

# WAYS OUT OF INTERNATIONAL MARKET LIBERALISM

by

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# INTRODUCTION

## **For whom is this book written?**

The book is mainly written for people who think something like this:

I am sceptical of international market liberalism, i.e. of the free flow of goods, services, capital and labour across the borders between countries. I therefore believe that the current economic system should be changed. But I have very vague ideas about how it should be changed. This is extremely unsatisfactory. It makes little sense to demand a new system unless you can say which system ought to replace the current one.

But I also wanted to write a book which may be regarded as a valuable contribution to public discussions about how economic activities ought to be organized.

There are probably many people who think this:

The positive effects of international market liberalism are so important that I feel sure that we should keep this system. However, this does not prevent me from wanting to know how people argue against international market liberalism.

I hope that some of these people will read this book and comment on it.

## **A note to potential readers of the book**

If you don't know more about the book than what is said above and have not yet decided whether you want to read it, I suggest that you do the following to get an impression of it: read the rest of this introduction and then skim through Chapter 10.

## **Contents**

The following topics are discussed.

### *1. "The five problems"*

In all industrial countries there now exists:

mass unemployment,

public sector poverty,

very unequal distribution of income and welfare,

a hard working life for many,

the use of production methods that increase global environmental problems.

These problems are called "the five problems" in the book.

2. *A theory claiming that it is impossible for the industrial countries to get rid of "the five problems" when the economic activities are organised in the way they are organised now*

By "the *framework conditions* in a country" what is meant are the conditions that determine how profitable it is for businesses to produce in that country. The tax level and the rules for the labour markets are examples of framework conditions.

I believe that "the five problems" have the same cause. Here is a simplified version of a theory about what that cause is:

The free flow of products and capital makes the markets for products and capital international.

Economic policy is mainly national. This implies among other things that every national government can influence the framework conditions for the businesses located in their country.

The combination of "international markets for products and capital" and "an economic policy that is mainly national" leads to competition between the countries about being an attractive location for trade and industry and having a good ability to compete.

To avoid ending up as a loser in this competition, every government gives top priority to the following goal: domestic businesses must have framework conditions which are as at least as good as those of their foreign competitors.

Giving top priority to this goal for the framework conditions makes it impossible for the governments in the industrial countries to do what must be done if they are to get rid of "the five problems".

3. *The industrial countries can get rid of the five problems by making the markets for products and capital less international*

According to the theory I use, it is impossible to get rid of "the five problems" if the markets for products and capital are international and economic policy mainly is national.

I therefore tried to find a reorganisation of the economic activities that satisfies these two demands:

The markets for products and capital shall be less international than they are now and this shall make it possible to get rid of "the five problems".

The reorganisation shall not have side effects that make the conditions at least as unacceptable as now.

The second of these two demands makes the following two alternatives uninteresting:

*North Korea's organisation of its economic activities*

North Korea has very little economic contact with other countries. That alternative is unacceptable for the following reason:

Suppose that a country produces more than it needs of certain products, sells them abroad and buys certain other goods abroad. If that happens, economists say that this country participates in the international division of labour.

If a country abstains from participating in the international division of labour, as North Korea has chosen to do, then the production per inhabitant will be very low. Very low production per inhabitant means a very low standard of living.

*The planned economy in the Soviet Union*

In the Soviet Union, the central authorities made a large number of the economic decisions. It turned out that in the long run this organisation had serious weaknesses.

A planned economy of the form that the Soviet Union had is not an acceptable alternative.

I succeeded in finding an alternative that meets both the demand that it should make it possible to get rid of “the five problems” and the demand that it should not have unacceptable side effects. This alternative is described and discussed in chapters 3-7.

#### *4. The industrial countries cannot get rid of “the five problems” by making economic policy more international*

In chapter 9, I argue that it is impossible to get rid of “the five problems” by transferring decision-making power from national to international authorities, but letting the markets for products and capital be at least as international as now. “There are limits to how much decision-making power the individual countries will be willing to give up” and “there are limits to international authorities’ ability to govern” are keywords in the argumentation.

#### *5. Consequences for the typical developing countries of the organisation of economic activity in the industrial countries*

I divide the developing countries into two groups. The first includes China, India and some other countries, where the economy is undergoing rapid change and production per capita is increasing rapidly. The second group I call *typical developing countries*. It consists of African, Latin American and some Asian countries. In what follows I shall by “the developing countries” mean “the typical developing countries”.

I argue in chapter 1 that “the competition between the industrial countries about having the best framework conditions” leads to the following situation in the industrial countries.

The authorities have little room for manoeuvre other than to try to ensure that domestic businesses have framework conditions that are at least as good as those of their foreign competitors.

Under such conditions the governments in the industrial countries will not allow themselves “the luxury” of letting their policies be influenced by what will be best for the developing countries. The industrial countries therefore try to ensure that their products can be sold in developing countries without being hindered by customs or trade barriers. This benefits industrial countries’ businesses, but it does not benefit the developing countries.

If the industrial countries switch over to “the alternative system” it will be easier for them to tackle their domestic problems. That will make it easier to get a breakthrough for the idea that people who live in the industrial countries for humanitarian reasons ought to consider what benefits developing countries.

Another effect is that it will be easier for the authorities to consider the long-term effects of their policies. Perhaps some of them will occasionally think along these lines:

There are several reasons for believing that it is in our interests to avoid a world where the developing countries have the problems they have now. It is hence in our own interests to conduct policies that increase the chances of improvements in the developing countries.

From what is pointed out above, it follows that the chances of developing countries escaping poverty will increase if the industrial countries switch over to “the alternative system”.

#### *6. Consequences for the global environment of the organisation of economic activity in the industrial countries*

The global environment is threatened in many ways.

In Chapter 12 I discuss one of them, climate changes resulting from emission of greenhouse gasses. I have chosen to focus on this threat both because it is very serious and because it provides a good illustration of this: what will happen to the global environment is influenced by how the economic activities are organized in the industrial countries.

The greenhouse gasses are gasses that influence the climate on the earth. CO<sub>2</sub> (carbon dioxide) is the most important of them.

Many types of production lead to emission of greenhouse gasses. How large that emission is depends on *how much* is produced, *what* is produced, and *how* it is produced.

Every country wants to increase its production, and will do this in the long run. "What happens with *how much*" will therefore increase the emission.

"Most measures that reduce the emission because these measures change *what* and *how*" usually also increase production costs. Under the current economic system every country is therefore reluctant to use such measures in large doses. They are reluctant because they fear that this may make the country a loser in the competition over having a good ability to compete and being an attractive location for trade and industry.

From what is pointed out here, I conclude:

If the industrial countries keep the current economic system, emissions of greenhouse gasses will not be sufficiently low in the future. By "sufficiently low" what is meant here is "as low as the experts in the field regard as being necessary in order to avoid grave conditions".

It is also pointed out above that under the current system there is competition between countries and that this competition makes production increase fast. That competition will be weaker under "the alternative system". From that I conclude:

If the industrial countries switch over to "the alternative system", then emissions of greenhouse gasses will be smaller than they will be if the current system is kept.

## **Simplifications**

I discuss many large topics in this book. This makes it necessary to simplify greatly. But as far I can judge, none of the simplifications I am aware of has lead to errors in the most important conclusions I have drawn.

In the above survey of the book, it has of course been necessary to simplify even much more than in the book.

## **Where can you find the book?**

You can find the book on [www.fritzholtte.com/book](http://www.fritzholtte.com/book). Those of you that want to skim through chapter 10 may also find this at the same address.



# CHAPTER 1

## THE CURRENT ECONOMIC SYSTEM PART ONE

### 1.1 INTRODUCTION TO CHAPTERS 1 AND 2

In this book, the term *the industrial countries* is meant to refer to the countries in Western Europe, the United States, Canada, Australia, New Zealand and Japan.

There are such strong economic ties between the industrial countries that in some contexts it is useful to regard them as one society. I call this society "*the industrial society*".

In chapters 1 and 2, I discuss various economic problems that exist in the industrial countries. I argue that it is impossible to get rid of these problems as long as the industrial society maintains its current economic system.

In the discussion of one of these problems, mass unemployment, I find it useful to regard the industrial countries as one society. In the discussions of the other problems, the focus is on what happens in one of the countries. It matters little *which* country is used.

In order to try to make sure that also the minor details in the discussions are correct, I shall focus on Norway, because Norway is the country I know best. The fact that I write about Norway should not make the discussions irrelevant for those who are more interested in other industrial countries. As far as I can judge what is important for the main questions in this book is the same for all industrial countries.

#### **The problems**

These are some of the problems in Norway now.

*Mass unemployment.* When I write this in December 2005 there are approximately 90,000 registered unemployed, i.e. there are approximately 90,000 people who have contacted the public employment agencies seeking help for finding jobs (Statistics Norway). In addition, there are many others who would like to get work, but who for various reasons do not contact the public employment agencies.

*Public sector poverty.* The term *public sector poverty* means that the income of the state and the municipalities, or at any rate what the authorities think that they can use, is not large enough to make it possible for them to do in a satisfactory way what they are supposed to do.

There is public sector poverty in Norway today. This has many negative effects, especially on vulnerable groups.

*Very unequal distribution of income and welfare.* Many managers in large businesses have salaries which are at least five times higher than the wages that most of the employees get. Some have salaries that are more than ten times higher.

Only some Norwegians own capital and there are great differences in how much capital each of them owns. As a result of this, income from capital is very unequally distributed.

Some people are very poor and thus have a standard of living that is much lower than most people's.

*Many people have a hard working life.* Many employees are pressured to work so hard that their health is affected.

There is weaker protection against dismissal and extensive use of overtime than there was some decades ago.

Many workers are afraid that there will be fewer people employed in the businesses where they work and that this will mean that they will lose their jobs. The fear of losing their jobs is a serious problem for many people.

*Some businesses use production methods that increase the global environmental problems.* The global environmental problems are very serious. Many Norwegians think that it is a problem that their country uses production methods which increase the global environmental problems.

### **Are these problems important?**

I have met several Norwegians who have said something similar to this to me:

“There is not so much unemployment in Norway as there is in countries we usually compare ourselves with. Therefore, it is wrong to say that unemployment is a problem in Norway.”

“We also have less public poverty, a more equal distribution of income, the working life is less hard than in most countries and Norway does at least something to reduce the global environmental problems. Accordingly, I don’t agree with you that Norway has serious problems in these areas.”

These are my comments.

Unemployment is above all a problem for the people who are unemployed. Their situation is not made easier by the fact that other countries have higher unemployment rates than Norway. So having as much as 90,000 unemployed, such as Norway has today, is a serious problem (in section 2.1 it is explained why being out of work is a serious problem for most of the unemployed).

Something similar is the case for the other problems that I have described. Also when it comes to these problems, I regard it as irrelevant to point to how conditions are in other countries when we are deciding whether they are so serious that Norway should try to get rid of them.

## **1.3 THE HOLDEN COMMITTEE’S MAIN CONCLUSION**

The Holden Committee was a committee which consisted of economists and representatives from private businesses and public administration. It was appointed by the Government and presented a report in June 2000 where it gave the authorities advice about what policy they should conduct.<sup>1</sup>

This assumption was an important part of the basis of the committee’s work:

Norway shall continue to participate in an international economic system where there are large elements of free flow of capital.

If this assumption is fulfilled, then Norway may be hit by capital flight in the future. The committee wrote this about how capital flight from Norway should be prevented.

”Norway must be an attractive country for localisation of trade and industry.”

I call this statement *the committee’s main conclusion*. The conclusion can be argued for in the following way:

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<sup>1</sup> The report was published in *Norway’s public reports 2000:21*.

Due to several reasons, including technical developments, many jobs are lost each year. This happens in all industrial countries. If a country wants to stop unemployment rates from increasing, many new jobs must be created every year in that country. To create jobs, capital is needed.

To a great extent there is free flow of capital between the industrial countries. Under such conditions capital will be placed in those countries where it is most profitable to place it.

## 1.4 THE SIX REQUIREMENTS FOR EQUALLY GOOD FRAMEWORK CONDITIONS

On the basis of its main conclusion, The Holden Committee drew these conclusions about what Norway should do in the future:

*The tax level should not be higher in Norway than in other countries.* Justification: A higher tax level in Norway will tend to make the “profits of businesses after taxes” lower when it is placed in Norway than when it is placed in other countries. If this happens, Norway will not be an attractive country for the localisation of trade and industry.

*The wages must develop approximately as in other countries.* Justification: If Norway wants to attract investments, then the income on capital must be as high in Norway as in other countries. Over time this means that wages must develop more or less as in other countries.

*The labour market should be made more flexible.* Justification: A more flexible labour market means that among other things workers have less protection against being dismissed and against working overtime.

If the labour market becomes more flexible, it is easier for employers to dismiss workers when *this* is profitable for them and to require that the employees work overtime when *that* is profitable for employers. The more flexible the labour market is, the more profitable is production.

Compared to other countries, the labour market in Norway is inflexible. It should therefore be made more flexible.

*Support education and research which meet the needs of the businesses.* Justification: Education and research of high international quality is an important means to increasing productivity.

*Build infrastructure which meets the needs of businesses.* Justification: The infrastructure plays an important role in businesses’ ability to compete. All types of infrastructure may be important, but for Norwegian businesses there are convincing reasons to emphasise the importance of transport and communication (“infrastructure” here means the constructions, which are the basis of profitable enterprise, e.g. power plants, airports, ports and roads).

Let me for a moment assume that we accept the committee’s main conclusion, i.e. that Norway must be an attractive country for the localisation of trade and industry. It would then seem reasonable to draw also this conclusion:

*Norway should not use “measures that protect the environment but increase production costs” before its trading partners use these measures.* Justification: Higher costs in Norway than in other countries make Norway less attractive to businesses.

*Box 1.1*

*More about the six requirements for equally good framework conditions*

It is a simplification to say that each requirement for equally good framework conditions must be met equally well in Norway as in other countries. What matters is whether “the requirements as a whole” are met equally well in Norway as they are in other countries.

Nor will it create problems if one of the requirements is broken if something happens with another requirement that compensates for this. But it is unlikely that this will occur to such an extent that it will remove the basis for the conclusions that are drawn in chapters 1 and 2.

I shall call the six conclusions mentioned above *the six requirements for equally good framework conditions*. This expression will be shortened to “*the six requirements*” when this does not create confusion.

## 1.5 TWO REASONS WHY NORWAY CANNOT BREAK “THE SIX REQUIREMENTS” UNDER THE CURRENT ECONOMIC SYSTEM

In section 1.3 and 1.4, it is shown that:

If Norway wants to avoid increasing unemployment, then Norway must be an attractive country for the localisation of trade and industry.

Norway can be an attractive country for localisation of trade and industry only if “the six requirements” are satisfied.

This is one reason why Norway must satisfy “the six requirements”. But there is also another reason why Norway must do this under the current economic system. Breaking “the six requirements” reduces the ability to compete, and a reduced ability to compete means loss of jobs and therefore increased unemployment. That is not acceptable. Here is an example.

Suppose that at a certain point in time Norway satisfies “the six requirements” and therefore has an acceptable ability to compete. Then the Norwegian authorities increase the value added tax and thus break the requirement that the tax level should not be higher in Norway than in other countries. The increase in the value added tax makes the production costs higher and therefore reduces the ability to compete for trade and industry located in Norway. A reduced ability to compete makes some businesses go bankrupt. That leads to loss of jobs and consequently to increased unemployment in Norway.

Breaking the requirement concerning the tax level only for a short time may lead to an increase in unemployment which is so small that it is acceptable. But breaking that requirement permanently will permanently make the ability to compete too weak, and therefore make the unemployment become greater and greater. Such a development is unacceptable.

## 1.6 THE CONSEQUENCES OF FULFILLING “THE SIX REQUIREMENTS”

### **Consequences for the public sector**

#### *Public sector poverty*

If Norway wants to be an attractive country for the localisation of businesses then these are some of the requirements that must be met:

The tax level must not be higher in Norway than in other countries.

Support education and research that meets the needs of businesses.

Build infrastructure that meets the needs of businesses.

Taxes are the public sector's most important source of income. The requirement concerning the tax level limits the public sector's income.

Meeting the requirements concerning education, research and infrastructure increases public sector expenses.

This means that meeting the requirements concerning the tax level, education, research and infrastructure limits the public sector's income and increases its expenses. That it is necessary to meet these requirements consequently makes it impossible to avoid public poverty.

*Box 1.2*  
*The Norwegian Oil Fund*

In Norway a significant part of the public sector's income comes from oil and gas production. However, using a lot of this income domestically will make domestic prices rise so fast that Norway's ability to compete will worsen. Most Norwegian economists and national politicians therefore believe that Norway should not spend more of this income than now.

*Other limitations on what the government can do*

Meeting the requirement for a more flexible labour market reduces the possibilities to introduce labour market legislation. This limits the possibilities to make the working conditions less hard.

The requirement not to use environmental measures that increase production costs before other countries do this, reduces the possibilities to protect the environment.

### **Consequences for the trade unions**

Some years ago Norwegian trade unions could fight for increases in the workers' share of the values created in Norwegian businesses. But if the requirement concerning the wage share must be met, this will not be so in the future. This share will then mainly be determined by conditions abroad.

Meeting the requirement for a more flexible labour market means that the labour unions can no longer fight for legislation and wage agreements which give the workers better protection against being dismissed or having to work overtime.

## **1.7 PROSPECTS FOR "THE SIX REQUIREMENTS"**

### **Schröder's plan**

Let us take a look at what happened in Germany in 2003.<sup>2</sup>

In March 2003, unemployment in Germany was at its highest level in five years with 4.7 million jobseekers out of work. That was almost 12% of the workforce. On March 15, the German Chancellor, Gerhard Schröder, presented a plan in which he outlined what he would do to reduce the unemployment. These were some of the main points in the plan:

In the future, unemployment benefit would be paid to people out of work only for the first twelve months, 18 months for people over 55 and up. Until then, it had been paid for up to 32 months. After these periods had elapsed, the unemployed would receive only modest social security benefits. It would also be more difficult to refuse to take a job on the grounds that it was "unsuitable". In addition, the government wanted to weaken the protection against dismissals. This proposal was based on the following assumption: the easier it is to fire a worker, the easier it is to employ new people. It would also be easier to deviate from broad wage agreements.

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<sup>2</sup> The information about Schröder's plan is taken from an article in the Norwegian newspaper Aftenposten March 17 2003.

In addition, people would have to pay more themselves for the health service, less money would be paid out in sick pay and there would be a small adjustment to the pension arrangements. "Either we modernise ourselves or we will be modernised by the inevitable forces of the market," the Chancellor said.

Schröder's plan was heavily criticised by several of his fellow party members. Many on the left of the SPD (Social Democratic Party) thought that if the party decided to carry out these reforms, it would lose its right to exist.

At the SPD conference of 1 June 2003 Schröder threatened to resign if the plan was not accepted, so it was accepted.

*Why?*

The situation is absurd. Productivity has never been higher in Germany than it is now. That ought to give the German society an economic basis for being better than ever. Nevertheless, Schröder proposed measures that will lead to larger differences in income, less protection against being dismissed and cancellation of many welfare benefits. Why?

Most of Germany's foreign trade is trade with other industrial countries and there is to a great extent free trade between the industrial countries. It is therefore important for Germany to have an acceptable ability to compete with other industrial countries. If Germany's ability to compete is unsatisfactory, which is the case now, Germany will get an "unreasonably large" share of the total number of unemployed in the industrial countries. Because of this, Schröder regarded it as necessary to try to improve Germany's ability to compete with other industrial countries. However with the current rules on trade he could not improve it by means other than those he proposed in his speech, with one exception.

The exception is to grant more money to education and research, in order to get a faster growth in productivity. But it will take time to get results by using this measure and Schröder probably felt that he needed results fast.

*International competition to have the best framework conditions?*

If Schröder's medicine against unemployment improves Germany's ability to compete with other industrial countries, this means that other countries' abilities to compete with Germany will become weaker. This could cause them problems. It may lead to the following development:

To strengthen their own businesses' ability to compete, each government tries to give them conditions that are better than the conditions businesses in other countries have. There will be a competition between countries, where each of them tries to have the most business-friendly conditions, i.e. the most flexible labour market, the most business-friendly infrastructure etc.

This competition has the following effects:

Less protection against dismissal.

Public poverty increases (it increases because measures to have business-friendly conditions cost money).

This increased public poverty leads to worse conditions for the most vulnerable members of society.

The competition between countries to have the most business-friendly conditions, is sometimes called the race to the bottom. The expression "to the bottom" is used because the fight to be competitive worsens the conditions in several ways.

*The prospects for "the six requirements"*

We do not know what will happen to "the six requirements" if the industrial society keeps its current economic system. But I regard this as a reasonable assumption:

It is unlikely that “the six requirements” will become weaker. They will probably become stronger.

If that assumption is correct, then this situation will continue:

There is not much governments can do other than to try to give their businesses framework conditions that are at least as good as the framework conditions in other countries. This leads to a feeling of political powerlessness in large parts of the population and accordingly weakens democracy.



## CHAPTER 2

### THE CURRENT ECONOMIC SYSTEM, PART TWO

#### 2.1 INTRODUCTION TO THE DISCUSSION OF UNEMPLOYMENT

##### **Overview of some of the effects of unemployment**

###### *Being unemployed can cause distress and frustration*

Some people do not mind being out of work as long as they receive benefits they can live off. For others, however, being unemployed causes distress, and that is not just because they have a lower income than they would have if they had had a regular job.

Here are some of the reasons why being unemployed can cause distress for people who have previously been in work.

Going to work has been an important point of reference in their lives. When that point of reference is gone, it is difficult for them to adapt to the new situation. They find it difficult to fill all their new “free time” with something meaningful.

They miss the fellowship that they used to have with other workers.

After having applied for many jobs without success, a person who is unemployed may begin to think in this way: even though I have some years left before I am of pensionable age, it seems I’m not good enough for an employer to find me useful.

Receiving benefits may be viewed as living off society without giving anything back. Having this feeling can make some people unhappy.

Being unemployed may give lower status in the eyes of families, friends and/or neighbours.

One or more of these negative effects of unemployment can cause distress also to people who have never had paid work.

###### *Health problems*

The mental stress which being unemployed for a long period of time can cause, may lead to health problems. It is well known that people who are unhappy more often suffer from health problems than people who are satisfied with their lives. The unhappiness that being unemployed can cause, means that some unemployed people become ill.

Unemployment can even cause depression that may lead to hospitalisation or, in the worst cases, suicide.

##### **The extent of unemployment**

###### *Unemployment in the Industrial Society*

As mentioned above, it is sometimes useful to view the industrial countries as one society. I call this the *Industrial Society*.

Table 2.1 shows the average level of unemployment in the Industrial Society within certain periods.

**Table 2.1**

*Unemployment in the Industrial Society 1960-2000, measured in % of (employed + unemployed)<sup>3</sup>*

Period:	1960-1973	1973-1980	1981-1990	1991-2000
Unemployment:	3.3	5.0	7.2	7.0

In November 2005, aggregate unemployment in the Industrial Society was 6.5%<sup>4</sup>.

For the purposes of this book, there is no need to explain what happened within each period, or that there have been and still are significant differences between the levels of unemployment in individual industrial countries.

*Box 2.1*

*Market liberalism and unemployment*

A person who supports market liberalism said to me that there is a tendency for unemployment to be lowest in the countries, which interfere the least in the countries' economic lives. He views this as an argument in favour of market liberalism.

My comment to that is this: partly because this book does not aim to discuss the organization of domestic economic activity, I have not investigated whether a connection like this exists. But even if we assume that this connection does exist, it is not important to the discussion here. As far as I know, there are few if any countries that have less unemployment than Norway. In most countries the level of unemployment is much higher. For me this means that unemployment is a serious problem in all industrial countries. And as I will explain in this book, I believe a convincing argument can be made that what I call "mass unemployment" is an inevitable result of international market liberalism. This is a strong argument against market liberalism.

## 2.2 HOW WOULD THE DEVELOPMENT OF UNEMPLOYMENT HAVE BEEN IF THE PRODUCTION TECHNIQUES HAD CHANGED SELDOM?

According to a certain theory the unemployment in the Industrial Society is due to the fact that the production techniques change often. This theory is too simple to be able to explain all unemployment in this society. But this does not prevent it from being useful when we try to understand what is happening there.

As the first steps in a presentation of the theory I shall here in section 2.3 do this: I shall make the very unrealistic assumption that "the production techniques which are used in the Industrial Society" change very seldom and I shall discuss what this means for the unemployment.

Suppose that at a certain point in time there are stable conditions and full employment in the Industrial Society. Then a few businesses start using a new technique which reduces the amount of work needed to produce one unit of a certain product. This weakens the competitiveness of businesses

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<sup>3</sup> The figures in this table are probably not completely exact. This is among other things because I have had to use several different sources for my calculations. (See list of references for the sources I have used). However, I am sure that the numbers are exact enough to give the main picture.

<sup>4</sup> See [http://www.oecd.org/document/36/0,2340,en\\_2649\\_34251\\_35901156\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/36/0,2340,en_2649_34251_35901156_1_1_1_1,00.html).

which cannot or do not want to transfer to the new technique. The introduction of this technique starts a development that consists of two parts.

The first part is that a number of jobs are lost because production decreases in businesses which have become less competitive. Jobs may also be lost in businesses which start using the new technique, although the level of production increases. The fact that they use less work on the production of each unit of the product, may mean more than that the production in these businesses increases because they have become more competitive.

The second part of the development is that the people who have become unemployed, find new jobs through two economic “mechanisms”. One is that some people retrain so that they can do other types of work. The other is that the wages decrease for the types of work that are negatively affected by the change in production techniques. Lower wages lead to more jobs for people who can and are willing to do such work.

Adapting to the new technique takes time and during parts of this time this adaptation is only done by halves. By this I mean that it is only the first part that is completed, i.e. that part of the process that consists of jobs being lost. This creates unemployment. But the unemployment is only temporary. After some time, everyone who is willing to work will be working.

Because the production techniques change seldom it will take time before there again will be unemployment. Therefore there will usually be no unemployment.

## 2.3 UNEMPLOYMENT IN THE INDUSTRIAL SOCIETY

### What has occurred?

As assumed in section 2.2 this has occurred in the Industrial Society in the last decades.

