UNCLASSIFIED/NONCLASSIFIE

UNCLASSIFIED/NONCLASSIFIE

3

## IN MY VIEW

Observer
June 14, 1987

BY WILLIAM KEEGAN

# The Empress's new clothes

EVENTS may shortly demonstrate that the election was even better timed for the Empress than she thought. The only surprise was that she did not choose Ascension Day itself.

The first thing the Government must do is return to reality, and forget its campaign rhetoric. It inherits, from itself, an economy that is at or near the bottom of the European growth and employment league (from 1979 to 1986), with one of the highest inflation rates in the industrial world.

The recent spurt of growth, which results largely from the re-application of the economic policies of the 1970s — fiscal and monetary expansion, devaluation, that sort of thing — has badly damaged the non-oil trade balance, but the effects continue, for the moment, to be disguised by the North Sea.

More immediately worrying for the Government is the general acceleration in wage inflation in the private sector, and the outbreak of strikes, go-slows and so on in the public sector. According to the *Financial Times*, the industrial relations scene in the country is, even now, not greatly improved from the 1970s. There could be a few problems here.

But I suspect the real threat lies outside. Politicians are fond, when it suits them, of talking as if the British economy were an independent entity, over whose destiny they can have full control, provided they are given office. They are also, when things go badly, equally capable of pointing out that the UK is only a small part of an increasingly integrated world economy, and highly vulnerable to the international trade winds.

The truly interesting economic events during the past month have not taken place in Britain at all. While various partisan voices in this country fantasise about 'economic miracles' and 'a permanent revolution in expectations,' the chassis on which the world economic system runs has been showing disturbing signs of falling apart.

Perhaps the most illustrative symbol of this is the 'resignation' of the single most important figure on the world economic stage during the 1980s — that great national and international public servant — Paul Volcker of the US Federal Reserve Board.

Volcker is one of the few people I have encountered in this business who comes perilously close to heroic status. In a country where greed and self interest were considered the great social virtues long before Mrs Thatcher was thought of, Volcker has run the most important central bank in the world on a salary lower than that paid to a British Prime Minister.

It is no secret in Washington that Volcker would have stayed on at the Fed if he had been asked to do so in the national (even international) interest, and provided President Reagan had given him the reassurances he regarded as necessary on economic policy.

Reagan did not give him those reassurances; nor did he make a serious attempt to dissuade him. Volcker had been arguing that the US was living beyond its means, and that, in addition to

the dollar devaluation of the past two years, it needed to cut its budget deficit, and reduce domestic demand, so that production could be transferred to exports, and import saving.

The US budget deficit had led the western world out of recession, but enough was enough; Volcker kept pointing out that the United States was having increasing difficulty in financing both its budget and balance of payments deficits, as the scale of its overseas debts soared. Like any other country in such a crisis, it should be drawing in its horns for a while.

On the way to the Venice summit President Reagan made it plain he was not prepared to contemplate the kind of tax increases—on petrol, alcohol, cigarettes, etc.—that most economists in Washington thought necessary. At the same time the West Germans, despite continual downward revisions to their growth forecasts — now barely 1½ per cent — made it plain that they were not going to take measures to expand their economy. The French, meanwhile, revised their growth forecast down to a little over 1 per cent too.

The Japanese skilfully announced what sounded like a large expansionary package *en route* to the summit; but closer scrutiny suggests a rather smaller package, with tax cuts being balanced by tax increases, and clouds over the size of the planned public works programme.

The Venice summit was meant to be about building on the promises made at the earlier Paris 'Louvre Agreement' in February on currency stability. It was then generally agreed that, to avoid a 'free fall' for the dollar, the United States had to cut its budget deficit, and the other major countries had to take steps to expand.

All the steps since then have in fact been backwards. At a time when the Third World is in dire straits, and unemployment in most European countries still shamefully high, we are already in what economists call a 'growth recession.' That is to say, the 24 member nations of the Organisation for Economic Co-operation and Development are not expanding fast enough to bring unemployment down—and probably too slowly to prevent it rising again.

The kind of sober, unsensational international monetary officials I talk to are now increasingly fearful that we are heading for something much worse than a growth recession: they fear a dollar fall, and a sharp rise in US interest rates—inevitably affecting most other countries. We may be on the verge of a beggar-my-neighbour period when countries refuse to take in one another's dirty washing. And the favourite stock market for early collapse — again, with repercussions around the world — is the heavily overvalued Tokyo market.

There are many people like myself who have been urging greater economic policy co-ordination for some years now; but the kind of short-sighted selfishness that plagues the yuppie world of Thatcher's Kingdom also afflicts policy-makers in individual countries. This could well be the rock on which Mrs Thatcher's illusory economic miracle founders.

I note with interest that Nigel Lawson has got the message, and while using the code phrase 'supply side' measures—is in effect urging Germany to expand demand before a recession in Western Europe knocks him for six.

59