Western governments, faced with the economic crisis, have opted for restructuring through allowing the free play of market forces. The US is taken as a model. But can these policies really work?

StarSpangled Economies

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IN THE LAST few years, a consensus has been forming in the IMF and in the economic ministries of Washington, London and Bonn. This consensus is based on a common analysis of the long-term structural problems of Western industrial nations— that they have become too rigid, too insulated from the free play of market forces. In response, it is proposed firstly, to increase the 'flexibility' of the economy by making workers more willing to take any available jobs and by enabling firms to hire and fire as they please and secondly, to decrease the average wage of workers. The first set of policies is supposed to increase economic efficiency and the second is the proposed 'solution' for unemployment. By adopting these policies, we are assured, Western economies will be able to attain high rates of economic growth without inflation. As the main evidence cited in favour of this approach is the supposed superior performance of the US economy, we must ask whether the 'US model' actually delivers the goods, and how its performance compares with the West European economies?

The American model

The case for the American model is only partially based' on the surging growth of the US economy in recent months. Following the record interest rates of 1980/81, industrial production collapsed in the US in 1981/82 and unemployment rose to over 10%, a postwar high. However, with lower interest rates and record government deficits, by June of this year US unemployment rates were down 7.1%, ie to almost 'normal' levels (see table). This ability of the US economy to recover quickly from a recession, without as yet experiencing an increase in inflation, is often contrasted unfavourably with the persistence of high unemployment rates in Western Europe.

Indeed, for the last decade the US and Canada have created substantiallv more new jobs than have the nations of Western Europe. Although the *rate* of job creation has in fact been higher in Canada than in the US, the vast size of the US economy means that the number of new jobs created there exceeds considerably .the *number* which have been created in all of Western Europe combined. If one combines this superior record in job creation (line 2 of table) with the fact (line 3) that the US is the only industrial nation where average wages after taking into account inflation actually fell during the same period, then one has the basis of a simple-minded policy prescription: decrease wages to increase employment.

In addition, there is a quite surprising persistence in Western Europe of a cultural image of the US as the economic leader — more affluent, more advanced technologically, the place where major trends first emerge. The enormous disparities of American life and the relative sophistication of Scandinavia and Federal Germany are generally not appreciated. Certainly there are usually a few American firms in most industries that compete with the world's best and in some sectors, such as civilian aircraft, American firms still dominate the international market. However, Americans themselves are too well aware that large sectors of American industry, from steel to automobiles, have fallen behind their international competitors and now survive only behind the protection of trade barriers and quotas.

Industries may receive protection but American workers are, in general, far more exposed to the 'full play of market forces' than are the workers of other industrial nations. American workers are only 20% unionised, redundancy pay is unknown and there are no legal impediments to speak of to lay-offs or plant closures. Even unionised workers have little protection from an employer who is really determined to cut manning levels. During the 1981-82 recession, only 40% of unemployed American workers received unemployment insurance benefits. In addition, the medical and dental care which Europeans take for granted are, in the US, often paid by employer-sponsored health insurance plans — and therefore last only as long as one's job. In this situation, workers cannot afford to be 'inflexible' in their aspirations for jobs.

The US and Western Europe

In popular economic commentary, there is often a tendency to emphasise only the most recent set of figures on the economy. So, if we compare the growth rates of the US and the EEC for 1982/83, we find that the US economy grew by 3.5% while the EEC as a whole grew only 0.8%. On this basis, US economic performance looks good, but what this really reflects is the fact that North America is recovering from a sharper recession than that which hit West Europe. If we look back just one

'efficiency' is a word that is said with a sneer

more year, and examine growth over the period 1981 to 1983, the EEC actually comes out slightly ahead, with an increase of GDP (gross domestic product) of 1.2% as against 1.05% in the US. These comparisons indicate two things: (1) comparisons of short term growth rates are very unreliable, since they are affected so greatly by differing phases of national business cycles and (2) differences in short term growth rates don't matter very much (eg, 1.2%-1.05%=0.15%).