When a change in a production technique has created unemployment, this has triggered off these two adjustment mechanisms: people retrain so that they can do other types of work. The wages decrease for the types of work which are negatively affected by the change in technique and lower wages lead to more jobs for people who can and are willing to do such work.

But in contrast to what is assumed in section 2.2 this has occurred in the Industrial Society:

Techniques have changed so often and adapting to these new techniques has taken such a long time that before adaptation to one change can be completed, other changes have already occurred which also require adaptation. As a consequence, there has always been unemployment which is due to the fact that changes in production techniques have created a need for adjustment. This kind of unemployment, which in this book will be called *adjustment unemployment*, has increased a great deal during the last decades.

### Comments and explanations

So far I have assumed that all adaptations are completed, i.e. that everyone who has become unemployed due to changes in production techniques eventually finds a new job. In practice many will never get back into work. Some are not able to get the knowledge and/or skills which are necessary for the new jobs. Others cannot find a new job because they are not considered young enough by employers. And some people find it difficult or impossible to move from the place where they live, and no new jobs have been created in that place or a reasonable distance from it.

After a period of time, many people who have not got back into work are no longer registered as unemployed. We then find most of these people as disabled pensioners, as people who have taken early retirement or as people who live on social security benefits.

The fact that many people never get back into work after losing their jobs means that the effects that "the changes in production techniques" have on unemployment, is a much greater problem than the statistics on the number of people registered as unemployed indicate.

The level of registered unemployment has increased a lot during the last decades. This is primarily due to a development which has taken place in all the industrial countries and which I will describe by looking at Norway.

Even well into the twentieth century, relatively few Norwegians had higher education. Most had attended only what was then called the “folkeskole”, and which is now called “barneskole” (“primary school” in English). However, most Norwegians had grown up on farms, and this gave them physical strength and taught them practical skills which could be useful in many kinds of work.

A large share of the jobs available in those days only required primary education. After some on-the-job training, many men could work well as sailors, as workers in the fishing or forestry sector, as construction or plant workers, and as workers in many branches of industry. Most women were able to do a large proportion of the jobs that were then available to women.

If there were opportunities for employment in some branches, there was usually no great need to retrain if jobs were lost in other branches. Therefore, there was not much adjustment unemployment.

This situation has now changed completely. To a greater and greater extent most jobs in today’s society require specific knowledge and/or experience that most people do not have. This is the most important reason why adjustment unemployment has increased a lot. Due to changes in production techniques, adjustment unemployment has also been affected by factors other than changes to work demands.

There are also a number of other factors that lead to unemployment, in addition to changes in production techniques and changes to work demands. You can read more about this in Section 2.5. However, as I see it, none of these factors explains much of the very large *increase* in unemployment in the Industrial Society in the past decades. As far as I can judge, this increase must, as already mentioned, primarily be due to the fact that adjustment unemployment has increased (more about this in appendices A and B).

## 2.4 AGGREGATE DEMAND, UNEMPLOYMENT AND PRICE RISES

### **Branches of industry which sail with the wind and branches which sail against the wind**

The discussion in this section concerns a society in which the branches of industry can be grouped into “branches which sail with the wind” and “branches which sail against the wind”.

In branches which sail with the wind the situation is this: there are good sales opportunities. Producers can sell everything they have the capacity to produce. Therefore people who work in these branches rarely lose their jobs, and when they lose them, it usually does not take them a long time to find new jobs. There is, therefore, little unemployment in these branches.

As far as “branches which sail against the wind” are concerned, the situation is this: the opportunities to make sales are poor. Producers go bankrupt all the time. Because of this, many people who work in these branches become unemployed each year. It also usually takes a long time for the people who have become unemployed to find new jobs. Because of this there is a lot of unemployment in the branches which sail against the wind.

### **Effects of increased aggregate demand**

Let us assume that aggregate demand increases and that this leads to increased demand for products both from the branches which sail with the wind and from the branches which sail against the wind.

The branches which sail with the wind are already producing as much as they have the capacity to produce, so production cannot be increased. In these branches the increased demand will lead to “prices for the branch’s products” rising faster than before. And because *those* prices rise faster, prices rise faster in society as a whole.

This is what happens in branches which sail against the wind: better opportunities to make sales means that fewer businesses go bankrupt. Therefore fewer people become unemployed. In addition, it

becomes easier for people who lose their jobs to find new ones. Because of this there is less unemployment in these branches than there was before aggregate demand increased.

The conclusions here can be summed up in this way: increased demand leads to faster price rises and lower unemployment.

### **The conditions in practice**

The discussion above is based on a number of simplifications. For example, in practice it will not be possible to divide the branches clearly into “branches which sail with the wind” and “branches which sail against the wind”. As far as I can judge, however, this simplification or other simplifications that I am aware of do not mean the following conclusion is incorrect:

In practice, increased aggregate demand leads to faster price rises and lower unemployment.

## **2.5 CONFLICTING TARGETS**

The industrial countries’ governments’ economic policies always include a number of targets, usually including the following two targets:

Fast price rises should be avoided.

There should be little or no unemployment.

The discussion in the previous section showed that these targets are in conflict.

The conflict is usually “solved” in the following way: the most important target is that prices should not rise faster than prices in other countries because this would seriously harm the country’s ability to compete. This means that the countries have to put up with the unemployment which results from aggregate demand being so low so that the target for price rises can be met.

## **2.6 PROSPECTS FOR UNEMPLOYMENT IN THE INDUSTRIAL SOCIETY**

### **Two questions**

The term *adjustment unemployment* is used here to mean unemployment due to businesses and the labour market having to adapt to changes in economic conditions.

The majority of unemployment in the Industrial Society in the years ahead will be adjustment unemployment. When trying to estimate how much adjustment unemployment there will be, we have to answer the following questions:

Which changes will create a need for adjustments?

How much time will “people who have lost their jobs because of adjustments” need to find new jobs?

## **Which changes will create a need for adjustments?**

### *Changes in production techniques*

Competition between businesses and countries may become even tougher. This would lead to faster and faster changes in production techniques. Another reason that we could see faster changes in production techniques is that it is likely that many large companies will become richer and can therefore spend more money on developing new production techniques.

On the other hand a development may take place, which leads to there being fewer but larger multinational companies who divide the markets between themselves. This could lead to slower changes in production techniques.

In most of the service industry there are fewer opportunities to find new ways of increasing productivity considerably than there are in sectors which produce goods. There are good reasons to believe that an increasing share of people in work will be employed in service production. The combination of "an increasing share of employment in service production" and "relatively few opportunities to increase productivity significantly in service production" contributes to making the following development likely: productivity will increase more slowly than it does now. Slower change in productivity will reduce the adjustment problems caused by changes in the production techniques.

I believe that as a whole productivity will increase more slowly than it does now. This is because I place the most emphasis on the fact that the share of people employed in the production of services will increase.

### *Which products consumers wish to buy will change*

In the last 20-30 years there have been significant changes in what people want to buy, often over a short period of time. Among other things, the development of new products has meant that the demand for certain other products which once were in great demand has been greatly reduced. There are reasons to believe that this development will continue.

### *Changes in other parts of the world*

Today great changes are going on in other parts of the world, especially in China and India, which create adjustment problems for businesses in the Industrial Society. There are reasons to believe that these changes will become even more important.

### *Changes in the relation between the increase in aggregate demand and the increase in productivity* *Productivity here means production per employee.*

In some years aggregate demand for products increases more slowly than productivity. Employers therefore need fewer employees. This means that some people lose their jobs, even people who are employed in branches with few or no adjustment problems caused by changes in production techniques. In years like this it is also difficult for first-time jobseekers to get into work.

Experience has shown that periods in which aggregate demand increases more slowly than productivity are sooner or later replaced by periods within which it increases faster. This leads to higher demand for labour and therefore also to this: some of the people who lost their jobs because aggregate demand was increasing more slowly than productivity, get their old jobs back or get new ones. It is also easier for first-time jobseekers to get into work.

The changes in the relation between "the increase in aggregate demand" and "the increase in productivity" create adaptation problems and these problems are grater the larger the changes are. It would therefore be an advantage if the authorities could ensure that these changes either disappear or become weak. However, neither national governments nor international authorities can ensure this as long as economic activities are organized in the way they are organized now. How the relation between the increase in aggregate demand and the increase in productivity develops is decided to a great extent by what occurs in markets over which the authorities have no control.

## **How much time will “people who have lost their jobs because of adjustments” need to find new jobs?**

There are reasons to believe that there will still be a significant number of people in the Industrial Society who only have primary education. It is also probable that many of these people will have lost out in school and therefore do not have important skills like being able to read and write well enough.

A number of the jobs created when the production of services increases, will be jobs that require neither education nor professional experience. However, on the basis of what we have seen up to now, it seems reasonable to assume that also in the years ahead it will take “the people with the least qualifications” a long time to get new jobs if they lose their old ones.

For people who have more than primary education, the opportunities to get quickly back into work will depend on what they have worked with before. Let us take a look at two people, who are both trained engineers.

One of them has spent the past years working as a personnel manager, but has now become unemployed because the business he worked for went bankrupt. If there are enough available positions for personnel managers, it probably will not take him a long time to get a new job although he may have to change branches.

The other person has worked as an engineer and has considerable skills within a specific area. The professional skills she has built up by working in this area are worth little in other areas. If this engineer becomes unemployed, she will probably need a rather long time to do the necessary retraining to get a new job.

## **Conclusions**

### *The unemployment in the Industrial Society*

Based on what I have pointed out above, I conclude in this way:

If economic activity remains organized in the way it is now, there will be mass unemployment in the Industrial Society in the years ahead.

### *Can an industrial country have a significantly lower level of unemployment in the future?*

We must count on there being a great deal of unemployment in the Industrial Society in the years ahead.

However, for a long period of time it will be possible for an industrial country to have a level of unemployment which is much lower than now. This will happen if the country in that period can always ensure it appears to be more attractive for localising business than most other industrial countries.

But it is unlikely that any country will be able to do this. Countries compete to be places where businesses wish to be localised. Experience shows that the winners change in this competition.

*Box 2.2*  
*The Extended Industrial Society*

In the subsection "Which changes can create a need for adjustments?" I point out that the development in China and India will mean a lot for what I call the Industrial Society. This is because China's and India's trade with the Industrial Society is increasing rapidly.

China and India are becoming more similar to the industrial countries not just by the changes in their foreign trade, but also because their production per inhabitant is approaching that of the countries in the Industrial Society.

In this situation, it may sometimes be reasonable to regard (the Industrial Society + China and India and some other Asian countries) as one society. We can call this society the Extended Industrial Society. In the discussions of the future prospects it would perhaps be more useful to focus on the Extended Industrial Society rather than the Industrial Society.



# CHAPTER 3

## AN ALTERNATIVE SYSTEM FOR ONE COUNTRY, PART ONE

### 3.1 INTRODUCTION TO CHAPTERS 3 - 6

Before you start reading Chapter 3 you should take a look at Appendix H.

In chapters 1 and 2, five serious economic problems were discussed. The industrial countries cannot get rid of these problems unless the current economic system is changed.

Suppose one and only one industrial country, for instance Norway, wants to get rid of these problems by changing its economic system. In chapters 3 – 6, “an alternative economic system which makes this possible” is described. In these chapters, I also discuss the consequences of using that system.

The following conclusions will probably be of interest to many readers:

Norway can get rid of public poverty (c.f. section 4.7).

The authorities can make unemployment much lower than it is now and they can do this by using a policy that does not result in faster price rises (c.f. sections 5.6 and 5.7).

In what follows, I, among other things, give a thorough account of how I arrived at the system I discuss. This account can also serve as an argument for using that system.

#### **Three expressions**

In chapters 3-6, I use three expressions so often that I want to define them here.

One of these expressions is “*the five problems*”. It refers to the five serious economic problems that were discussed in section 1.2 in chapter 1. The problems are: mass unemployment, public sector poverty, a very uneven distribution of income and welfare, a hard working life for many people, and the use in some businesses of production methods which worsen global environmental problems.

The second expression is “*the six requirements*”. It refers to the “requirements for equally good framework conditions for Norwegian businesses as for foreign businesses” that were discussed in section 1.2. The requirements are that the tax level must not be higher in Norway than in other countries, wages must develop as in other countries, the labour market must become more flexible, education and research must satisfy the needs of the businesses, infrastructure must satisfy the needs of businesses and that Norway must not use environmental measures which increase production costs before other countries use them.

“The six requirements” are requirements that, as long as Norway keeps its current economic system, must be satisfied in order to avoid increasing unemployment in Norway.

The third expression is “*the alternative system*”. This is an alternative economic system for Norway, which will be described in section 3.4.

### 3.2 DEMANDS ON A NEW SYSTEM AND A NEW SET OF MEASURES

I have looked for a system and a set of measures that satisfy these demands:

By using the system and the measures it is possible to get rid of "the five problems".

Neither the system nor the set of measures should have "side effects which make conditions as unacceptable as they are under the current system".

Using the system and the measures must not improve any country's ability to compete with other industrial countries.

### **Comments on the demands**

This is why I demand that use of the system and the measures must not improve the ability to compete:

I want the insight I gain in chapters 3 - 6 to be useful in chapter 7.

In chapter 7, I want to arrive at an economic system and a set of measures that make it possible for the industrial countries to get rid of "the five problems". I assume that this means that I must arrive at measures that a country can use to solve *its* problems without creating problems for other countries. This demand is not satisfied by measures that improve the ability to compete.

## **3.3 THE DISCUSSIONS ARE MAINLY ABOUT WHAT WILL HAPPEN AFTER THE TRANSITIONAL PROBLEMS HAVE BEEN SOLVED**

The work it takes to find and evaluate a new economic system can be divided into two phases:

During the first phase, we find a system and discuss how it will function after "temporary problems caused by the transition from the current system" have been solved.

During the second phase, we discuss the temporary problems caused by the transition.

In this book, I focus on the consequences of the system after the temporary problems have been solved. I think that these consequences ought to be thoroughly discussed before we attack the temporary problems caused by the transition. If it cannot be argued in a convincing way that the system will function well after the transitional period is over, it will usually not be very interesting to discuss the problems of the transitional period.

### **More about the transitional problems**

One of the people who have read a draft of this book said this to me:

"I think the transitional problems will be so serious that neither Norway nor the Industrial Society should go over to the systems you discuss."

I replied in the following way:

"I assume that you think that we can live with the current economic system. If this is the case, then I understand that you think we ought to discuss the transitional problems and maybe let them decide whether we should go over to "the alternative system"."

"However, I think that we cannot live with the current system and that we should therefore be willing to go through a transitional period no matter how long and difficult this period is."

## 3.4 THE ALTERNATIVE SYSTEM FOR NORWAY

In this section, I outline an economic system for Norway. As pointed out above this system will be called “the alternative system”. In later sections, I explain why I am interested in this system.

### ORGANIZATION OF ECONOMIC CONTACT WITH OTHER COUNTRIES

In the following I consider the organisation of trade in industrial goods, trade in agricultural products, trade in services, capital transfers, and buying and selling of foreign currency.

#### **Trade**

##### *Trade in industrial goods*

The term industrial goods is used here to mean goods that are not agricultural products.

The main rule is that anyone who wants to import or export industrial goods can do so without having to apply for permission from the authorities.

There are certain exceptions to this rule, for example the trade of narcotics.

##### *Trade in agricultural products*

In the following, fish are included in the category called agricultural products.

Whether a licence from Norwegian authorities is required to import an agricultural product, depends partly on the following questions. Can the product be produced in Norway? How important is the production of it to the regions of Norway? Can import of it lead to the transmission of diseases from sources in other countries?

The rules for import of agricultural products are also influenced by the fact that, at least at present, it is important for some developing countries to be able to sell their agricultural products to the industrial countries.

Agricultural products produced in Norway can be exported without hindrance from the Norwegian authorities. To what extent an agricultural product is exported depends mainly upon these questions. Can it be sold in other countries? If it can be sold there, for what prices can it be sold?

#### **Trade in services**

Firstly, I will say a little about the terms “export of services” and “import of services”.

Let us imagine a Swedish business whose product is the provision of care needed by patients in nursing homes. Let us assume that the business starts selling its product to Norwegians as well, either by giving them care in the business’ nursing homes in Sweden or in nursing homes that the business starts up in Norway. In both cases, economists will say that Sweden is exporting care services to Norway and that Norway is importing care services from Sweden.

This rule is used in “the alternative system”:

The main principle for import of services is that Norway does not import services.

This principle means that most of the educational, health and care services Norwegians need are provided in Norwegian schools, Norwegian hospitals and Norwegian nursing homes.

There are several important exceptions to this principle. Some of them are made because it is a goal to have a lot of cultural contact with other countries. “Tourism” and “extensive contact between Norwegian and foreign scientists” are keywords for others.

## Capital transfers

With *capital* is here meant both real assets, for instance machines, and financial assets, for instance bank deposits.

These are the rules for capital transfers:

Licences issued by Norwegian authorities are needed before capital can be transferred from Norway to other countries. All foreigners who apply are granted such licence. It is very difficult for Norwegians to get such licences.

Licences issued by Norwegian authorities are needed before capital can be transferred to Norway from other countries. All Norwegians who apply are granted such licences. It is very difficult for foreigners to get such licences.

## Buying and selling foreign currency

These are the rules for the buying and selling of foreign currency:

All buying and selling of foreign currency, for payments in Norwegian kroner, takes place in Norges Bank (Norges Bank is the Central Bank of Norway).<sup>5</sup>

Norges Bank sets the exchange rates.

It is mentioned above that permission will be granted for the import of certain goods and services and for certain capital transfers. Buying foreign currency is permitted if and only if the currency is needed for payments for such imports or for payments for such capital transfers.

Exporters must sell the foreign currency they receive as payment for the products they sell to Norges Bank. This rule ensures that Norges Bank gets the foreign currency it needs to be able to meet its obligations to sell currency.

## Work permits

Norwegians who live abroad do not need permits from the Norwegian authorities to start working in Norway and neither do foreigners who live in Norway.

Foreigners who do not live in Norway, must have work permits before they can work in Norway.

## ORGANISATION OF THE DOMESTIC ECONOMY

A complete description of an alternative system must give rules for how the domestic economy is organised. To simplify, I shall assume that these rules are the same as under the current system. But a transition to “the alternative system” may be combined with a transition to a system where the domestic economy is organised in a way that differs from the way it is organised now.

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<sup>5</sup> Instead of only allowing the buying and selling of foreign currency to take place in Norges Bank, it may be more practical to allow such transactions to occur in Norges Bank and in some other Norwegian banks, which follow the rules set by Norges Bank.

### 3.5 WHAT MUST THE NORWEGIAN AUTHORITIES DO IF NORWAY GOES OVER TO “THE ALTERNATIVE SYSTEM”?

#### **Withdraw from two international agreements**

##### *EEA*

EEA (European Economic Agreement) is an agreement between EU and Norway, Iceland and Liechtenstein. It demands free flow of goods, services, capital and labour between the EU and the three other countries listed. A country can withdraw from the agreement if it no longer wishes to be bound by it. After withdrawal, it takes a year for a country to be released from the obligations it undertook when it became a member of EEA.

##### *OECD*

30 countries, including all the industrial countries, are members of the OECD (Organization for Economic Cooperation and Development). The members must follow certain rules, including rules called capital codes. The capital codes demand the free flow of certain types of capital between the member states.

A country can withdraw from the OECD. Its obligation to follow the capital codes ends one year after withdrawal.

#### **Other things the authorities must do**

##### *Modify “the alternative system” in such a way Norway can keep its membership in the WTO*

The WTO (World Trade Organisation) is an organisation whose main task is to set rules for the trade between the countries that are members of it. Most countries in the world, among them Norway, are members.

Norway's membership in the WTO means that other members of the WTO have the right to sell

#### *Box 3.1*

##### *Flight of capital in the transitional period?*

Let us assume that the Norwegian authorities decide to use “the alternative system” and thus withdraw from the EEA. Many people have said this to me:

“After Norway has withdrawn from the agreement, but must allow capital to flow freely for another year, people who have capital placed in Norway will transfer it to other countries. This will create such significant difficulties for Norway that it will be impossible for Norway to live with it.”

My answer is that for the following two reasons the difficulties may not be as serious as some think.

Many Norwegians who have capital placed in Norway will prefer to keep it in a country that they know well. They will probably not like placing it in another country, if they only know little about the business conditions in that country.

Through a fund, which is called The Oil Fund, the Norwegian authorities have placed over one trillion kroner abroad.<sup>1</sup> If this capital is transferred to Norway, it is unlikely that Norway will lack capital.

certain types of services to Norway. It is unlikely that Norway will change its economic system in

such a way that it becomes impossible to remain as a member of the WTO. If Norway decides to go over to “the alternative system”, it must be to a modified version of the system, where the modifications are such that the rules in this version are compatible with the rules in the WTO. As long as the WTO rules are as they are today, the necessary modifications are rather small. But that may change (more about this in section 6.4).

*Set rules for trade, capital transfers and buying and selling foreign currency*

Set those rules for trade, capital transfers and buying and selling foreign currency that are described in section 3.4.

*Make certain changes within the state administration*

The authorities must set up the following offices:

An office that evaluates applications for capital transfers to and from other countries.

One or more offices, which check that the rules for trade, capital transfers and the buying and selling of currency are followed.

Instead of setting up these offices, it may be better to let the work be done by offices that already exist.

### **Much more bureaucracy?**

*Will many employees be needed to evaluate applications for capital transfers?*

Licences will be granted to all foreigners who want to transfer capital out of Norway and to all Norwegians who want to transfer capital into Norway. This process can be automated so that not many employees will be needed to do it.

After a while, it will be known that licences are rarely granted to Norwegians who want to transfer capital out of Norway. It will also be known that licences are rarely granted to foreigners who want to transfer capital into Norway. As a result, there will be few applications for such permits. This means that there will be few cases to handle. It follows from this that few employees will be needed to evaluate the applications for capital transfers.

*Will many employees be needed to check whether the rules are followed?*

Checking whether the rules for trade, capital transfers and buying and selling currency are followed can be automated to a great extent. Few employees will thus be needed to do this.

### **Conclusion**

There will not be much more bureaucracy under “the alternative system” than under the current system.

## **3.6 HOW I ARRIVED AT THE RULES FOR CAPITAL TRANSFERS**

Note! Some readers may find it useful to reread chapter 1 before they read this section.

In sections 1.3 - 1.5, these are the conclusions that were drawn:

The free flow of capital to and from Norway makes it impossible for the country to free itself from “the six requirements“ without getting increasing unemployment (c.f. sections 1.3 and 1.4).

It is impossible for Norway to get rid of “the five problems” unless the country frees itself from “the six requirements” (c.f. sections 1.4 and 1.5.)

It follows from these two conclusions that if there is a free flow of capital to and from Norway then Norway must choose between “getting increasing unemployment” and “keeping the five problems”. I wanted to find a system that would allow Norway to not have to make this choice. That is why there is a rule in “the alternative system” which says that licences from the authorities are needed to transfer capital to and from other countries.

When I was considering how the rules for granting licences ought to be, I reasoned in this way:

Suppose a situation arises where many who have capital placed in Norway want to transfer that capital to other countries. If all of them do so over a short period of time, this will probably create great difficulties for Norway.

In situations such as this, the authorities ought to refuse most of the applications for licences. But it may be difficult to refuse applications from foreigners, since they may ask for support from their governments to put pressure on Norway to grant the licences.

The less capital foreigners own in Norway, the less of a problem this will be. This indicates that it may be an advantage for Norway if foreigners own only a small proportion of the capital placed in Norwegian trade and industry.

Foreign owners of Norwegian businesses will probably let their decisions be guided only by what will give them most profit. Many Norwegian owners will do the same. But it seems likely that Norwegian owners, more often than foreign owners, will also take this into consideration: will the decisions they make, create problems for their employees and/or the municipalities where their businesses are located? This is another reason that it might be an advantage to Norway if foreigners own only a small proportion of the capital placed in Norwegian trade and industry.

What is pointed out in the following explains why I chose these rules:

Licences issued by Norwegian authorities are needed before capital can be transferred from Norway to other countries. All foreigners who apply are granted a licence. It is very difficult for Norwegians to get such licences.

Licences issued by Norwegian authorities are needed before capital can be transferred to Norway from other countries. All Norwegians who apply are granted such licences. It is very difficult for foreigners to get such licences.

These rules were chosen, because if they are followed Norwegians will own an increasing share of the capital placed in Norway.

## 3.7 HOW I ARRIVED AT THE RULES FOR TRADE IN INDUSTRIAL GOODS

### **Two alternatives which should not be used in the organisation of trade in industrial goods**

While trying to find an alternative to the current economic system, I have looked for a system and measures that satisfy several conditions. This was one of the conditions:

Neither the system nor the use of the measures should have “side effects” which make conditions as unacceptable as they are under the current system.

That excludes the following well-known economic strategies used to avoid the negative effects of market liberalism:

*North Korea's strategy*, which is to have very little economic contact with other countries.

A large number of different industrial goods are used in a modern society. Many of them are produced most efficiently by large businesses. In Norway, there is not enough labour to efficiently produce all types of industrial goods used in Norway. Also, there is not a large enough domestic demand to form the basis for efficient production of all such goods. In consequence, Norway both imports and exports industrial goods extensively.

If Norwegian businesses were to produce all of the industrial goods that are used in Norway, production would have been a lot less efficient than it is now. This would have made the average standard of living much lower. This is one effect of North Korea's strategy, which makes it irrelevant to Norway.

*The strategy that was used in the former Soviet Union.* Before 1990 the former Soviet Union had an economic system where the national authorities made many economic decisions. This included deciding which industrial goods should be imported and in what quantities. It turned out that the negative economic consequences of that system outweighed the positive ones. The planned economy, of the type the Soviet Union had before 1990, is therefore not a relevant alternative for Norway.

### **A part of the current system which ought to be kept**

I have not been able to find a system which I think gives a better answer than the current one to this question: who should decide which industrial goods are to be imported and exported? The following rule is therefore used in the alternative system:

With certain exceptions, anyone who wishes to import or export industrial goods may do so.

## **3.8 MORE ON THE EFFECTS ON IMPORTS AND EXPORTS**

### **Imports**

Under "the alternative system", imports will be lower than they will be if Norway keeps the current system. This is primarily because the main principle for the import of services is that Norway does not import services.

