Capitalism with Capital: The Recipe for Full Employment

Paul Fabra

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Dans la présente réédition, les seuls mots à ne pas être de Paul Fabra sont les quelques explications que voici. Alors que la première parution en 432 pages de *L'Anticapitalisme / Essai de réhabilitation de l'économie politique* date de **1974**, les 55 pages de *Capitalism with Capital: The Recipe for Full Employment*, ont été écrites en **1994**. Ce « Vingt ans après », jamais paru en librairie jusqu'à présent, n'en reste pas moins définitivement actuel.

DM, juin 2015

Deux numéros sont placés à chaque début de paragraphe. Le premier est celui de la page au format A4 où le paragraphe se trouve, le deuxième celui du paragraphe dans le développement où il se trouve.

A Cultural Bias against Employment

Paul Fabra, written in English, 1994, 1/8, 9 paragraphs

2-1 Over the past 20 years unemployment in Europe has been steadily rising. It has become the single most urgent challenge to our societies. Suggestions and recommendations on how to deal with it abound. The OECD has recently (7th June, 1994) published a well-documented Jobs Study. In December 1993 the Twelve adopted the Commission's *White Paper* on *Growth, Competitiveness, Employment: The Challenges and Ways Forward into the 21st Century*, with a view to laying ''the foundations for sustainable development of the European economies, thereby enabling them to withstand international competition while creating the millions of jobs that are needed".

2-2 I am strongly convinced that it is possible to change the course of events gradually. But the road towards full employment should be rediscovered. The root of the problem is that our political, financial and economic culture is biased against employment. The mainstream of current analyses and propositions, including those presented in the papers mentioned, whatever their merits may be when considered in isolation, offer no breakthrough. A change in the direction of policy and management is long overdue.

2-3 In this booklet we have taken care to avoid the use of phrases such as "new strategy" and the like. A military approach to economic activity, so entrenched in our vocabulary and way of thinking, is precisely part of the problem. In a war everybody's requirements are sacrificed to the support of the relatively small fraction of the population that is best suited for the battlefield in terms of age, sex, mental/physical staying power etc., whilst the latter are themselves devoted to the supreme sacrifice. This is not so in an economy of exchange, i.e. a market economy. Exchange is by nature beneficial to both parties. A market economy is no zero-sum game. However, economic policies and managerial "strategies" which, consciously or unconsciously, draw their inspiration from a command-economy, tend to transform exchange into warfare, the marketplace into a battlefield where participants will be divided between winners and losers. The latter will join the number of those who, owing to age, psychological and/or physical "unfitness", etc., were more or less "excluded" from the game from the start.

2-4 The causes of (and remedies for) unemployment which are currently advocated, all have in common that they beg the question. Experts assume that if the labour market worked better (thanks to improved flexibility), or if the job-seekers were more adequately trained, the sought-for jobs would become available. However, this is not so, not even in the United States [1] which are usually, if sometimes reluctantly, referred to as the country one must emulate in any attempt to get a larger proportion of the working population employed. True, both skilled and unskilled people are more likely to find a job in America than in Europe, but they are also more likely to find one they will lose in a relatively short time. Many Americans complain about economic insecurity. It would be too easy to accuse them of failing to understand how a modern free market economy should function.

2-5 Our contention goes far towards challenging the popular view, nowadays shored by many conservatives and social democrats, which holds that new technologies and trade competition (especially from the so-called *New Industrialised Countries*) are the prime causes of economic insecurity. Due allowance being mode for the obvious need for flexible markets, the claim for more stable jobs is legitimate not only from a sociological point of view – the requirements of the modern

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[1] The *Financial Times* certainly has a point when it assesses, in an editorial (October 2, 1993) that "America has a problem of joblessness among young and prime-age men which is at least as severe as in Europe."

lonely and wandering individual must be met, but so must those of the many people, equally modern, who are family breadwinners! – but also from an economic point of view. Current analyses assume in one way or another that unemployment means that the productive sector no longer needs the unemployed. It may well be that the opposite view is a more accurate rendering of reality: the productive sector as a whole has been gradually deprived of the resources which it needs to provide jobs for all those looking for one.

3-6 There is a strong case for arguing that the main factor responsible for the shortcomings of the labour market in quantity (no jobs offered: the worst situation) or quality (no choice except for insecure jobs, either limited-duration or part-time) is that too large a share of savings is being diverted from productive use. It is not a question of savings being insufficient. [2] Contrary to a common prejudice nurtured by governments, the capacity for saving is unimpaired. Evidence for this is provided by the huge amounts of bonds which until recently increasingly debt-ridden governments have been able to sell with great success all around the world ("the strong demand was reflected in lower and lower interest rates). In other words, savings are not scarce. They are being misallocated, and the main culprits for this misallocation are governments who divert an enormous portion of savings to finance their respective deficits. This was not the case during the period up to around 1974, when the OECD region was experiencing full employment. Then the national states had not established themselves as the Great Borrowers which they have become in the past 20 years.

3-7 It is not only a question of absolute shortage of resources available to feed the productive private economy. In the corporate world, debt capital is not a perfect substitute for equity capital, notwithstanding the sophistry of "modern" financial theories. Too high gearing ratios impair the capacity of business to provide secure jobs. Let us say, broadly speaking, that the quantitative aspect of unemployment (not enough jobs to meet the demand) is a consequence of the private sector being the *parent pauvre* in the global allocation of resources, while the precariousness of many available jobs (the so-called "qualitative" aspect) can be ascribed not so much to fiercer competition as to the financial vulnerability of highly-leveraged companies.

3-8 Bearing the foregoing in mind, it appears that the solution ought not to lie in the so-called "convergence" between earnings, with wages in the industrializing world going up and wages in the richest OECD countries going down. The latter course would constitute the first of an indefinite number of steps backwards. In most cases, the companies that are "threatened" by the competition from low-wage countries are those which are financially unsound. The advanced OECD countries, which still constitute the core of world capitalism, need not envisage a lowering of their standard of living. What they urgently need is to become a bit more genuinely capitalist in the strongest sens of the word: capitalist economies are those that generate enough capital to employ labour. A genuinely capitalist programme would involve many changes, beginning with a reappraisal of the common notions of "productivity" and "competition" along with an emphasis upon enhancing availability of equity capital for all companies, small, medium and large. Such changes could not be achieved without a major reassessment of current redistributive policies: why they do not really serve justice and why they are self-destructive. Almost fortuitously, *The Dictionary of Modern Economics* published by the MIT Press (General Editor: David W. Pearce) discloses what is at stake under the entry "redistribution": "Examples of deliberately redistributive policy include high levels of *income*

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[2] National accounts only provide implicit data about saving. Implicit means that they are not calculated directly. Experts may say as much as they like that the savings ratio has dropped to a very low level in such and such a country, the truth is that statistical evidences are shaky. Two years ago, a controversy arose in England about the "true" savings ratio. Some analysts argued that it was above 11%, while most estimations put that percentage well below 6%.

tax on high earners and *income maintenance* policies which provide payments to the poor." The choice, if there is a choice, is either to maintain the poor through welfare by raising a *levy* upon the productive sector, or else, through the working of the market, to let new savings generate capital *adding* to the capacity of the productive sector to provide the poor with jobs. The welfare solution is a recipe for empoverishing the productive sector and indefinitely increasing the number of the poor. The capitalist solution tends to match the creation of fresh capital with the demand lor new jobs by the potentiai workforce.

4-9 If OECD countries do not accept the logic of a new capitalist revolution, the aftermath of the severe recession and deflation, from which continental economies are just beginning to recover, is very likely to introduce a further cycle of deteriorating employment, both quantitatively and qualitatively.

Piecemeal Policies Offer No Solution

Paul Fabra, written in English, 1994, 2/8, 3 paragraphs

5-1 In its *White Paper* Jacques Delors' European Commission bravely states "Yes, we can create jobs" and sets out to propose a "full-scale overhaul of employment policy". After some precautionary modifications were introduced in the wording of the original blueprint, the Commission's propositions received wide approval. But the approval was founded upon a misunderstanding, and, more ominously still, an accepted one. Most governments were all too happy to be offered, under the guise of a new employment policy, a continuation of the programmes they have been selling to their electorate for the past 15 years or so. (Not because they could boast any tangible success, but because they had no other ideas to air.) However, the issue comprises more. A careful reading of the *White Paper* reveals that the implicit model for a pan-European employment policy was the course followed by the most interventionist countries. The authors of the *White Paper* themselves do not believe in what is supposed to be the objective of their policy, namely laying the foundations for sustainable job-generating growth in a free market economy.

5-2 Since the adoption of the *White Paper* by the Twelve at the Brussels summit on 11 December 1993, events have occurred with potentially far-reaching economic and political implications. In France, the very country whose experience, legislation and lines of thinking constituted the main source of inspiration for the Commission's Paper, the government has suddenly been confronted with the unexpected rejection, both by employers and future job-seekers, of a much-heralded *Loi quinquennale relative au travail, l'emploi et la formation professionnelle* (*quinquennial law concerning labour, employment and professional training*). This text was devised along the same lines as Jacques Delors' and relies upon the conventional policy of subsidising employment. However, the general scepticism expressed by all those immediately concerned provides no way out unless it is accompanied by viable alternative propositions. Consequently, opposition to the *Loi quinquennale* and unrest in the streets of Paris and Lyons were followed by yet more subsidies aimed at inducing employers to engage young graduates at an undiminished minimum salary. Nevertheless, the fact remains that one EC government has been politically defeated in the name of a piece of legislation which is very close, in letter and in spirit, to the *White Paper*. Four months after having been adopted by the French parliament, most of the *loi quinquennale* was already shelved. But the same old ideas which prompted the political endorsement of the *White Paper* ("there are good things in it" Chancellor Kohl said recently) are still there. The time could be ripe for a new public approach to the most challenging issue.

5-3 Yet in the western world at large there is at present no market oriented full-employment model to be opposed to the Delors-Balladur-Clinton-Major-Kohl piecemeal pharmacopoeia. An illustration of the (almost) complete absence of any serious debate on the subject (unless one considers Robert Reich's ideas to be serious!) was the *Jobs Summit* of the G7 in Detroit on 14 and 15 March 1994. This situation need surprise no one. Free-marketeers and their disillusioned social-democrat contenders seem to have provisionally settled for peace on the basis of a few shared notions, and rather shaky ones at that.

Concepts and Events: A Revisited Survey

Paul Fabra, written in English, 1994, 3/8, 22 paragraphs

6-1 A fair and well-conducted "Working Paper" was published in 1993 by the OECD under the title: *High and Persistent Unemployment: Assessment of the Problem and its Causes*.[3] Even so, the author, Jorgen Elmeskov, a member of the OECD Resource Allocation Division, begins his investigation as follows: "Unemployment is a key economic policy target because of its association with governments' objectives of using labour resources efficiently and reducing social problems and poverty". Every segment of this sentence runs against the traditional tenets of a free society: (a) the importance of unemployment is not associated with the economically and ethically imperative fulfilment of individual self-support but with governments' objectives; (b) efficient use of labour resources and reduction of poverty (not to mention the apparently all-encompassing "social problems") appears to be primarily a government responsibility.