However, if cumulated over many years, smallish differences in growth rates do produce large changes in living standards. But this suggests that one ought to be asking which sort of economy produces the best sustained economic growth in the long term rather than which sort recovers most quickly from the depths of a recession. In this respect, as in respect of the long term average rate of unemployment, a comparison clearly favours Western Europe. It is the higher rates of economic growth of West European nations, based on a higher rate of growth of labour productivity, that have produced the convergence of living standards between the US and Western Europe — in 1950 per capita GDP in Federal Germany was 52% of that in the US — by 1980 it was 101%.

Until the 1970s, Americans could argue that Europeans were simply'catching up'

with US technology. The best period for comparison is, therefore, the late 1970s, since the oil shocks of 1973 and 1979 ushered in a period substantially different from that of the 1960s. To put things on a basis that is as comparable as possible, the accompanying table gives data for the period 1974 to 1982 (although this has the significant disadvantage of including, for the UK, the first two years of the Thatcher shift of policy and its impact in higher unemployment and lower growth). In labour productivity growth, GNP per capita growth, average unemployment and growth of real wages, the record is clear — Western Europe did better than the US.

Only in employment creation does a comparison favour the North American economies. The key factor here, however, is the much greater increase in labour *supply* in Canada and the US than in Western Europe. During the 1970s both Canada and the United States had extremely fast rates of growth of labour supply, partly because the North American postwar 'baby boom' reached the labour market and partly because of a dramatic increase in the paid employment of married women. The supply of jobs did not increase as fast as the supply of people, and the unemployment rate moved slowly up over the decade, but the increase in paid employment was still very considerable.

Most of these jobs were, however, in the trade and services sector and many of them were part-time. Average wages fell, since job creation was greatest in low wage sectors of the economy and aggregate demand was kept at a low enough level to maintain a consistent surplus of job seekers. Euorpean industry did not need to create, and did not create, as many jobs, but the ones that were created were more productive. It is this long term differential in productivity trends which lies behind the narrowing of the differential in standards of living in the US and Western Europe.

Flexibility and efficiency

But how is it that the US economy is more efficient at recovering from a recession and generating low-paid jobs and less efficient at producing an increase in living standards and high-paid jobs? How is it that Federal Germany can be more successful in producing higher standards of living and less successful in reducing unemployment after a recession?

The answer lies in the distinction between allocative efficiency, the most productive use of a given technology and capital stock, and dynamic efficiency, the most efficient use of resources over time. For maximum allocative efficiency, labour should move as quickly as possible from low productivity jobs to higher productivity jobs. This sort of movement is impeded when it is difficult to lay off workers or when laid-off workers receive redundancy payments. Firms will hesitate to lay-off workers until they are sure they will not be required in future months and they will be even more hesitant to hire new workers, unless they are *sure* that they will not have to lay them off in the future.

When demand turns down in a recession, it will be a while before employment falls, since firms will wait to see if the recession is going to be a short and mild one, but a severe recession will leave firms hesitant to rehire the workers they have so painfully made redundant. A more flexible economy will be more efficient, in the allocative sense, since workers move more rapidly from firm to firm and employment will recover more quickly after a recession.

Among developed countries, the polar case of a 'flexible' economy is the US, while Canada's unionisation rate of 38% and more generous social welfare legislation puts it a bit closer to the European model. In both countries workers have few legal protections against lay-offs and in both industrial relations are marked by a high level of conflict. Labour is easily hired and fired, but union/firm negotiations are highly legalistic and centre around the pay and conditions of precisely defined jobs - which creates endless points of friction when firms attempt to change working practices. The UK has had a less legalistic industrial relations framework, but a higher rate of unionisation. Compared to North America, British workers have been more cushioned by the welfare state against the consequences of unemployment, although compared to Europe they have relatively fewer legal or institutional protections against being sacked or made redundant. For manv vears econo-