### **Exports**

I assume that if Norway has gone over to "the alternative system", Norwegian authorities will want to have balance in foreign trade. Here is why I assume this:

The imports must not usually be larger than the exports because this will cause increasing payment problems for Norway.

If Norway's exports are larger than its imports, then the imports must be larger than the exports in one or more other countries. This will create payment problems for them. I assume that the Norwegian authorities do not want this to happen. (c.f. section 3.2.)

Under "the alternative system", Norwegians are free to import all types of industrial goods and some types of services and agricultural goods. This part of the alternative system, together with prices and exchange rates, determines how large imports will be.



The goal of having an exchange rate policy that gives a balance in foreign trade means that the exports will be equal the exports.

Potential exporters of industrial goods, services and agricultural products compete with each other under the same conditions. The ones who manage to make export profitable under those conditions will be the ones who will export. Because the exports will be equal to the imports and therefore lower than they were under the current system, some businesses, which are able to compete now, will not be able to compete after the change of the system. This will create transitional problems.

## CHAPTER 4

### AN ALTERNATIVE SYSTEM FOR ONE COUNTRY, PART TWO

#### 4.1 DEVALUATIONS

The discussion in chapters 1 and 2 shows that it is “the six requirements” that make it impossible to get rid of “the five problems”. If Norway wants to get rid of these problems, then Norway cannot satisfy those requirements. But if Norway does not satisfy them then the ability to compete will become worse and worse. That is not acceptable. (In section 1.1, it is explained what is meant by “the six requirements” and “the five problems”). In that connection, it was natural to think of devaluations. A devaluation of the Norwegian krone will lead to a lasting improvement in the ability to compete if Norway can prevent the devaluation from making domestic prices rise faster than foreign prices.

##### *Box 4.1 Currency*

With *currency* in this book meant other countries' money. Example: Euro and dollar are currencies for Norway.

An *exchange rate* is the price of a given amount of a country's money, measured in another country's money. Example: if 100 Swedish kroner can be bought for and sold for 94 Norwegian kroner, then "the Norwegian currency rate on Swedish kroner" is 94.

If a country's authorities make their country's money become less worth in other countries' money, then we say that they *devalue* their country's money.

This reasoning led to the following conclusion: one part of the economic policy used after the transition to the alternative system ought to be a deviation from “the six requirements” and another part ought to be a devaluation.

How much each of these two parts affects the ability to compete is important. If the deviation from “the six requirements” means more than the devaluation, then the ability to compete will be reduced. That is not acceptable. On the other hand, if the devaluation means more than the deviation from “the six requirements”, then the ability to compete will be improved. That will mean breaking this rule, which I presented in section 3.2:

The measures that are used should not improve the country's ability to compete.

#### **Devaluation packages**

The conclusion of the considerations which are described above, was that Norway should use a means which I call devaluation packages.

By a *devaluation package*, I mean a combination of

*a devaluation* which does not make Norwegian prices rise faster than foreign prices, and

*one or more measures* which break "the six requirements" and therefore weaken Norway's ability to compete by as much as the devaluation improves it.

## Can Norway devalue without making Norwegian prices rise faster than foreign prices?

The devaluations in the devaluation packages do not make Norwegian prices rise faster than foreign prices. That one can achieve this is unlikely when the usual form of devaluation is used, but not if the so-called *crawling peg* is used. Here is more about that.

### *The usual form for devaluation*

Devaluations usually take place in this way: exchange rates that have been kept constant for some time are changed by several percent from one day to the next.

To begin with, such devaluations improve the ability to compete. Here is an example:

Suppose it costs Norwegian businesses 16 kroner to produce a kilo of a certain product. If the Norwegian euro rate is 8 kroner per euro, the production costs of the business are 2 euros per kilo. But if the rate is changed to 16 kroner per euro, then the costs are 1 euro per kilo. This means that an increase in the Norwegian euro rate from 8 to 16 kroner will reduce “Norwegian production costs measured in euro” by 50%. This reduction will improve Norwegian businesses’ ability to compete with businesses in countries that use the euro.

However, a devaluation means that measured in Norwegian kroner, foreign goods become more expensive. It is likely that these effects will follow from a devaluation which reduces the value of Norway’s currency by several percent from one day to the next:

To avoid the price increases on foreign goods reducing their standard of living, many employees demand and get significant increases in wages. That makes Norwegian prices on domestic products rise fast, perhaps so rapidly that after a relatively short time the following has happened: “the improvement in Norway’s ability to compete” caused by the devaluation, is lost because Norwegian prices have increased faster than foreign prices.

### *The crawling peg*

To try to avoid that this rapid domestic price rise “eats up” the improvement in the ability to compete caused by a devaluation, the authorities can use a form of devaluation called *the crawling peg*. In this form a devaluation consists of many small steps. Here is an example:

In 2007, the Norwegian authorities devalue a little every day (or every week). These small devaluations add up to 2% during the year.

In this example, the authorities use the crawling peg to achieve a devaluation of 2% in 2007.

When the crawling peg is used, the effects of the devaluation on “the Norwegian prices for imported goods and services” come gradually. This makes it easier to avoid the increase in prices and wages, which a usual devaluation very often creates.

The crawling peg was proposed by the Nobel Prize winner in economics, James Meade in the 1960s and drew considerable interest to begin with. But after the transition to an economic system where all important currency rates are decided by supply and demand in international currency markets, the interest became much smaller.

The Norwegian authorities can only use the crawling peg if they control the currency rates<sup>6</sup>.

## **An important consequence of how fast Norway can devalue**

Let us first look at a devaluation package where the devaluation is only 2% per year. The measures Norway can use in this package to compensate for the deviation from “the six requirements” will be rather weak. Because of this, the step Norway takes towards breaking free from those requirements when it uses this package will be rather small.

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<sup>6</sup> When the authorities control the exchange rates and change them seldom, we say that we have “fixed exchange rates”. The opposite, i.e. that exchange rates are set by supply and demand in currency markets, is called “floating exchange rates”.

Let us next look at a devaluation package where the devaluation is 8% per year. The measures Norway can use in this package to get rid of “the six requirements” will be much stronger. Because of this, the step Norway takes towards breaking free from those requirements when it uses this package will be much longer.

These examples show that we can draw the following conclusion:

The faster Norway can devalue, the faster Norway can free itself from “the six requirements”.

## 4.2 HOW I ARRIVED AT THE RULES FOR BUYING AND SELLING CURRENCY AND SETTING THE EXCHANGE RATES

### **Buying currency**

As mentioned in section 3.4, the following rules are used:

Those who are given permits to import, can buy “the currency they need to pay for that import” from Norges Bank.

There is a similar rule for those who are given permits to transfer capital from Norway to other countries.

These rules are based on the following reasoning:

If the authorities permit certain kinds of import and certain capital transactions, then they ought to have a currency policy that makes that import and those capital transactions possible.

### **Selling currency**

As mentioned in section 3.4, the following rules are used:

Exporters must sell to Norges Bank the currency they receive as payments for goods and services they sell. There is a similar rule in connection with transfers of capital.

This is the basis for those rules:

Norges Bank must sell currency to those who are allowed to buy currency. Therefore the bank needs supplies of currency. It will get the necessary supplies if Norwegians who receive currency have to sell it to Norges Bank.

### **Setting the exchange rates**

As mentioned in section 3.4, Norges Bank sets the exchange rates. This rule is based on the following reasoning:

Devaluation plays an important role in “the alternative system”. If it is to be possible for Norway to devalue, Norwegian authorities must be able to set the exchange rates which determine the value of Norwegian kroner. It is probably most practical to let Norges Bank set the rates, following guidelines given by the government or the parliament.

## 4.3 AN IMPORTANT EFFECT OF THE DEMAND FOR FOREIGN PRODUCTS

### Introduction to this and the next section

The discussion in this and the next section leads to conclusions which the readers of this book ought to become acquainted with. However, in these sections there are several long chains of reasoning using economic theory, that some readers may find it hard to work through.

Here is a short summary of sections 4.3 and 4.4:

It creates problems for Norway that its economy is so strongly “woven together” with the economies of the other industrial countries. The “weaving together” can be reduced by using this rule: Norway shall not import services.

It can be argued for this: using "a certain modified version of the rule that Norway shall not import services" does not have negative side effects that outweigh the advantages of using that version (in section 3.4 is described how the rule is modified).

You, the reader, have a choice. You can choose to read only this summary. Or you can choose also to read the rest of this section and section 4.4.

### An important relationship

We can reason in this way:

The less the share “the demand for products produced abroad” is of “all demand from Norwegians”, the less the Norwegian economy is connected to the economies of other countries.

The less the Norwegian economy is connected to the economies of other countries, the less important it is for Norway how much the Norwegian krone is worth compared to foreign currencies.

The less it means for Norway how much the Norwegian krone is worth compared to foreign currencies, the smaller the problems a devaluation will cause Norway.

The smaller the problems a devaluation causes for Norway, the faster Norway can devalue.

The faster Norway can devalue, the faster Norway can free itself from “the six requirements”. (This is the last conclusion in section 4.1.)

Let us take the first and the last sentences in this reasoning and cut out the other sentences. Then we get this:

The less the share “the demand for products produced abroad” is of “all demand from Norwegians”, the faster Norway can free itself from “the six requirements”.

A justification for this conclusion that is more thorough, but also harder to read, is given in appendix C.

## 4.4 HOW I ARRIVED AT THE MAIN PRINCIPLE FOR THE IMPORT OF SERVICES

### **The basis for the principle**

Here are two conclusions which can be drawn:

The less the Norwegian import of services is, the less is the share that “the demand for products produced abroad” is of “all demand from Norwegians”. (This is obvious).

The less the share of “the demand for products produced abroad” is of “all demand from Norwegians”, the faster Norway can free itself from “the six requirements”. (This was the last conclusion in section 4.3.)

From these two conclusions follows that the less the Norwegian import of services is, the faster Norway can free itself from “the six requirements”.

On the basis of this, I decided to make the following rule a part of “the alternative system”:

The main principle for the import of services is that Norway shall not import services.

### **Why are the rules for the import of services different from the rules for the import of industrial goods?**

*Why are the rules for importing industrial goods as they are?*

In section 3.8, I gave the following reason why there ought to be free import of industrial goods:

Norway uses a large number of different types of industrial goods and many of them are produced most efficiently by large businesses. Norway does not have enough labour to be able to produce efficiently all the industrial goods the country needs. And the Norwegian market is not large enough for efficient production if all products must be sold in Norway.

What is pointed out here is more important than what a low import of industrial goods contributes to making it possible for Norway to devalue rapidly.

*Why are the rules for the import of services as they are?*

In most branches which offer services, “production” in very large companies is not a necessary condition for efficient production. Often the opposite is the case, i.e. that it is an advantage that businesses which offer services are relatively small.

Here is an example: a nursing home which has hundreds of patients is, at least from what many think ought to be the purpose of nursing homes, less efficient than most of the nursing homes that are much smaller. This is because most people who live at nursing homes tend to think it is more pleasant to live in a small nursing home than in a very big one<sup>7</sup>.

An economist might say it in this way:

The most important purpose for nursing homes is to produce welfare for the patients who live there. When we say that big nursing homes are not very efficient, we mean that “the welfare they produce per kroner” is low.

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<sup>7</sup> I have been told this several times. I believe that it is true and therefore use it here. But I cannot refer to research which indicates that it is true.

### *Conclusion*

It is pointed out above that there is an important difference between the production of industrial goods and the production of services. This difference explains this: in “the alternative system”, the advantage of being able to devalue quickly has a decisive influence on the rules for import of services, but not on the rules for import of industrial goods.

## 4.5 EFFECTS OF THE PRODUCTIVITY ON DEVELOPMENT

### **The effects**

Let us assume that this happens in a certain period:

Productivity, i.e. production per employee, increases by 100% in the production of PC's.

Productivity in private nursing homes increases by 10%. By this I mean: a private nursing home with a constant number of employees can, without reducing the quality of the care, by the end of the period give care to 10% more people than it could at the beginning of the period.

Economic theory and experience both show this:

The difference in the developments in productivity means that PC's will become much cheaper compared to what care in private nursing homes will cost.

This price development will cause “the amount of money spent on buying PC's” to increase more slowly than “the amount spent on buying care in private nursing homes”.

The examples illustrate this:

In the production of industrial goods, it is still possible to increase productivity considerably.

In most of the production of services, the possibilities to increase productivity are much smaller compared to industry.

Prices for services will increase. The price of an industrial good will increase much less, for some of them not at all.

This is one of the consequences of such a price development: measured in money, as we usually do, the demand for industrial goods will increase less than the demand for services. Therefore:

The share which “the demand from Norwegians for industrial goods” is of “all demand from Norwegians” will get smaller and smaller.

Because most of the Norwegian demand for foreign products is demand for industrial goods, this means:

The share which “the demand from Norwegians for goods produced abroad” is of “all demand from Norwegians” will get smaller and smaller. Therefore, it will be possible for Norway to devalue faster and faster.

### **Simplifications**

There are of course many simplifications in the description above. One of them is that I without any justification have made this assumption.

There are reasons to believe that productivity will continue to increase rapidly in transport and some other service sectors.

Assume for a moment that I had made neither this simplification nor other simplifications I am aware of that I have made. As far as I can judge, this would not have meant that I would have had to reject the conclusion I have drawn about how the relation between “the demand for foreign products” and “all demand” will develop.

## 4.6 WHAT MAY HAPPEN TO PUBLIC SECTOR POVERTY

*Public sector poverty* means that the state’s and municipalities’ incomes are not high enough to make it possible for them to do all their tasks satisfactorily.

There is public sector poverty in Norway today.

### **If Norway does not change its economic system, public sector poverty will increase in Norway**

In Norway, the most important goal of economic policy is that Norway must avoid a development where more and more people become unemployed. If this goal is to be reached then Norway must satisfy “the six requirements”.

These are three of the requirements that must be satisfied:

The tax level must not be higher than in other countries.

The education which is given and the research which is done must be of high international quality and satisfy the needs of trade and industry.

Infrastructure must at any point in time satisfy the needs of Norwegian trade and industry.

That public sector poverty is inevitable because these three requirements must be satisfied, can be justified in this way:

Taxes are the public sector’s most important source of income. The requirement concerning the tax level sets a limit to how high the taxes can be.

If the requirements concerning education, research and infrastructure are to be satisfied, public expenses will increase.

This can be summed up in the following way: satisfying the requirements for taxes, education, research and infrastructure limits public income and increases public expenses.

Satisfying these requirements therefore makes public sector poverty unavoidable.

The conclusion that increasing public sector poverty is unavoidable is strengthened by the fact that the share of elderly people in the population will increase.

### **Under “the alternative system” Norway can get rid of public sector poverty**

What will happen to public sector poverty under “the alternative system” depends on this. How high of a level of taxes will be accepted? How fast can the Norwegian kroner be devalued without Norwegian prices rising faster than foreign ones?



*How high of a level of taxes can be accepted?*

Today many find it difficult to cover their expenses. They will have large problems if taxes immediately become much higher. Partly for that reason it is probably not possible to get enough support for a policy which makes taxes much higher over a short time.

The willingness to increase taxes depends on a number of things, including the consequences of public sector poverty. There are probably many people who would say this:

“I dislike high taxes. But I dislike the consequences of public sector poverty even more.”

I believe that in the long run taxes will become much higher than they are now. This opinion is mainly based on the fact that many people dislike the negative effects of public sector poverty.

*How fast can the Norwegian kroner be devalued?*

As far as I can judge, the situation is this: it will be the willingness to pay taxes, and not the speed at which the krone can be devalued, that will determine how fast Norway can get rid of public sector poverty. This opinion is based on the assumption that the speed at which the kroner can be devalued, will increase.

*In the long run Norway can get rid of the public sector poverty*

After Norway has changed from the current system to “the alternative system”, Norway can use devaluation packages to increase taxes. Increased taxes lead to a higher public income. It is extremely unlikely that the increase in income will ever become so large that the state and the municipalities can afford to do everything that people want them to do. But if I am right in believing that in the long run people will accept considerably higher taxes, the increase in public income will be so large that it no longer will be reasonable to talk about public sector poverty.

## 4.7 OTHER GOALS THAT CAN BE REACHED BY USING DEVALUATION PACKAGES

Using devaluation packages may not only help Norway get rid of public sector poverty. In this section, I shall point out what can also be achieved by means of such packages.

### **Give workers back the influence they once had on their share of the values created in trade and industry**

Under the current economic system, Norway must satisfy this requirement:

Income on capital is as high as in other countries.

There are two reasons why this requirement must be satisfied. One is that Norway must be an attractive country for localisation of trade and industry. The other is that it is unacceptable if the ability to compete becomes weaker and weaker (c.f. section 1.5).

It can be shown that when the requirement is satisfied in the ways which are possible under the current system, Norwegian workers have little influence on the wages they get. Those wages will mainly depend on what happens abroad (c.f. section 1.6).

"The requirement on the income of capital" which is mentioned above must be satisfied also if Norway has gone over to "the alternative system". But control over capital transfers can make it unnecessary for Norway to be attractive for localisation of capital, compared to other countries. And the demand on the ability to compete can be satisfied by using devaluation packages. Such a package may consist of a devaluation and “an agreement between employers and workers” that changes the Norwegian wages in a way which reduces the income on capital. That agreement can be one which implies that "the workers' share of the income created in trade and industry" will increase.

What is pointed out in the above paragraph means that under the alternative system, Norwegian workers can get back the possibilities to influence "the share they get of the values that are created in trade and industry."

## **Make working conditions less hard**

### *Flexibility in the labour market*

Under the current economic system, Norway must satisfy this requirement.

The labour market must become more flexible.

Justification:

The more flexible the labour market is means here that there is less protection against dismissal and the extensive use of overtime.

If the labour market becomes more flexible, employers can dismiss workers more easily when *this* is profitable it for them and decide that workers must work more overtime when *that* is profitable. The more flexible the labour market is, the more profitable production.

The Norwegian labour market is less flexible than the labour market in other countries. Therefore it ought to be become more flexible.

A devaluation package may consist of a devaluation and an agreement between employers and employees which gives the employees better protection against dismissal and extensive use of overtime.

Because such devaluation packages can be used under "the alternative system", working conditions can become less hard under that system.

### *The working conditions in the public sector*

In many parts of the public sector, working conditions are good. But in other parts, the situation is as follows:

Public sector poverty has led to a reduction in the number of employees. However, there is as much work to be done as before. For people who are still working, the workload has therefore become so great that many of them get health problems.

Under "the alternative system" it will be possible to avoid this, because under that system one can get rid of the public sector poverty that leads to the hard working conditions.

## **Make it possible for Norwegian authorities to do more to protect the global environment**

Under the current economic system, Norway must satisfy this requirement:

Norway should not use "a measure which has positive effects on the global environment, but which increases production costs" before its trade partners use this measure.

This is why that requirement must be satisfied:

Costs that are higher in Norway than in other countries make Norway less attractive for the localisation of trade and industry.

A devaluation package may consist of a devaluation and "a measure which has positive effects on the global environment, but increases production costs".

This shows that going over from the current system to "the alternative system" will make it possible for the Norwegian authorities to do more to protect global environment than at present.

# CHAPTER 5

## AN ALTERNATIVE SYSTEM FOR ONE COUNTRY, PART THREE

### 5.1 INTRODUCTION

In chapter 4, it was explained how using devaluation packages can help the authorities:

reduce public sector poverty

give back to workers the influence they once had over their wages

make life at work less hard and

make it possible for the Norwegian authorities to do more than now to protect the global environment.

These are four of “the five problems”. The use of devaluation packages is not sufficient to get rid of the fifth problem, which is mass unemployment. When dealing with mass unemployment, we must use devaluation packages as well as other measures. (More about this in sections 5.2 - 5.7)

### 5.2 GUARANTEED JOBS

#### **The idea**

I use the term *ordinary jobs* here to mean jobs in private businesses, the state sector and municipalities that are not a result of the policy that is described in sections 5.2-5.7.

The point of departure for this section and the following ones is the idea that unemployment can be reduced by establishing a job type which I call *guaranteed jobs*<sup>8</sup>.

#### **Making the idea more concrete**

##### *Project plans*

Plans are made for projects that satisfy the following demands:

it is desirable to realise these projects and

they are projects the public sector does not give top priority to.

Here are two examples of projects which can meet these requirements:

Provide help to people at home who can get by without this kind of help, but who have health problems which mean that their quality of life will be significantly improved if they receive help at home once a week.

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<sup>8</sup> The idea originates from Professor William Mitchell, but I use a modified version of his idea. You can read more about Mitchell and his colleagues’ work on the homepage of the Centre of Full Employment and Equity (CofFEE) at [http://e1.newcastle.edu.au/coffee/job\\_guarantee/JobGuarantee.cfm](http://e1.newcastle.edu.au/coffee/job_guarantee/JobGuarantee.cfm).

Build up parks in towns and cities where more parks are desirable.

If possible, the projects should create different types of jobs. Some of them should require neither education nor professional experience. Other jobs should be more demanding, so that they are more interesting to people with qualifications that can be useful in these jobs.

#### *The administrations of the projects*

Norway should be divided into regions and an administration should be established in each region. This administration should:

Make plans of the type described above, for its region. The projects should be designed so that the number of guaranteed jobs can be quickly increased if more people want such jobs. They should also be designed so that it is possible for people with guaranteed jobs to quit almost immediately without this causing unacceptable difficulties for the projects.

Let everyone who applies for a job be offered a job right away. If they accept the offer, it should be possible to let them start working at once.

#### *Wage and working conditions for the guaranteed jobs*

The wage is the same for all guaranteed jobs. It is paid by the state, set by the state and is lower than the wages in ordinary jobs.

The employees have the right to holiday pay and sick pay. They cannot be fired. But as mentioned above, they can quit almost immediately.

## 5.3 MORE ABOUT GUARANTEED JOBS

### **How large should the regions be?**

The regions should be so small that the following demand is satisfied:

Suppose someone loses their job and takes a guaranteed job in the region where they live. The distance between their home and the place of work should not be so long that they have to move.

In addition, it is an advantage if the regions are so large that the following demand can be satisfied:

In each region, the administration can offer different kinds of jobs.

In some parts of Norway, people live so far apart from each other that it would not make sense to try to establish guaranteed jobs there. In other parts of the country, the conditions are as follows: if the demand for how small a region shall be is satisfied, then it is impossible to satisfy the demand that different types of jobs should be offered.

This means that it is not possible to find a perfect way of using the guaranteed jobs. But this will not prevent Norway from benefiting considerably from a way of using them that is possible.

### **How high should the wage be?**

Guaranteed jobs should be jobs most jobseekers want to have only if they cannot get ordinary jobs. The wage paid in guaranteed jobs should therefore be lower than the wages for ordinary jobs.

On the other hand, the wage ought to be so high that having a guaranteed job is more advantageous economically than living on unemployment benefits.

It should be up to the parliament or the government to decide how high the wage is to be.

## **How much will the guaranteed jobs cost the state?**

The net expenses of establishing and running guaranteed jobs will be the difference between the gross expenses and “the savings which are made by establishing and running guaranteed jobs”.

The gross expenses are:

Establishing and running the administrations.

The costs of the projects. Most of these costs will be wages to employees in guaranteed jobs.

The savings are the money the authorities save because:

Unemployment benefits are reduced, since some people who have received such benefits no longer need them because they have got a job and

National Health Service expenses will be reduced for the following reason: some people become healthier, because they are more satisfied after they have found jobs than they were when they were unemployed.

I believe that that the gross costs will be much higher than the savings. If they had been only slightly higher, measures similar to guaranteed jobs would probably have been used in the industrial countries to a much greater extent than they are used today.

## **It will be possible to get rid of an unreasonable situation**

The current situation in Norway is as follows:

There are many needs people think the state and municipalities ought to meet, but which the authorities do not have the resources to meet.

There are a lot of people who can work and who have a strong desire to work, but who are nevertheless unemployed and receive unemployment benefits.

Many people think this is a very unreasonable situation. By establishing and running guaranteed jobs it will be possible to get rid of it.

## **Should people who have guaranteed jobs, work on projects that have high priority?**

Here are three conditions that contribute to the same conclusion, which is that people who have guaranteed jobs should not work on projects that have a high priority:

Suppose that some people who have guaranteed jobs work on a project that has a high priority. If many of these people quit at the same time, the work on this project may suffer from that. Because the project has a high priority, the authorities may want to avoid this and thus deny some of the workers the right to leave the job almost immediately. This would be unfortunate, because the right to leave almost immediately, if one can get an ordinary job, is an important property of the guaranteed jobs.

Assume that a municipality must, in addition to the work it has done before, meet certain new needs which are given a high priority. It must therefore hire more people.

If the municipality has financial problems, it may be tempted to let the new employees be people who have guaranteed jobs. At first that may result in low costs, because the wages are

low in guaranteed jobs. But doing this would lead to frequent changes in the work stock. In the long run that would probably result in higher costs.

Many people regard it as wrong to let permanent municipal activities be done by employees whose wages are lower than those of other municipal employees.

## 5.4 EQUILIBRIUM UNEMPLOYMENT AND MODIFIED EQUILIBRIUM UNEMPLOYMENT

### **Are ordinary jobs, guaranteed jobs or unemployment preferable?**

#### *Ordinary jobs and guaranteed jobs*

Some people who have ordinary jobs will probably prefer to get away from the hard and stressful work they have, if this can be done by taking less stressful work in the guaranteed jobs. But most people who have ordinary jobs will probably want to keep their job instead of changing to a guaranteed job. An important reason for this is that such a change of jobs would lead to lower income and for many at least to a lower status. In addition, most people will probably prefer the work they already have, to the work they can receive from guaranteed jobs.

It is also likely that most of the people that are unemployed will prefer ordinary jobs to guaranteed ones.

#### *Guaranteed jobs and unemployment*

Some people do not mind being unemployed as long as the unemployment benefits are high enough to give them a standard of living they find acceptable. But many people dislike being unemployed (cf. section 2.1). As a result, they will prefer having a guaranteed job to being unemployed.

### **The theory of equilibrium unemployment**

This is an economic theory which is widely accepted today:

If there is only a little unemployment, the demands of employees for wage increases become so high that a wage-price spiral is created. Such a spiral is a development that creates a situation where faster and faster wage increases lead to faster and faster price increases and where faster and faster price increases lead to faster and faster wage increases.