6-2 So long as official economic thinking takes for granted such pervasive Fabian postulates, unemployment stands to rise at a steady pace. Simultaneously, the struggle against poverty will, and vainly so, absorb an increasingly large portion of the national income, because systematic support (innocently labelled "safety net") is an engine for the expansion of poverty. Let us take a closer look at the instruments of analysis to which this otherwise well-balanced OECD study and its likes stolidly adhere.

6-3 "If the late 1980s are compared with the 1960s, it seems [this wording is the only restriction expressed in the passage – *pf*] that currently wages start to accelerate when unemployment falls to a level that is much higher [sic] than was previously the case". The author apparently retains the so-called concept of "non-accelerating wage rate of unemployment" (NAWRU) as a measure of (rising) trend unemployment. NAWRU is supposed to indicate the rate of unemployment needed to stabilise wage inflation. Presented thus, as a measurement, it appears as just a neutral conceptual tool for grasping a current phenomenon. A closer examination suggests that NAWRU might be nothing more than the reincarnation, 30 years later, of Phillips curve type wage equations. These assume a trade-off between inflation and employment; in other words, full employment could only be achieved at the expense of price stability. This assumption was accepted as the revealed Truth in the sixties, because it fitted so well into the Keynesian ideology. Its blind acceptance by a whole generation of economists and official experts, both national and international, says a great deal about the American and European elites and how thoroughly unprepared they were to understand the upheavals of the early seventies and their aftermath, in which we still live.

6-4 In particular, conventional economists never completely came to terms with the fact that full employment ultimately fell victim to the surge of global inflation. The latter was unleashed during the period 1971-1973 by a sudden doubling of central bank reserves [4] as a consequence of their massive purchases of dollars in a desperate attempt to prevent the collapse of the Bretton Woods fixed-exchange-rates system (which was ultimately blown up in March 1973). To begin with, monetary and credit inflation boosted world prices at an accelerated pace never before experienced

[3] Department of Economics Working Papers, No. 132.

[4] An increase in the assets of a central bank (domestic assets or, or in the period under review, foreign assets) is matched on the liability side by a balancing creation of money. The latter is labelled "high-powered money" because that money which is a liability for the central bank is on asset for commercial banks. On the basis of the "reserves" which they have placed with the central bank, commercial banks are given the capacity to extend credit with a multiplier.

in peace time: the prices of all commodities, agricultural and mineral, quadrupled and quintupled during the period 1971-1973 – a rise which was absurdly attributed by the disgraced *Club of Rome* to the exhaustion of the earth's resources. It is only at the end of this extraordinary wave of inflation that the OPEC countries, grasping the opportunity provided by the Kippour war, seized the monopoly power from the oil cartel and in their turn quadrupled the price of oil (4th Quarter 1973).

7-5 But the so-called "oil shock" was used as a universal alibi to hide the fact that the monetary, financial and economic disruptions from the early seventies onwards have been entirely of our own making. The rise in the price of oil was not a cause but a consequence. Of course, a consequence can, through its own effects, become a cause in its turn. The "oil shock" (coming in the wake of a wheat shock, a cotton shock, a wool shock, a copper-zinc-iron-lead-tin-manganese shock, a phosphate shock, etc.) merely made things worse, but not necessarily much worse given the formidable magnitude of the inflationary forces released by the breakdown of the Bretton Woods gold-dollar standard. This collapse ushered in a new era, one we are still in: a combination of floating rates and cross-monetisation of key reserve currencies. This has removed every obstacle to an indefinite accumulation of national public debts. The implications for employment are of critical importance.

7-6 Floating is considered, wrongly, to be the system corresponding to a free market. Economists and experts have completely lost sight of the fact that normally floating rates constitute the exchange regime for inconvertible currencies. The latter, traditionally called "fiat money", are bound to float with each other. The dollar officially lost its convertibility into gold on 15 August 1971. (Until March 1988 the major European currencies also used to be indirectly convertible into gold through the gold pool mechanism.) At the time there was a debate, which still surfaces now and again between the partisans of fixed and floating rates. In fact their argument was (is) without significance. What both camps – Milton Friedman as well as the lesser stars – forgot to tell us is that we no longer have any choice. Once any connection with a standard (be it gold or any other material) has been severed, any attempt to reintroduce pegging is both artificial and precarious. (The most recent illustration is the de facto forsaking of the Exchange Rate Mechanism of the EMS in early August 1993.)

7-7 The severance from an external standard has other very important consequences. One of these is that, for-the past twenty odd years, central banks have increasingly become involved in supporting national debts. This has given added impetus to the explosion of public sector borrowing all around the world.

7-8 Before the collapse of Bretton Woods, only the dollar (and, to a lesser extent, sterling) was considered as a reserve currency alongside gold. Those dollars which were kept as reserves in the books of European (and Japanese) central banks were invested in U.S. Treasury bills and bonds. In other words, they were lent bock by creditor foreign central banks to the U.S. government. But the lending was optional, in the sense that those central banks, instead of acquiring U.S. Treasury IOU, could also convert the dollars into gold at the U.S. Treasury. Even though the option was less and less frequently used (due to U.S. political pressure on the main creditors), the very fact that it was open constituted a check to the unlimited accumulation of U.S. national debt by European and Japanese central banks. During the past 20 years, the amount of U.S. national debt held by monetary institutions abroad has multiplied by ten.

7-9 Under the guise of "diversification of risks", central banks all around the world have been acquiring a few other currencies (the German mark (DM) being the main one) as complementary reserves. In doing so they are indirectly supporting the public debts of the issuing countries. On top of that, many governments are financing part of their deficit by issuing bonds in the euro-currencies markets.

8-10 Cross-monetisation of currencies (the Bundesbank issuing DM in exchange for the dollars – U.S Treasury bills – it acquires, and Saudi Arabia issuing riyals in counterpart of the DM it acquires) amounts to international cross-monetisation of public debts. (While domestic monetisation of national debt is forbidden by the Maastricht Treaty.) This mechanism is responsible for all the worldwide inflation waves that have occurred since the aftermath of World War 1 (and even more since World War 2).

8-11 Huge issuances of bonds by national treasuries are crowding out the productive use by the private sector of the limited savings. In this way the productive private sector has unnoticeably and gradually been deprived of its oxygen – equity capital. There may be a good case for arguing that the enduring success of modern theories of corporate finance which so blatantly run counter to the facts (and which keep on exercising a negative influence) resides in the fact that they serve to cover up this economic strangulation. The pivotal theory is the Modigliani-Miller Proposition according to which the value of a firm is independent of its capital structure. [5] It is taught to the new generation by management schools all over the world. It has been critical in converting business to high leverage "strategies".

8-12 No serious inquiry has so far been made to determine whether and to which extent leverage practices are detrimental to employment. Reasoning and experience point out that equity-financed companies tend to keep and train their personnel, while the vulnerable position in which debt-ridden corporations find themselves induces them to keep down recurring costs, of which the payroll is usually the principal one. Leveraged companies are perpetually seeking to cut down all expenditure, apart from the unavoidable financial expenses. This "strategy" is comparable with the fiscal policy conducted by heavily indebted governments: pushing down current and investment expenditures in order to finance public debt.

8-13 Sophisticated corporate financing is usually interpreted as evidence of a freer and more mature capitalism. However, I have misgivings about this lenient interpretation. Big companies no longer seek credit with the banks, but borrow directly on cheaper terms in the open market. This is significant change: traditionally credit was not considered fungible. It was arranged directly between the borrower and the lender, the latter usually being a banker. The risk was assumed by the bank's capital. Today, the risk is supported by the ultimate investors of mutual funds in the market. This "disintermediation" (big corporations raise funds directly in the market) was initiated by two factors:

8-14 1 °) The government is by far the biggest borrower in the financial markets. To satisfy its huge and diversified requirements, financial markets have been deregulated so that there is no longer any demarcation between short, medium and long term. The State can borrow at any maturity between 3 days to 30 years. Big corporations with a well-known signature have followed suit. As the Treasury has saturated the long-bonds market, the private sector is more active in the short and medium term compartments of the continuous market. Nevertheless, the treasury's methods of financing have become the pattern to which the corporate sector conforms in spite of me continuous market. Nevertheless, the treasury's methods of financing have become the pattern to which the corporate sector conforms in spite of the fact that the nature of the risk taken by the ultimate investor is not the same. As the market as a whole is taking more risks, it is to be expected that the corporate sector

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[5] In June 1958, when the « MM » Proposition (high leverage does not impair the value of a firm) was first published in the *American Economic Review*, American companies were very low geared, interest rates on corporate debts (up to 30 years) were in the 3% to 5% range. With such a favourable starting position, recommending leverage could appear riskless for companies in particular and for the whole economy in general. Among the factors which later eroded this position one must include the adoption of the MM Proposition as a standard for financial management.

is generally less keen on engaging large numbers of employees. In increasingly volatile markets short-termism tends to become the rule of the game, also in "human resources" management. Growing uncertainty about the future is a further pretext for employers to give up their ethical commitment to ensuring stable jobs for their workforce.

9-15 2°) Commercial banks have been mode more fragile – and more reluctant to lend – by two successive decades of misdirected loans: The "Latin America Bubble", followed by the dash for real estate, the Maxwell-Braufman-Schneider etc. infatuations. In the words of the former head of the New York Federal Reserve Bank, Gerald Corrigan, those successive debacles are the upshots of "far too little capital" (especially if one takes into account the off-balance-sheet commitments of the banking System) and "a breakdown in the culture of banking and finance". ("Perhaps the movies and bestsellers exaggerated that latter phenomenon, but not by much.") [6] . Moreover, commercial banks have come to constitute portfolios of treasury bonds. Some of the most important financial innovations were initiated precisely to allow them to do so. The first interest rate futures contract was developed on the Chicago Board of Trade (CBT) in 1975 for that purpose. After the U.K., continental Europe followed suit with the creation by France in 1986 of a Paris-based market for interest-rates futures (MATIF).

9-16 In the U.S., monetary policy during the last recession has been specially devised to help bruised commercial banks to rebuild their balance sheet: the Fed aggressively pushed down short interest rates so that banks could borrow on the cheap (3% and less) and massively purchase long term T bonds which bring them a nice return (9% and later down to 6%). In doing SO, the banks have become lenders to the government: hardly a step towards private capitalism and a free market economy. As for small and medium companies, the main job creators in modern economies, they have no easy direct access to borrowing on the financial market. Consequently, they continue to be the customers of commercial banks at a price. In this way they are placed at a disadvantage compared with the big corporate sector. Will small and medium companies ultimately gain access to the market and issue collective CDs (3-month certificates of deposit)? Even if this problem is solved, fact remains that the question is not only how to accommodate further categories of borrowers at the cheapest terms available. To the extent that the market takes on more and more unidentified risks, the "financial system in which credit has no guardian", to put it in Henry Kaufman's words, [7] is becoming more and more nervous. As a consequence, interest rates are becoming more volatile: not the best conditions to promote steady growth, which could generate jobs galore.