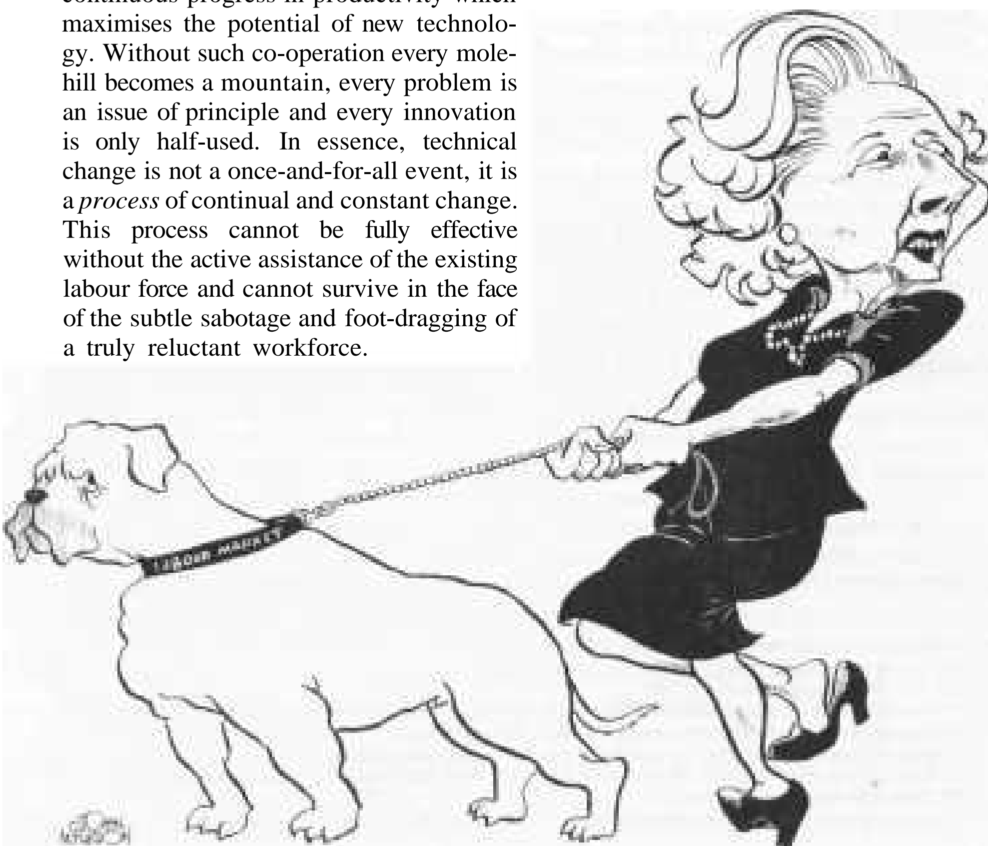
	USA	Canada	UK	France	Germany	Italy	Japan	Sweden
Unemployment rate *First Q. 1984'*	7.8	11.3	13.3	8.5	7.7	(N.A.)	2.7	3.2
% employment increase. *1974182**	15.6	22	-4.7		-1.7	5.9	6.0	6.6
Real wages change *1974/81**	-7.5	5.3	3.3	21	13.5	(N.A.)	12	(N.A.)
Average unemployment rate *1974181"*	6.9	7.3	6.3	5.3	3.4	3.6	1.9	1.9
% Labour Force growth *1974/81"*	19.4	23	3.6	5.0	1.9	6.4	7.4	7.5
GNP per Capita annual rate of increase *1975/80*[6]	2.6	1.9	1.6	2.9	3.7	3.4	4.2	0.9
Labour Productivity annual growth *1975/80 (manufacturing only)*[7]	1.7	2.3	2.7	5.1	4.3	5.1	8.0	2.6
Average days lost in strikes (per 1,000 employees) *1974181*[s]	377	859	453	148	33	957	61	160
Homicide rate (per 1,000,000 population) *1978*[9]	9.4	2.5	1.2	1.0	1.2	(N.A.)	1.1	1.2

1 OECD, *Main Economic Indicators,* May 1984
2 ILO, *Year Book of Labour Statistics.* 1983
3 ILO, *Year Book of Labour Statistics,* 1983
4 US Dept. of Commerce, *Statistical Abstract of the U.S.,* 1981 and 1982-83 (adjusted to US Labour Force definition)
5 US Dept. of Commerce, *Statistical Abstract of the U.S.,* 1981 and 1982-83
6 US Dept. of Commerce, *Statistical Abstract of the U.S.,* 1981 table 1553. p.879
7 US Dept. of Commerce, *Statistical Abstract of the U.S.,* 1983, table 1522 (output per labour, manufacturing)
8 ILO, *Year Book of Labour Statistics,* 1983
s US Dept. of Commerce, *Statistical Abstract of the U.S.,* 1984, table 295

mic thinking in the English-speaking countries has, it should be noted, stressed the allocative efficiency of unfettered markets.