Suppose now that unemployment becomes higher. This makes people who have work more afraid of losing their jobs. That fear leads to more moderate demands for wage increases.

When unemployment becomes so high that it reaches a level which is called *equilibrium unemployment*, the demands for wage increases have become so moderate that they can be met without creating a wage-price spiral.

With some simplification, we can say that Norway tries to conduct a policy which makes its unemployment equal to its equilibrium unemployment.

Equilibrium unemployment is sometimes called *the nonaccelerating inflation rate of unemployment*. This term is usually shortened to NAIRU<sup>9</sup>.

## Modified equilibrium unemployment

The theory about equilibrium unemployment is based on the assumption that the people who want to work either have ordinary jobs or are unemployed.

If guaranteed jobs are created, it can be useful to modify the theory of equilibrium unemployment. I do this by introducing the concept of “modified equilibrium unemployment”. This type of unemployment is the number of (unemployed + people in guaranteed jobs) needed to avert prices rising faster and faster. When I use the modified version of the theory about equilibrium unemployment, I assume the following:

People in ordinary jobs will not want to become unemployed or to have a guaranteed job. They fear that high wage demands may mean that they have to do one or the other. This fear is greater the larger the number of (unemployed + people in guaranteed jobs) is.

Many people fear being unemployed more than they fear taking guaranteed jobs. This may for instance mean that 80,000 unemployed are needed to avoid faster and faster price increases if guaranteed jobs have not been established and that 100,000 (unemployed + employees in guaranteed jobs) are needed if guaranteed jobs have been established.

Suppose that guaranteed jobs are established in Norway. I shall assume that the Norwegian authorities will then conduct a policy that makes the unemployment equal to the modified equilibrium unemployment.

## 5.5 A NUMERICAL EXAMPLE

By using a constructed numerical example, I shall in this section illustrate some effects of establishing guaranteed jobs. In the example, I compare two years with different conditions.

*Note: You may skip reading this section without this making it difficult for you to read the rest of this chapter.*

### Two different years

2007

In 2007, the situation is like this:

no guaranteed jobs have been established,

equilibrium unemployment is 80,000 and

the number of registered unemployed is equal to the equilibrium unemployment, i.e. it is 80,000.

2008

In 2008, the situation is like this:

---

<sup>9</sup> As far as I can judge, the “standard” theory of equilibrium unemployment should be replaced by a theory which is similar, but which is a little more complicated. More about this theory in Appendix E.

guaranteed jobs have been established,

modified equilibrium unemployment is 100,000 and

(the number of people in guaranteed jobs + the number of registered unemployed) is equal to the modified equilibrium unemployment, i.e. it is 100,000.

### **Effects of establishing guaranteed jobs**

#### *The registered unemployment will be reduced*

I shall assume that when guaranteed jobs are established, then half of the 80,000 who were registered as unemployed in 2007, accept the offer of such a job. I shall also assume that the number of people registered as unemployed in 2008 will be half of what it was in 2007, i.e. that it will be 40,000.

#### *Improvements of welfare*

The welfare will be improved for the 40,000 who in 2007 were unemployed, but in 2008 have a guaranteed job. The fact that they have chosen to work in such jobs is an indication of that.

But this is not all. The modified equilibrium unemployment will be 100,000 in 2008. This means that in this year 100,000 will either be registered as unemployed or will have guaranteed jobs. Because 40,000 are registered as unemployed, this also means that  $(100,000 - 40,000)$ , i.e. 60,000 people will have guaranteed jobs. Only 40,000 of them were registered unemployed in 2007. More than likely, a large majority of the other 20,000 are people who also wanted jobs in 2007, but did not apply for a job then because they did not think they would get jobs by doing this. For many of them, it will improve their welfare considerably to get a guaranteed job.

Establishing guaranteed jobs will also have the following positive effect on welfare: many people who have ordinary jobs will be less afraid of losing their jobs if they know that they can get a guaranteed job whenever they want.

## **5.6 A POLICY FOR LOW UNEMPLOYMENT WITHOUT FASTER AND FASTER PRICE RISES**

### **The basis of the discussion**

The basis of the discussion in this section consists mainly of two parts.

The first part is the explanation of the way aggregate demand affects unemployment and price increases. This was described in sections 2.4 and 2.5. Instead of repeating it, I will encourage the readers to reread those sections before continuing.

The second part of the basis is the guaranteed jobs. They are described in sections 5.2 - 5.4.

### **The policy**

The government should:

Set up guaranteed jobs in all parts of the country where the population is dense enough to make this sensible and

conduct a policy that leads to the following: aggregate demand is just large enough to make (registered unemployment + people in guaranteed jobs) equal to the modified equilibrium unemployment.



## **This policy cannot be used under the current system**

Under the current system, there will be public sector poverty in Norway. (c.f. section 1.5). Public sector poverty will mean that most ministerial services will find it difficult to finance new measures. It may be tough enough to sufficiently finance the measures that they already use.

This means that even if guaranteed jobs should be set up under the current system, it is unlikely that this would be done to as great an extent as in the policy outlined above.

## **5.7 HOW FAST AND BY HOW MUCH CAN THE POLICY THAT IS OUTLINED REDUCE UNEMPLOYMENT?**

### **How quickly can unemployment be reduced?**

To simplify the discussion, I shall assume the following:

After changing to “the alternative system”, the authorities concentrate on getting rid of mass unemployment before they try to get rid of the four other problems.

The effort to get rid of the mass unemployment consists of two phases. During the first phase, the authorities use devaluation packages to free themselves from the requirement that taxes must not be higher than in other countries. Doing that leads to higher income for the state. (cf. section 4.7.)

In the second phase, the increase in income is used to establish and to run guaranteed jobs.

As far as I can judge, the increase in income the state needs before it can go over to the second phase is not larger than they can get it in a relatively short period of time. Neither will there be a need for the second phase to take a long time.

Based on this, I shall assume:

Unemployment can be reduced significantly during a relatively short period of time, perhaps during four to six years.

This is an educated guess. It is based on my attempts to evaluate how fast taxes can be increased and how large the costs of setting up and operating guaranteed jobs will be.

### **How low can the unemployment become?**

Suppose the authorities conduct the policy outlined above.

Some people who are unemployed live in areas where the population density is so low that they cannot be offered guaranteed jobs. They are probably few.

The other unemployed people can be divided into those who accept the offer of a guaranteed job and those who prefer receiving unemployment benefits. The number of people who will choose to remain on unemployment benefits will depend among other things on the increase in income they get if they start working. My guess is that it will be possible to find a wage for guaranteed jobs that will enable the authorities to achieve the following:

The level of unemployment will be less than half of the current level.

I regard this to be a cautious estimate of what is possible. But, I will emphasise that the estimate has a weak basis.

## 5.8 MORE ON HOW UNEMPLOYMENT CAN BE REDUCED

The policy outlined in section 5.5 can be used to get rid of a lot of unemployment, but not all. This chapter points out some of the other measures the government can use to reduce unemployment.

### Measures that influence the transferral to new techniques

By supporting research, the authorities can contribute to the development of new techniques.

This policy can increase the speed with which domestic businesses change techniques.

However, another possibility, which is important for the goal to reduce the adjustment unemployment, is that the government can *slow down* the transferral to new techniques. They can do this by means of rules about when and/or to what extent certain new technologies may be used. They can also make it less profitable for some time for businesses to transfer to new techniques. This can be done through temporary taxes on businesses that use new techniques and/or through temporary subsidies to businesses that do not use them.

New techniques are usually more efficient than “old” techniques. Therefore, in most branches it will probably be out of question to use brakes on transferral to new techniques. But here is an example where the authorities may decide to use brakes.

The rules that govern trade with foreign countries include a ban on importing certain agricultural goods, which Norway can produce enough of itself. A fast reduction in the number of people who are needed to produce these goods might lead to rapid depopulation of areas where the goods are produced. If that happens, it will probably increase the adjustment unemployment. In such case, using brakes on the transferral to work-saving techniques might be considered.

In chapters 12 there is more information on why it may be desirable to put the brakes on transferring to more efficient techniques.

### Measures that help the unemployed find jobs

Also under the current economic system, the authorities try to help the unemployed find jobs. They arrange retraining and the employment offices keep the unemployed informed about what kinds of jobs are available and where these jobs are located.

This type of activity will almost certainly continue under “the alternative system”. Under that system it can, if it seems desirable, be extended considerably.

In contrast to how it will be under “the alternative system” there will be “public sector poverty” under the current system. That poverty will make most government agencies, including the employment agencies, not get the resources that they need to handle their tasks in a satisfactory way.

## 5.9 COUNTER-CYCLICAL POLICY

### The goal

The economic conditions are international. Suppose that they change in the United States or in another country that has a considerable influence on international trade. The economic contact between the countries will then make the economic conditions, without much delay, change in the same direction in most industrial countries.

As in other countries, changes in the economic conditions make the employment in Norway increase considerably in some periods and fall considerably in others. Adapting to these changes creates problems. Those problems will be smaller the less the employment varies. It is therefore a goal for the Norwegian government to make “the variation in the employment which is caused by the the cyclical changes in the economic conditions” as small as possible.

## **Measures that lead to fewer people losing their jobs when economic conditions worsen**

### *The state buys goods, stores them and sells them later*

Some people, who risk losing their jobs when the economic conditions worsen, will be able to keep their jobs if this happens.

When the economic conditions are poor, Norwegian businesses that are hurt by this produce more goods than they can sell on the markets. The state purchases the goods the businesses cannot sell on the markets, stores them and sells them when the economic conditions have improved.

This policy would cost the state some money. But those costs can be covered if Norway has gotten rid of public sector poverty.

### *Loans from the state that make it economically possible for businesses to store products*

The state can also use a measure that is similar to the one outlined above. When the economic conditions are poor, it can give loans under the following conditions:

Businesses that are given loans must produce more than they can sell, store the extra goods and sell them when the economic conditions have improved. The loans are given in order to make it possible for the businesses to pay “the costs that result from extra production” long before they receive “the income they get when the goods are sold.”

## **Measures that make people who have lost their jobs find new jobs faster.**

### *Guaranteed jobs*

Guaranteed jobs will be the most important measure to help “people who have become unemployed because of the poor economic conditions” find new jobs fast.

### *Establishing new jobs in the public sector more quickly than average*

Every year some jobs are wound up in the public sector, while some new ones are established there.

“People who have been made unemployed because of poor economic conditions” will find it easier to get new jobs if the following occurs in those periods: more new jobs are established in the public sector than what is the average over a long period.

## **Which policy should be conducted when the economic conditions are good?**

When bad economic conditions have been replaced by good ones, it would seem reasonable to conduct a policy which, in some ways, is the opposite of the policy used under poor economic conditions. Here is an example. As mentioned above, when the economic conditions are poor new jobs ought to be established in the public sector at a faster than average tempo. This must mean that when there are good economic conditions, such jobs should be established at a tempo slower than average.

## **5.10 HOW MANY FOREIGNERS SHALL BE GIVEN WORK PERMITS AND WHICH GROUPS SHALL BE GIVEN TOP PRIORITY TO GET SUCH PERMITS?**

Foreigners who do not live in Norway must have work permits before they can work in Norway.

The authorities ought to consider many arguments, both ethical and economic, before they decide how many foreigners shall be given work permits and which groups shall be given top priority to get

such permits. A satisfactory discussion of this must be so long that I have not found space for it in this book.

## CHAPTER 6

### AN ALTERNATIVE SYSTEM FOR ONE COUNTRY, PART FOUR

#### 6.1 HOW FAST CAN NORWAY GET RID OF “THE FIVE PROBLEMS”?

##### **Introduction**

Section 4.7 is called “What may happen to public sector poverty ” and section 4.8 is called “Other goals that can be achieved by using devaluation packages”. Section 5.6 is called “A policy for low unemployment without faster and faster price increases”. In these three sections five serious economic problems were pointed out and it was shown that Norway can get rid of them if it switches over to “the alternative system”.

In this section, I shall evaluate how long it will take to get rid of “the five problems” if Norway uses the policies described in sections 4.7, 4.8 and 5.6.

##### **The goals compete with each other**

I shall assume that the government wants:

unemployment to become lower

to get rid of public sector poverty

to make workers regain their influence over their wages

to make working life less hard, and

to have an increased contribution from Norway to the protection of the global environment.

Devaluation packages play an important role in the policies that can achieve these goals. But there is a limit on how fast Norway can devalue without making prices increase faster and faster. Therefore these goals compete with each other. The more the authorities do within a certain period to reach one of goals, the less they can do in this period to reach the other goals.

##### **Conclusions**

The fact that there is a limit on how fast Norway can devalue and that there are so many goals probably implies that it will take Norway many years to reach all of its goals.

But there is an important difference between the current system and “the alternative system”.

Under the current system, the Norwegian government cannot conduct a policy which reduces “the five problems”. There is, in fact, reason to believe that the policies the government will be forced to conduct, in the long run will make the problems more serious.

Under “the alternative system”, the governments can conduct a policy that reduces “the five problems”.

## 6.2 SHOULD ALL SYSTEM CHANGES BE MADE?

### **Introduction to this section and the next**

An alternative system and some measures that may be used in that system are described and discussed in chapters 3 - 5.

Several people have said this to me:

It will be easier to get your ideas accepted if you make them less drastic. If Norway goes over to “the alternative system” then it must withdraw from the EEA. Can’t you make a modified version of your system so that this is not necessary? And if Norway goes over to a modified version, is it then necessary to use all the measures you describe? One of them is a large increase in taxes. This is a measure many will dislike. Is it necessary?

### **How does “the alternative system” differ from the current system?**

In contrast to the current system, the Norwegian authorities under “the alternative system” control the:

import of services,

capital transfers to and from other countries,

buying and selling of foreign currency and

exchange rates which tell how much the Norwegian kroner is worth in foreign currencies.

### **What can be achieved if some of the system changes are not made?**

In chapter 1, it was pointed out that Norway has these problems today:

mass unemployment

public sector poverty

very unequal distribution of income and welfare

for many people working life is very hard

some Norwegian businesses use production methods which worsen global environmental problems

The core of chapters 3 - 5 is that it is impossible for Norway to get rid of “the five problems” unless it frees itself from “the six requirements”. This liberation is impossible if capital can flow freely to and from other countries. This means that if I omit the control of the authorities over the flow of capital, then an important part of the basis for the discussions in chapters 3 - 5 is lost.

Chapters 3 - 5 contain many descriptions of how Norway can free itself from “the six requirements” without worsening the ability to compete. The use of devaluation packages plays a crucial role in all these descriptions.

It is impossible to use devaluation packages if the exchange rates are determined by supply and demand in international currency markets. The following system changes are therefore necessary parts of the basis for the discussions in chapters 3 - 5:

the control of the authorities over the buying and selling of Norwegian money for payments in foreign currencies and

the control of the authorities over “the exchange rates that tell how much the Norwegian kroner is worth in foreign currencies”.

If the Norwegian authorities choose not to control the import of services, they can nevertheless control capital transfers to and from other countries, the buying and selling of Norwegian money for payments in foreign currencies and set the exchange rates that tell how much the Norwegian kroner is worth in foreign currencies.

This means that the systemic change that makes it possible for the Norwegian authorities to control the import of services is not a necessary part of the basis for most of what is said in chapters 3 - 5. Even if this change is not made, it will be possible for Norway to get rid of “the five problems”. But it will then take much more time.

The discussions above can be summed up in this way:

Suppose that Norway, in order to get rid of “the five problems”, wants to go over to “the alternative system” or a modified version of that system. If Norway is to be able to get rid of the problems by doing this then, with one exception, Norway cannot omit any part of “the alternative system”. The exception is the control of the authorities on the import of services. However, that control is very important for how fast Norway can get rid of the problems.

## 6.3 SHOULD ALL THE MEASURES BE USED?

### **The measures**

In chapters 3 –5, it is assumed that these measures are used:

devaluation packages

increases in taxes

stronger protection against dismissal and the extensive use of overtime

measures which reduce the use of production methods that are harmful for the global environment

guaranteed jobs

ban on the import of most types of services

### **Why are these measures used?**

#### *Devaluation packages*

Devaluation packages play an important role in the policy to free Norway from “the six requirements”.

#### *Increases in taxes*

Increases in taxes are necessary to get rid of public sector poverty. In a more indirect way, they are also necessary to get rid of mass unemployment. This is because the public sector must become less poor if it is to be possible for the authorities to establish and run as many guaranteed jobs as needed.

*Stronger protection against dismissals and extensive use of overtime*  
Stronger protection is needed to make working life less hard.

#### *Guaranteed jobs*

By setting up guaranteed jobs, Norway can get rid of a large part of the domestic unemployment.

#### *Measures to reduce the use of production methods that are harmful for the environment*

Such measures will make the influence on the global environment less harmful.

Among the measures that could be used, are measures which reduce the emissions of greenhouse gasses (more about the greenhouse gasses in chapter 12).

#### *Ban on the import of most types of services*

Norway does not need to use this measure to get rid of “the five problems”. But if this measure is used, then Norway will be able to weaken these requirements faster than if the measure is not used.

### **Conclusion**

If Norway wants to get rid of “the five problems”, then the country must free itself from “the six requirements”. And if Norway is to be able to do that, then Norway must with one exception use all the measures that are mentioned above.

The exception is “ban on the import of most types of services”. Here, Norway must decide what is the most important: the advantages of not having restrictions on the import of services or the advantage of getting rid of “the five problems” considerably faster than it otherwise can be done.

## **6.4 CONSEQUENCES OF NORWAY 'S MEMBERSHIP IN WTO**

In section 3.5 I wrote this:

The WTO (World Trade Organisation) is an organisation whose main task is to set rules for the trade between the countries that are members of it. Most countries in the world, among them Norway, are members of the WTO.

Norway's membership in the WTO means that other members of the WTO have the right to sell certain types of services to Norway. It is unlikely that Norway will change its economic system in such a way that it becomes impossible to remain as a member of the WTO. If Norway decides to go over to the alternative system, it must be to a modified version of it, where the modifications are such that the rules in this version are compatible with the rules of the WTO. As long as the WTO rules are as they are today, the necessary modifications are rather small. But the rules will change (more about this in section 6.4).

The current WTO rules will be changed. When I write this it is not decided when and how. Several powerful members of WTO, among them the USA and the EU, want a strong increase in the members' right to export services to other members without meeting hindrances. If they get the revision they want, there will be a significant reduction in Norway's possibilities to ban the import of most types of services. This will reduce the speed with which Norway can get rid of "the five problems" if Norway goes over to a modified version of "the alternative system". But even with high import of services it will be possible to take steps towards solving these problems (cf. section 6.3).



# CHAPTER 7

## AN ALTERNATIVE SYSTEM FOR THE INDUSTRIAL SOCIETY

### 7.1 INTRODUCTION

In some contexts it is useful to regard the industrial countries as one society. This society I call the *Industrial Society*.

I have tried to find an economic system for the Industrial Society that makes it possible for this society to get rid of “the five problems”. The goal was to find a system which meets the following requirement:

If the system is used, that should enable all industrial countries to achieve what one country can achieve by using “the alternative system for one country”.

This chapter outlines a system which satisfies that requirement.

Note the following: In chapters 3 - 6, the expression “the alternative system” means “the alternative system for Norway”. Here in chapter 7, the expression means “the alternative system for the Industrial Society”.

### 7.2 “THE ALTERNATIVE SYSTEM”

#### *THE ORGANISATION OF TRADE AND CAPITAL TRANSFERS IN THE INDUSTRIAL SOCIETY*

##### **Trade**

###### *Trade in industrial goods*

The main rule here is that anyone who wants to import or export industrial goods can do this without having to apply for permission from national or international authorities. There are certain exceptions from this rule, e.g. for trade in narcotics.

###### *Trade in agricultural goods*

National governments can decide whether they want to import a particular agricultural good and if so how much they want to import of it.

###### *Trade in services*

National governments can decide whether they want to import a particular service and if so how much they want to import of it

##### **Capital transfers between countries**

To transfer capital from one industrial country to another, it is necessary to have a permit from:

the authorities in the country which the capital is to be transferred *to* and

the authorities in the country which the capital is to be transferred *from*.

## ***INTERNATIONAL PAYMENTS***

### **Establishing the I-Bank**

A bank called “The Industrial Countries’ Currency Bank” is established. In this chapter its name is usually shortened to *the I-bank*.

The I-bank's task is to organise the payments between the industrial countries. It has certain functions in the start-up phase in the organisation of "the alternative system" and other functions when that phase is over.

The bank has a board of representatives where each member represents an industrial country or a group of such countries.

### **The I-Bank’s activities in the start-up phase**

In the start-up phase, the I-Bank will:

Create a new type of currency called *bancor*<sup>10</sup>.

Demand that bancors are used from now on in all payments for trade and capital transfers between industrial countries.

Decide how large the amount of bancors is to be.

Distribute bancors between the individual industrial countries.

Decide what each industrial country’s currency is to be worth in bancors.

How large the amount of bancors is to be, is decided based on prognoses for how much trade there will be between the industrial countries.

This is the way bancors are distributed: the bank opens an account for each industrial country. In this account the bank deposits a certain amount of bancors. The amount which is deposited depends on the size of the country’s trade as a share of all trade between the industrial countries.

The value of each country’s currency in bancors is set based on how much the currency on average was worth in gold over a certain period. Instead of gold, a specific currency, e.g. the dollar or the euro, can be used as a benchmark for setting the value of a country’s currency in bancors.

### **The I-Bank’s activities after the start-up phase is over**

#### *Overview*

After the start-up phase is over the I-Bank will:

be a clearing bank for payments between industrial countries,

fine countries which have either too large deficits or too large surpluses in payments to and from other industrial countries

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<sup>10</sup> The name “Bancor” has been chosen because John Maynard Keynes, the British economist, used this name for a type of international currency he believed should be established. More about this below.

perhaps sometimes decide to increase the amount of bancors and

perhaps at other times decide to reduce the amount of bancors

#### *The I-bank as a clearing bank*

When an industrial country imports something from another industrial country, the payment for this is made in the following way: the I-Bank is notified that the country that is importing is to pay a certain amount in bancors to the country that is exporting. At the end of each day, the bank calculates for each country the difference between “payments to the country” and “payments from the country”.

If the difference is negative, the country has spent more bancors in trade with other industrial countries than it has received through this trade. In this case, the amount in the country’s I-Bank account is reduced by the difference.

If the difference is positive, this means the country has received more bancors through trade with other industrial countries than it has spent on this trade. In this case, the difference is deposited in the country’s I-Bank account.

This process is called *multinational clearing*. This allows a country to have large trade surpluses with some countries and large trade deficits with other countries without this necessarily leading to problems.

By “payments from a country” I mean “payments from someone who belongs to that country”. The payer could be the state, a municipality, a private business or an individual.

The expression “payments to a country” is used in a similar way.

#### *The fines*

We can look at it in this way: a country which usually has a trade balance deficit uses foreign trade to get more goods and services than it produces.

Countries are not supposed to do this under the alternative system. To encourage countries to follow a policy that will prevent them from doing this, the following rule is used:

When a country has spent more than 5% of the money in its account it must each day pay the I-Bank a fine. The fine is higher the more the country has spent.

If an industrial country has a trade surplus with other industrial countries, one or more countries will have trade deficits. A country that usually has foreign trade surpluses necessarily causes one or more other countries to have deficits. To encourage countries to avoid policies that lead to increasing surpluses in foreign trade, the following rule is used:

When a country has increased its deposit in its I-Bank account with more than 5%, the country must each day pay a fine to the bank. The larger the increase is, the higher the fine.

#### *Devaluations*

When I say that a country devalues, this means here that it makes its currency less worth in bancors.

A country may devalue, but there are rules for how this should be done. These rules are explained in section 7.4.

## 7.3 DIFFERENCES BETWEEN THE ALTERNATIVE SYSTEM FOR THE INDUSTRIAL SOCIETY AND THE OTHER SYSTEMS I DISCUSS

“The alternative system” differs from the current system among other things in that each country’s national government can control:

capital transfers to and from other industrial countries and

the import of services.

These rules are generalisations of the rules used by one country under “the alternative system for one country”. (C.f. chapters 3 - 6.) In section 6.2, reasons were given why these rules may benefit that country. The same reasons can be used in an argument that shows why there are reasons to believe that the Industrial Society will benefit from such rules.

In addition, we have the following:

“The alternative system for the Industrial Society” has rules for how payments between industrial countries are organised. They are different both from the rules which are used under the current system and from the rules which are used under “the alternative system for one country”.

In the two next sections, I shall comment on the rules for payments between industrial countries under “the alternative system for the Industrial Society”.

## 7.4 DEVALUATIONS

### **Introduction**

Under “the alternative system for the Industrial Society” bancors are used as payment in trade between industrial countries and the I-Bank functions as an international clearing bank for these payments. To make sure that this system works as intended, the bank will fine countries that have large overall deficits or surpluses in the trade with other countries.

These rules in the alternative system are taken from a plan made by the British economist John Maynard Keynes at the beginning of the 1940's<sup>11</sup>.

### **Keynes' view on devaluations**

In the 1930's several industrial countries devalued to improve their ability to compete. This created problems. To avoid these problems, Keynes proposed in his plan that individual countries should not be allowed to devalue.

But he realised that if countries developed differently, the exchange rates ought to be changed. He proposed that decisions on this should be made by an international body of experts.

### **My view on devaluations**

I agree with Keynes in that countries should not be allowed to devalue to improve their competitiveness. However, to prevent this from happening, I will use a policy which is different from that of Keynes.

I will allow countries to devalue. But I will require that if a country devalues, it then also has to do something that worsens the country's ability to compete. This “something that worsens the country's ability to compete” should be such that the combination of it and the devaluation leaves the country's ability to compete unchanged.

### **Devaluations under “the alternative system”**

Under “the alternative system” a country is allowed to devalue if and only if the following demands are met.

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<sup>11</sup> See list of references for sources on the Keynes plan.

A devaluation must be combined with one or more measures that worsen the country's ability to compete by as much as the devaluation improves it.

The crawling peg is used. In other words, a devaluation consists of many small steps.

Each country must always have a plan that sets its currency rate for the following 12 months. The plan must be made public. This means that people will know what the country's currency will be worth in bancors on any given day the next twelve months.

There is no particular reason why I have chosen the period to be 12 months. The period can be shorter or longer than 12 months. This is not important for the discussion of "the alternative system" in this book.