9-17 Not only has the past twenty-odd years failed to generate fresh capital on a scale sufficient to keep the working-age population fully employed, but a huge amount of invested capital has been periodically destroyed during that period. Naturally this destruction was accompanied by a corresponding that period. Naturally this destruction was accompanied by a corresponding cancellation of jobs. As we have seen earlier, mainstream economists were very much biased in favour of moderate inflation (which they considered to be a boost for employment). They completely overlooked a phenomenon which was well understood by the best pre-Keynesian economists, namely that eventually inflation is bound to burst into deflation. Modern inflation is basically credit inflation, hence its cumulative nature. Sooner or later debt-ridden borrowers go bust. The massive liquidation of debts is deflation. Highly-leveraged companies collapse, debt-financed investments prove to be misallocations of resources. Along with the accompanying losses of equity-capital the

[6] E. Gerald Corrigan (A lecture given September 30, 1993), *The Financial Disruptions of the 1980s: A Central Banker looks back*, Group of Thirty, Washington, DC.
[7] Henry Kaufman (1986), *Interest Rates, the Markets, and the New Financial World*, Times Books, New York.

corresponding productive assets become idle or under-utilized, temporarily or permanently as the case may be.

10-18 There is a widely accepted explanation for the Depression of the thirties that should be revisited in the light of recent experience. Milton Friedman persuaded not only his fellow-economists but many experts of other persuasions that the Depression could have been avoided had the Fed not squeezed the so-called money supply after the Crash. Following the lectures of Chicago monetarists, governments and central banks reacted to the October 1987 crash by flooding the world with liquidities. At that moment the world economy was spared the woes of chain-bankruptcies and a general shrinking of credit. However, the political and monetary authorities engineered a boom for the ensuing years (1988-1990), only to postpone and probably to worsen the inevitable recession. The boom proved characteristically to be a tug-of-war between buoyant asset-inflation and underlying deflationary forces which ultimately found their way through. Once again, the price paid in terms of a further ratcheting rise in unemployment is heavy.

10-19 A final word on that score: on examining the stock markets' behaviour during the months preceding the October 1987 crash, one can observe that Wall Street was heading for a severe correction around the end of April of that year, but the downward move was soon aborted. Two months earlier (February 22, 1987) the G7 had signed the so-called *Louvre Agreement* which provided unlimited support from fellow central banks to the falling dollar. The outcome was a repeat, on a much wider scale, of what had happened already twice – in 1971 -1973 and in 1977-1978 -, namely a formidable increase in world liquidities through central bank operations in the exchange markets. Those periodic massive interventions in the exchange markets have been the most powerful engines of credit inflation – soon followed by debt-deflation – which plagues the world economy.

10-20 Another conceptual framework associated with practically all the current macro-economic analyses (including the OECD analysis mentioned above) is the "equilibrium" rate of unemployment. The universal use of this concept, derived directly from Keynes' analysis in his famous book (1936) *The General Theory of Employment, Interest and Money*, testifies how much we remain the victims, to paraphrase Keynes himself, of some dead economists. Keynes thought that "a somewhat comprehensive socialisation of investment will prove the only means of securing an approximation to full employment." I think that the negative forces behind the deterioration of western capitalism (and Keynes 'ideas played no small part in breeding those forces) point to the reverse. Capitalists can no longer properly perform their task, namely to provide "approximately" the entire working-age population with jobs' for the single most important reason that the very source of capital, namely savings, has been deflected from the productive private sector. The prime deflector is the State, which pre-empts most of available savings. Keynes offered the consolation that "the euthanasia of the rentier, of the functionless investor, will be nothing sudden, merely a gradual but prolonged continuance of what we have seen recently in Great Britain, and will need no revolution." [8] Here also, facts do not bear out this anti-free-savings stance. The future of full employment depends wholly upon investors – including rentiers! – operating in stock markets which are fully dedicated to the purveyance of equity capital to private entrepreneurs. What is urgently needed is a full-fledged

[8] John Maynard Keynes(1936), *The General Theory of Employment, Interest and Money*, (final) chapter 24 *Concluding notes on the social philosophy towards which the General Theory might lead*.

capitalist world, i.e. an economic world where once again investors fulfil the eminent function of prime fosterers of jobs.

[11-21] In his preface (7 September 1936) to the German edition of *The General Theory*, Keynes wrote candidly: “the theory of output as a whole, which is what the following book purports to provide, is much more easily adapted to the conditions of a *totalitarian state* [my emphasis – *p/f*], than is the theory of the production and distribution of a given output produced under conditions of free competition and a large measure of laissez-faire.” Keynes, whose General Theory is based upon the assumption of a closed economy, was lucid and outspoken enough to disclose the very nature of his own doctrine. His influence was critical to the gradual undermining of the foundations for the splendid renewal of an open world economy initiated after World War 2 by the implementation of the Bretton Woods Agreement and of the GATT. (That the Uruguay round was a step forward in the same direction is far from certain.) Most outrageous is the oft-quoted quip of his, a resume of the current philosophy: “In the long run, we are all dead”. Before Keynes, economists – and people in general –would have said: “In the long run our grandchildren and/or grandnephews will take our place”. To sum up the whole issue, unemployment is plaguing those nations which no longer care about their future.

[11-22] In economic literature the equilibrium rate of unemployment is alternatively labelled “natural” or “normal”. Both qualifiers seem to convey the idea of on “equilibrium” settled by the anonymous interplay of supply and demand. However, the latter is obviously skewed by policy-induced behaviour on the part of the prospective employers and the job-seekers. The replacement ratio, namely the ratio of total net resources when unemployed to those when working, plays a role in setting what is known as the reservation wage (the minimum wage on applicant for a job will find acceptable). This raises questions concerning to which extent and on which conditions society should consider the refusal of a job by somebody on the dole as “natural” or “normal”. On top of this politico-ethical problem, there are, m my opinion, strong economic grounds for rejecting the very notion of unemployment equilibrium. Proponents of this notion assert that this equilibrium level is steadily rising in the course of time (meaning that it settles of a higher level of unemployment). Such o rise suggests the possibility that unemployment feeds itself under the influence of destabilising factors. At one end of the chain every increase in the number of unemployed entails heavier social contributions and taxes on the employed and their employers: consequently a further squeeze on savings leading to smaller capital generation. At the other end of the chain, generous unemployment benefits foster sloth and dramatically erode the work ethic among the population.

The Planners of Competitiveness

Paul Fabra, written in English, 1994, 4/8, 11 paragraphs

12-1 Regarding current proposals for curbing unemployment in Europe, one must note that unemployment policies are particularly liable to what is almost an axiom of any economic policy: no objective can be attained directly. Take inflation as an example: price controls may for a while suppress it, but sooner rather than later, these will fail dismally. (With the possible exception of a war economy when governments are endowed with exceptional and dictatorial powers.) Protectionism provides another good example of this axiom: erect barriers to competition from abroad and one ends up with an economy which is weaker and a standard of living which is lower than before the implementation of "protective" measures.

12-2 Disregarding this axiom accounts for most of the shortcomings of interventionism ("dirigism"). From this standpoint, liberal (in the continental European meaning of that word) policies ought to be considered as indirect action. Again inflation provides a straightforward illustration: prices will be stabilised in the marketplace not through direct restrictions but through sound monetary policy. The obvious problem with efficient indirect action is that it assumes knowledgeable policymakers. Yet that alone is not sufficient: not only do they need to know what the problem is all about – for instance, they must know that a steady rise in the Consumer Price Index is attributable not to any peculiar "behaviour" of shopkeepers but to the central bank's unashamed monetisation of treasury bills – but they must have faith in what they know. This faith must be so strong that they are willing to risk their reputations and political careers for it. A comparison with sports will help to understand why the latter condition is more rarely fulfilled than the former. In skiing, the beginning skier's instinct is, wrongly, to lean towards the mountainside. To stay up and go forward one must not only learn how to ski, but also to trust what one has been taught and muster enough courage to lean towards the void (the valley).

12-3 There is a further reason why policymakers will instinctively prefer to resort to inefficient direct economic action: this type of action is visible to the electorate. Giving the impression that one cares about employment may well be just as important as laying the foundations for sustainable employment, especially if one has no clear idea about what must be done to achieve the latter. Examples of direct action which supposedly fosters employment are programmes of public works, subsidies extended to companies which hire young people under such and such conditions. An example of indirect policy promoting employment is the facilitation of access for small and medium companies to fresh capital.

12-4 A great merit of the *White Paper* is that it furnishes (though in terms not fully understood by the Commission itself, not to mention the politicians who must approve it), the clue for understanding why, in the current political, intellectual and ethical (or unethical) environment, the so-called active policies in favour of employment, such as those put forward by the authors of the document, are actually biased against full employment: "We must increasingly think in terms of competitive rather than comparative advantages" {*White Paper*, part B, chapter 2). The choice which is expressed here in sophisticated terms is of utmost importance even though heads of state and governments are not expected to pay much attention to which concept – competitiveness versus comparativeness – is best suited to guide their economic decisions. In fact the Commission's wording very accurately encapsulates the main inspiration behind the concrete and (very) unwise decisions currently implemented by EC governments.

13-5 Germany's policy provides a telling example. Kohl's government and the *Treuhand* have been prompted by an obsession with competitive advantages (and a disregard for comparative ones) to embark on a policy of modernisation *à outrance* of the former DDR's enterprises, thereby recklessly accelerating the collapse of the old ones and putting millions of people out of work. The cost of this policy is enormous, while the end-result is dubious on at least two compelling grounds: (a) however dispiriting 40 years spent under the communist regime might have been, the "bad habits" contracted during that period can only be enhanced by the generous offer of greatly improved conditions whilst living on the dole; (b) subsidised investment often results in misdirected investments. The argument that there was no other choice given the state of disrepair of most East European companies, is debatable. Though the latter were in very poor condition, so were many Mexican and Brazilian companies when they provided the foundation for a massive export drive as soon as such an effort became necessary (to repay international banks after these refused to extend further fresh money to Mexico and Brazil). This illustrates the principle that comparative advantages open opportunities in any vast market, from which it follows that state-of-the-art equipment and techniques are no absolute prerequisite for participation in economic activity even in the worst economic circumstances.

