

OECD MINISTERIAL MEETING: 17 JUNE 1981

STATEMENT BY THE RT HON NIGEL LAWSON MP, FINANCIAL SECRETARY TO THE TREASURY.

There is, I think, general agreement that this meeting is taking place at a time when the OECD economies, including the United Kingdom's, are in a difficult transition phase. After absorbing the impact of the 1979/80 oil price increases the industrialised countries' task is now to move towards a sustainable recovery of output without rekindling inflation. The United Kingdom's experience over the past two years has mirrored broadly that of others. Our experience in terms of output and unemployment has for various reasons been more severe than that of most other countries, but the reduction in inflation that we have achieved has been particularly substantial and there are growing signs that the trough of the recession has been reached.

Looking at the world economy as a whole at this point in the cycle there is, I think, no need to take too pessimistic a view. There have certainly been some encouraging factors in the way in which economies have adjusted to the 1979/80 oil price increases and the prudent policies adopted in the past two years are proving their worth. The IMF Interim Committee rightly said in their communique at Libreville the other day that the reaction to the second oil price increase had been better managed than the first. The direct impact of the two oil price increases on OECD economies was much the same. However, and the contrast is I think an interesting one, output was on average two per cent higher and inflation three per cent lower in 1980/81 than in 1974/75. It is the non-accommodating policies which the major countries have largely followed since 1979 which have produced these results. They have helped to ensure that on this occasion pay increases were more moderate and did not simply reflect automatically the inflationary surge of the oil price increase.

Another area in which the OECD economies have done better is energy use. As the Secretary-General's paper points out, overall energy used per unit of output fell by five per cent between 1978 and 1980. In the case of oil alone the drop was as much as twelve per cent. Most of this success can be attributed to vigorous use of the price mechanism to transmit the correct signals to consumers and to producers.

We should also note that in spite of the large external current payments imbalances of the past two years the recycling process has worked relatively smoothly. This has reflected both the efficient operation of the international capital markets and, in the case of some of the needier developing countries, the increased role of the multilateral financial institutions in channelling funds.

A recovery in output now seems to be getting under way in the world economy as a whole. Certainly it is at present somewhat modest and hesitant. It would be unrealistic to expect it to be otherwise. Not unnaturally, there is deep concern about the costs, particularly in terms of unemployment, of adjusting our economies to rapid changes in the world environment and to restoring the basis for sustainable growth without inflation. However, the experience of the 1970s has taught us an important lesson which we disregard at our peril. This is that until inflation and inflationary expectations are convincingly mastered there will be no basis for any lasting or worthwhile increase in output and employment. Some I know may be tempted to argue that with unemployment at its present level we cannot afford to do as the IMF Interim Committee recommended, and I quote, "continue giving the highest priority to fighting inflation". But this is to see unemployment and inflation as alternatives, to believe that there is some kind of stable medium-term trade-off between them. I am convinced that there is not. The two problems are inextricably linked. Over the past two decades both inflation and unemployment have peaked at ever higher levels in each successive business cycle. Within

our economies rigidity has been piled upon rigidity and inflexibility upon inflexibility and in many cases the area within which market forces could operate has been progressively reduced. This has had the effect of a ratchet mechanism embedded in the system. This surely indicates quite clearly that it is not possible to reverse the trend of unemployment either by generalised demand measures or by short-term action to paper over important structural cracks. The inflationary risk of such policies is simply too great, particularly at a time when the rate of inflation in many countries still remains stubbornly high.

So far in the fight against inflation most of us have placed the main emphasis on monetary policies, and there can be no doubt that a slow-down in the rate of monetary growth is essential to secure a reduction in inflation. In general countries' attempts to control monetary expansion have been rather more successful than their attempts to control government borrowing and this has been an important factor I believe behind the very high level of interest rates throughout most of the industrial world. I note the concerns that have been expressed about the international transmission of interest rate pressures between countries and the accompanying fluctuations in exchange rates. We all have an interest in a reduction in inflation in the economies of the main reserve currencies and I believe that this will only be achieved if domestic monetary policies are tailored to that end. At the same time, monetary firmness does need to be supported by appropriate fiscal policies if interest rates are not to be asked to bear too much of the burden. Again, this is something that was acknowledged by the IMF Interim Committee. It was to get a better balance between fiscal and interest rate policy in the United Kingdom that the Chancellor of the Exchequer took some tough and unpopular measures in his Budget in March of this year to reduce public borrowing significantly as a share of GDP, despite the depths of the recession.

Firm macro-economic policies, however, need to be supported by policies to remove the rigidities in our economies and to improve the working of markets, both domestically and internationally. We need to encourage the efficient allocation of resources in goods, labour and capital markets. At the international level we need to preserve the open world trading system which has been a powerful contributory factor to the growth of our economies over the past two decades. A retreat into protectionism would be self-defeating, with grave risks of exacerbating inflation and no guarantee of benefits to output.

I do not for a moment under-estimate the gravity of the problems that confront us, but I do believe that we can take encouragement from the progress achieved so far and above all that we should persevere with the prudent policies needed both to conquer inflation and to provide the only basis for sustainable growth. I have no doubt that a reversal of these policies will risk throwing away the important gains that we have made, and to no advantage, and would simply mean that the costs of the past two years have been in vain.

Having listened to the very interesting contributions of my colleagues during the morning session, it is of course clear that there are some differences of opinion round this table. It is clear too that there are a number of differences of emphasis. But what struck me most forcibly was the very substantial degree of agreement, the very substantial concensus, that was emerging from the majority of the contributions. The tone was set initially by my German colleague, Count Lambsdorff, and the same message was echoed broadly speaking by among others my colleagues from the United States, from Canada, from Japan, from Australia, from The Netherlands, and others. And that general message, that broad thrust of agreement, seems to me to consist of three main points. First that the fight against inflation must continue to enjoy the highest priority. This is not an alternative to a policy against unemployment, indeed no sustainable reduction in

unemployment is possible without it. Second, this means that we have to maintain a firm framework of a non-accommodating monetary and fiscal policy. I thought there was wide agreement in particular on the need to control and to reduce budgetary deficits. Third and finally, there seems to me to be a clear agreement on the need for structural and supply side policies to reduce the rigidities of our economies on a medium-term basis. Admittedly this is harder than what, I think Mr McNamara called the quick-fix policy of a short-term boost to demand, demand stimulus. It is harder partly because there are vested interests always at stake that one is tackling. But the difference is that tackling the structural and supply side problems are a part of the solution whereas the quick-fix demand stimulus is in fact a part of the problem. And so I am encouraged by the wide degree of agreement that we have heard this morning on these three key points.