The devaluation rules are the result of a compromise between:

the goal to allow countries to free themselves from "the six requirements" and

the goal to have as much as possible of "the security in knowing what the future exchange rates will be" that a system with fixed exchange rates gives.

That a country is allowed to devalue means that the goal to allow countries to free themselves from "the six requirements" has had some influence on the rules.

The use of the crawling peg means that there will never be large changes in the exchange rates from one day to the next. And that the exchange rates for the next 12 months are set and made public, means this: people will have an important part of "the security of knowing what the future exchange rates will be" that they have when the exchange rates are fixed.

Some people will perhaps think that there should be a limit on how fast a country can devalue. But this is probably unnecessary. The speed of a country's devaluation will be limited by the fact that no country will want to devalue so fast that prices increase faster domestically than abroad.

## 7.5 MORE ON DEVALUATIONS WHEN "THE ALTERNATIVE SYSTEM" IS USED

### **What happens if all countries devalue equally much?**

Let us assume that Norway devalues by 4% in a specific year and lets the devaluation be one part of a devaluation package where the second part consists of breaking one of "the six demands". If no other industrial country devalues, we have the same situation as the one that was discussed in chapters 3 - 6. The discussion in those chapters concluded that this policy will help free the country from "the six requirements".

But under "the alternative system for the Industrial society" all the other industrial countries can also devalue, not just Norway. Suppose now that in the year Norway devalues by 4%, all the other industrial countries also devalue by 4%. Several people have asked me if this will prevent the Norwegian government from reaching the goal they wanted to reach by devaluing.

My answer is that the Norwegian government would not achieve its goal if this was the case:

Norway devalued to improve Norway's ability to compete.

Each of the other countries devalued to improve their ability to compete.

But this is not the case.

The Norwegian devaluation does not aim to improve the ability to compete, but to make room for measures to free the country from one or more of “the six requirements”.

The devaluations of the other countries do not affect *Norway's* ability to compete because each country must let its devaluation be part of a policy that does not change *its* ability to compete.

### **It is unlikely that all industrial countries will use devaluation packages**

There are at least two reasons for this.

One is that in some countries, the conditions in the labour market are such that the positive effects of the devaluation probably will be “eaten up” by domestic price rises. The other is that devaluation means that more must be exported to pay for the import the country wants. More about this in Appendix D.

## **7.6 AN EXAMPLE OF HOW CONDITIONS COULD BE TEN YEARS AFTER THE INDUSTRIAL SOCIETY HAS GONE OVER TO “THE ALTERNATIVE SYSTEM”**

In this section I will describe how the conditions could be in Norway ten years after the Industrial Society has gone over to “the alternative system”<sup>12</sup>.

### **Less public poverty**

Taxes have been increased. This has led to higher income for the state and for the municipalities. The income is still considerably lower than it must be if Norway is to be able to get rid of the five problems. Nevertheless, the increase in income has made this possible:

There are many guaranteed jobs. This has led to considerable reduction in the number of unemployed.

There are more people employed in nursing homes, as homehelps and in other public-sector operations that provide care. This has led to increased welfare for many people who need care. This has also led to fewer public-sector employees wearing themselves out because the institutions they work at are understaffed. However, there are still a lot fewer people working in providing public-sector care services than a lot of people think there ought to be.

### **Employees have gained more influence over their wages**

In wage negotiations, Norwegian employees still have to take into account how “the value created by businesses” is distributed between employees and businesses in other countries. But they have gained more influence on how this value is distributed in Norway.

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<sup>12</sup> Note the use of the word “could” in this sentence. Conditions could also be different from the ones I have outlined above. This is partly because I do not know enough about which opportunities the transition to the alternative system will offer, and partly because I do not know how the Norwegian government will choose between the different goals.

### **The working life has become less hard**

There is better protection against dismissals and extensive use of overtime. In addition, as mentioned above, more staff at some of the public institutions that provide care has made the working life at these institutions less hard.

### **In Norwegian production of gas and oil there is more emphasis on avoiding pollution which increases global environmental problems**

The use of devaluation packages has made it possible to place more emphasis than before on avoiding the global environmental problems that production of oil and gas can create.

## CHAPTER 8

### CAN THE SYSTEM CHANGES BE MADE?

#### 8.1 INTRODUCTION

I have met many people who have said something similar to the following to me:

“I like the system changes that you have discussed. But they will not mean anything in practice. The forces which want to keep international market liberalism are so strong that this system is here for good.”

This view will be discussed here in chapter 8.

#### 8.2 HOW STRONG SUPPORT WILL IT BE POSSIBLE TO GET FOR DEMANDING A NEW ECONOMIC SYSTEM IN NORWAY?

##### **Reasons to be frustrated with the consequences of the current economic system**

For various reasons, Norwegians can be frustrated with the consequences of the current economic system. Some people are most concerned about global problems, others with national problems, while others dislike conditions that affect themselves or the people close to them.

Here are some groups who dislike the current conditions and the current development:

People concerned about how terrible the conditions in developing countries are.

People concerned about the global environmental problems.

People concerned about high unemployment and/or the unequal distribution of wealth both nationally and internationally.

Young people who are in this situation: they live with their parents, but they would very much like to live on their own. However, rent nowadays is so high that it is impossible for them to find a place to live which is acceptable and which they can afford.

People who have parents in nursing homes and who are very dissatisfied with the conditions in these homes.

People concerned about worsening conditions where they live. Many people of all ages protest if the conditions in their local community are given lower priority than economic concerns, for example in decisions concerning where to locate motorways, shopping centres or large car parks.

##### **Will it be possible for these groups to unite in actions where they demand a system change of the kind proposed in chapters 3 - 7?**

First, let's consider young people who would like cheaper housing. Many of the themes in this book are only discussed in arenas that are unknown to them. How the buying and selling of foreign currency should be organised and whether devaluations should be allowed or not are questions that few of them



ask themselves. However, I don't think it will be impossible to recruit some of these young persons to support changing to a system similar to the one outlined in chapters 3 - 7. It can be argued in this way:

Suppose the authorities build housing complexes, which can then be rented out to young people who want to establish themselves. This has been done before to a certain extent. If this is also done now, young people can get themselves housing that they can be satisfied with at a rent that they can afford.

However, the chances of having a housing policy such as this today are small. This is because the government and parliament must put decisive weight on avoiding poor competitiveness. This reduces the chances of the authorities to make sure that the municipalities have economic conditions, which allow them to build houses that can be rented out.

The reason that it is very important to avoid a poor ability to compete is, to a great extent, because of free trade and the free flow of capital.

Less free trade and free flow of capital would make Norway less dependent upon the requirement of a good ability to compete. This would increase the possibilities that the municipalities might have good economic conditions and could conduct a housing policy that would be better for you than the current one.

It is then in your interest that Norway's economic contact with other countries be organised in a different way than it is today.

Something similar applies to the other groups mentioned above. The discussion of how Norway's economic contact with other countries should be organised goes on in arenas that are unknown to them. However, it will perhaps nevertheless be possible to reach out to them with an argument where at the core is this:

Less free trade and free flow of capital will make Norway less dependent upon the requirement of a good ability to compete. This will increase the chances of changing the political decisions you dislike.

*Will it be possible to get socialists and non-socialists to co-operate on bringing about a system change of the type discussed in chapters 3 - 6?*

Many non-socialists will probably not have any serious objections to a co-operation like this.

The re-organisation of foreign trade, which is the purpose of the co-operation, will neither make Norway a socialist country nor take it a step towards becoming a socialist country.

Many socialists will probably think in this way:

International market liberalism is a condition that allows for many of the worst effects of capitalism to occur. If we could get rid of international market liberalism, we would already have come a long way towards getting rid of the problems caused by capitalism.

We should therefore actively participate in the fight towards getting rid of international market liberalism. There is no reason for us not to co-operate with non-socialists in this fight.

Based on the above, I do not believe that different views on socialism will be an important barrier for co-operation between people who agree that the free flow of goods, services and capital creates serious problems for Norway.

## 8.3 THE OPPOSITION TO CHANGING THE ECONOMIC SYSTEM IN NORWAY

There will without a doubt be a lot of opposition to changing the organisation of Norway's economic contact with other countries in the way outlined in chapters 3 - 6. This is partly due to a belief that is common in many circles, including amongst the leaders of most political parties, that it is best for the society to have free trade and free flow of capital. However, it is probably more important to point out that some people find it in their own best interest to keep the current system. These include among others:

Norwegian businessmen, who wish to continue to have the challenges and "the opportunities to make money" that the markets in other countries give them.

Norwegians who have skills that will be of less value if the markets for capital and services are no longer international. An example of this could be a broker who specializes in advising Norwegians on the buying and selling of foreign stocks. This broker's skills would be of less worth if foreign stocks could not be traded in Norway.

Workers who work in businesses that will experience worse conditions if Norway withdrew from the EEA agreement.

Norwegians who have high incomes, and who would profit more from low taxes than they would lose from reductions in public welfare goods. Taxes are currently limited because of a fear of capital flight and poor competitiveness. This fear will disappear if there are regulations on capital that eliminate the fear of capital flight and the possibility to devalue eliminates the fear of a poor ability to compete.

As far as I can judge, these groups make up far less than half the Norwegian population. With the exception of workers in businesses that benefit from the EEA agreement, these groups are very resourceful. This makes their overall influence much larger than their share of the population.

In addition to the Norwegians who want Norway to keep "the organisation of Norway's economic contact with other countries" the way it is today, there are foreigners who also want this.

One important group consists of the leaders of multinational companies. These companies have a large share of the world trade. The freer trade is and the freer capital can flow, the greater are the possibilities for these companies of making a profit. If Norway gets rid of free trade and the free flow of capital, the direct negative effects for these companies will probably not be too serious. But if Norway's experiment is successful, the idea may "infect" others. Such an infection could seriously affect the multinational companies.

There are a number of other foreigners who are in the same situation as the leaders of the multinational companies. Organisations such as the WTO (World Trade Organisation) and the OECD (Organisation for Economic Co-operation and Development) work for free trade and a number of governments, including the United States' government, believe that the interests of their countries are best served if their businesses are allowed access to the markets of other countries. Also, for these organisations and governments the possibility of infection is probably more important than the direct effects.

## 8.4 WHAT WILL HAPPEN TO THE ECONOMIC SYSTEM IN THE INDUSTRIAL SOCIETY?

In sections 8.2 and 8.3, I presented the conditions that will be decisive for the organisation of Norway's economic contact with other countries. Similar conditions will be decisive for whether the Industrial Society's economic system will be changed in the direction described in chapter 7.

There is a certain possibility that the current wave of protests against the economic system will lead to the markets for products and capital becoming more national in the industrial countries. But the wave may also die out without reducing free trade and the free flow of capital. Here is my picture of “what the future will be like” if that happens:

Each country's economy will become more and more dependent on the economies of other countries.

There will still be mass unemployment, a very unequal distribution of wealth, hard conditions at work for many people, less welfare benefits and too few measures to tackle global environmental problems (c.f. chapters 1 and 2 about conditions under the current system).

After a time, there will come a powerful new wave of protests against the economic system. Suppose this wave has also little effect before dying out. In that case, after a few years, a new wave of protest will come.

Sooner or later the pressure on the system will be so great that it collapses.

This may occur in the following way. Many people in a certain country have serious problems in their daily lives. The authorities cannot help them, because they do not have enough influence over the economic conditions. This leads to pressure on the government, demanding that something must be done. Finally, the pressure becomes so great that the government, in order to get control over the development, finds it necessary to break with international agreements about free trade and the free flow of capital. To begin with, this is done in as hidden a way as possible, while the government still says that it supports international market liberalism. This way of behaving eventually spreads to other countries. After a while, perhaps rather quickly, there will no longer be any point in trying to pretend that goods, services and capital can flow freely over national borders.

If international market liberalism winds up in this way, it may be appropriate to say that it is rotting from the inside. There are several historical examples that a system can wind up in this way (box 8.1 illustrates one of them).

A collapse would create more serious problems than a controlled transition of the type outlined in chapter 7 would. In a few years, the economies of the individual countries will be even more interwoven with the economies of other countries than they are now. The problems caused by breaking the ties between them will therefore become more serious. In addition, a collapse, particularly a collapse that happens over a short period of time, would create more serious problems than a controlled transition.

I expect that what I have said above will be met with the following objection:

People have many times before predicted the collapse of the market economy in the near future. Such predictions have always proven to be wrong. For that reason, there is little reason to take such predictions seriously.

This is my answer to that:

We are living in a world that is very different from what it used to be. Experiences from the world of yesterday can thus be a poor basis for predictions about the future.

*Box 8.1*  
*The collapse of the Soviet Union's planned economy*

The Soviet Union had a planned economy. The rulers controlled the army, the KGB and the police. Those who opposed the system were not organised. It would seem that under these conditions it would be impossible to get a change in this system. Most people outside of the Soviet Union thought this would not happen for a long time.

But that is not what happened. The planned economy collapsed in the last half of the 1980s and the first half of the 1990s. It is a generally accepted view that the following was the most important reason for the collapse:

Inefficiency and other negative effects of the long-term planned economy in tens of thousands of local communities made an increasing part of the population understand that the economic system had serious weaknesses.

According to what I have read about this, the collapse did not result from pressure from other countries. Nor was it due to a well-organised opposition carrying out a coup.

Some people have put it this way: the Soviet Union's planned economy rotted from the inside.

# CHAPTER 9

## INTERNATIONALISING GOVERNANCE

### 9.1 INTRODUCTION

I often meet people who say something similar to the following to me:

“I agree with you when you say that economic development must be governed. However, markets have become international and will remain so in the future. We should hence internationalise governance to get rid of the problems that are created, because markets have become international, while politics remain mainly national.”

Since many people seem to think this, there is good reason to discuss what the industrial countries can achieve by internationalising governance. I do this here in chapter 9. In the discussion I assume that goods, services and capital can flow as freely over national borders as they can today.

### 9.2 FEDERALISM IN THE INDUSTRIAL SOCIETY?

#### **The main question in this chapter**

*Federalism* is a type of political organisation where two or more states form a certain type of union. In this union, national bodies have transferred decision-making power in some areas to bodies that the union has established. The national governments keep their decision-making power in other areas.

The main question in this chapter is:

Can the industrial countries get rid of “the five problems” if they form a federation?

#### *A detour*

The industrial countries have never tried to form a federation that includes all the industrial countries and as a result we do not have any empirical knowledge about how such a federation will function.

In this situation, I have chosen to take a detour. The EU (European Union) is a federation. The experiences from the EU may be useful when we try to answer this question:

How much decision-making power will the industrial countries be willing to transfer to a federation of industrial countries?

### 9.3 THE EU

#### **Similarities between two groups of countries**

There are important similarities between “the group of EU countries” and “the group of industrial countries”. For both groups:

there is to a great extent free flow of goods, services and capital between the countries in the group,

trade and capital transfers to and from other countries in the group are important for each country,

all countries have “the five problems” and

for every country in the group it seems to be impossible to get rid of “the five problems”.

### **A theory about why it is impossible for the EU countries to get rid of “the five problems” as long as EU keeps its current economic system**

In chapters 1 and 2, a theory was outlined about why it will be impossible for the industrial countries to get rid of “the five problems” as long as the Industrial Society keeps its current economic system. The similarities between the “group of EU members” and “the group of industrial countries” made me think that the theory outlined in chapters 1 and 2 also applies to “the group of EU members”. On the basis of this, I use the following theory:

In each of the EU countries, the national government can influence the framework conditions for the businesses located in their country. (c.f. what is said in section 1.7 about the conditions in Germany.)

The combination of “national governments which can influence businesses’ framework conditions” and “open borders between countries” leads to competition between the EU countries over being attractive locations for trade and industry.

To avoid ending up as a loser in this competition, each EU government gives top priority to the following goal: domestic businesses must have framework conditions that are as at least as good as those of their foreign competitors.

Giving top priority to this goal makes it impossible for the EU countries to get rid of “the five problems”.

### **What must happen before the EU countries can get rid of “the five problems”?**

It is the combination of “open borders” and the “ability of the national governments to influence the framework conditions” which is the basic cause for the fact that it is impossible for the EU countries to get rid of “the five problems”.

Here in chapter 9, I assume that the borders remain as open as today. The only possibility of getting rid of “the basic cause” is therefore to transfer so much decision-making power from the national governments to the EU that the transfer leads to the following:

The influence of the national governments over the framework conditions for “trade and industry” is so little that these conditions are not significantly influenced by what the governments do. There will thus no longer be a competition between the countries over framework conditions.

Note: By transferring a lot of decision-making power from national to international bodies, EU countries can get rid of *the current* basic cause for why it is impossible to get rid of “the five problems”. However, these countries should not disregard the possibility that such a large transfer of decision-making power may mean that for other reasons it will then be impossible to get rid of “the five problems”. (More about this in section 9.6).

## 9.4 THE CRISIS IN THE EU DUE TO THE FRENCH AND DUTCH “NO” TO THE PROPOSED CONSTITUTION

### **The proposed constitution**

In December 2001, the European Council decided to set up a group called the “Convention”. Its task was to work out a proposal for a constitution for the EU. (The European Council is the EU’s supreme body. It consists of the heads of states and governments of the EU countries).

The Convention had 105 members. The chairman and the two vice-chairmen were appointed by the Council. The other representatives were heads of states and governments or coming from national parliaments, the European Parliament, the Commission and the countries seeking EU membership.

The most important work took place in a presidium that had 10 members. The presidium’s meetings were not open to the public.

The Convention presented its proposal in the spring of 2005. It must be accepted by all the EU members if it shall become a constitution for the EU.

### **What happened to the proposal?**

The proposal was accepted by all the EU’s heads of state and governments. But some countries thought that this question was so important that it should be decided on in national referenda.

The media and all prominent politicians in the EU countries seemed to assume that there would be a majority in favour of the proposal in the countries where referenda were to be held.

This did not happen. At the time of writing, four referenda have been held. Spain held a referendum on the 20th of February 2005 and voted “yes” with an overwhelming majority, but with rather low voter turn-out. In France, a large majority said “no” on the 29th of May. The same happened in the Netherlands on 1 June. On the 10th of July, a significant majority said “yes” in a referendum held in Luxemburg<sup>13</sup>.

### **The crisis and how it was handled**

The French and Dutch no's led to a crisis in the EU, which should have meant that the proposal should have been shelved. But this was viewed as unacceptable by the EU’s authorities and the most prominent politicians in the EU countries.

The European Council therefore decided this:

The deadline of the countries to ratify the proposal was postponed from the 1st of November 2006 to the middle of 2007.

Before June 2007, the proposal should be debated in each country.

In June 2007, a new EU top meeting will be held to sum up the national debates. This meeting is also to decide what shall then be done with the proposal.

The Council's decision has been characterised as a decision to have a pause for thought. There is little doubt that the Council hopes and probably also believes, that this pause will create enough support for the constitution to make all countries accept it.

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<sup>13</sup> See [http://europa.eu.int/constitution/ratification\\_en.htm](http://europa.eu.int/constitution/ratification_en.htm) for news on the ratification process.

## 9.5 EXCERPT FROM BERNARD CASSEN'S ARTICLE "POUR UNE EUROPE DE L'INNOVATION DEMOCRATIQUE"

### Introduction

Bernard Cassen is the Director and a member of the Editorial Staff of the French newspaper *Le Monde diplomatique*. In that newspaper, he wrote in July 2005 an article called "Pour une Europe de l'innovation démocratique (For a Europe of Democratic Innovation)".

I shall cite some of Cassen's article in the following. But first some remarks:

The excerpt from Cassen's article will be used as part of the basis for discussing this claim: if the EU keeps the current free flow of goods, services and capital, then the EU countries cannot get rid of "the five problems".

Cassen is against international market liberalism. This can sometimes be seen in his use of language and what he chooses to write about. Nevertheless, he discusses important points in a way that I find clear and full of insight.

Not all readers will be familiar with some of Cassen's terminology and he does not always explain the meanings of the expressions he uses. However, a large majority of the readers will probably not find it difficult to understand the main points of his arguments.

In the excerpt that I cite, Cassen starts by quoting statements made at a press conference on the 15th of June 2005 by Jean-Claude Juncker, Luxemburg's Prime Minister who was then the Chairman of the EU's Council of Ministers. Juncker gave among other things a reason for the pause for thought described at the end of section 9.4.

### The excerpt<sup>14</sup>

"Because the voters, and this is why we need this period of explanation and debate, have not understood that the text of the constitution, the very nature of the constitution, was meant to respond to their concerns." [This was Juncker's reason for the pause for thought.]

Because the "no votes" were in fact "yes votes" without knowing it, a bit of pedagogy should set things straight. One could almost hear or read the French editorialists, literally stunned by the voters' refusal to bow to their injunctions and who continue (...) to campaign for the "yes" many weeks after the vote of 29 May. For his part, Jacques Chirac expressed himself in the truism that "the citizens said no to the Constitution because they reject Europe as it is today", from which he drew a rather curious conclusion: "We need to explain what Europe is." It did not seem to cross the President of the Republic's mind, something he shares with the leaders of the Socialist Party, that if the citizens said an overwhelming "no" to this Europe, it is precisely because they, living there, are very familiar with it!

After the shock, and in an attempt to explain what really happened, some "yes" supporters have proposed analyses which differ little from those of their opponents. Rupturing the image drawn up till then by the media of a Germany which was supposed to feel that France had turned its back on her, and therefore tempted by divorce, Daniel Vernet writes: "In some sections of German opinion, support for the constitutional project is not as unanimous as the ratification by the two chambers of Parliament might have led one to believe".

That is in fact a euphemism. If one is to believe the evolution in opinion polls and the declarations made by leading politicians from the majority and from the opposition, Germany too would undoubtedly have cast a negative vote, should a referendum have taken place.

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<sup>14</sup> The excerpt has been translated from French by Asmund Rygh. The footnotes of the original article have been deleted. See also list of references.



Germany would then have been made into a third black sheep. And the herd would probably have been joined by most of the countries where a referendum was envisaged, such as Sweden, where a large majority of the citizens demanded the government organize one, probably not to say “yes”. The myth of populations in union with their elites, the latter themselves united behind the Constitution, has been shattered, and this crisis of political representation can but aggravate that of the European construction.

Mr Hubret Védrine, former Foreign Affairs Minister in the Jospin government, provides some very lucid explanations for the “malaise” made evident by the “no” votes: “What poisoned the debate above all, was the determination to ridicule any normal patriotic sentiment, to caricature any worries over the enlargement [of the EU], even when legitimate and not xenophobic, to cast suspicion on any natural desire to maintain a certain sovereignty over one’s destiny and one’s identity in the midst of globalisation, and to reject all criticism contemptuously. It is all this, together with social insecurity, uncertainty over one’s identity and a feeling of being stripped of democratic rights which closed all the doors and forced the French to knock as hard as they did.

On one key point, namely the identity dimension of the crisis, this analysis is echoed by another “yes” supporter, Pierre Nora. “We are now paying the price for the systematic rejection of the least sign of attachment to the nation state as old-fashioned. Consciously or not, one has not ceased ridiculing and neglecting a very powerful collective subconscious, sacrificing it to the mirages of a European construction - a Europe which was lacking definitions or limits, but which nonetheless had been erected to an “endless horizon”, and even a “dream”.

Social insecurity, insecurity of identity and the feeling of being stripped of one’s democratic rights are closely linked and explain unprecedented French voter participation in a referendum on Europe. These three ingredients play roles in different proportions according to the country in which the debate takes place in the present rejection of the European construction. The Dutch “no” is perhaps more a question of identity, while that of France is more about class and social questions (80% of manual workers and 60% of employees said “no”) with its relentless rejection of liberalism, which is by the way shared by many “yes” supporters”.

## 9.6 REASONS WHY THE EU COMMISSION CANNOT GOVERN THE EU SOCIETY IN A SATISFACTORY WAY

### Introduction

By *the Commission*, I mean in the following the body in the EU which is called the Commission.

Despite what Bernard Cassen pointed out, I shall assume here in section 9.6 this:

The Commission functions as a government for the EU. All decision-making power that the national governments of EU countries have today is transferred to the Commission.

This unrealistic assumption is used to make it possible to describe certain conditions that are important when I evaluate what can be achieved by transferring decision-making power to international bodies.

### A heterogeneous society

The EU society is *heterogeneous*. By this is meant here that there are great differences between the countries in this society.

That the EU society is heterogeneous makes it impossible for the Commission to conduct a policy which is good for all countries that are EU members. Here is an important example.

Because the countries have a different distribution of economic activity across industries, the situation will usually be as follows: it will be advantageous for some countries if the aggregate demand in the EU is increasing fast, but it will be disadvantageous for other countries. No matter

which demand policy the Commission conducts, the policy will hence be a policy which is disadvantageous for some EU countries.

Before the readers try to “digest” what is said above, some of them may benefit from rereading sections 2.4 and 2.5. In those sections, a situation is discussed that in relevant ways is similar to the one discussed above.

### **A complicated society**

The EU society is complicated. In this chapter, this means that there are many cases where one part of the economy is “interwoven” with other parts in a complicated way.

Here is an example: the production in a certain business may depend on supplies of production equipment, raw materials and semi-manufactured products from a large number of other businesses in the EU.

### **A society which changes constantly**

Under the current economic system, there is hard competition between some of the businesses in the EU. This leads to rapid development of new production techniques and these changes lead to other changes in the economy. Here is an example: each year many businesses are no longer able to compete and consequently go bankrupt.

### **The combination of “a complicated society” and “fast changes in the economy” make it impossible for the Commission to govern the EU society**

To be able to govern the EU society, the Commission must know the most important economic relationships in this society. For example, it must know how business is organised and how consumers and businesses will react to changes in economic policy.

Because the EU society is complicated, it is impossible for the Commission to have the relevant knowledge about it. Getting information takes time. It takes time both to gather information and to give it a form which makes it useful for the politicians who make the policy decisions.

At any given time, the Commission has therefore at best relatively good knowledge about how the conditions were “yesterday”, i.e. some time ago. But because the EU society changes quickly, knowledge about how the conditions were “yesterday” will not be a satisfactory basis for governing it.

### **Long distance between the governed and those who govern**

If the EU is governed by the Commission, then there will be a long distance both geographically and socially between most of those who are governed and those who govern.

One negative effect of this long distance is that many of the governed probably will regard the EU authorities as foreigners who make decisions that are important for them, but which they have no influence on. That reduces both the welfare of the governed and the efficiency of the governance.