13-6 A careful scrutiny of the reasons put forward by Jacques Delors' Commission for prescribing ("we must…") Europeans to think in terms of competitive (a) rather than comparative (b) advantages discloses distinct ideological biases:

13-7 (a) "Comparative advantages traditionally relate to endowment in factors such as natural resources and are therefore fairly rigid," says the *White Paper* (part B, chapter 2). In this statement the Commission does not adopt any traditional (classical) interpretation of the notion of comparative advantage; it adopts the very limited meaning given to this notion in modern economics. However, to hold that natural endowments – by virtue of which Spain specializes in orange harvesting and Sweden in iron ore mining – represent the standard comparative advantages, is restricting the concept to the point of denying it any useful meaning: natural resources constitute an absolute rather than a comparative advantage. David Ricardo (the unavoidable reference on this score as on some others) took great pains to explain that the comparative advantages he had in mind were not of that sort. For that purpose he devised one of his most famous "counter-factual" cases: "Now suppose England to discover a process for making wine, so that it should become her interest rather to grow it than import it… If the improvement in making wine were of a very important description, it might become profitable … for England to make all the wine, and Portugal to make all the cloth consumed by them."[9]

13-8 (b) To justify its neglect of comparative advantages the Delors' Commission's final argument reads as follows: "Competitive advantages are based on more qualitative factors and can thus be influenced, to a large degree, by corporate strategies and by public policies" (same passage as quoted above). One might think that a moderate modern social-democrat accepts the global monitoring role of the market and confines government interventions to "correcting" or "supplementing" the so-called failures of the market. Not so in this text. It is because public policies are supposed to be able to influence competitive advantages that the latter are considered more noteworthy than comparative ones. Public intervention for the sake of public intervention has seldom been so conspicuously recommended. One must also note the mention of "corporate strategies" alongside "public policies". Both are presented as conniving plans of action towards a

[9] David Ricardo, *On Principles of Political Economy and Taxation* (first published in 1817): Chapter VII *On Foreign Trade*.

common objective. This perception of "global competitiveness" more closely resembles the mindset of a commando-economy than Adam Smith's world.

14-9 Modern economic parlance conveys a Darwinist notion of competitiveness. From the idea (which is only true to a point, as we shall see) that a person or a company must outperform his (or its) competitors in order to hold his (its) own in the marketplace, one too easily shifts to the idea that only the fittest will ultimately – how long the long run? – survive. The latter conclusion is usually not voiced in so many words, but the incantation about competitiveness is usually understood in this sense. The whole issue is very often hopelessly muddied up by the dismissal of one of the fundamental features of a free economy, namely the absence of any essential difference between domestic and foreign trade: if I buy a Toyota, the seller is not Japan as a national entity, but a Toyota dealer (Ricardian and Austrian economics did not need to wait for Robert Reich to know that.) Consequently, the global marketplace is misrepresented as a locus where national economies are pitted against each other ("Ultimately, our industry will be smashed out by Japanese or low-wage countries" – as the case may bel) with the inevitable result that international trade is mistaken for a zero sum game. Whether it is applied to individual firms or to national economic entities, the Darwinist approach to competitiveness assumes the elimination of the "unfit" from me marketplace, thus surreptitiously introducing permanent unemployment into the general picture. Economists and experts never explicitate this point but one may suspect that this distorted, incomplete, view of market competition somehow underlies the slippy notion of "equilibrium" rate of unemployment (see supra).

14-10 On the face of it, this line of reasoning cannot be pursued to the limit. The function of selecting the best producers of the best products (or services) is only one aspect of an (free) exchange economy and in itself it does not suffice to explain in the way a free economic system works. The view of the marketplace as mainly an instrument for selecting champions ultimately destroys the market economy. Firstly, the maintenance of an increasing number of people supposedly knocked down by "Darwinist" competition is becoming a social responsibility. This leaves us with a truncated market. Secondly, this support constitutes on ever increasing burden upon the productive sector and the so-called champions are bound to have their competitive edge blunted. Thirdly eventually governments take over the responsibility for supporting not only the losers but also the winners.

14-11 The underlying concept of economic war is the stuff that industrial policy feeds on. Nothing less than national independence and national pride is supposed to be at stake when the national "champions" perform in the international market. This provides further motivation for governments and/or the Brussels Commission to come to their old and act as pioneers of competitiveness (see the *White Paper*'s statement above about public policies "influencing" competitive advantages). The underlying concept of economic war ignores that "Every transaction in commerce is an independent transaction". Modern economics seems to be (re)discovering this Ricardian statement, especially through the theory of contractual arrangements. Every independent transaction must be profitable for both parties. For instance, international trade implies that both the exporter and the importer make a profit. Markets do not function as a zero sum game.

Rehabilitate the Second Driving Force

Paul Fabra, written in English, 1994, 5/8, 8 paragraphs

15-1 The best evidence that a market economy is naturally geared to employing the full labour force is the fact that innumerable second-rate potential producers of goods or services – i.e. all of us! – are granted a chance, through the operations of independent private transactions, to hold their own in the marketplace. To understand how this is made possible, one must take into account, besides the competitive drive (promoting the best), the operation of another constraint: on the one hand the most efficient (in absolute terms) performers are selected through competition, while on the other hand the readiest and most convenient, albeit not necessarily the best, suppliers enter the market because it is comparatively advantageous to employ them. Both of these principles are constantly at work, also within individual companies, in the ceaseless succession of exchanges. (Paul Samuelsson, a Nobel Prize winner, once said that Ricardo's comparative advantage theory explains why he himself is hiring a secretary even though he can type better than any secretary; he does so because, hopefully, he had better be writing articles about economics than typing them.)

15-2 Any market economy is driven by these two forces, but they can be combined in different proportions, depending on circumstances, but also on economic policy. The crucial point here, as noted above, is that the planning State can be expected to unduly promote championship (or what it believes to be a promise of championship) at the expense of all other players. Competitiveness in the world markets conveys the idea of national superiority and prestige. In promoting competititivity (or posturing to do so) through subsidising R&D, training, etc. governments win the favour of big business, while they can buy votes by caring for the unemployed with "generous" benefits. Even more compelling for the emphasis being put upon the promotion of competitiveness is that, rightly or wrongly, politicians and technocrats feel confident that they have the means to intervene efficiently to do so. The fact that it can be done conspicuously is no small incentive for them to conduct Industrial Policy or similar programmes.

15-3 Conversely, full employment is achieved through the invisible (at least to outsiders) market process based upon the almost unlimited opportunities offered by combinations of comparative advantages (such as the mutually advantageous contract between Samuelsson and his secretary). After World War 2, the mainstream economists were expecting a relapse into pre-war unemployment rates as soon as the reconstruction period was over. They were very much surprised that full employment continued beyond that period. Their surprise was an expression of their ideological reluctance to admit the working of the Invisible Hand°[10] and to acknowledge the meaning of this symbol: the global efficiency of free trade between independent transactors.

15-4 The reader might be surprised by our reference to the testimony, if not the authority, of thinkers long dead, but modern economics does not relate to "old" economics in the same way as modern

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[10] In the last article he wrote (published after his death by *The Economic Journal*, June 1946) Keynes said: "In the long run more fundamental forces may be at work, if all goes well, tending towards equilibrium, the significance of which may ultimately transcend ephemeral statistics. I find myself moved, not for the first time, to remind contemporary economists, that the classical teaching embodied some truths of great significance, which we are liable today to overlook because we associate them with other doctrines which we cannot now accept without much qualification. There are in these matters deep undercurrents at work, natural forces, one can call them, or *even the invisible hand* (my emphasis-pf), which are operating towards equilibrium." That is beautifully said, but the wording is significant: the last thing a contemporary economist of Keynesian persuasion (still probably the majority) is willing to concede is that the invisible hand could operate towards equilibrium in a sense transcending ephemeral statistics.

physics relates to old physics. Modern physics has almost entirely replaced old physics. This is not the case in economics [11] . To ignore what the great economists of the past (such as Adam Smith, David Ricardo, Jeon-Baptiste Say, Augustin Cournot, Alfred Marshall, Knut Wicksell and others) have established is to cut oneself off from a considerable portion of available knowledge. Furthermore, modern economics has reintroduced preclassical assumptions which, in some crucial matters, make modern reasoning less reliable than classical reasoning. As noted above, even today Ricardo's pioneering work in discovering the impact of comparative advantages in economic remains the supreme reference. (Also for other important modern topics: see for instance the so-called Ricardian *Theorem of Equivalence* between taxation and borrowing, (re)discovered twenty years ago by Robert Barro only to initiate a major academic controversy which is still going on and where contenders miss a few crucial points.)

[16-5] Comparative advantage is usually construed as meaning only that economic agents specialise in production for which they are more efficient than competitors. In this interpretation modern treatments of the concept eliminate half of what Ricardo explains in a famous "case" encapsulated '" a few lines (*On Principal of Political Economy*, chapter VII, *On Foreign Trade*) which appeared in a footnote (entire developments of economic theory rest upon Ricardo's footnotes): "Two men can both make shoes and hats, and one is superior to the other in both employments; but in making hats, he can only exceed his competitor by one-fifth or 20 per cent, and in making shoes he can exceed him by one-third or 33 per cent; - will it not be in the interest of both, that the superior man should employ himself exclusively in making shoes, and the inferior mon in making hats?" From this hypothetical case, it follows (a) that to find an occupation, one can make with the least comparative disadvantage (the latter phrase conveys unambiguously what the concept "comparative advantage'' amounts to and should be used systematically to designate it.) Personal experience is a reminder that just to do that is already quite an achievement! (b) that the function performed by the market is much more sophisticated than is usually assumed even by staunch free-marketeers. The greater the market's extension, the more exchanges take place between producers of unequal capability and, contrary to what Marxists contend, the relationship of exchange is equally beneficial to both parties. It is from this standpoint that the delocalisation of industries towards low-wage countries should be considered.

[16-6] What is critical for full employment in the hat-and-shoe example is that selection based upon comparative disadvantage does not imply exclusion. Consequently, specialisation does not rely upon the selection of naturel endowments, as modern economics assumes[12], but on the fact that every person has different degrees of skilfulness or unskillfulness. Consequently, an economy of exchanges will naturally allocate to the "disadvantaged" agent on activity in which he or she is the most skilful on his or her own scale of skilfulness. No degree of planning is capable of such allocation based upon

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[11] R.H. Coase, Nobel Prize 1991, and a pioneer of the contractual school, writes: « The [micro-economic] analysis is held together by the assumption that consumers maximize utility (a nonexistent entity which plays a part similar, I suspect, to that of ether in the old physics)…" (extracted from the book *The Firm, the Market and the Law*, a series of articles republished in 1991). In the lecture he delivered in Stockholm, December 9, 1991 R.H. Coase said: "What is studied is a system which lives in the minds of economists but not on earth. I have called the result 'blackboard economics.' The firm and the market appear by name but they lack any substance." In his book the author emphasizes this point: "Although economists claim to study the working of the market, in modern economic theory the market itself has an even more shadowy role than the firm."

