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Forum on Economic Reform

In recent decades the alliance of neoclassical economics and neoliberalism has hijacked the term "economic reform". By presenting political choices as market necessities, they have subverted public debate about what economic policy changes are possible and are or are not desirable. This venue promotes discussion of economic reform that is not limited to the one ideological point of view.

Some Primitive Robust Tests of Some Primitive Generalizations

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Few economists – in fact few people in general – would deny that the economy is a very complex phenomenon with many interdependencies and that complex phenomena are difficult to analyse. Many of the important questions raised by economic theory and economic policy cannot be answered easily and definitely because of the dynamics and complexity of the economic system. In the fifties and sixties of the last century this was clearly visible when economic policy controversies were dominated by the metaphor of "magic polygons" (normally triangles or pentagons) of desirable targets: growth, price stability, full employment, balanced external relations, and a just or fair distribution of incomes. The "magic" element mirrored the complexity and the interdependencies of the system which prevent a full simultaneous achievement of all the desired items. Quite apart from differences in the preferences for the competing targets there were considerable uncertainties and disagreements with regard to trade-offs and combinations connected with various policy decisions. Economic theory and increasingly sophisticated empirical and econometric studies helped to gain some insights but could not provide definite final answers. Complexity, situational and historical differences, lack and weakness of data all contributed (and still contribute) to a wide field of observations which show that every decision requires careful considerations of the question which results are probably relevant in a given situation. The diversity of results also contributed to an awareness of the uncertainty and openness of any action taken. Room for discussion and controversy was an obvious and accepted necessity.

With the advance of the neoliberal revolution, with Ms Thatcher's TINA (There Is No Alternative) pronouncement and the "Washington Consensus" the situation has dramatically changed. At least in the political and public sphere the "magic" has disappeared and has given place to some simple catchwords which are taken as reliable signposts for an economic policy leading to growth and welfare always and anywhere. Forgotten is the necessity for a careful weighing of advantages and disadvantages, of trade-offs, winners and losers in connection with different approaches. Deregulation, Privatisation, Balanced Budgets, Central Bank Independency, Slim States are taken as guarantors for satisfactory economic outcomes. Economic theory and applied economics continue of course to show the diversity and fragility of outcomes under different conditions[1]. But the more sophisticated and demanding these studies become (which is part of the scientific progress) the less do they influence the interest-driven public policy and policy discussions. Too difficult to be understood fully by the layman they are either neglected in the public discussion or reduced to vulgarised simplifications which can be used to support the chosen neoliberal path.

Rather than showing the discrepancy between the simple neoliberal folklore and the diversified assumptions and approaches of economic theory I want to present in a similar simple way

some robust economic facts in order to show that the neoliberal catch-phrases cannot be taken as reliable guides. There is a German proverb which says “Auf einen groben Klotz gehört ein grober Keil” (“When dealing with a rough log you need a rough wedge”) which is used here. The primitive generalizations are met with primitive answers which cannot reveal the whole “truth” but should be sufficiently robust to shatter the generality and credibility of the attacked assumptions.

What I am going to do is to confront a few simple but strongly held neoliberal articles of faith with a very rough picture of long-run experience (1970-2004) of sixteen Western European OECD countries. The long period should help to iron out short-term shocks and special partisan policies, while a rough division of the sixteen countries into “good guys” and “bad guys” by neoliberal standards presents the stipulated robustness of the argument.

In each of the following examples the sixteen countries will be divided – for each characteristic under discussion – into two groups: an upper group of the eight “best” performers (by neoliberal standards), and a lower group of the eight “worse” performers (always based on averages of the period 1970-2004). An analogous grouping of the sixteen countries is then provided for characteristics which are supposed to be the *consequence* of good behaviour[2]. The degree of correspondence between “cause” and “effect” groups can then be regarded as a rough indication of the validity of the simple beliefs. The procedure will be at once clear with the following examples.

An important item among the neoliberal targets is the achievement of price stability. This is taken up in the first two examples postulating that low inflation is beneficial for economic growth and low unemployment.

