobility from what may well be more passing features of the world economic framework. In particular, as everyone knows, there is an enormous volume of funds flowing in and out of the City of London and other financial markets, much of which is clearly speculative in the sense that it involves purchases of foreign exchange not as instruments of other economic transactions but in order to make profits/avoid losses on fluctuations in the price of foreign exchange.

This explosion in the volume and volatility of short-term capital flows can largely be accounted for by the breakdown of the Bretton Woods exchange rate system. The volatility of exchange rates and interest rates which has followed from this breakdown has created enormous incentives for corporate treasurers to deal in the foreign exchange markets on an ever increasing scale. In addition, the failure of floating exchange rates to equilibriate current accounts of the balance of payments has required much greater offsetting capital flows to give overall balance to the balance of payments.

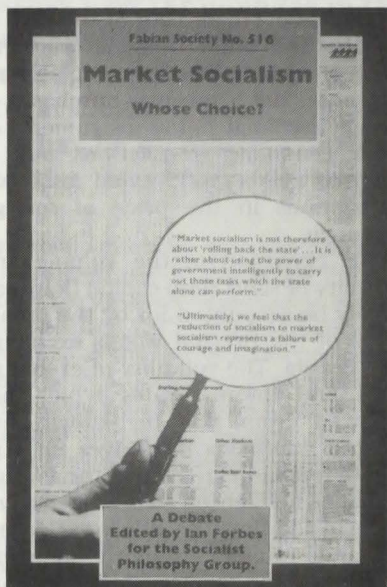
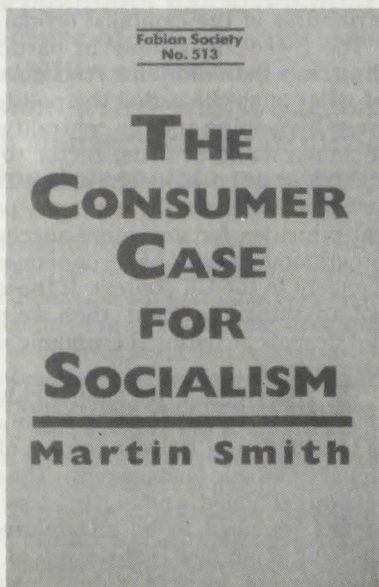
The important point in the current context is that a large proportion of the current capital flows are due to quite specific institutional problems, *not* to secular trends in the level of integration of the world economy. This is not, of course, to say that these problems can be easily righted (see S Strange, *Casino Capitalism*, Basil Blackwell, 1986), but that it would be wrong to put these

flows on a par with the increasing trade dependence of national economies and increasing multinationality of production, which are clearly longer-term trends more deeply embedded in the structures of the capitalist economies.

The Swedish example in particular illustrates the continuing crucial nature of what might be called the politics of wage bargaining and the centrality of a dynamic manufacturing sector to the success of macroeconomic policy. These two points indicate the necessary political priorities for any more successful programme of national economic management in the UK context. If these are got anything like 'right' then we need not despair of national economic management.

The argument of this pamphlet is not that we can return to the halcyon days of the 1950s and 1960s in respect of national economic management. The context *has* changed, and in particular this means we need to be imaginative in thinking about new *instruments* of that management, an area of debate which logically follows on but cannot be pursued here. The political implication of the position taken in this pamphlet can however be briefly re-emphasised. It is above all that the successful pursuit of national economic management is not a chimera, or a lost cause to be abandoned. For the foreseeable future British Labour governments will have to deliver a degree of success in such management to survive electorally, and hence to be able to deliver all the other objectives socialists desire.

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