Another possible effect of this long distance is that those who govern may feel little attachment to those who they are governing. That may make “those who govern” more concerned with what is best for them themselves, than with what is best for “those who they are governing”.

### **Conclusions**

“A heterogeneous society”, “a complicated society”, “a society in which the economy changes fast” and “a large distance between the governed and those who govern” are keywords for conditions, which each make it difficult or impossible for the Commission to govern the EU in a satisfactory way. The set of these conditions is, as far as I can judge, a good basis for concluding as follows:

The Commission cannot conduct a policy, which makes the conditions in the EU satisfactory.

From this I draw the following conclusion:

It is not possible to get rid of “the five problems” in the EU countries by transferring to the Commission all decision-making power that “the national governments in the EU countries” have today .

## 9.7 THE EU COUNTRIES CANNOT GET RID OF THE FIVE PROBLEMS BY TRANSFERRING DECISION-MAKING POWER TO THE EU

Above are given two reasons for assuming that the EU countries cannot get rid of “the five problems” by transferring decision-making power to the EU.

### **The first reason**

Here are two conclusions which have been drawn previously.

Today it is impossible for the EU countries to get rid of “the five problems”. The basic cause for this is that there is a competition between the EU countries over being attractive locations for trade and industry. (c.f. section 9.2). Suppose that the EU countries want to get rid of this cause and hence transfer decision-making power to the EU. If they shall succeed, then they must transfer much more decision-making power than they have done so far (c.f. section 9.3.).

In several EU countries, the population is demanding that national bodies keep at least as much decision-making power as they have today. (c.f. section 9.5.)

Therefore:

The EU countries are not willing to transfer as much decision-making power to the Commission as is necessary to get rid of “the basic cause” by doing so.

### **The second reason**

The second reason is based on the discussion of whether the EU will be governable if all decision-making power in the EU is transferred to the Commission. This is the conclusion:

“A heterogeneous society”, “a complicated society”, “a society in which the economy changes fast” and “a long distance between those who govern and those who are governed” are keywords for conditions which each make it difficult or impossible for the Commission to govern the EU. The set of all of these conditions is as far as I can judge a good basis for concluding as follows:

It is not possible to get rid of “the five problems” in the EU countries by transferring to the Commission all decision-making power that “the national governments in the EU countries” have today.

## **It is enough to accept one of the reasons**

Suppose I reject one of these two reasons for why the EU countries cannot get rid of “the five problems” by transferring decision-making power to the EU. This is not important if I accept the other reason.

## **9.8 THE INDUSTRIAL COUNTRIES CANNOT GET RID OF “THE FIVE PROBLEMS” BY TRANSFERRING DECISION-MAKING POWER TO THE ICUS**

In this section, I shall assume that the industrial countries have formed a federation which is called *the Industrial Countries United States* (shortened to ICUS).

In sections 9.3 - 9.7, I discussed the chances of the EU countries of getting rid of “the five problems” through federalism if the flow of goods, services and capital in the EU is as free as it is today.

I shall now evaluate the chances that the industrial countries have in getting rid of “the five problems” through federalism, if goods, services and capital can flow just as freely in the ICUS as today. I reason in the same way as in the discussion of the EU countries in sections 9.3 - 9.7 and draw this conclusion:

The industrial countries cannot get rid of “the five problems” by transferring decision-making power to the ICUS.

The conclusion about what can be achieved in the Industrial Society with “more federalism and as much free flow as now” corresponds to the conclusion in section 9.7 about what can be achieved in the EU through “more federalism and as much free flow as now”. The only difference between these conclusions is that we are talking about two different societies.

As far as I can judge, the arguments behind the conclusion about the EU are very convincing.

The arguments behind the conclusion about the Industrial Society are even more convincing.

One reason for this is that the Industrial Society is more heterogeneous than the EU Society. This means that an industrial country will have more to lose by giving away most of their decision-making power to the ICUS, than an EU country can lose by giving away most of their decision-making power to the EU.

There is also something else that pulls in the same direction. Many Frenchmen consider themselves to be both French and European and many Dutchmen consider themselves to be both Dutch and European. The fact that many Frenchmen and Dutchmen regard themselves as Europeans, increases the chances of successful federalism in the EU. On the other hand, there are probably not many people who would say that belonging to the Industrial Society is a part of their identity.

## **9.9 THE COUNTRIES WHICH ARE MEMBERS OF THE UN CANNOT GET RID OF “THE FIVE PROBLEMS” BY TRANSFERRING DECISION-MAKING POWER TO THE UN**

As already mentioned, many people I have talked to have said that governance should be internationalised. When I asked them what they meant by this, most of them said that decision-making power should be transferred to the UN (United Nations).

In this section, I shall evaluate the chances that “the countries which are UN members” will be able to get rid of “the five problems” by transferring decision-making power to the UN if goods, services and capital can flow as freely as now between UN members.

Also here I reason in the same way as in the discussion about the EU countries in sections 9.3-9.7. I draw this conclusion:

Members of the UN cannot get rid of “the five problems” by transferring decision-making power to the UN.

The conclusion about what can be achieved in “the society of UN members” corresponds to the conclusion in section 9.7 about what can be achieved in the EU society. Again the only difference is that we are talking about two different societies.

I have already said that as far as I can judge, the arguments behind the conclusion about the EU society are very convincing. But the arguments behind the conclusion about the UN are even more convincing.

It is true that the “willingness to transfer decision-making power to the UN” is increased by the fact that many people, whether they are French, Dutch or of other nationalities, feel that they are citizens of the world. But this is probably less important than the fact that the UN society is much more heterogeneous than the EU society. This means that a state that is a member of the UN can lose much more on transferring decision-making power to the UN than an EU country can lose by transferring most of its decision-making power to the EU.

What is pointed out here is true for all UN members, including the industrial countries.

## 9.10 THE MOST IMPORTANT CONCLUSION IN CHAPTER 9

The main goal of this book is to contribute to a better understanding of the effects of some of the ways that economic activity can be organised in the industrial countries. We may therefore say that the most important conclusion in chapter 9 is:

Suppose goods, services and capital will continue to flow as freely as now between industrial countries. It will then be impossible to get rid of “the five problems” by transferring decision-making power from national to international bodies. This is the case both if the international bodies represent the industrial countries or if they represent the UN.

## CHAPTER 10

### COMMENTS ON CHAPTERS 1-7 AND 9

#### 10.1 INTRODUCTION

In chapters 1-7 and 9, I discuss only how the conditions in the Industrial Society are affected by how the economic system is in this society. These chapters are therefore so closely related that we may say that they form a unit. In this chapter, I point out and comment on what I consider to be most important in this unit.

##### **This chapter is written for two groups of readers**

Two groups of readers may find that it is useful to read chapter 10.

*The first group* are people who have read chapters 1-7 and 9. I hope they will find that chapter 10 is useful as a repetition of these chapters.

*The second group* are the new visitors to this webpage. In the presentation of the book, I suggested that they should do this to find out if they would like to read it: read the introduction and skim through chapter 10.

I also wrote that they probably would understand most of chapter 10. An exception to this is section 10.3. To understand that section you probably need to be an economist or to have read sections 4.3 and 4.4.

##### **What kinds of conclusions are drawn in the book?**

The conclusions drawn in this book are mainly conclusions of the following type:

If the Industrial Society goes over to “the alternative system”, then this will create opportunities to improve the conditions in that society.

Whether going over to “the alternative system” will lead to better conditions depends on what policies are conducted in the Industrial Society after the transition. (More on this in section 7.6).

#### 10.2 THE MOST IMPORTANT CONTRIBUTION IN THIS BOOK

Under the current economic system an industrial country tries to solve its economic problems by improving its ability to compete with the other industrial countries. This can be described as a policy of pushing its problems onto other countries.

I believe that this is the most important contribution in this book to the debate on alternatives to international market liberalism:

“A country must use measures that solve *its* economic problems without creating problems for *other* countries” (c.f. section 3.2).

#### 10.3 DEVALUATION PACKAGES

A devaluation package is the combination of:

*a devaluation* that does not make Norwegian prices rise faster than foreign prices and

*one or more measures* that weaken Norway's ability to compete by as much as the devaluation improves it.

The British economist, John Maynard Keynes, wanted to prevent devaluation being used as a means of improving competitiveness. I follow him on this, but not in the way in which he wanted to do it. In his plan from the early 1940s, he proposed that countries should not be allowed to devalue (c.f. section 7.4). I will allow countries to devalue. But I will require that if a country devalues, it also has to do something that worsens the country's ability to compete.

The devaluation packages are based on the principle that "a country must use measures that solve *its* economic problems without creating problems for *other* countries".

## 10.4 THE IDEA THAT TAXES SHOULD BE INCREASED SIGNIFICANTLY

The most important difference between "the ideas that are the basis of market liberalism" and "the ideas that ought to be the basis for an alternative to market liberalism" is sometimes described in the following way:

"The ideas which are the basis of market liberalism" are that an individual is mainly concerned with what benefits him and that there is nothing wrong with that.

This ought to be the ideas which are the basis for an alternative to market liberalism: people have an ability to show solidarity and the alternative should be based on this ability.

What follows is an important part of how the ability to show solidarity should become apparent in the alternative to market liberalism:

People have to be willing to pay higher taxes. Higher taxes are necessary if the incomes of the authorities are to become so large that they can make sure that the most vulnerable groups of society live under acceptable conditions.

## 10.5 THE SUBSIDIARITY PRINCIPLE

The *subsidiarity principle* says that a political decision should be made at the lowest level it can be made on without setting aside important considerations. (Some readers may find the expression "at the lowest level" unclear. I hope that the three examples which follow will clarify what is meant by this expression in this book).

### **The first example**

Let us imagine that a road is to be built in a Norwegian municipality called Dalen. Mainly the people living in Dalen will use this road. To illustrate the subsidiarity principle, I assume that the road's route is to be decided either by the municipal council in Dalen or by the Ministry of Transport. There are in that case good arguments for letting the municipal council make that decision.

Firstly, there are strong reasons to believe that the members of the municipal council have a better knowledge of the conditions in Dalen than the Ministry of Transport's employees. This makes it likely that a better route will be chosen by the members of the municipal council.

Secondly, the shorter the distance is between "those who are governing" and "those who are governed", the better the chances that the decision to be made will be a democratic one. In this case, it

is the people who are going to use the road that are “the governed”. The distance between them and “those who govern” will be shortest if the members of the municipal council choose the route<sup>15</sup>.

### **The second example**

Apart from very primitive societies that cannot be a model for most of the world’s population, each society of the size of a Norwegian municipality needs products that are not produced in that municipality.

It will not be advantageous for the people living in Dalen if that need is satisfied by letting all businesses in the world sell their products there. That will make the development in Dalen very dependent on decisions taken by people who are not interested in how their decisions affect the people living in Dalen.

This problem cannot be solved in the following way: the people in Dalen establish “a border between Dalen and the rest of the world” and control the trade over that border.

It will be very unrealistic to assume that this can be done. But as far as I can judge, the problem can be solved in an acceptable way if there is a border between Norway and the rest of the world and Norway control the trade over that border. Norway’s population is so large that Norway can do this without having to use a considerable share of all Norwegians to do it.

Because Norwegian authorities are able to solve the problem discussed above, they should be the ones who do the solving. The advantages of having the shortest possible distance between those governing and the governed, is an argument against letting the problem be solved by international bodies.

### **The third example**

Some problems are of a nature which means that they cannot be solved nationally, but only through international co-operation. The most important examples are the global environmental problems.

## **10.6 ARGUMENTS FOR KEEPING THE NATION STATE**

In recent years, the freer flow over national borders of goods, services, capital and labour has made the nation state less important than before. Many think that this development both should continue and will continue.

In the following, I describe three arguments against this view. These arguments are more thoroughly explained in other parts of this book.

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<sup>15</sup> In The Brazilian town of Porto Alegre, the use of something called *participatory budgeting* has been initiated. This involves the following:

Public meetings are arranged in various parts of the town. At these meetings, topics where priorities have to be made are discussed in the municipal budget. Those present can help decide which areas should be given priority. This is decided either by voting at the meeting itself or by delegates being elected who will at a later stage participate in making the priorities.

A number of other towns, especially in Brazil, but also in other countries, have started using participatory budgeting.

Transitioning to the alternative system that is outlined in chapters 3-6 will make it possible to improve the financial situation of the municipalities. Such an improvement will increase the advantages associated with participatory budgeting.

(Source: Einar Braathen: “Deltakerdemokrati: hvorfor, hvordan? (Participatory democracy: how and why?)”, *Utveier nr. 5 2004*.)



## The three arguments

### *An argument based on organisation theory*

The municipalities are economical units that are too small to make it possible for a municipal council to get rid of “the five problems in its municipality”. Most of this job must be left to authorities at a higher level.

Suppose that all decision-making power that the nation states have today is transferred to a government for the Industrial Society. Several conditions suggest that this government will not be able to ensure that the industrial countries get rid of “the five problems”. “A heterogeneous society”, “a complicated society” and “a society in which business life is changing constantly” are keywords for some of these conditions. (More on this in section 7.6).

This indicates that at least one level of decision-making will be needed between the municipalities and the government for the Industrial Society. This level does not have to be the nation states, but they are probably a sensible choice because they already have institutions for governance.

This is a possible argument against giving the nation states an important role in the governance of the Industrial Society’s economy: if the nation states govern, there will then be competition between countries to be the most attractive one for the localisation of businesses. Competition like this will make it impossible to get rid of “the five problems”. (c.f. chapter 1).

This problem can be avoided by requiring that “a country must use measures that solve *its* economic problems without creating problems for *other* countries”.

### *The democracy argument for keeping the nation states*

There are probably many people who want the organisation of the Industrial Society to be democratic at least to more or less the same degree as the countries of Western Europe are democratic now. It can be argued that this goal can be reached only if the nation states are kept. (See appendix E which is an excerpt from the article “Global Capitalism and National Democracy” by Professor Øyvind Østerud.)

### *The identity argument for keeping the nation states*

Many French people feel that being French is a part of their identity. Many Dutch people feel that being Dutch is a part of their identity, and so on. This is an argument for keeping the nation states.

## 10.7 “THE MAIN PRINCIPLE FOR THE IMPORT OF SERVICES IS THAT NORWAY SHALL NOT IMPORT SERVICES”

I reason as follows:

The less Norway imports from the other industrial countries, the less Norway is dependent on the other industrial countries.

The less Norway depends on other industrial countries, the faster Norway can get rid of “the five problems”.

Therefore I conclude:

the less Norway imports from the other industrial countries, the faster Norway can get rid of “the five problems”.

In section 4.3, I give more thorough argumentation for the conclusion.

The above conclusion is the basis for the following rule in “the alternative system” for Norway:

the main principle for import of services is that Norway shall not import services.

(More about this rule and the exceptions from it in section 2.4).

## 10.8 GUARANTEED JOBS

Guaranteed jobs are a measure, which according to the discussions in sections 5.2 – 5.7 will lead to this: unemployment becomes much lower and more work that is useful for a society is accomplished.

After guaranteed jobs are established, this will be the situation for most of the people who are unemployed: a guaranteed job that they can get exists and this job is so close to their home that it will not be necessary to move if they decide to take the job.

Here are some other advantages that a guaranteed job can offer a person who has become unemployed: they can start the job right away and cannot be fired, but may quit at a short notice. The wage is higher than what they would get from receiving unemployment benefits.

But a guaranteed job has one disadvantage that can motivate, and which is meant to motivate a person who has such a job to search for an ordinary job: the wages for guaranteed jobs are lower than the wages for ordinary jobs.

The guaranteed jobs are not meant to “squeeze out” ordinary jobs. Thus, they are not used to do the most highly prioritised tasks in the public sector. Instead they are used to do work, which has a lower priority, but which is nevertheless desirable to get done.

Extensive use of guaranteed jobs will lead to large expenses for the state. This means that public sector poverty makes such use impossible under the current economic system. But because public sector poverty can be reduced under the alternative system, extensive use of guaranteed jobs is possible under that system.

## 10.9 THE REQUIREMENT FOR EQUALLY GOOD FRAMEWORK CONDITIONS

### **Introduction**

In the unit which consists of chapters 1-7 and 9, a large number of theories are presented and a large number of conclusions are drawn. There are probably many readers who find it difficult to get a clear overview of all these theories and conclusions.

The purpose of this section is to contribute to such an overview by drawing attention to a topic which plays an important role in almost all chapters in the unit. The topic is the requirement for equally good framework conditions.

### **An overview of chapters 1- 7 and 9**

#### *Chapters 1 and 2*

Chapters 1 and 2 deal with the current economic system in the Industrial Society. Here is a summary of the contents:

In the current economic system, there is to a great extent free flow of goods, services and capital between the industrial countries.

A consequence of this is that if a country is to avoid increasing unemployment it must be competitive and attractive for the localisation of businesses. This leads to competition between the countries where each country tries to ensure that the framework conditions for their businesses are at least as good as the framework conditions for other countries' businesses.

Because a country's authorities must make it a priority to avoid the country losing this competition, it is impossible for these authorities to get rid of “the five problems”.

### *Chapters 3-6*

Chapters 3- 6 deals with an alternative economic system for Norway. When I developed this system, one of my goals was to find a system that could make it possible to avoid “the five problems”. The problems cannot be avoided unless Norway frees itself from the requirement for equally favourable framework conditions for Norwegian and foreign businesses.

### *Chapter 7*

Chapter 7 deals with an alternative system for the Industrial Society. When this system was developed, I used what I had arrived at in chapters 3- 6 to a great extent. Because the requirement for equally good framework conditions plays an important role in those discussions, it also plays an important role in chapter 7 in a somewhat indirect way.

### *Chapter 9*

Chapter 9 deals with an economic system for the Industrial Society that differs from the current system, because decision-making power has been transferred from national to international authorities. It differs from the alternative system for the Industrial Society because goods, services and capital can flow over national borders as freely as they can under the current system.

In chapter 9, it is argued that it will not be possible to transfer so much decision-making power from national governments that the following can happen: national authorities have so little decision-making power that the basis of the competition over framework conditions disappears.

If that competition remains, then it will be impossible to get rid of “the five problems”.

# CHAPTER 11

## CONSEQUENCES FOR THE DEVELOPING COUNTRIES OF THE ECONOMIC SYSTEM IN THE INDUSTRIAL SOCIETY

### 11.1 INTRODUCTION

#### **Simplifications**

In this chapter, I shall simplify even more than in chapters 1 - 10. This I shall do partly by disregarding some questions that it might seem reasonable to ask here and partly by using simple theories to describe complicated conditions. Despite these simplifications, I believe important features in the picture I will present have parallels in practice.

#### **Two groups of developing countries**

I shall divide the developing countries into two groups.

The first group includes China, India and some other countries, where the economy is undergoing rapid change and production per capita is increasing rapidly.

The second group, I shall call "typical developing countries". It consists of African, Latin American and some Asian countries.

I shall only discuss typical developing countries in the rest of this chapter.

### 11.2 THE CURRENT SITUATION

#### **Differences and similarities between typical developing countries**

Two typical developing countries may be very different. They may among other things have different access to natural resources and different economic systems. Generalisations about typical developing countries should thus be used with caution.

However, typical developing countries have several common features. Here are some of them:

#### *Standard of living, health and education*

Compared to the conditions in the industrial countries, conditions in a typical developing country may be described as follows: most people living in these countries have a very low standard of living. Health and education systems are in poor shape. The mortality is high, especially for newborns and small children.

#### *Production*

A large part of the population consists of farmers or fishermen.

It is difficult for typical developing countries to change the distribution of industries they received when they were colonies. A typical developing country is therefore often highly dependent on the sale of a single or a small number of commodities to industrial countries. To be highly dependent on the sales of a small number of products may cause very serious problems because the products are usually raw materials (like coffee, tea, cocoa and different

metals) and in the world markets prices for such products vary much more than prices for industrial goods.

### 11.3 PROSPECTS FOR TYPICAL DEVELOPING COUNTRIES IF THE INDUSTRIAL SOCIETY KEEPS ITS CURRENT ECONOMIC SYSTEM

I argued in chapter 1 that “the competition between the industrial countries about having the best framework conditions” leads to the following situation in these countries:

The authorities have little room to act within other than to try and ensure that domestic businesses have framework conditions which are at least as good as those of their foreign competitors.

Little room to act within leads to conditions where many domestic problems are handled unsatisfactorily. This gives political parties in opposition opportunities to attack the current government. The government will therefore utilise its “little room to act within” primarily to try to survive to the next election.

Under such conditions, the governments of industrial countries will not allow themselves the “luxury” of letting their policies be influenced by what would be best for the developing countries. The industrial countries therefore ensure their products can be sold in developing countries without being hindered by customs or trade barriers. This benefits industrial countries’ businesses, but it does not benefit the typical developing countries. Among other things, it will be impossible for them to build up their own industries. Combined with several other conditions, this leads to the following:

If economic activity in the industrial countries remains organised as now in the future, it will be impossible for most developing countries to escape the poverty and deprivation now affecting them.

In appendix G I describe and comment on a different theory concerning the prospects of typical developing countries, if the Industrial Society keeps the current economic system.

### 11.4 PROSPECTS FOR THE TYPICAL DEVELOPING COUNTRIES IF THE INDUSTRIAL SOCIETY GOES OVER TO “THE ALTERNATIVE SYSTEM”

If the industrial countries go over to “the alternative system”, they will find it easier to tackle the domestic problems that make it impossible for them to allow themselves the “luxury” of conducting policies that are beneficial to developing countries.

One effect of this is that it will probably be easier to get a breakthrough for the idea that people who live in the industrial countries ought for humanitarian reasons to consider what benefits developing countries.

Another effect is that it will probably be easier for the authorities to consider the long-term effects of their policies. Perhaps some of them sometimes will think along these lines:

There are several reasons why it is in our interest to avoid a world where the developing countries have the problems that they have now.

If we do not avoid such a world there will be favourable conditions for organisations that hate the industrial countries and act out that hate through terrorism.

In a world where the developing countries have great difficulties, there will be a risk of war between these countries. This could have very serious effects for us, among other things because some developing countries already possess atomic weapons and more developing countries will get such weapons in the future.

It is therefore in our own interests to conduct policies that increase the chances of improving the situations in developing countries.

From what is pointed out above, it follows that:

The typical developing countries have a greater chance of escaping poverty if the Industrial Society goes over to “the alternative system”.

## 11.5 THE MULTINATIONAL COMPANIES

The multinational companies have in two ways considerable influence on what happens in developing countries under the current system and on what will happen in the future. They use the opportunities that exist for selling on the markets in these countries, and they are pressure groups for further liberalisation of those markets when the WTO rules are changed.

An acceptable discussion of the effects on developing countries of the multinational companies' activities must be rather long. For that reason and because I don't think that have anything new to contribute in this area, I shall not discuss those effects in this book.

## CHAPTER 12

# CONSEQUENCES FOR THE GLOBAL ENVIRONMENTAL PROBLEMS OF THE ECONOMIC SYSTEM IN THE INDUSTRIAL SOCIETY

The global environment is threatened in many ways. In this chapter, I discuss only one of them, climate changes resulting from the use of fossil fuels. I have chosen this threat both because it is important and because it provides a good illustration of the fact that what will happen to the global environment is influenced by how economic activities are organised in the industrial countries.

### 12.1 REASONS FOR AND EFFECTS OF CLIMATE CHANGES IN THE PAST DECADES

*Greenhouse gasses* are gasses that influence the climate on the earth. CO<sub>2</sub> (carbon dioxide) is the most important of them. Many types of production and consumption lead to emission of greenhouse gasses.

During the past thirty years, increased production and consumption in the industrial countries have contributed to climatic changes that have had serious consequences and that in the future will have consequences which are even more serious<sup>16</sup>.

Figure 12.1 gives an overview of the links in the chain of causes and effects which has led to these serious consequences. In the figure, an arrow means “has contributed to”. Here is an example: the first arrow shows that increasing production in the industrial countries has contributed to increasing emissions of greenhouse gasses into the atmosphere.

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<sup>16</sup> For more information on climate change and other environmental problems, see e.g. the report by many leading scientists for the UN, the **Millennium Ecosystem Assessment** (2005), *Ecosystems and Human Well-being: Synthesis* at <http://www.maweb.org/en/Products.Synthesis.aspx>.

*Figure 12.1*  
*The route from increasing production and consumption in the industrial countries to climate changes that create global environmental problems*

Increasing production and consumption in the industrial countries



Increasing emissions of greenhouse gasses into the atmosphere



Increasing amounts of greenhouse gasses in the atmosphere



Stronger and stronger greenhouse effect



Climate changes



A warmer climate than before and little rainfall in some areas have transformed places where the soil used to be fertile, into barren deserts. Increased rainfall in other areas causes flooding which has led to loss of life and great material damage. Strong storms have also led to loss of life and great material damage.



## 12.2 WHAT WILL HAPPEN TO THE EMISSIONS OF GREENHOUSE GASSES IF THE INDUSTRIAL SOCIETY KEEPS ITS CURRENT ECONOMIC SYSTEM?

### **Production will increase**

The goal of avoiding high unemployment will contribute in two ways to making production increase significantly in the industrial countries in the future.

There will be competition between the countries over having a good ability to compete and over being an attractive location for trade and industry (c.f. sections 1.3 and 3.7). To avoid high unemployment, each country will try to be the winner of that competition. This will contribute to a significant growth in productivity over any fairly long period. This growth in productivity will contribute to growth in production.

In addition, experience shows that if there is low growth in production, then unemployment will be high (c.f. section 2.6). As a result, policies will often be conducted that try to avoid low growth in production.

### **Will growth in production lead to increased emissions of greenhouse gasses?**

There is a growing understanding of the consequences of the large amount of greenhouse gasses in the atmosphere and most countries take part in conferences where the following is done: for each country that participates in the conference, an upper limit is set for the emissions of greenhouse gasses in a certain future period (the Kyoto agreement from 1992 is an important example). However, the experiences so far indicate that it will not be possible to reduce the emission of greenhouse gasses sufficiently by doing this. What is meant here by “sufficiently” is “as much as the experts in the field regard as necessary in order to avoid grave conditions”.

Here is why it, under the current economic system, will be impossible to make future emissions from production low enough.

The emission depends on *how much* is produced, *what* is produced and *how* it is produced. Every country wants to increase production and will at any rate in the long run do this. What happens with *how much* will therefore increase the emission.