[12] As economists well know, modern economics is at odds in explaining how the principle applies to an economy with more than two products and two producers. The reason may be that modern economics does not include in its model the central Ricardian (and classical) assumption about the relative values (prices) of merchandise being proportional to the quantity (duration) of labour bestowed on their production (due allowance being made for the independent impact of profit).

comparative disadvantage. Such specialisation is the outcome of innumerable mutually beneficial contracts. The above does not imply that business management is unaware of the comparative disadvantage motivation. When a large company gives up the production of certain components to buy them from independent (or semi-independent) suppliers, this does not necessarily mean that the subcontractors are more efficient. It may even be that they are less so but that the company management has discovered a better use for its workforce.

[17-7] In this way the comparative (dis)advantage principle provides a basis for full employment. The difficult question is how not to impede the invisible hand as it functions to provide full employment: in this sense the claim for more flexibility in the labour market is justified. But the two most decisive ways, in the modern world, in which the comparative disadvantage principle is being prevented from extending its beneficial effect (in terms of full employment) throughout the economy are the following: 1 °) In its promotion of competitiveness the State is directing further resources towards the so-called champions, so that medium and small companies, being deprived of financial resources, are hampered in their development; 2°) Being offered the option of receiving unemployment benefits with no strict conditions attached, many people simply make no effort to find a job which matches their capacities.

[17-8] The way in which the *White Paper* sets out to "deal with new needs" testifies to the very narrow meaning given by the European Commission to fresh opportunities for job creation. What the authors have in mind is nothing more than a preconceived list of "Sources of new jobs" to be offered by programmes that are supported by public money. The Commission's Paper points to "local services" and publishes a list comprising "Home help for the elderly and handicapped", "Assistance to young people facing difficulties" (the very expression used in the "Loi quinquennale" to designate the young graduates who can find no job and were offered on under-the-minimum-wage formula, a formula which they rejected when they defeated the French government in the streets), "Acting OS caretaker for blocks of flats" (in the old days, such caretakers existed in Spanish towns under the name of *serenos*), "Provisions of leisure and cultural facilities, provided they are thereby made more accessible to all" etc. The conditionality (emphasised by the use of the conjunction "provided'') attached to those "new jobs'' clearly indicates that what is being proposed are job programmes supported by public money: this has nothing to do with sustainable economic development generating new occupational opportunities. That, in a properly deregulated economy, new needs" are likely to be token core of by private initiatives benefitting from comparative advantages, or rather comparative disadvantages, seems to be a foreign idea to the authors of the Brussels blueprint. Otherwise they would not have confined their list to those few desirable and exquisitely media friendly local services (however much they deserve attention as such).

More Flexible Labour or More Flexible Companies?

Paul Fabra, written in English, 1994, 6/8, 23 paragraphs

18-1 The OECD Jobs Study reads as follows: "The single most important cause of rising unemployment, as well as a growing incidence of low-wage jobs, is a growing gap between the need for OECD economies to adapt and to innovate and their capacity and even their will to do so." Such a broad statement is a reminder of the limited relevancy of current analyses about unemployment. We shall not dwell on a slight but inconsequential contradiction: however rigid OECD economies may be, they still are by far the major source of innovation in the world. The authors of this otherwise inspiring work may tell us as often as they like that "Companies, trade unions, people and governments face the joint challenge of adapting to the new technologies and responding to intensified competition from around the world", they offer no global breakthrough to meet the "joint challenge". Why?

18-2 As far as governments are concerned, the study contents itself with renewing the ritual call for the need to "set appropriate macroeconomic policy". Indeed, the whole problem is defined as follows: "Macroeconomic policy has two roles in reducing unemployment: over the short term it limits short cyclical fluctuations in output and employment; and over the longer term it should provide a framework, based on sound public finances and price stability, to ensure that growth of output and employment is sustainable, inter alia *through adequate levels of savings and investment* (my emphasis-pf)". Stark facts are (a) that while governments have been praised for years (by the OECD, the IMF etc.) for having substantially improved the so-called "fundamentals" (price stability and so on), cyclical fluctuations are becoming increasingly violent and costly in terms of employment; (b) public deficits have been exploding in the whole OECD employment; (b) public deficits have been exploding in the whole OECD area (with New Zealand as one possible exception), encroaching upon savings and productive (private) investment. The solution which is advocated, namely "medium term…fiscal consolidation" is the stuff innumerable communiques of the G7 are mode of. In a separate study, we shall examine why such medium term fiscal consolidation programmes cannot help but fail, as they actually do. In the above historical survey, we have mentioned some destructive factors which have been at work since the Bretton Woods monetary system collapsed. (The Bretton Woods system for a while restore a monetary and economic – free trade – order to the extent that it was a reconstruction of the gold standard, and it ultimately floundered because it was only a partial reconstruction.) For the past, twenty years, global marketisation has been functioning more as an instrument of universal deficit financing than as an engine of sustainable growth of output and employment through adequate levels of investment. As for financial innovations, they aim mainly at protecting both the private and public sectors, at a very high cost indeed, from the ever increasing risks (volatile exchange and interest rates) attached to a system of unconvertible, i.e. floating, currencies. We are very likely approaching the point where the price paid for these defects, inter alia in terms of unemployment and the spreading of poverty in the so-called rich world, has become so high that both the notions of market economy and free trade will be emptied of any substance.

18-3 In this context, the way in which the key issue of flexibility is raised almost amounts to an admission of failure. The basic reason why the whole issue is flawed is because it is truncated, and this is so because no official body is willing to address the central question facing modern capitalist economies: precisely the inadequate levels of savings and investment. If the issue were properly tackled in all its aspects, one would acknowledge that the responsibility for a more flexible, i.e. a more adaptable economy lies first with private companies. Given the fact that any economy is based upon the combination of two productive factors, capital and labour – or, to put it more accurately: upon the availability of capital to employ people – it is obvious that if the economy in general and companies in particular are not irrigated with a sufficiently abundant flow of fresh savings invested in capital, the whole productive apparatus is working in conditions of “under-pressurisation”. This type of subdued economy not only operates below capacity, but has been crippled. At the level of firms this is a well-known phenomenon: a debt-ridden company, i.e. a company deprived of adequate permanent resources (equity capital), has no room for manoeuvring. Hence it is bound to shun any expenditures dispensable in the short term, however necessary they may be for future development, such as, for instance, proper training of its own workforce.

19-4 For the economy as a whole (we share the Hayekian reluctance to use phrases like “at the macroeconomic level” which is an invitation to reason in terms of statistical aggregates and diverts attention from the basic fact that “every transaction in commerce is an independent transaction”), one has failed to recognize the whole phenomenon of under-pressurisation because an “absence” cannot be directly measured and the cure would entail incremental increase. Let us assume that the amount of real wealth diverted from productive use by entrepreneurs is roughly equal to the real savings borrowed annually by the government to finance the budget deficit plus the amortisation of the accumulated public debt. Departing from this one can estimate roughly that with on extra investment of 5% to 8% of GNP in the production of goods and services, a measure of full-employment would be restored in most Western countries.

19-5 Unstable and part-time jobs in themselves constitute no sign of progress. On the one hand, the OECD study acknowledges that: “Even the official number of 35 million unemployed [in OECD countries] does not reflect the full extent of joblessness…There is considerable involuntary part-time work. In some European countries, short-time work, or “partial unemployment”, financed by unemployment benefit systems, has become common.” On the other hand, the authors are recommending “to foster the growth of voluntary part-time work.” In real life the boundary between voluntary and involuntary part-time work is extremely thin, especially if the applicant is entitled to a partial unemployment benefit. Obviously the problem is very different, both economically and psychologically, if (as is the case in Japan) flexibility of working-time is only a method for individual companies to minimise cuts in their workforce and – which should normally be considered each company’s own responsibility – to train or retrain their employees. Putting aside common prejudices the OECD experts write: “Only the Japanese economy handled the problems of this period of adjustment relatively well, although more recently it, too, has been wrestling with substantial pressures for changes”. Admittedly, some of those changes are desirable, but others seem to be unwelcome consequences of the weakening of the financial structure in Japanese companies, which so far have been amply irrigated by a steady stream of national savings (even though, in purely juridical terms, the Japanese corporations appear to be relatively poor in equity capital stricto sensu).

19-6 Of course, better training is highly desirable, but on infatuation with the idea [13] is part of the self-delusion many economists, experts, trade-unionists, presidents of employers’ organizations and, last but not least, politicians tend to indulge in, especially if training involves, as nowadays it regularly does, government-supported programmes. The Clinton Job Summit which took place March 14th and 15th in Detroit was an example of such organised enthusiasm. In particular, there are two facts of life that nobody with responsibility is willing to publicly acknowledge: 1°) There are many people who, for whatever reason, will never be fit for technological training (in spite of Robert Reich’s writings on the subject). 2°) There are many unskilled jobs (or jobs which are considered as such by experts of

[13] A stimulating analysis of the ambivalent evidence for training as a solution for the rich world’s jobs deficit is to be found in The Economist, March 12th 1994 under the title: *O Brave New World*.

the same persuasion os the U.S. Secretary of Labour cited above) which will keep on fulfilling useful social functions, as will become obvious when nobody is any longer willing to perform them.

20-7 The authors of the OECD Study themselves occasionally seem to be trapped in the simplistic vision according to which a technologically advanced society has no place for unskilled jobs (as if a PC meets all our needs). To them the appearance of widespread unemployment as well as of “poor quality” jobs “stemmed from the same root: the failure to adapt satisfactorily to change”. If there still are unskilled jobs this is because “education and training attainments have failed to keep pace with the requirements of a more technologically advanced economy”. However, one of their great merits is that they bring to light o taboo which could prima facie be expressed as follows: there is no unemployment where there is no unemployment benefit (this is true to a point)! The study puts it as follows: “In the United States, where the economy is highly flexible, many of those with few skills could find only jobs with poor wages and conditions. In Europe, Canada, Australia and New-Zealand, by contrast, such low-wage jobs were, by and large, disallowed by society, whether through state-imposed or union-negotiated wage/income floors and employment protection. So the problem which appeared as a combination of low-wage jobs and unskilled unemployment in the United States took the form in Europe mainly of unemployment of the low-skilled.” This analysis is only partly relevant. It misses three fundamental points:

20-8 (a) The first one is that unskilled employment is not doomed to be poorly paid. Wages will go up when the jobs are needed.

20-9 (b) The reason why unskilled jobs are associated with low wages (below the so-called poverty threshold) in the U.S. and elsewhere is the same reason why for the past 12 years or so, wages, both nominal and real, have scarcely risen even for skilled people in many OECD countries (notably France). During that period, profits which had been badly damaged by the stagflation of the seventies had to be restored. In the context of almost general scarcity of capital resources, this readjustment was accomplished at the expense of labour compensation.