(1) *Low inflation promotes economic growth*

In Table 1 the left part (1.1) contains the sixteen countries ranked with regard to inflation rates (annual change of consumer prices), and the right part (1.2) the ranking according to GDP growth rates[3]. The figures in brackets below the upper and the lower half show the range of values for each group. Thus in the case of inflation we have a range of 3,1% for Switzerland to 5,6% for Norway in the upper half and of 5,9% for Finland to 12,9% for Greece in the lower half. (Averages for all countries are given in the Appendix).

Comparing parts 1.1 and 1.2, the quoted assumption demands that countries in the upper half, i.e. low inflation and high growth (L/H for short) should coincide, as well as countries in the lower half (H/L) indicating that high inflation is assumed to hamper economic growth. As can be seen these required coincidences are by no means the rule. They apply only to six of the sixteen countries: Austria, Netherlands, Norway (L/H) and Sweden, UK and Italy (H/L). For the other ten countries we have either high inflation coinciding with high growth (H/H), viz. Finland, Ireland, Spain, Portugal, and Greece, or L/L countries (Switzerland, Germany, Belgium, Denmark, France).

TABLE 1

1.1 **Inflation** Annual % change of CPI	1.2 **GDP Growth** Annual % change
Switzerland	Ireland
Germany	Norway
Austria	Portugal
Netherlands	Spain
Belgium	Finland
France	Greece
Denmark	Austria
Norway	Netherlands
(3.1% - 5.6%)	(5.2% - 2.5%)
Finland	Belgium
Sweden	France
United Kingdom	Italy
Ireland	United Kingdom
Italy	Germany
Spain	Sweden
Portugal	Denmark
Greece	Switzerland
(5.9% - 12.9%)	(2.4% - 1.3%)

Thus a first look shows dramatically that the simple generalization regarding inflation and growth is strongly contradicted by our rough look at reality. One reason for this (perhaps) surprising result is however

easily recognized. It concerns the inhomogeneity of the countries considered. When we distinguish between economically more advanced and less advanced countries we can allow for a special "catching-up" effect for the latter group giving it a special growth advantage. Counting as less advanced the four countries (in alphabetic order) Greece, Ireland[4], Portugal and Spain we see that all four have a high rank in the growth table. The positive catching-up factor may have decisively counteracted negative inflation influences, enabling all four countries to move into the H/H group. It seems therefore appropriate to look at the situation when these four countries are excluded. This is done in Table 1A. We now get twelve cases of which eight coincide with the stipulated rule (L/H: Austria, Netherlands, Belgium, France; H/L: Denmark, Sweden, UK, Italy) and four contradicting it (L/L: Switzerland, Germany; H/H: Norway, Finland). With 8:4 in favour of the "rule" the fragility of the "traditional" belief is less gross than before but still considerable.

TABLE 1A

1A.1 **Inflation** Annual % change of CPI	1A.2 **GDP Growth** Annual % change
Switzerland	Norway
Germany	Finland
Austria	Austria
Netherlands	Netherlands
Belgium	Belgium
France	France
(3.1% - 5.4%)	(3.3% -2.4%)
Denmark	Italy
Norway	UK
Finland	Germany
Sweden	Sweden
United Kingdom	Denmark
Italy	Switzerland
(5.4% - 8.3%)	(2.3% - 1.3%)

(2) *Low inflation promotes low unemployment*[5]

Just as in the former and in the following examples the upper halves of 2.1 and 2.2 contain the desirable cases (low inflation and low unemployment) and the lower halves the opposite combination (high inflation and high unemployment). As before, correspondence between the two sides (here: L/L and H/H) confirms the standard assumption, and L/H or H/L contradict it.

As Table 2 shows, there are 12 cases confirming the postulate and 4 (Belgium, France, Portugal, Sweden) contradicting it. With a relation of 12 to 4 this assumption fares better than the previous one but still rests on weak foundations. For less obvious reasons than before the four “catching-up” countries seem to play a special role. They form – together with Italy – the group with very high inflation and unemployment rates. When they are excluded the result for the remaining twelve countries shrinks to 8:4[6]. The four contradicting cases are divided into two L/H cases (Belgium and France) and two H/L cases (Portugal and Sweden) reflecting the role of different policy targets and policies.