Most measures that reduce emissions of climate gasses through what is produced and how it is produced also increase production costs. Every country is reluctant to use such measures in large “doses”. This is because they fear that using them may make the country a loser in the competition over having a good ability to compete and being attractive for localisation of trade and industry.

### **Conclusion**

If the industrial countries keep the current economic system, the emissions of greenhouse gasses will not be sufficiently low in the future.

## 12.3 WHAT WILL HAPPEN TO THE EMISSIONS OF GREENHOUSE GASSES IF THE INDUSTRIAL SOCIETY SWITCHES OVER TO “THE ALTERNATIVE SYSTEM”?

### **Production will increase more slowly**

In the previous section, it was pointed out that under the current system there is a competition between countries and that this competition makes production increase quickly. The economic ties between

countries will be weaker under “the alternative system” than under the current one. Therefore “the competition” will be significantly weaker. Because of that, production will increase more slowly under “the alternative system”.

### **Increased possibilities for developing and using environmentally-friendly technology**

Under “the alternative system” the industrial countries can free themselves from the requirements for framework conditions. This creates possibilities for increased governance and thus also for the use of measures that affect “what is produced and how it is produced”, in ways which reduce greenhouse gas emissions. The authorities may for instance increase the support of research to develop environmentally-friendly technology.

### **Conclusion and comments on the conclusion**

I conclude as follows:

If the Industrial Society goes over to “the alternative system”, then the emissions of greenhouse gasses will be smaller than they will be if the current system is kept.

Let us assume that it is a goal that the amount of greenhouse gasses in the atmosphere should become so low that it does not lead to serious climate changes. The conclusion means that going over to “the alternative system” is a step towards reaching that goal.

But even if this “step” is taken, the goal will be far away for many years unless something else is also done. Here are two of the reasons for this:

There are processes in nature that reduce the amount of greenhouse gasses in the atmosphere. But they are so slow that the greenhouse gasses that are in the atmosphere now will continue to have a negative effect on the climate for many years.

In the next few years, production will probably continue to increase quickly in China and India. Therefore China's and India's emissions of greenhouse gasses will also increase quickly.

As I see it, the situation is as follows:

If we wish to get rid of “the greenhouse gas problems” before they become much more serious than they already are, then it will not be enough if the Industrial Society goes over to “the alternative system”. Much more dramatic changes in the organisation of the world economy will be necessary.

## CHAPTER 13

### DEBATE WANTED

I believe that this book is important and thus that a debate about it is desirable. In this chapter there is more about this.

#### **The theory in sections 1.3-1.6 and chapter 2**

The theory I present in sections 1.3-1.6 and chapter 2 is the basis for the discussions in the rest of the book.

There are strong reasons to believe that this theory describes a part of what it is useful to know about the Industrial Society if a change in this society's economic system is considered. However, there are without doubt different views on how large this part is.

Suppose that after a thorough debate about the theory, many believe that this part is considerable. In that case, it should be of interest to look at the conclusions I draw on the basis of the theory. But, if after such a debate it is a common view that the part is very small, then it will probably be a waste of time for "most people interested in alternatives to the current economic system" to read the book.

Therefore, I think a discussion about the book ought to start with a thorough debate about the theory in sections 1.3-1.6 and chapter 2.

In what follows, I shall assume that the theory is a useful basis for discussing changes of the economic system.

#### **An important assertion in chapters 3-7**

An important assertion in chapters 3-7 is that the industrial countries can get rid of "the five problems" by making the markets for products and capital less international.

If this assertion is correct, then it is important. Chapters 3-7 should therefore be discussed thoroughly.

#### **An important assertion in Chapter 9**

An important assertion in chapter 9 is that the industrial countries cannot get rid of "the five problems" by making economic policy more international.

If this assertion is correct, then it is important for two reasons. One of them is that it makes the discussions in chapters 3-7 more important than they would be otherwise. The other is that it means that one should not spend time on trying to get rid of "the five problems" by making economic policy more international, because such attempts will be fruitless.

What is pointed out here is a strong argument for discussing chapter 9 thoroughly.

#### **Chapters 11 and 12**

Chapters 11 and 12 deal with the consequences of the economic system in the Industrial Society for the developing countries and for the global environment. How important these chapters are, depends on whether the main conclusions of chapters 1-7 are correct. If a thorough discussion of chapters 1-7 makes it reasonable to believe that these conclusions are correct, then chapters 11 and 12 become very important.

## **Chapter 8**

Chapter 8 deals with whether it will be politically possible to make the markets for products and capital less international. An argument for having a discussion of chapter 8 is that such a discussion will make more people consider the possibility that the answer may be ‘yes’.

## **Chapter 10**

Chapter 10 is mainly a collection of conclusions drawn elsewhere in the book. But one of the conclusions in the chapter is that the nation states should play an important role in the alternatives to international market liberalism. This conclusion ought to be discussed.

## **A final note**

I regard this note to be so important that I have placed it at the end of the book in order to reduce the risk that it will be overlooked.

Many people believe this: giving national and/or international authorities control over the capital flows is the only change that it is necessary to make in order to get rid of the problems international market liberalism creates.

This is not correct. Getting that control is necessary, but not enough. We must also make it unnecessary for a country to have equally good framework conditions as its trading partners in order to avoid a worsening of its ability to compete (cf. section 6.2 and 6.3).

What is said in the preceding paragraph, means that there is a need for considerable additions to the most usual debate about how to get rid of the problems international market liberalism creates. It is therefore important that there be a discussion of what is said in that paragraph.

## APPENDIX A

### NOTES ON SIMPLIFICATIONS IN THE THEORY OF UNEMPLOYMENT USED IN CHAPTER 2

#### **The Theory**

In Chapter 2, I use the following theory about the changes in unemployment in the industrial countries in recent decades.

Techniques have changed so often and adapting to these new techniques has taken such a long time that before adaptation to one change has been completed, other changes have already occurred that also require adaptation. Due to this, there have at any given point in time been adaptations that are only partly completed and these partly completed adaptations create unemployment. Thus, there has always been unemployment due to changes in production techniques. This type of unemployment has increased a great deal in the last decades.

This theory will be called the “Theory” in the following.

#### **Simplifications**

There are many simplifications in the above description of what has happened in the industrial countries in the last decades. Here are some other causes of unemployment during that period:

##### *Changes in what the consumers want to buy*

In the last 20 to 30 years, there have been significant changes in what people want to buy. Among other things, the development of new products has meant that the demand for certain products, which were once in great demand, has been greatly reduced. Such changes have led to adjustment problems.

##### *Changes in other parts of the world*

There have been large changes in other parts of the world, especially in China and India in recent years.

##### *Classical unemployment*

Suppose that the price of labour, i.e. the wages, was so high that the supply of labour was higher than the demand for labour. Suppose also that for some reason, usually as a result of opposition from trade unions, wages do not fall. In that case, there will be unemployment that is equal to the difference between supply of and demand for labour. Such unemployment is called “classical unemployment”.

##### *Not all who are unemployed are unemployed because they have lost their jobs*

To lose a job is a common way of becoming unemployed, but not the only one. Here are three others:

Some people want to get paid work after having been out of work for some time. This includes women who have stayed at home with small children and people who have been educating themselves.

Some people are first-time jobseekers.

Some people give up their jobs voluntarily before they find a new job.

A couple of these modifications of the Theory are also mentioned in section 2.7.

## **The simplifications don't make it reasonable to doubt the conclusions based on the Theory**

*The economic mechanisms described in the Theory are also found in practice*

In practice too, the following applies:

The production techniques have changed. This has created need for adaptations. The techniques have changed so fast that before one adaptation has been completed, new adaptations have become necessary.

*The changes that are described in the Theory are not counterbalanced by the economic mechanisms I have disregarded*

One of the simplifications that I have disregarded is the changes in what the consumers want to buy. It is conceivable, but not likely that this may happen:

“The changes to what the consumers want to buy” influence the unemployment in the opposite direction of what “the changes in the production techniques” do. This influence is so strong that an employment policy based on the Theory increases the unemployment instead of reducing it.

However, I regard this possibility as so unlikely that I choose to disregard it. For similar reasons, I do the same as far as the other simplifications I have mentioned above and for simplifications I am aware of, but have not mentioned.

## **The Theory gives a large part of the explanation of why unemployment has increased so much in the last decades**

I believe that the Theory gives a large part of the explanation of why unemployment has increased so much in the last decades. Here are my arguments for believing this:

I think that the Theory offers a convincing explanation of why unemployment has increased so much during that period.

I know of no other theories that provide convincing explanations of why the unemployment has increased so much during that period.

## **The Theory as a basis for policies that are intended to reduce unemployment**

I believe that it is a useful simplification to assume that the Theory explains why unemployment has increased so much in recent decades. I also believe that the Theory hence explains why the current unemployment is so high and that the Theory is thus a good basis for finding policies that reduce the unemployment.

However, suppose for a moment that the Theory explains a much smaller part of the unemployment than I believe, for instance only 30% of it. It will be useful also in that case, but of course not as useful as it will be if what I believe about it is true.

## APPENDIX B

### TECHNOLOGICAL UNEMPLOYMENT?

#### **The theory about technological unemployment**

This is the theory:

The production techniques have become so efficient that there is no longer work for everyone. This means that we have got a kind of permanent unemployment that is usually called *technological unemployment*.

#### **What has happened?**

It was widely believed in the 1980s and the 1990s that the use of computers and robots would create permanent unemployment because less labour would be needed.<sup>17</sup> However, today it seems like the following has been the case:

New technology has led to the creation of certain new branches in industry including production of computers and robots and in that way created many new jobs. In addition, employment has increased in many “old” branches after they started using the new technology.

That the pessimists were wrong is not in the least a result of this: more efficient techniques lead to higher production, higher production leads to higher income, higher income leads to higher demand for goods and services, and higher demand for goods and services leads to higher demand for labour.

#### **My evaluation of the theory of technological unemployment**

For people who have read at least one of my recent books, I have sometimes been asked:

I get the impression that you want to make as few as possible "changes in technology that make production more efficient". Is that correct? If it is correct then what is the reason? Are you afraid of technological unemployment?

I have answered:

I am for going over to new techniques that make production more efficient, if that can be done in ways which do not create high unemployment and/or other serious problems

I believe that regardless of how efficient the production techniques will become, there will be so many useful things that can be done that there can be work for everybody.

During the past few decades, production has become more efficient with great speed. In the same period, the number of unemployed has increased quickly. It looks like it has been impossible to avoid high unemployment during that period and it also looks like this cannot be done now. That indicates that under the current economic system, it may be impossible to get low unemployment if the efficiency of the production techniques increases quickly.

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<sup>17</sup> See for instance “The Global Trap” by Hans-Peter Martin and Harald Schumann, Zed Books, Ltd. 1997

My reaction to this problem is not to mean that production should not be made more efficient. It is to look for an economic system that makes quick increases in the efficiency of the production compatible with an ability to avoid “the five problems”.



## APPENDIX C

### MORE ON THE EFFECTS OF THE DISTRIBUTION OF THE DEMAND

In this appendix, I give a simplified justification of the following: “How fast Norway can liberate itself from the framework conditions by means of devaluation packages” is influenced by “the distribution of the demand from Norwegians between the demand for foreign products and the demand for Norwegian products”. In the justification it is assumed that the euro is used for payments in the countries Norway trades with and the Norwegian kroner is used in Norway.

#### **Devaluation increase**

Let us first assume that “the Norwegian euro” rate remains constant. Norwegian prices for foreign products Norway buys would then increase with the same speed as the prices for these products increase abroad.

But suppose that Norway devaluates. Norwegian prices for foreign products would then increase because the devaluation makes the Norwegian kroner worth less compared to the euro. The increase will be equal to the devaluation, i.e. if the devaluation is 2% then the increase will also be 2%.

The increase in “the prices for foreign products in Norway” will increase the price level in Norway. How large this increase is, depends on how large a share “the demand for foreign products” is of “all demand for products in Norway”. Here is an example.

Suppose that Norway devaluates by 2%. As mentioned above, this will make “the Norwegian prices on foreign products” increase by 2%. Suppose also that “the demand for foreign products in Norway” is 40% of “all demand in Norway”. In this case, the increase in the Norwegian price level will be

0.4 times 2%, i.e. 0.8 %.

I shall call the increase in the price level in Norway caused by the devaluation *the devaluation increase*.

#### **The brake**

By *the productivity* what is meant here is “the production per man-hour”.

What is meant by *the real wage* is sometimes explained in this way: the real wage is the amount of goods and services a person can buy for the wage they get for working one hour. If the prices remain the same, the real wage is the same as “the wage for one hour, measured in money”.

Under conditions that are otherwise equal “the prices of products produced in Norway” increase more slowly the slower the real wage increases. This is because the wages are “costs for the businesses” that are covered by the prices they get for their products.

Suppose that the real wage increases slower than the productivity. That will create a tendency for the Norwegian price level to increase slower than the price level abroad. This assertion can be justified as follows:

When the real wage increases slower than the productivity, then only part of the increase in productivity is used to increase the real wage. “The rest of the increase in productivity” functions, via its effects on the prices on products produced in Norway, as a brake on the increase in the Norwegian price level.

#### **Price development and ability to compete**

I shall assume the following:

If Norway's ability to compete is not to change, then the price level must increase with the same speed in Norway and its trading partners.

This means that if "the improvement in the ability to compete" which a devaluation causes is not to be "eaten up" by a faster increase in the price level in Norway than in the countries that are Norway's trading partners, then these two quantities must be equal:

the devaluation increase (which makes the Norwegian price level increase faster) and

the brake that is mentioned above (which makes the Norwegian price level increase slower).

If Norway has gone over to "the alternative system" this requirement can be met. Each devaluation can then be part of a devaluation package and in such a package the devaluation increase and the brake are of the same size.

### **An important effect of the composition of the demand**

I shall assume the following:

Norwegian wage earners are willing to accept that the real wage increases so slowly that the brake is 0.8% per year. But they are not willing to accept a slower increase in the real wage.

If the ability to compete is not to be changed, then the devaluation increase and the brake must be equal. (I have argued above for this assumption.)

From these assumptions, it follows that Norway, without getting a weaker ability to compete, can organise its economy in such a way that the devaluation increase is 0.8% per year. Table C.1 describes four possibilities for how this can happen.

The table shows that the lower the demand is for foreign products, the more Norway can devalue without making the devaluation increase higher than 0.8%. For example, the possibilities increase from 2% per year if the share of imports is 0.4 to 8% per year if the share of imports is 0.1. We can therefore conclude that the lower the share of imports is, the faster Norway can liberate itself from "the six requirements".

As mentioned in the first paragraph of this appendix, the above reasoning is based on simplifications. Here is an example. For some of the products Norwegians use, part of them are produced in Norway and part of them are imported. This means that the division between various groups of products is not as sharp as assumed above. But it can be shown that if we replace the simplified assumptions with more realistic ones we can nevertheless conclude:

The lower the share of imports is, the faster Norway can liberate itself from "the six requirements".

**Table C.1**

*Share of imports, devaluation and devaluation increase*

In this table, *share of imports* means “demand for imported products, calculated as a proportion of all demand for products in Norway”. The figures for devaluation and devaluation increase show what may occur in a certain year.

<b>Share of import</b>	<b>Devaluation</b>	<b>Devaluation increase</b>
0.4	2 %	0.4 times 2 % = 0.8 %
0.3	2 2/3 %	0.3 times 2 2/3 % = 0.8 %
0.2	4%	0.2 times 4 % = 0.8 %
0.1	8 %	0.1 times 8 % = 0.8 %

## APPENDIX D

### A CONSEQUENCE OF DEVALUATING

Assume that Norway exports only one type of goods and imports only one type of goods. My reasoning starts with looking at this situation:

A bancor costs 7 Norwegian kroner.

In Norway the price of the export good is 14 kroner pr kilo. Since a bancor is worth 7 kroner this means that in trade with other countries Norway's export product costs 2 bancors pr kilo.

The import good costs 1 bancor per kilo when traded between industrial countries.

In this situation Norway can buy two kilos of the import good by producing and selling one kilo of the export good.

Norway then performs a devaluation which after a relatively short time leads to this situation:

A bancor costs 14 Norwegian kroner.

In Norway the price for the export good is still 14 kroner pr kilo. Since a bancor is now worth 14 kroner, this means that in trade with other industrial countries the export good now costs 1 bancor pr kilo.

The import good still costs 1 bancor pr kilo in trade between industrial countries.

In this situation, Norway must produce and sell two kilos of the exported good to be able to buy two kilos of the imported good.

This example illustrates that this will happen to a country which devaluates.

In international trade "the goods the country exports" are worth less than before compared to "the goods the country imports". This means that the country must produce and sell more of the goods it exports to be able to buy a certain amount of the goods it imports.

In some countries this may be regarded as such a disadvantage that the national governments choose not to devalue although this leads to the following: these countries will be bound by "the six requirements" which all countries are bound by under the current economic system.

# APPENDIX E

## A SYNTHESIS OF THEORIES ON THE LONG-RUN PHILLIPS CURVE

### E.1 INTRODUCTION

What is meant by inflation here is the “increase per year in the price level”. A Phillips curve is a curve that gives information about how inflation varies with unemployment.

Among the theories on the relation between unemployment and inflation, there are two that have chiefly been used in the last forty years. One of them I call the theory of the 1960s and the other I call the theory of the 1990s. In this appendix, I will first give an account of these theories and point out that each of them has a certain weakness. I assert that by making a synthesis of these two theories we can get a theory that has none of these weaknesses. Then I show how the theory of the synthesis can be used to explain what happened with unemployment and inflation from the 1960s to the 1990s. Finally, I use that theory to discuss the widely used policy of tying the inflation to a low nominal anchor. This is an important conclusion of that discussion:

In the long-run, there is a trade-off between inflation and unemployment. The higher the inflation we are willing to accept, the lower the unemployment will tend to be.

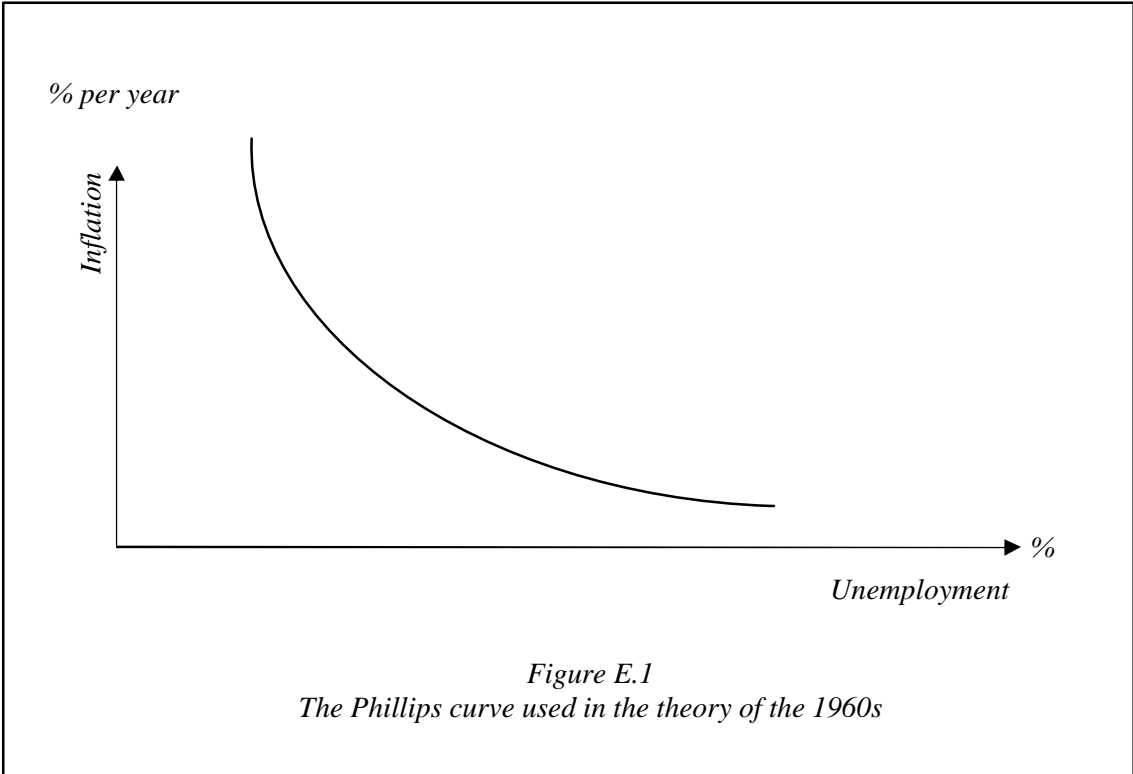
That conclusion is important because it shows a way to reduce the unemployment. I use this way in Chapter 5 in the section called "Accepting higher inflation as a means to get lower unemployment".

### E.2 THE THEORY OF THE 1960'S OF THE RELATION BETWEEN UNEMPLOYMENT AND INFLATION

In the 1960s and the first part of the 1970s, it was common to use a Phillips curve, which falls when we move to the right in a diagram where we measure unemployment along the horizontal axis and inflation along the vertical axis (cf. figure E.1). In that period, economists did not distinguish between the influence in the short-run and the influence in the long-run of unemployment on inflation. The curve in figure E.1 was regarded both as description of what happens in the short-run as well as a description of what happens in the long-run.

In the 1960s and the first part of the 1970s, it was common to reason as follows: the authorities want both low unemployment and low inflation. The Phillips curve can be seen as a kind of menu for politicians. On this menu, they can choose low unemployment, but then they must accept that prices increase rapidly. Alternatively, they can choose a slow price increase. But the slower price increase they choose, the more unemployment they must accept.

The theory expressed by figure E.1 will be called *the theory of the 1960s*.



*Figure E.1*  
*The Phillips curve used in the theory of the 1960s*

## E.3 THE THEORY OF THE 1990'S ON THE RELATION BETWEEN UNEMPLOYMENT AND INFLATION

In this section, I present a theory that is probably accepted by a majority of economists today. I call it the theory of the 1990s, even though it was developed earlier.

### **The long-run Phillips curve**

The long-run Phillips curve is a curve showing the combinations of unemployment and inflation that keep inflation constant. According to the theory of the 1990s, this curve is a vertical line in a diagram where we measure unemployment along the horizontal axis and inflation along the vertical axis (cf. figure E.2).

Why is inflation constant in the situations described by the vertical line in figure E.2?

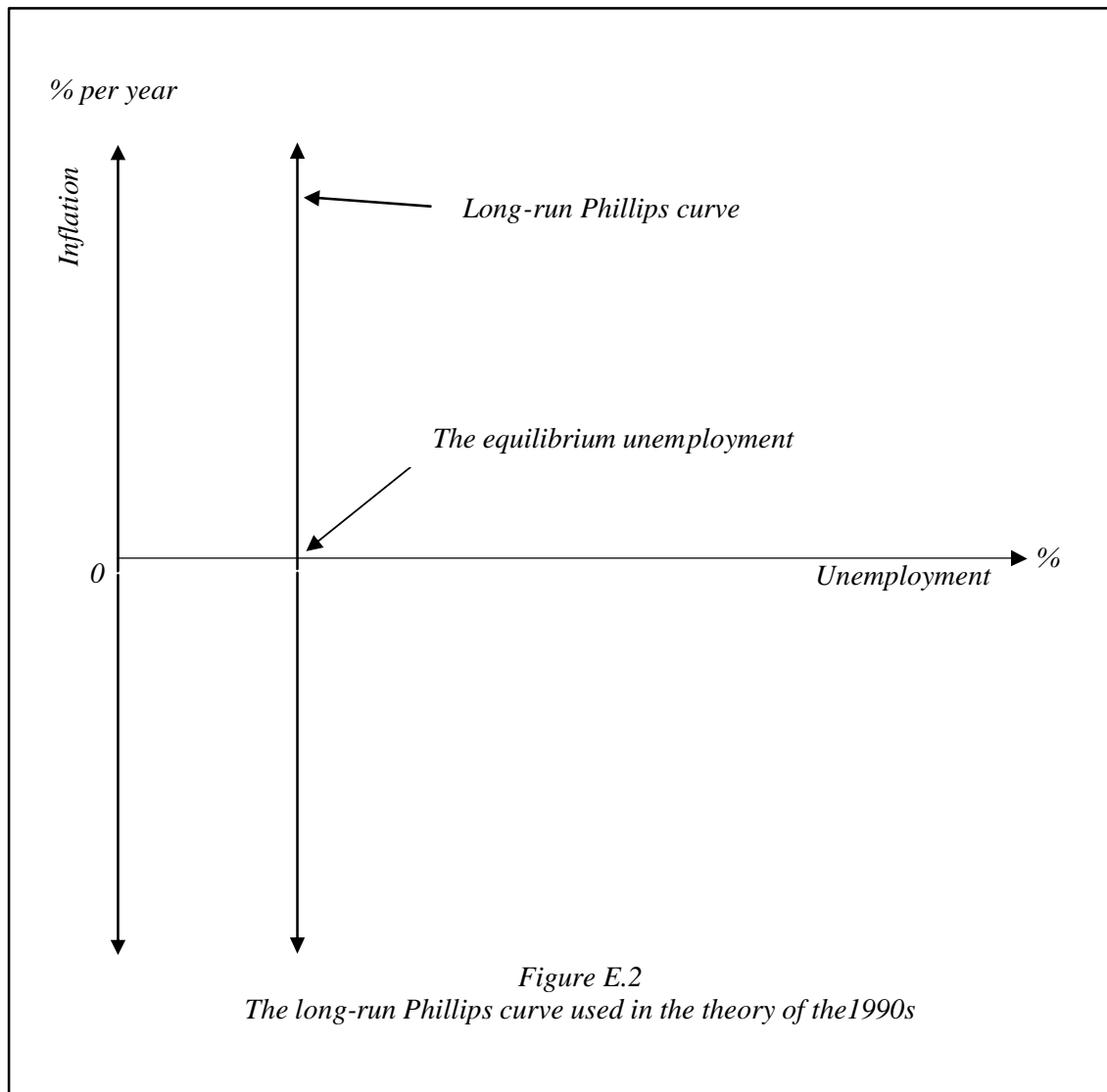
Let us start by looking at the situation where inflation has been 2.5% per year for some time. According to the theory of the 1990s, this will have the following effects:

The business managers and all other people making economic decisions expect that inflation will remain at 2.5% per year.