20-10 (c) All work, skilled or unskilled, can be performed well or badly. This simple truth constituted the basis for what used to be called “conscience professionnelle”. To perform well was a matter of honour whatever the job. Can one be certain that such motivation, deeply rooted in the tradition of European culture, has become outdated? What is far from clear is the motivation for the more “advanced” European societies to “disallow” low-wage jobs and accept long-term unemployment with its frequent aftermath of despair, sloth and degradation. Must we forever take for granted and for morally, politically and culturally acceptable, something which amounts to an official system of gradual exclusion? Some fifteen years ago the Parisian dustmen were poorly paid and most of them were of African descent. With its management greatly improved (and without any significant rise in local taxes), Paris has been transformed into one of the cleanest big cities. Now dustmen are well-paid and have gained the esteem of the citizens, while a majority of them were born in the country from French parents (a sign that the profession has acquired some degree of respectability.)

20-11 The flexibility agenda represents the gist of the OECD study and quite an important port of the Commission’s *White Paper*. The basic idea is that a major cause for unemployment resides in the mismatch of demand and supply on the labour market. As the OECD study puts it, the aim is “in the context of high and persistent unemployment, to give more weight to the market-clearing role of wages, while pursuing equity objectives through other instruments” (the latter subordinate clause is discussed later). However, in my view this market-clearing role of wages is limited by nature: nothing compared with, for instance, the market-clearing role of prices in a commodity market (the prudent wording of the OECD indicates a similarly cautious approach). This position is not at odds with free-market economics. On the contrary. It is only at the end of the last century with the artificial and non-operational concept of “General Equilibrium” devised by Léon Walras that economists started to think of wages as being essentially determined by the interplay of demand and supply. On that score Keynes, who reintroduced the notion of wage “stickiness”, was nearer to the great than were the neoclassical economists. For all practical purposes (as well as theoretical ones which I do not intend to discuss here), I believe that the whole question of the role and economic status of wages should be examined with the following three considerations in mind:

21-12 (a) Labour as such is not a commodity, and consequently the notion of the “value” (i.e. price) of labour is strictly meaningless; [14]

21-13 (b) at the macroeconomic level wages must be considered as the portion of the gross national income accruing to employees;

21-14 (c) in each country and each period there is a broad consensus of what fair wages are. In this sense a statutory minimum wage need not constitute an infringement upon the functioning of the market, provided such statutory wages are not used as an instrument to raise minimum wages for the sake of egalitarian ideology.

21-15 Assuming that the minimum statutory wage simply reflects the general sentiment about fairness, another critical problem remains: the level at which the minimum unemployment benefit is fixed. If the difference with the market minimum wage for labour (statutory or otherwise) is too small then it will constitute a major inducement to unemployment. Any scheme entitling a minimum income to everybody regardless of participation in the labour force, should be rejected, even if such a scheme is presented under the Friedmanite label of “negative taxation”.

21-16 Proposition (b) provides the clue to both why the wage level is not bound to vary much over time, and how wage-earners can nevertheless price themselves out of the market: this happens when the remuneration they demand does not leave room for a profit on the part of the employer. Regarding the theoretical background to this aspect, the neoclassical principle according to which the wage is equal to the value produced by the “last” (marginal) worker hired is an artificial construction. Even the so-called marginal worker’s employment needs to contribute to profit.

21-17 Special mention must be made of the distortion of the market caused by heavy social contributions, especially those relating to low-wage employment. For the employer, such contributions add directly to labour costs and can be a disincentive to hiring, while the employee does not always perceive them to be a component of remuneration. That being said, the OECD study’s authors are right in stating that “it would be unrealistic to expect long-run declines in unemployment in response to tax shifting.” The real solution is not to shift contributions but to curb social spending and reintegrate a portion of the social security contributions into the wage-earners direct compensation. Any attempt to break the social security monopoly should be encouraged. Two important insurance-related EC-directives, which had to be implemented by July 1st, 1994, provide

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[14] For a discussion of the theoretical and practical implications of labour not being a commodity, see my book *L’anticapitalisme, Essai de réhabilitation de l’économie politique* first published in France in 1974 (reprinted in paperback – currently unavailable – in 1979 by Flammarion) and translated into English under the title: *Capital for Profit: The Triumph of Ricardian Political Economy Over Marx and the Neoclassical*, Rowman and Littlefield Publishers, 8705 Bollman Place, Savage, Maryland 20763 (1991). In this book I endeavour to demonstrate the fallacy of the celebrated diamond-water paradox upon which the founders of the marginalist and neo-marginalist schools built their theoretical concepts.

some leeway in certain areas relating to accidents, illness and retirement. Their full implementation should be encouraged.

22-18 From the above it follows that a policy which aims to make the labour market so flexible as to allow wages to fall to whatever level is needed to match supply and demand is a dangerous fiction, a fiction moreover which is bound to lead to further encroachment of the public sector upon the private one. Why? Note in the excerpt above how the OECD experts qualify their proposal to enhance the market-clearing role of the market. They suggest “pursuing equity objectives through other instruments”. However, equity in this context refers to the ensuring of deficiency payments to those workers whose remuneration has been settled below the fair wage (as estimated by society) through the operations of the clearing market. Obviously the deficiency payments will have to be mandated by the public authorities and corresponding resources will again be transferred from private savings to the State’s purse. This will widen the capital gap and consequently job-generating investments are likely to be nipped in the bud.

22-19 The latter circumstance accounts for the fact that the staunchest promoters of “active employment policy” – the European Commission, the Clinton administration and, in a more balanced fashion, the authors of the OECD study – understandably cannot believe in the objective they are supposed to pursue and come close to admitting it. Their avowed objective is to prepare the job-seeker for his entry into the productive private sector. Using a Robert Reichian vocabulary the whole exercise aims at nothing less than the birth of the new information era. The old-fashioned “foot soldier” of capitalism, the production worker, must be replaced, in Reich’s words by highly-trained “problem-solvers, problem-identifiers and strategic brokers” dealing with “knowledge-intensive” processes in “high-performance work-places”, except that there will be fewer workplaces in a world where computerised messages “flow quickly and clearly” and where there is “no place for bureaucracy”. In real life, it very often appears that the first thing trainees need to be taught is to learn to express, orally and in writing, a few intelligible sentences in their own native language (which might prove useful for conveying “messages”).

22-20 Under the name of “active measures”, as opposed to “assistance”, the Jacques Delors *Withe Paper* proposed the “full-scale overhaul of employment policy” nominally endorsed by the Twelve in their December 1993 European Council. What does this mean? The Commission’s paper reads as follows: “A complete reversal attitude is required, the aim being to prevent long-term unemployment. On the one hand, the unemployed should be offered, according to how long they have been unemployed, first training leading to meaningful qualifications, then the possibility of working, possibly *in the public sector* [my emphasis-pf], for or a number of months. In exchange, unemployed people who are thus given real assistance in returning to employment would make a personal investment in this training and employment.” For good measure it adds: “Such a substantial change would require a considerable increase in public employment services.” In other words, it appears that the surest way to cut unemployment is to appoint as many public employment advisers as are necessary to attend to “every” unemployed person and to enlist the newly trained unemployed as assistant public advisers.

22-21 For many years the Swedish unemployment policy has been considered a mode and what is presented under the name of “active policy” is a (more or less accurate) imitation of it. However, what deserves praise and imitation in the Swedish System is – why should one refrain from saying it? – the Lutheran approach to work ethics (for a long time the system used to be very tough on the unemployed who refused job offers). Until recently admirers of the Swedish model have made us believe (and probably themselves believe) that the low level of unemployment in Sweden was evidence for the effectiveness of active programmes emphasising training and mobility of the workforce. Without denying any positive effects in this respect, one is now more aware of another and certainly more decisive fact: during the seventies and most of the eighties in the Nordic nations the public sector absorbed much of the growth of the workforce. When exploding public deficits prompted the Swedish government to stop hiring applicants, the rate of unemployment started to soar.

[23-22] The way the “overhaul” is presented by the Commission is also misleading in another way. It hides a disturbing analogy between the so-called old and the new approach. In contrasting “active” unemployment policy with the “passive” attitude which consists in restricting intervention to providing replacement incomes for the unemployed, the Commission fails to say that the unemployment insurance and related benefit systems currently dubbed “assistance” were originally devised as active measures. Appropriately the OECD study recalls that those systems “have drifted towards quasi-permanent income support in many countries” but that they “were originally designed to provide temporary income support to the unemployed *during the process of finding a new job* [my emphasis-pf].” With the Commission admitting (above) that the change “would require a considerable increase in public employment service”, suspicions arise that the whole programme amounts to a considerable expansion of the public-assistance sector. This, however, is possibly the greatest danger threatening Western societies today. Briefly, so-called “active” unemployment policies, that ignore the main couse of unemployment (lack of flexibility on the part of the companies owing to their lack of capital) are flawed with contradictions and call for ever more state intervention. Flexible labour and training are the two most important components of these “active” policies, but how con one expect companies to train staff when they employ part-time or to a short duration? State-supported training programmes are often no more than disguised assistance programmes, designed to take care of people who have not found a “flexible” job.

[23-23] The Clinton administration has devised a plan to “end welfare as we know It . The gist of the plan is to put a two-year time Iimit on welfare; beyond that point, recipients would be required to work. So far so good. In practical terms the scheme is very ambiguous and raises many questions. How far will the requirement be enforced? In 1989 the Michel Rocard government created a *Revenu Minimum d’Insertion* (minimum income of entry into active life): the insertion condition was very quickly forgotten and since then the number of people on RMI increases by 20% a year. A large portion of the French Caribbean islands and of the Réunion Island populations is living – and, indeed, gambling on the national lottery – on this programme. However, suppose the work requirement was seriously enforced in the Clinton scheme: would that mean that the ex-welfare recipient will keep on receiving checks from the government on the single condition that he or she is working? It would, but would this constitute a real change? The scheme explicitly promises to create public-service jobs if necessary. Though official experts contend that the private sector will be in a position to provide most of the jobs, they have nevertheless already calculated that they will need to create about 400,000 public jobs by 2004. Others outside the administration (see *The Economist*, June 18, 1994) deem it more realistic to multiply that figure by almost 4. The author, of the article in *The Economist* adds: “And the public might come to see too big a jobs programme as welfare by another name.”

The Idol Productivity

Paul Fabra, written in English, 1994, 7/8, 12 paragraphs

24-1 The whole problem of unemployment is made worse by the private sector overstretching the notion of productivity.

24-2 One could contend that the concept of productivity is misused, thus bringing companies to lay off too many people. The negative effects of such “human resources” mismanagement are compounded by government interventionism. Public programmes subsidise companies both to induce them to hire young people and to allow older ones to leave prematurely on early retirement schemes. Consequently many companies have a double incentive to substitute young and relatively untrained workers for experienced ones. This policy, however, deprives them of the possibility to conduct on intergenerational management of their own workforce. No wonder, with training increasingly becoming the State’s responsibility.