TABLE 2

1A.1 **Inflation** Annual %change of CPI	1A.2 **GDP Growth** Annual % change
Switzerland	Norway
Germany	Finland
Austria	Austria
Netherlands	Netherlands
Belgium	Belgium
France	France
(3.1% - 5.4%)	(3.3% - 2.4%)
Denmark	Italy
Norway	UK
Finland	Germany
Sweden	Sweden
United Kingdom	Denmark
Italy	Switzerland
(5.4% - 8.3%)	(2.3% - 1.3%)

(3) *Low government expenditure (slim states) promotes GDP growth*

As Table 3 shows, we get 10 confirming cases (L/H and H/L) and 6 contradicting cases (L/L and H/H). As in all cases where growth is involved, the special catching-up effect dominates and it is again interesting to look at the twelve “advanced” countries. The relation between conformity and contradiction now shrinks from 10:6 to 6:6. Finland remains as the only advanced country belonging to the L/H group.

TABLE 3

3.1 **Government Expenditure** As % of GDP	3.2 **GDP Growth** Annual % change
Spain	Ireland
Switzerland	Norway
Portugal	Portugal
Greece	Spain
United Kingdom	Finland
Finland	Greece
Ireland	Austria
Germany	Netherlands
(35.3% - 45.8%)	(5.2% - 2.5%)
Norway	Belgium
France	France
Italy	Italy
Austria	United Kingdom
Denmark	Sweden
Netherlands	Denmark
Sweden	Switzerland
(45.8% - 57.0%)	(2.4% - 1.3%)

Next we turn to the standard assumption that trade unions and corporatism – by disturbing the market mechanism and keeping up wages – are detrimental for growth and create unemployment.

(4) *Low Trade Union Density (TUD) is favourable for GDP growth*

In Table 4 the upper halves confront low TUD (trade union membership as a percentage of non-agricultural employment) countries with high growth countries and the opposite applies to the lower halves. Correspondence consequently implies the stipulated connection L/H and H/L. From Table 4 we get a draw of 8:8 between affirmation and negation. However here again taking into account the special growth preponderance among the four late-comers leads to a radically changed picture. Removing them from the sample results – for the remaining 12 countries – in a (surprising?) relation of 4:8, i.e. a clear domination of contradicting cases. The four "surviving" affirmative cases are France, the Netherlands (L/H) and Denmark and Sweden (H/L).

TABLE 4

4.1 **Trade Union Density** As % of non-agricultural employees	4.2 **GDP Growth** Annual % change
France	Ireland
Spain	Norway
Greece	Portugal
Portugal	Spain
Switzerland	Finland
Netherlands	Greece
United Kingdom	Austria
Germany	Netherlands
(6.1% - 29.6%)	(5.2% - 2.5%)
Italy	Belgium
Ireland	France
Austria	Italy
Belgium	United Kingdom
Norway	Germany
Finland	Sweden
Denmark	Denmark
Sweden	Switzerland
(30.6 – 77.2%)	(2.4% - 1.3%)

(5) *Low TUD promotes low unemployment*

The upper halves contain "desirable" low rate countries, the lower half high rate countries, i.e. correspondence (L/L and H/H) involves confirmation. Here the special growth differentiation is irrelevant and the data for the 16-country case and the 12-country case yield the same result of 50% correctness: 8:8 and 6:6 respectively. It is noteworthy that Austria, Denmark, Norway, and Sweden (the "Scandinavian Model" states) all fall into the contradictory H/L group.

Finally we take up the case of corporatism and growth which to some extent coincides with the TUD case, but goes beyond it by covering also other elements (see Appendix).

TABLE 5

5.1 **Trade Union Density** As % of non-agricultural employees	5.2 **Unemployment** Annual % rate
France	Switzerland
Spain	Austria
Greece	Norway
Portugal	Sweden
Switzerland	Portugal

Netherlands	Germany
United Kingdom	Denmark
(6.1% - 29.6%)	(2.0% - 6.3%)
Italy	Greece
Ireland	United Kingdom
Austria	Finland
Belgium	France
Norway	Belgium
Finland	Italy
Denmark	Ireland
Sweden	Spain
(30.6% - 77.2%)	(6.7% - 13,5%)

(6) *Low corporatism favours high GDP growth*

This comparison yields a result of 8:8 for the sixteen countries and 6:6 for the twelve. The difference vis-à-vis the TUD result for the group of twelve is caused by shifts of Germany from a low TUD value to a high Corporation Index and of Belgium from a high TUD value to a low Corporation Index. These shifts improve the correspondence with growth.