The dominant factor in long-term productivity growth is, however, the development and implementation *of new* technology and methods of production. The gains to be had from the efficient allocation of existing resources are quantitatively much smaller than the gains in dynamic efficiency which can be produced by the continual development and diffusion of more productive *new* technologies. The primary requirement for the implementation of new technologies is not flexibility of movement of labour *between* firms, rather it is the flexibility and co-operation in the use of labour *within* firms.

The effective implementation of new technology is an incredibly diffuse process. It is extremely rare for innovations proposed by 'head office' to fit exactly right the first time - far more frequently a proposed innovation requires modification in the light of shopfloor experience and is not fully effective until it incorporates some of the practical lessons of experience which only the existing workforce knows. With the active co-operation of workers the inevitable difficulties of new technology can be minimised, informal solutions to problems can be arranged and suggestions for new improvements can produce the continuous progress in productivity which maximises the potential of new technology. Without such co-operation every molehill becomes a mountain, every problem is an issue of principle and every innovation is only half-used. In essence, technical change is not a once-and-for-all event, it is a *process* of continual and constant change. This process cannot be fully effective without the active assistance of the existing labour force and cannot survive in the face of the subtle sabotage and foot-dragging of a truly reluctant workforce.



Short run gains and long run pains

Of course, as the case of British Leyland illustrates, a determined management can force through a particular package of innovations if it can convince its workers that the alternative is the closure of the firm and no other jobs are available. In addition, when the demand for goods recovers a little (as it has done in the UK in recent months) some excess capacity will be put to better use. Although the recovery in demand for goods may not be sufficiently large to reduce unemployment, statistical data will show an increase in output per employed worker. In the short run, therefore, we may see an increase in labour productivity if the government follows a Thatcherite policy of massively deflating the economy and then allowing it to recover a little.

But the real issue remains the long run trend in labour productivity.. In the short run, fear of unemployment can scare workers into acquiescence with a particular series of innovations, but unless there is continual increase in unemployment the threat of plant closure will gradually lose its intimidating effect on employed workers. There seems to be a genuine sense of surprise in Whitehall that trade union militancy and resistance to changes in work rules have re-emerged at BL as the prospects for its survival have improved. But why this surprise when labour has no control over technical change and no protection against the job loss it entails?

If labour productivity is to continue to improve, firms must continue to develop new methods of producing the same output with fewer workers, but why should intelligent workers assist in this process? To the extent that unemployment remains high and unemployment benefit remains low, any reasonable person will know that they will face a long and unpleasant wait for a new job if productivity improvements should eliminate their current job. The prudent course of action is to ensure, to the maximum extent one can, that this does not happen. Trying to climb higher on the firm's promotion ladder is one possible strategy to avoid personal redundancy, but it is a very uncertain one. A more likely bet is to hamstring change wherever possible, through both individual and collective action.

When aggregate demand is kept low, in order to 'fight inflation', the requirements of allocative efficiency and long-run dynamic efficiency are therefore in direct conflict. Governments can make unemployment more unpleasant, for example by cutting benefit levels, and this may make the unemployed more 'flexible', but that simultaneously increases the incentives which the employed have to be *inflexible* and to protect their existing jobs by all available means. One cannot expect workers to acquiesce in technical change which costs jobs *unless* there are other jobs for them to go to.

To take another example, in the 1950s and 1960s, when the unemployment rate in the UK was rarely over 3%, hundreds of pits were closed and hundreds of thousands of coalminers left the coal industry, without strikes or major protest. There was somewhere to go in those days and there is something in the argument for a high productivity, high output coal industry based on fewer, more modern pits which can afford to pay higher wages. However, there is nothing at all to be said for forcing a miner out of a low output job in a marginal pit and into a zero output life on the dole. When the Thatcher government abandoned the postwar consensus that a major responsibility of government is to maintain full employment, it made it entirely reasonable for the miners, and everybody else, to try and protect each and every existing job. There is no point in laying people off and improving the accounting profitability of the coal industry or the steel industry or any other

industry if they remain unemployed and the economy as a whole produces less as a result.