24-3 No doubt, maintaining employment for the sake of employment would be a meaningless posturing, and a very destructive one indeed for any company and for the whole national economy. This fact does not detract from some glaring inconsistencies about productivity. Take, for example, the following familiar statistical item. To pin down the competitive edge of the Japanese car makers over their European counterparts, emphasis is usually placed upon the much higher “productivity”, roughly double, of Japanese workers compared with the Europeans (and Americans). While Nissan’s or Toyota’s plants turn out about 80 cars per man a year, the average annual output per man is about 45 in European car factories.

24-4 These are doubtlessly interesting figures which the European (and American) manufacturer cannot afford to ignore. However, in themselves the figures are hopelessly insufficient for assessing the relative competitive position of the industries compared. The missing information is the extra cost in capital investment, if any, at which the Japanese performance has been accomplished. To be significant the comparison must include the depreciation costs incurred by the various competitors. Why should one assume that a greater use of robots is always rational? The very obsession with “productivity” performance can constitute an inducement to systematically replace manpower even where this is not justified on economic grounds. Yet investment for the sake of investment has nothing to do with a market-oriented economy. It should properly be called cd a *Gosplan* (or Stalinist) approach to economic management. How can one explain that, in a free market environment, managers happen to conduct their business contrary to the laws of the market?

24-5 Productivity is defined as output per unit of input employed. Because it is possible to divide a quantity of output either by the number of people employed in its production or by the number of capital units bestowed on it, modern mainstream economists and statisticians conclude that such a thing as labour productivity and such a thing as capital productivity ought to exist separately Intuitively it is clear – to us and to them – that such a distinction does not correspond with economic reality. Even the most unskilled work cannot be performed without the help of a tool (capital good). One cannot sweep the courtyard without a broom. Though the sweeper Peter can perform better, or worse, than the sweeper John with the same broom, both sweepers’ labour is productive only because they have been provided with an instrumental device.

25-6 Capitalist logic is for a firm to concentrate on the return on capital invested in the liability sense. [15]. From that point of view there is no such thing as productivity per worker: the capital invested has been used to set in motion a process of production (of goods and/or services) involving labour and machines. So entrenched is the model through which capital is viewed not as a prerequisite but as a substitute for labour that the very mechanism of capitalism is distorted. Consequently, the very meaning in economic terms of technical progress has almost fallen into oblivion. It is a long-established economic truth that any improvement in the production process ultimately boils down to an economisation of human toil. If less work is necessary to produce o computer (including the work performed on the machines used to manufacture the computer and on all other inputs), the market value (price) of the computer will decrease accordingly, assuming there is free competition in the marketplace. In this case the benefit goes entirely to the consumer.

25-7 This fundamental effect of a competitive market contradicts the commonly accepted idea that productivity gains are shared between "social partners" (workers and capitalists). In the Commission's *White Paper*, it is suggested that the sharing should be negotiated between employers and trade-unions under the guidance of the government. This is incompatible with the mechanism of competitive market where profit is defined as what is left for the owner of capital once competition has ensured the full benefit of improvements in the productive process to the consumer.

25-8 From the arbitrary assumption that the benefits of improved productivity are destined to be shared, it follows that the greater the output per worker, the greater the firm's share is likely to be (whatever the bargaining power of the unions). This is the basic reason why, quite illogically, productivity of labour is nowadays considered as a gain for the firm even though (as noted above) it is achieved at the cost of disproportionately onerous investment in equipment and other devices. However, seeking profit by reducing the denominator in the ratio output/workforce is an endless and deceptive game: fierce competition lowers the selling price and the clients (including the staff of the firm) quickly become, as they should, the sole beneficiaries. Each wave of lay-offs is followed by another at an accelerating pace. Managers would do better to focus on o more balanced (between labour and equipment) organisation of their company so that investment will still yield a nice net profit at a *competitive* (and not at a monopolistic or oligopolistic) *price*. This analysis can be pursued to demonstrate how the wrong approach is leading firms to incorrectly determine their marketing policy. Instead of endeavouring to maximise the profit margin per unit of product sold, they had better pay more attention to the rotation of invested capital. Basically, rotation of capital is the soles/investment ratio which measures the capacity of an investment to generate fresh sales (turnover). With higher rotation, a lower profit margin per unit of product sold could translate into an increased return on investment (the only thing which matters). By opting for the second alternative, they could both strengthen and expand their position in the marketplace.

25-9 The proper functioning of capitalism is impeded by standard economic models. For many years capitalist logic has too often been overlooked, also by free-marketeers. The latter are influenced as strongly os everybody else by the methods and concepts of national accounting. These are generally taken for granted in spite of their being largely a by-product of the war economy, i.e. of a command economy. The very notion of labour productivity os distinguishable from capital productivity is a by-product of the national accounting approach to economics.

25-10 Only a direct approach (one which disregards aggregates) to the functioning of a free market discloses the mechanism whereby cheaper goods and services produced by more performing

[15] The word capital can be used to designate o portion of the assets (for instance: a capital good) or a portion of the liabilities, i.e. of the resources (equity capital).

machinery and organisational methods translate into enhanced purchasing power for consumers. As a rule the extra funds thus released will generate further savings which in turn will provide fresh capital to produce new goods and services. Full employment will not be impaired. The misunderstanding cannot be illustrated more clearly than by the following extract from the Jacques Delors *White Paper*. "Increasing investment profitability requires *distributing productivity increases among capital and labour* [my emphasis-pf]. During most of the 1980s, real wages increased in the Community on average by one percentage point less thon productivity. This could constitute an acceptable rule of thumb to be followed to achieve the necessary improvement in profitability and competitiveness…"

[26-11] First of all, with the 80s having been a period of underemployment in Europe, to recommend a continuation of the some path does not seem very appealing. Second, the whole policy recommendation is an appalling example of the confidence planners have in the most unreliable national accounting statistics. There is no reliable measure of "real" wages and productivity for any one country, let alone for the whole Community. As for the 1 % gap cited, the figure is smaller than the accepted margin of error! How can one purport to devise on economic policy on such a shaky basis? However, even if these statistics were "acceptable os a rule of thumb", the fact would remain that the reasoning itself is a blatant, although quite common, misinterpretation of the way in which a market economy functions.

[26-12] We know that in a highly competitive environment (as is currently the case), there is no "distributing" of productivity gains among capital and labour. Any improvement in the production process will, sooner rather than later, lead the producer, willingly or not, to cut the selling price in proportion to the reduction in the production cost. Moreover, the recession has shown why and how it is perilous for a producer not to include this law of the market in his marketing policy. Whenever market shares become more vulnerable, a corporation eager to retain super profits will encourage new entrants. The latter will offer lower prices. Under the condition that the cheaper goods still allow a reasonable, though moderate, profit, new entrants may end up dislodging the older producers.

Conclusion and Recommendations

Paul Fabra, written in English, 1994, 8/8, 22 paragraphs

[27-1] In order to outline a pro-employment policy one needs a reappraisal of most current attitudes, concepts and methods. By its very nature an economy of exchange is the opposite of economic war. Free trade means that importing a car from Japan into France – a transaction mutually beneficial for the exporter and for the importer – is basically the same type of operation as when a Frenchman from Marseilles buys a Peugeot manufactured in Sochaux, near the Swiss border. Until the early seventies, the opening of frontiers and new markets, the introduction of new technologies, the rapid industrialisation of formerly agrarian countries (Spain, Italy, even France are good examples) were phenomena associated with as yet unheard of growth and improvement in the standard of living – and with full employment. During the past twenty years or so, employment has steadily deteriorated – in quantity and very often in quality. The blame is laid on both the emergence of new technologies and the Newly Industrialised Countries (NIC). This view, however, boils down to no more than an attempt to vindicate the Marxist analysis of free capitalism.

[27-2] In Europe millions of people, young and old alike, despair of finding a job or, if they have got one, are fearful of losing it and not being able to find another. The fundamental cause is not greater competition from abroad and in particular from NIC. Neither is it the intensification of technological change. The historical events have borne out, with a vengeance, what the greatest thinkers in political economy have established since the last quarter of the 18th century, at the down of the twin industrial and democratic revolutions in the European-American world: free capitalism (meaning the economic system based upon individual initiative) is both the most favourable environment for technological progress and the fastest multiplier of jobs – and consequently of purchasing power – ever recorded. The collapse of communism should be a warning: the Soviet Union may have been able to launch sophisticated missiles into space but it was unable to produce staples and ensure a decent living standard for its population, in spite of (or rather because of) the essentially distributive nature of the system.

[27-3] What really happened in the early seventies was the partial dislocation of the world order at the very moment that a mighty movement of globalisation was gaining momentum. That is the contradiction which still faces us. With the collapse in 1971 of the gold standard that was reshuffled at Bretton Woods, each national unconvertible currency become the centre of on independent price and interest system. Unconvertible currencies started to float with each other again as they had done in the early twenties and in the thirties. For years the ghost of deflation was exorcised through the hugest inflation ever recorded peace time. Within 25 years the quantity of money issued notionally and internationally (Eurocurrencies) roughly multiplied by 15. The great beneficiaries of this unleashed power to print money (*fiat money*) and therefore to tax the public at random have been the national states, at the expense of private producers and consumers.

[27-4] As in a war, there are no limits, so it seems, to the governments' capacity to borrow and spend. When private investors are submerged by ever-increasing flows of treasury bonds on the market and become reluctant to purchase them, commercial banks start lending to the governments – the modern method of reactivating the money-printing machine. The stark truth is that everywhere too huge a portion of private savings is being absorbed by the over expanded public sector's borrowing requirements. Consequently, the source out of which productive capital is formed is shrinking. However, no jobs can be created without a prior investment of capital. In this environment the terms of the unemployment drama can be summarised in a few points: through granting unemployment

insurance and the related benefits system, governments are buying political and social peace at an increasingly higher price. The assistance mentality is gradually demoralising the working population and the youngest population. The best way to reverse this situation no longer lies in exclusively focusing policy, as many well-intentioned free-marketeers do, upon “increasing wage and labour cost flexibility”

28-5 As in Adam Smith’s time, “The annual labour of every nation is the fund which originally supplies it with all the necessaries and conveniences of life which it annually consumes.” It is not a question of paying labour less. It is a question of (re)channelling towards productive employment a substantially greater proportion of available resources. The very fact that such a huge portion of the latter are currently being squandered by the political profligates in western societies is evidence that the resources are there. The whole issue must be redefined independently of modern socialist, Keynesian and neoclassical ideologies and translated into grassroots economic terms: to save in order to invest in profitable projects and in so doing to offer more jobs and promote consumption. The Newly Industrialised Countries are doing exactly this.