TABLE 6

6.1	6.2
Corporatism	**GNP Growth**
Ranking from 1 to 16 (1= low, 16 = high)	Annual % change
United Kingdom	Ireland
Switzerland	Norway
Spain	Portugal
France	Spain
Portugal	Finland
Greece	Greece
Ireland	Austria
Italy	Netherlands
(1-8)	(5.2% - 2.5%)
Belgium	Belgium
Netherlands	France
Germany	Italy
Denmark	United Kingdom
Norway	Germany
Sweden	Sweden
Austria	Denmark
Finland	Switzerland
(9-16)	(2.4% -1.3%)

The few examples should suffice to lead to the conclusion of this note that generalizations in general and some neoliberal articles of faith in particular rest on weak foundations or are altogether untenable. Politicians and interest groups might perhaps sometimes be excused when they try to press a point in the heat of disputes. Economists however should not only refrain from such generalizations but should contribute to a better general recognition of their fragility.

Appendix

Sources and details for the Text Tables

The rankings of GDP growth, inflation, unemployment and government expenditure (averages of the period 1970-2004) are all based on OECD sources. The data for Trade Union Density refer to the situation before the turn of the century and come from the ILO World Labour Report 1997-1998. The Corporation Index is a slightly extended version of an Index worked out by Noël P. Vergunst based on a combination of four items (values around 2000): trade union density, centralisation of collective bargaining, coordination of collective bargaining, and coverage rate of collective bargaining (available at: http:www.vergunst.com).

COUNTRY TABLE
Averages 1970-2005

	GDP Growth	Inflation	Unemployment	Government Expenditure[a]	Trade Union Density[b]
	Annual % increase	Annual % change of CPI	Rate of Unemployment as %	As % of GDP	% of total non-agricultural employment
Austria	2,6	3,8	3,0	47,8	36,6
Belgium	2,4	4,3	8,7	51,6	38,1
Denmark	1,8	5,4	6,3	50,7	68,2
Finland	2,9	5,9	7,1	42,7	59,7
France	2,4	5,4	8,2	46,0	6,1
Germany	2,0	3,2	5,9	45,8	29,6
Greece	2,7	12,9	6,7	38,9	15,4
Ireland	5,2	7,5	10,1	43,1	36,0
Italy	2,3	8,3	9,1	46,4	30,6
Netherlands	2,5	3,9	6,1	53,3	21,8
Norway	3,3	5,6	3,1	45,8	51,7
Portugal	3,2	12,4	5,8	37,1	18,8
Spain	2,9	8,7	13,5	35,3	11,4
Sweden	2,0	5,9	4,3	57,0	77,2
Switzerland	1,3	3.1	2,0	-	20,0
United Kingdom	2,3	7,0	6,8	41,7	26,2
a 1970-2000; b about 1995					

Endnotes

1. For a good example of this (in relation to unemployment) see for instance Howell (2004).

2. The upper (”good“) group can contain the low values of the characteristic (e.g. inflation, unemployment) or the high values (e.g. GDP growth).

3. Sources and notes for all tables are given in the Appendix.

4. The recent rapid growth of the Irish economy has moved Ireland into a high-income range. But for the earlier decades of the period considered (1970-2004) the catching-up assumption can be regarded as valid.

5. This ”rule“ reflects the neoclassical assumption that there is no long-run (traditional) Phillips curve and that stable prices help to achieve general equilibrium including labour markets.

6. Here and in the following cases ranking tables for the twelve „advanced“ countries are omitted. They can be easily deduced from the main Tables.

Reference

Howell, D. R. (2004), Fighting Unemployment; The Limits of Free Market Orthodoxy. Oxford University Press: Oxford.

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