The conservative option

To concern about unemployment, the present government has only one response - workers should 'price themselves into jobs' by accepting lower real wages and the unemployment problem will be 'solved'. Presumably, wage cuts have simply not gone far enough in the US since it remains, despite real wage cuts, an economy with rather high unemployment? But at what level of wages will we reach full employment? Nothing in economic theory says *how much* wages will have to drop to ensure full employment; but if the cut in wages is large enough economic theory does predict that it will become profitable to employ labour in less productive uses. Low productivity employment will expand. And if wages are cut far enough, the upper middle classes will be able to afford again the gardeners and the maids which they have had to do without in recent decades. Market forces will then have solved both unemployment and 'the servant problem'.

In a highly competitive capitalist global economy, jobs go to the places where capitalists make profits. Whether goods can be priced competitively depends, however, not on wage rates but on labour costs per unit of output, ie wages cost per hour/output per hour. The Thatcher/ Reagan strategy is based on decreasing unit labour cost by decreasing wages (and simultaneously decreasing the expenditures on research, education, training and health that are needed to produce a productive labour force). This article has argued that this strategy is unlikely to produce long run gains in labour productivity but as long as declines in wages exceed the slowdown in productivity, a nation can always maintain its international competitiveness. Since, however, the vast majority of the population depend on wages for their standard of living, the cost of their strategy is long run stagnation and/or decline in the standard of living of those who do not receive dividends or employ domestic help.

The alternative

Socialists clearly want an economic strategy that provides *increases* in the standard of living of the working class. Socialists, therefore, have to concentrate on output per hour. Only countries with full employment have been, able to reconcile the requirements of allocative and dynamic efficiency in the long term and only with increasing output per hour can consumption per worker increase in the long term. The first step in a socialist economic programme has to be a full employment policy. Agreement on this much is easy - but the remaining choices are tougher.

Far too many on the Left seem to think that either an increase in government spending or 'planning' is all that we need to think about. Too often 'efficiency' is a word that is said with a sneer and contrasted with the comfortable, familiar world of life-as-we-know-it. But change is a continual process and if Britain doesn't change while others do, the UK will move relentlessly 'down market' in world trade, with British workers earning ever lower fractions of wages elsewhere. With less efficient industries there is less surplus, and less for workers, either under capitalism or under socialism.

If we want the standard of living of ordinary people to rise, we must therefore advocate policies that encourage both allocative and dynamic efficiency. We must accept the need for flexibility and change within firms. We must accept also that people will move between regions and will leave some industries and go to others. To be specific - we must recognise that the fight to stop plant closures makes a great deal of sense when there are no jobs for workers to go to - but it would make very little sense if there were good jobs available elsewhere. A successful socialist economic policy would maintain full employment and increase productivity so that real wages can rise - and a successful socialist economic policy would also have to close some plants, on purely economic grounds.

In addition, a socialist economic strategy will have to recognise the changing role of manufacturing. The" long run trend of technological development is that fewer people are required to produce goods and more to produce services. Agriculture, mining and forestry in developed nations provide the raw material for all our goods, but require the labour of less than 7% of the labour force. As the fabrication of those raw materials becomes more knowledge intensive, it too will require fewer workers in direct production. The 'automated factory' is today a rarity, but the trend in that direction is clear.

If goods production requires fewer workers, in a market economy there will be more unemployment and more private services for the affluent. In a socialist economy one would like to see no unemployment and more publicly available services. There are a vast number of public needs which remain unfulfilled, ranging from more beautiful streets to care for the sick and the elderly, so the problem is not one of finding socially useful public services. Rather the problem for socialists lies in recognising that large bureaucracies have not -historically been very good at providing services to people in a way that is both efficient and considerate. We need therefore to emphasise that a full employment, policy based on public services would be one where those services are provided on a decentralised basis, openly accountable and locally responsible.

Conclusion

The consensus of the new Right is correct in recognising that the rigidities of the welfare state imply that European economies recover more slowly from a recession and that allocative efficiency would improve if they were to become more market orientated, on the US model. This consensus fails to recognise, however, that the gains in dynamic efficiency which in the long run are so much larger cannot be achieved if high unemployment and reduced social welfare benefits make job loss very expensive for individual workers. The benefit of'shifting to a more purely market oriented economy, on the US model, is a short run increase in productivity - the cost is a long-run decline in efficiency, as the historical record clearly shows. D