28-6 It is the governments’ interventions that are distorting the working of the markets, transforming them into a battlefield where subsidised National Champions vie with each other to be the “winners” in procurement-contracts adjudication. In what we have called a Darwinist approach to competition, full employment is the victim, even if the official objective is to create or to save jobs. The first thing that must be done is to stop pretending there is an economic war and protecting big business. The authors of the 1994 OECD study very appropriately write: “The survival and expansion of new firms is impeded by policies which, often inadvertently, unduly favour “rent-seeking” in large well-established firms. Substantial government resources currently are transferred to large firms, often as job protection subsidies.” Unfortunately, the authors stop at this point of their analysis and conclude that the solution resides in extending the same system to all enterprises: “Small and medium-sized enterprises typically receive very little support. There is useful scope, often at relatively little budgetary cost [the usual argument to promote further public spending; it is particularly dubious in this context -pf], to improve access of new enterprises to government programmes in the areas of R&D, job creation and training.” In reality, small and medium-sized enterprises would need no governmental assistance if they could operate in a marketplace where big business is not being unduly subsidised with public money. A fair playing field does not mean that every player has to be “advantaged”. Both the budget and the private sector as a whole would be in better shape with a hands-off attitude on the part of the political authorities.

28-7 A restoration of full employment is possible but it calls for a major assault upon the ways in which public and (in self-defence) private affairs are currently conducted. Below a series of necessary reforms is listed:

28-8 ● Fiscal policy: a conjunction of soaring annual spending and of a huge accumulated public debt has created an almost unmanageable situation in almost every EC country (not to mention those which are still outside). Both aspects will have to be faced boldly, and the sooner the better. The policy must have as its explicit objective to (re)channel savings from the government debt market to the capital (stock) market. This means that the budget must be balanced. As for the curbing of current spending and deficit, we have misgivings about the method currently adopted in certain countries, namely the adoption by parliament of a Medium-Term Programme. First, such programmes actually involve no binding commitments on the part of the government. Second, they are still derived from the notion of “economic stabilisers” and from the idea that the budget only needs to be balanced over time. In times of recession, a deficit arising from fresh spending and from lower tax-revenue is welcome because it is believed to support economic activity. However, if only because of the "explosion" of deficits and the high cost of debt-servicing, the theory is unsound and should be openly rejected. Fine-tuning has long (since Kennedy's presidency) proved to constitute a succession of petty disasters that amount to one big and unremitting one. The only Sound approach is to solve problems and suppress deficit as they arise. Sound public finance entails annually balanced budgets. To begin with, governments would have to introduce considerable cuts in subsidies, to stop tampering with industrial policies, and, last but not least, to review current entitlements programmes with the aim of reshuffling them and reducing the cost for the public purse. In particular, pensions and social benefits funded on a "pay as you go" basis should be replaced as a rule by "capitalisation".

[29-9] However, a return to sound public financing cannot be adequately achieved while the central banks are allowed (and induced) to "intervene" in the exchange markets. For the past 35 years or so, by far the most important interventions have been those supporting the dollar (mandatory under the Bretton Woods fixed exchange rates system, discretionary since March 1973). As the dollars thus acquired by central banks are immediately invested into U.S. Treasury bills and notes, the whole mechanism boils down to the extension of direct loans to the US government by foreign central banks. During all these years, such loans have been providing Congress with extra spending money. This is a major cause of the apparently intractable U.S. twin deficits (budget and current balance of payments): when money is freely available, politicians usually spend it. Contrary to what Milton Friedman and other academics and economic pundits forecasted in the late sixties and early seventies, support interventions in the exchange markets not only have not ceased (or decreased) after 1973 with the dollar floating, but they have been hugely increased. In the year 1987, ¾ of the U.S. fiscal deficit was financed by foreign central banks in this fashion. This international monetisation of national debt is a major disruptive factor, both for the indebted country and for the creditor. In the case of other national currencies used as international exchange reserves (the DM being the most important one, next to the dollar), the monetisation is neither so straightforward nor so automatic. However, the fact remains that by acquiring Demarks in the exchange market and depositing them with commercial banks, foreign central banks are also providing the German monetary market with liquidities, thus indirectly facilitating the funding of German public sector deficits.

[29-10] One must bear in mind that the unique feature of an international gold standard (not the Bretton Woods version of a "gold-dollar" standard) is that stable exchange rates are maintained without any intervention (thanks to usually very small gold movements between financial centres). Such a mechanism must once again be devised and implemented.

[29-11] Could a sounder monetary system be implemented without a conversion of the national public debts? Probably not. Very likely the present generation will have to face this complex issue. Accumulated long-term public debts issued at extremely high interest rates are already providing a very heavy burden for the national budgets. The threat to internal and external stability (volatility of exchange rates is mainly caused by investors switching from U.S. to German bonds or from Swedish to Dutch bonds, etc.) arising from the ever increasing accumulation of public debt is likely to grow over the coming years. Many technical "solutions" can be devised to escape from the trap, but they all involve a sacrifice on the part of the state's creditors. This is illustrated by the way the LDC (Less Developed Countries) debt crisis was dealt with. As the market value of the debt is decreasing (interest rates are rising), one possibility might be for beleaguered Treasuries to offer bond owners a repayment of the debt at market price. Another one might be to refund and consolidate the debt by converting outstanding bonds into longer-term bonds issued at a much lower rote (around 3%). Both solutions could be made optional. Some prominent and conservative-minded economists, among them the Nobel Prize winner James Buchanan, think that the next generation will have a good case

for repudiating outstanding debts, on the grounds that the financing of recurrent public consumption by public borrowing is in itself immoral (on opinion I share) and that high interest rates actually imply anticipated repayment of the principal.

30-12 ● Tax policy: most continental countries still have much too high marginal income tax rates (over 50%). As a first step, 45% should be considered os a maximum. Fewer loopholes, a broader basis for taxation and lower rates should be the principles along which reforms are implemented. The ultimate goal should be to implement proportional taxation of income instead of progressive taxation. Proportional taxation is highly desirable because it would constitute the decisive break with the *systematic* policies of redistribution which are causing unemployment and a decline in the standard of living for the majority of the population. However, a gradual shift from progressive to proportional taxation should not be matched by a commensurate widening of the gap between high low incomes. To a certain extent, the market upwardly adjusts high incomes to allow for progressive taxing.

30-13 Abolishing the corporate tax is another overdue reform. The latter reduces the capacity of the economy to generate fresh capital. It is an indirect instrument of interventionism: governments distribute privileged treatment in granting exemptions or lowered rates.

30-14 In the longer run, a fresh look at certain aspects of the VAT will prove necessary. It is a fact that VAT on a wide range of services delivered to the final consumer – for instance, the VAT levied on carpenters, house pointers, etc. – is largely evaded. The difficulty of administering the tax has prompted exemptions in every country. Fraud and exemptions are sources of distortion. It would be wise to exempt all services at the final stage (direct soles to consumer).

30-15 ● Organise a political debate about the effect of public borrowing, which will bring to light that its economic effect is no better, and usually worse, than plain taxation. Submit public borrowing to strict limits which are voted by parliament every year. Due allowance should be made in the borrowing schedule for the financing of public works. However, this does not mean that in times of recession the government should plan extra public works programmes to compensate weak business activity. This was already criticised in the New Deal by Per Jacobsson, a prominent Swedish economist (who died in 1963 while he was Managing Director of the IMF). In a lecture held in May 1938 on the "Conditions for Recovery", [16] Per Jacobsson noted that "from 1931 to 1937 the increase in the national debt of the United States amounted to $20 milliard or nearly as much as the increase during the world war", and said that against this policy "must be set the fact that the absorption of funds by government agencies deprived the market to a very considerable extent of the impetus that would normally be exerted by private funds seeking investment. For the absorption by the government of bank credit and savings at such a high rate *necessarily reduced the amount of private funds on the lookout for new investment* [my emphasis-pf]. It is true that the amount expended by the State would generate income and from this income perhaps 10% or 15% would be saved but that addition in itself would be only a fraction of the actual amounts originally absorbed and leave only little for other investments, *as long as the demands of the government continued undiminished* [my emphasis-pf]."

30-16 It is worth noting that in 1938 such a leading economist perceived no significant recovery in the U.S. economy. Nevertheless, the mythology of the *New Deal* which is still alive, is largely based upon

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[16] The English version of this lecture was published in 1958 in *Some Monetary Problems International and National* by Per Jacobsson, Basle Centre for Economic and Financial Research, Oxford University Press. The speech was delivered on May 24th, 1938 at the *Institut für Weltwirtschaft* of the University of Kiel and appeared in that year in the original German Text in the series *Kieler Vorträge* No. 56.

the illusion that the public works programme (Tennessee Valley and the like) actually stimulated the general activity. Significant is also the parallel which Per Jacobsson draws between the way an interventionist policy is financed and the way a war economy is financed.

31-17 ● Industrial versus monopoly policies: from the above it follows that it is not the responsibility of governments to ensure "competitiveness" of the corporate sector, except in very broad terms (to provide business with an environment of sound money, reasonably low and neutral taxation, etc.). A market economy must surely be abetted by "antitrust" regulations, but the size of a company as such does not imply that fair competition is at risk. Modern economics (which also has its bright side) could help to devise a reasonable policy, by showing that what matters is that new entrants may enter the market at any moment and compete with the producers already there. To ensure this openness of the market should be a prime goal for policy-makers. Most of the time free trade provides its own solutions. Again, that which is endangering the working of markets toward full employment is the war-like collusion between Big Business and Big Government.

31-18 ● Capital markets: since 1982, stock markets have been almost completely overshadowed by bond markets. Interest rates reign supreme but they are no longer influenced mainly by economic factors. They are determined mainly by the degree of confidence placed in governments for coping with the public sector deficit problem and with the ever-looming "dollar problem". Sounder public sector financing must be accompanied (and even preceded) by measures aiming at introducing further impetus to capital markets. One very important measure would be to restrict the possibility for the corporate sectors to retain profits: it would be much better if entire profits were distributed as dividends to shareholders. This would both increase the flow of funds reinvested in stock markets and allow a more market-oriented allocation of those funds. The corporate sector should be induced (without undue government interference) to recapitalise: more equity capital in absolute and relative terms; less debts in relative which consists in terms. Needless to stress that the "junk bond" approach, which consists in making medium-sized companies pay access to funds at much higher prices, is no solution.

31-19 ● Make corporate accounting more strictly "capitalist-minded". For instance: goodwill is not on asset.

31-20 ● Abolish the monopoly of Social Security where such monopoly exists (which is the case in most European countries). Direct wages should be increased and the non-wage component of the pay-roll proportionately diminished. Here too, it is imperative that capitalisation be promoted instead of the "pay os you go" system for financing social benefits. As long as pension and health care benefits are not fully funded, the public sector will be a burden on the development of full employment capitalism.

31-21 ● Make stricter the granting of unemployment compensation benefits.

31-22 All these measures aim at nothing less than creating the conditions for a durable peaceful global economy This objective is something on which the right and the left should agree.