Since they believe that inflation will remain constant, the business managers will increase their prices by the same percentage that they have done in the preceding years. Other people making economic decisions will also behave in the same way as before.

This behaviour by the business managers and other decision makers makes prices rise with the same speed as before. In other words, inflation remains constant.

We can reason in the same way in connection with any other rate of the inflation. If for instance inflation has been 6% per year for some time, the conclusion will be that it will remain at 6% per year.



The real world is of course much more complex than what is assumed above. But as far as I can judge, most economists believe both that the long-run Phillips curve is vertical as well as that the above theory of why it is vertical comprises a useful simplification of the real world.

### **The equilibrium unemployment**

According to the theory of the 1990s, there is one value for unemployment that makes inflation remain constant. That value is called the equilibrium unemployment.



*Box E.1*

*The equilibrium unemployment changes over time*

The magnitude of the equilibrium unemployment depends among other things on these conditions:

How fast and in what ways do production techniques change?

How many people have an occupation where it is necessary to have qualifications that people in other occupations do not have (more about this in section 2.3)

The conditions that determine the equilibrium unemployment change over time. Therefore the equilibrium unemployment changes over time. (More about this in section 2.3)

### **Realised unemployment**

By an economic shock, we mean something that rapidly leads to a considerable change in the conditions for economic behaviour. A natural disaster that reduces production considerably is an example of an economic shock.

Economic shocks and trade cycles make unemployment different from the equilibrium unemployment. When such differences occur, they activate economic mechanisms and/or economic policies that make unemployment approach the equilibrium unemployment. If there are no new shocks for a sufficiently long time, these mechanisms will make unemployment equal to the equilibrium unemployment.

### **The short-run Phillips curve**

A curve called the short-run Phillips curve is used by economists when they deal with what happens in the near future. Today this curve plays an important role in economic analyses. However, the focus is on the long-run Phillips curve in this appendix. This it is not necessary to say anything about the short-run Phillips curve here.

## **E.4 FLAWS IN THE THEORIES**

### **A flaw in the theory of the 1960s**

According to the theory of the 1960s, low unemployment will never make inflation increase faster and faster regardless of how low unemployment is. However in the 1980s, prices rose faster and faster in the industrial countries.

### A flaw in the theory of the 1990s

The theory of the 1990s claims that only if unemployment is equal to the equilibrium unemployment is it possible to avoid inflation rising faster and faster. Experiences from the 1960s show us that this is not true (see figure E.3).

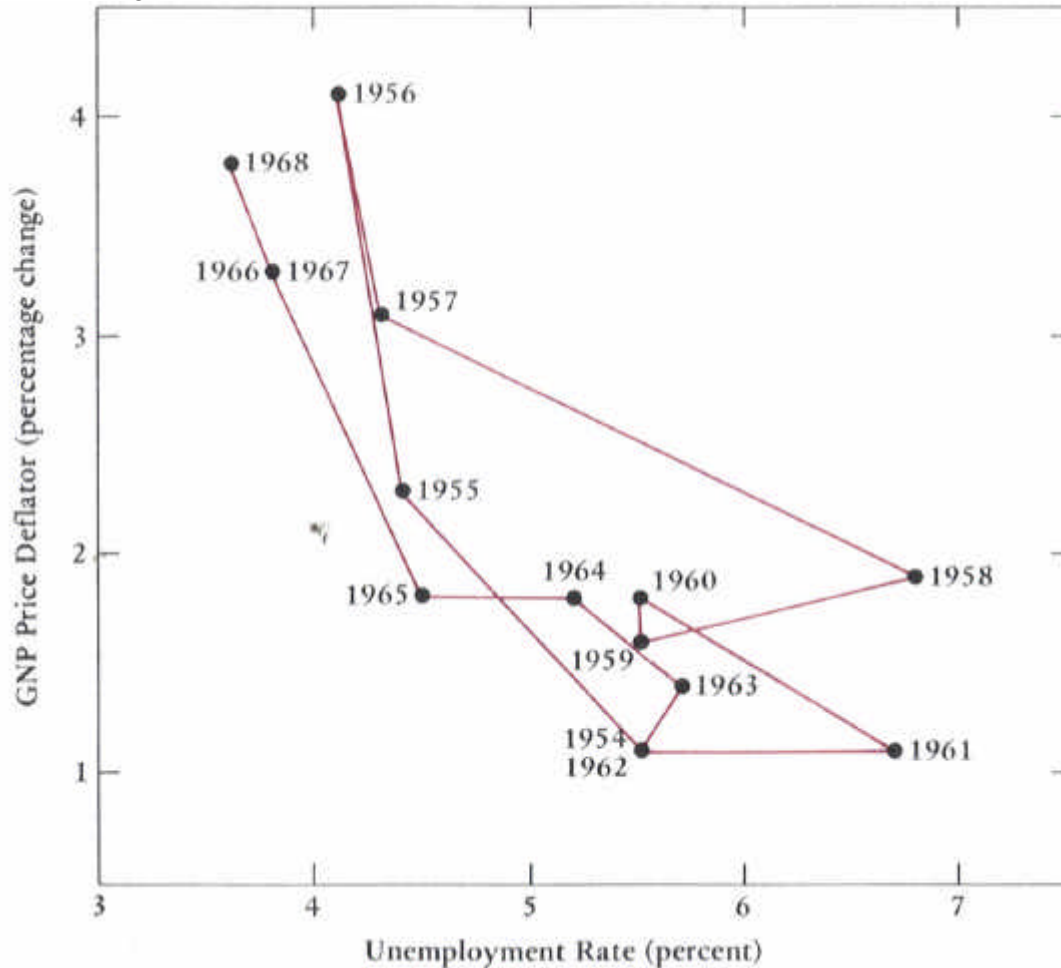


Figure E 3

Figure showing the trade-off in the long-run between inflation and unemployment

My source for this figure is Paul A. Samuelson and William Nordhaus: *Economics, Thirteenth Edition*, Magraw Hill Book Company, New York, p. 350.

## E.5 PREPARATIONS FOR A SYNTHESIS OF THE THEORIES OF THE 1960s AND THE 1990s ON THE LONG-RUN PHILLIPS CURVE

### Two theories that are not used in the price theory of the 1990s

These two theories are not used in the price theory of the 1990s:

Theory No. 1. The price increase in an industry depends on the development of productivity within that industry and on the market conditions for that industry. Thus, price increases differ between industries.

Theory No. 2. The price-setters are more reluctant to reduce their prices than to permit them to rise more slowly than a rising price level.

Theory No. 1 is probably fairly indisputable. Several factors may contribute to making Theory No. 2 likely. Here are two of them:

If a producer reduces the prices of his products, other producers in the same industry may regard this as an attempt to increase the producer's share of the market. Such interpretations can start a "price war", which will not be advantageous to any producer, and also which none of them want. To refrain from increasing the price of a product as much as the general price level increases will seldom be regarded as an invitation to a price war.

Many producers have stocks of goods they have manufactured, but not yet sold. Reducing the prices of these goods can mean that the money gained by selling them would be less than what it has cost to produce them. Reduced prices will therefore lead to registered losses and some producers seek to avoid registered losses. This affects their price-setting, although it can be argued that it is not rational to let the price policy be influenced by so-called sunk costs.

### **An example**

A greatly simplified example will be used to exemplify an important point.

I shall assume that:

We deal with a society where there are only two industries, which will be called A and B. The prices of the products manufactured in those industries will be called respectively A-prices and B-prices.

The production in A and B are about the same size and their prices are also rather equal. By "the price level", we shall therefore mean the average of the A-prices and the B-prices.

In each of the industries, there is a producer that may be called "the price-leader" in that industry. Towards the end of each year, this producer decides how high to set his prices for the coming year. The other producers within that industry normally follow the price-leader when setting their prices. However, even though he has considerable influence on price setting, the price-leader must take into account that price reductions may be interpreted by the others as an invitation to price-competition.

Let us assume that prices rose by 7% from 2005 to 2006.

Towards the end of 2006, the price-leader in A is to set its prices for 2007. At that time, it is difficult to sell A-products. Hence, this price-leader believes that it will be advantageous if his product becomes somewhat cheaper compared to the price-level. He knows that prices rose by 7% from 2005 to 2006 and he expects B-prices to rise at least that much from 2006 to 2007. On the basis of this, the price-leader in A increases his price by 5%. The other producers in A do the same.

For the B industry, the prospects look good. As a result, the price-leader in B believes that it will be advantageous if his prices increase somewhat faster than they did the previous year. So he raises his prices by 8% from 2006 to 2007 and the other B-producers do the same.

According to what is assumed above, A-prices will increase by 5%, whereas B prices will increase by 8%. The price level, which is the average of A-prices and B-prices, will therefore rise by 6.5%. This means that the price-increase will be 0.5% lower than it was from 2005 to 2006.

We shall now turn to another situation. Let us assume that the price level remains unchanged from 2005 to 2006, but that all other conditions, including unemployment and conditions in the product markets, are the same as assumed above. The combination of a stable price level and sales difficulties for A-products, activates a reluctance to reduce prices within A. Due to this reluctance, A-prices will

be the same in 2007 as they were in 2006, despite the marketing difficulties for the A-industry. For B, on the other hand, marketing possibilities look so good that the B-firms raise their prices by 1%. No change in the A-prices and 1% increase in the B-prices means that the price-level increases by 0.5% from 2006 to 2007.

Let us compare the two situations. Even though the unemployment is the same in both situations, the price level increases in the second case, but is reduced in the first. The reason for this difference is that the reluctance towards price-reduction is activated in the second situation, but not in the first.

This example sheds light on two points. One is that when the increase in the price-level is low, a reluctance to reduce prices is activated. The other is that this reluctance influences the development of the price level.

I have discussed a highly simplified case. But “the reluctance to reduce prices” influences the development of the prices also in countries where there are more than two industries and where prices are set in other ways than in my example.

## E.6 THE SYNTHESIS

In what follows, I shall give an account of a theory, which can be called the synthesis of the theories of the 1960s and the 1990s on the long-run Phillips curve. Figure E.4 will be used in this account.

By inflation, as usually is done, I shall mean the increase in the price level.

### **Price development if the unemployment rate is less than H or more than R**

If the unemployment rate is lower than a certain limit, which in Figure E.4 is called H, inflation increases. Possible reasons for this are mentioned in section 5.4.

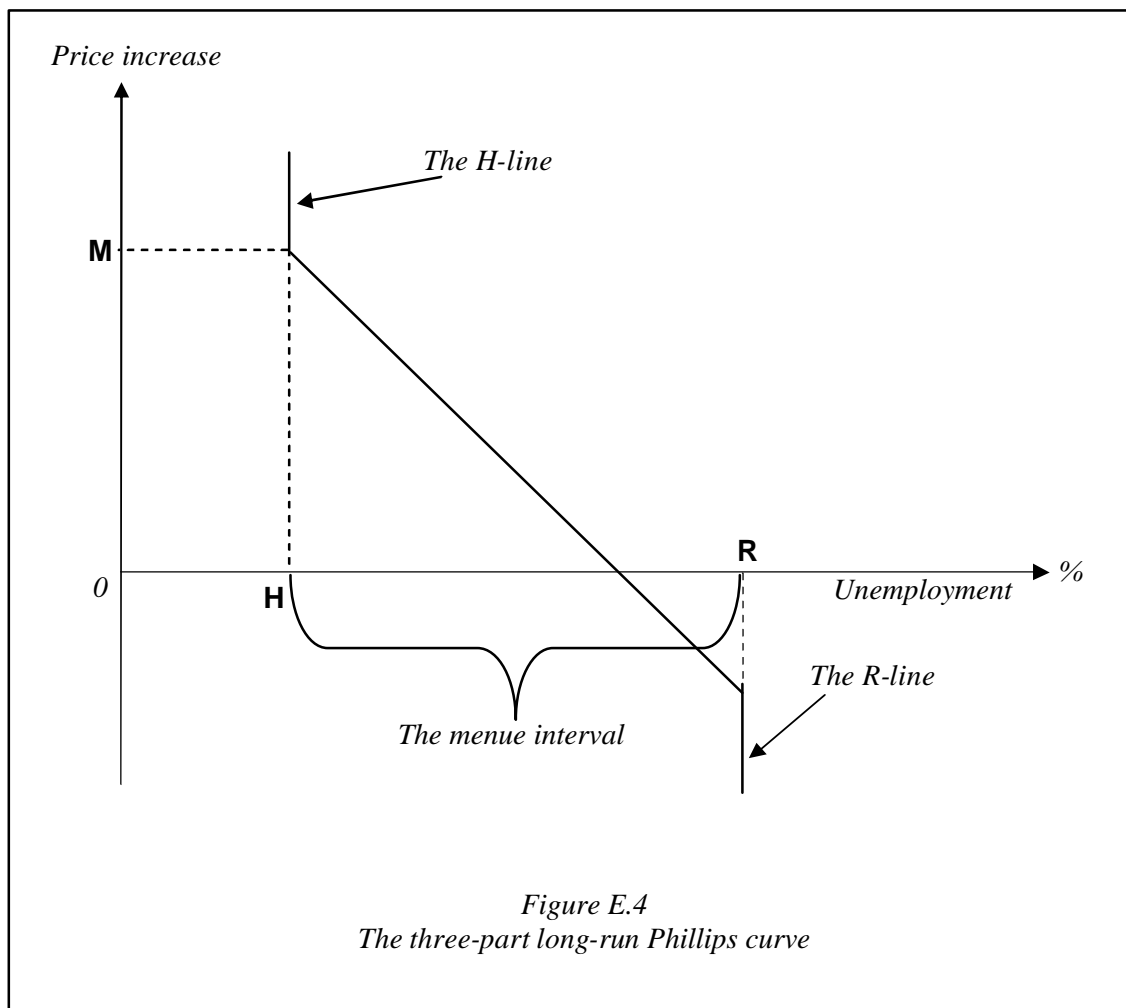
If the unemployment rate is higher than another limit, which is called R in the figure, inflation decreases. This implies that if the price level has been rising, then sooner or later it will change from rising to falling, and after that falls faster and faster.

### **Price development in the menu interval**

If the unemployment rate is larger than H, but less than R, I shall say it is in the menu interval.

Until stated otherwise, I shall assume that the authorities conduct a policy that ensures that unemployment does not change. Therefore, if the conditions change, the changes are only in the inflation. Or, expressing it by means of the figure: if we move in Figure E.4, then we move along a vertical line.

I shall assume that we start in a situation where unemployment is in the menu interval, and where inflation is so high that no producer is interested in reducing his prices. In figure E.4, this situation is represented by a point that lies above the long-run Phillips curve.



If a producer wants his prices to become lower, compared to other prices, he can achieve this by letting his prices increase slower than the price level. (c.f. the first part of the example in section E.5). Under such conditions, no reluctance to reduce prices will be activated.

I shall assume that the inflation slows down as long as there is no reluctance to reduce the prices. (c.f. once more the first part of the example in section 3).

After inflation has decreased for some time, it will have become so low that in some firms the reluctance to reduce prices is activated. That reluctance acts as a brake on further reduction of the inflation. At first that brake is not strong enough to stop the reduction, but only reduces its speed.

As long as inflation decreases, “the reluctance” is activated in more and more firms and “the brake” thus becomes stronger and stronger. Sooner or later inflation has become so low that we get the following situation: the reluctance to reduce prices is exactly strong enough to match the market forces that push towards reduced inflation. This implies that inflation remains constant.

If inflation for some reason becomes lower than in this situation, we get conditions where the reluctance to cut prices is stronger than the market forces that push towards lower inflation. If that happens, inflation increases. (c.f. the last part of the example in section E.5).

With reference to figure E.4, we can describe what happens as follows: moving downwards along a vertical line in the diagram we reach one, and only one, point on the long-run Phillips curve. (Remember that the long-run Phillips curve consists of those points, and only those points, which each represent a combination of unemployment and inflation that makes inflation constant).

## **What happens if unemployment changes, but still remains within the menu interval?**

The more difficult it is for a firm to sell its products, the stronger are the market forces that pull in the direction of decreasing inflation. This means that the larger the marketing difficulties are, the more reluctance to cut prices must be activated before inflation is stabilised. Therefore, the larger the marketing difficulties are, the lower will be the rate of inflation that makes inflation stable.

Unemployment can serve as an indicator of the marketing difficulties. The larger the marketing difficulties are, the higher unemployment there will be. From this and from the discussion in the preceding paragraph I conclude:

The higher the unemployment, the lower the inflation that stabilises the inflation.

In line with this conclusion, the menu in figure E.4 is drawn as a curve that falls as we move towards the right in the diagram. In order to simplify things, the curve is drawn as a straight line. That it should have exactly this form is probably unlikely, but we need not be concerned with that here.

## **Price development when unemployment equals one of the limits of the menu interval**

Suppose that unemployment equals  $H$ , i.e. it lies at the lower limit of the menu interval.

I shall assume that we start in a situation where the price level is rising so fast that no firm can be interested in reducing its prices. This means that no reluctance to reduce prices is activated. I shall also assume that in this situation the forces which pull in the direction of lower inflation, are exactly as strong as those pulling in the opposite direction. This means that the rate of inflation remains constant.

Let us now turn to a situation where inflation is lower than in the situation discussed above. If it is low enough we have a situation where it will be rational for one or more firms to reduce their prices. This activates the reluctance to reduce prices. As a result of that, the forces pulling towards a decrease in the price level are weaker than the forces pulling towards an increase. Consequently, inflation increases.

What is said above can be summed up in this way: if unemployment is equal to  $H$ , the inflation remains constant if and only if, it is above a certain level. In figure E.4, that level is called  $M$ . The conclusion that the inflation is constant if, and only if, it is above  $M$ , is expressed by letting a line called the  $H$ -line be part of the Phillips curve.

By reasoning in the same way as above, we can also conclude: if unemployment equals  $R$ , the inflation remains constant if and only if it lies under a certain level. In figure E.4, this is expressed by letting the  $R$ -line be part of the Phillips curve.

## **A synthesis**

The long-run Phillips curve in figure E.4 has two parts that are vertical lines, one connected to unemployment  $H$ , and the other to unemployment  $R$ . These parts have the form we should expect from the theory of the 1990s. According to that theory, the long-run Phillips curve is a vertical line.

The curve in figure E.4 also has one part which falls as we move to the right in the diagram. This part has the form we should expect from the theory of the 1960s. According to that theory, the Phillips curve falls as we move to the right.

On the basis of what was said above, we can regard the curve in figure E.4 as a synthesis of the long-run Phillips curves from the 1990s and the 1960s.

## **Another explanation of why there is a three-part long-run Phillips curve**

If my intention had been to present a comprehensive description of factors that influence inflation I would have put forth a theory that is more complicated than the one presented above. The conditions in the labour market would have been among the subjects I would have taken up.

However, my aim has not been to give as comprehensive a description as possible. I have instead focused only on some conditions that influence inflation. My view is that these conditions provide sufficient grounds for assuming that the long-run Phillips curve consists of three parts.

There are several other conceivable explanations of why there is a three-part long-run Phillips curve. In one of them, we could use the following two theories:

*Theory No. 3:* The wage increase in a certain industry depends on the relation between the demand for labour and the supply of labour in that industry, as well as on other factors. Therefore wage increases differ between industries.

*Theory No. 4:* Many employees are strongly opposed to wage reductions. They feel less strongly about losing ground in relation to other workers if this happens because their wages rise more slowly than wages of other groups.

By using these theories in a way similar to the way that I used theories No.1 and No. 2 above, I can argue for the three-part long-run Phillips Curve.

### **Econometric tests?**

It would have been appropriate to let the above description of the theory of the three-part long-run Phillips curve be followed with results from econometric tests of that theory. But as far as I know, such tests are not available.

## **E.7 DESCRIPTIONS AND COMMENTS BASED ON IGNORING THE INFLUENCE OF UNCONTROLLED MARKETS ON UNEMPLOYMENT AND INFLATION**

Unemployment and inflation are influenced by what happens in markets that are not controlled by the authorities. Until otherwise stated, I will simplify by disregarding that influence. I shall discuss the situation in Norway. But the main conclusions that I draw apply to other industrial countries as well

### **Unemployment and inflation in the period from 1960 to 1995**

Until otherwise stated, in this section I shall describe and discuss what happened in Norway.

*What happened in the 1960s and why did it happen?*

In the 1960s, there was always the following situation in Norway:

Increases in unemployment lead to slower inflation.

Reductions in unemployment lead to faster inflation.

There was never an inflation rate that increased for a long time.

This happened because unemployment was always in the menu area in the 1960s.

*What happened from 1970 to 1995?*

*A change in the position of the long-run Phillips curve.* Figure E.5 shows how the position of the Norwegian long-run Phillips curve changed some time before 1974. Why it changed in this way is discussed in Section 2.3.

*The economic policy.* Per Kleppe was the Minister of Finance in Norway from 1973 to 1979 in a Labour government. During that period, he had a decisive influence on the Norwegian economic policy.

In the book *Per Kleppe: Kleppepakke*, Aschehoug, 2003, he writes on p. 350:

“What we (i.e. the Labour party) were afraid of was unemployment. - - - If the registered unemployment was higher than 1 percent, then the warning signals started to flash. - - - We knew nothing about the so-called “equilibrium unemployment, - - -”.

In January 1974, the registered unemployment was higher than 1 percent. Based on experience and the theory from the 1960s it was assumed by politicians and economists that an increase in the demand for domestic products would 1) reduce unemployment and 2) have the following effects on inflation: inflation would first increase and then remain constant.

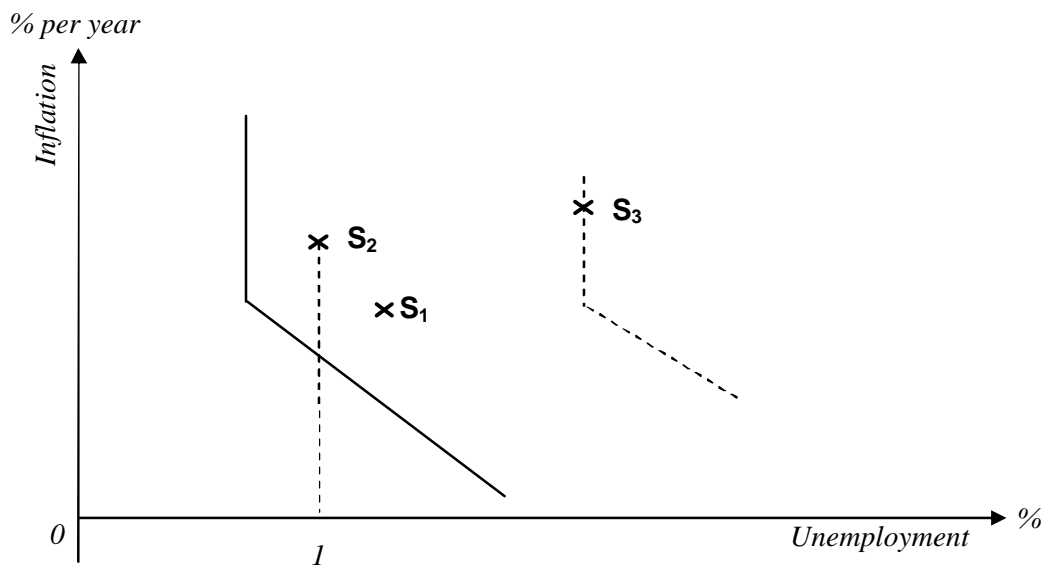
A graphical representation of what is pointed out here is that the economists and the politicians believed that “a demand policy that made unemployment 1%” would mean going from  $S_1$  to  $S_2$  in figure E.5.

On the basis of this belief, the government decided to conduct a policy that resulted in 1% unemployment. But because 1% unemployment at that time was too low to be in the menu interval, the increase in inflation never stopped as long as this was the policy. Instead inflation grew and grew.

This price development was unacceptable. Thus after some time the government decided to conduct a demand policy that stabilised inflation even though this meant that it had to give up the goal that unemployment should not exceed 1 percent.

After time using this policy some years Norway reached the combination of unemployment and inflation that is represented by point  $S_3$  in figure E.5. As a result of short-run variations in the neighbourhood of  $S_3$ , the equilibrium unemployment was “discovered”, and the theory of the 1960s was replaced by theory of the 1990s.





*Figure E.5*  
*Figure showing what happened to unemployment and inflation in Norway after January 1974*

To make the figure simpler I have left out the right-hand parts of the Phillips curves.

\_\_\_\_\_ = The long-run Phillips curves of the 1960s

- - - - - = The long-run Phillips curves of the 1990s

$S_1$ ,  $S_2$  and  $S_3$  are three points in the diagram that indicate how large unemployment and inflation were in three different situations.

$S_1$  describes the situation in January 1974.

$S_2$  describes the situation the government expected would occur as a result of its policy in 1974.

$S_3$  describes the situation some years after 1974.

### *Comments*

There are several simplifications in the above description of what happened in Norway. This is one:

During the period when Norwegian inflation grew with increasing speed, inflation trends in other industrial countries made the prices of Norwegian exports and imports grow with increasing speed. This is part of the explanation of why the Norwegian inflation increased so fast during that period.

Another simplification is the assumption that there was a sudden change in the long-run Phillips curve in the first part of the 1970s. The change came more gradually.

The above discussion of what happened from the 1960s to the 1990s strengthens the theory of the three-part long-run Phillips curve. By using this theory, it is possible to explain why there was a trade-off between inflation and unemployment in the 1960s, why the inflation grew in the 1970s and why the inflation has been rather stable in more recent years.

In the other industrial countries, the trend was more or less the same as the one in Norway. In part of the 1970s and the 1980s, there was a period where inflation grew. It was followed by a period where inflation was reduced and unemployment increased. I believe that the reasons for this development were to a large extent the ones mentioned in the above description of the trend in Norway. However I will not argue strongly for this belief, because my knowledge of what happened in other industrial countries is much less than I could have wanted it to be.

### **The nominal anchor**

#### *The main goal for the price policy*

In what follows “% per year” is shortened to “ %”.

When a country conducts a policy aimed at making its price level increase with constant speed, we say that the country ties its price level trend to a *nominal anchor*.

The goals for the economic policy are set by the government and the parliament. . The main goal for the price policy is to make the inflation low and stable. That goal is made more precise by letting “2.5% growth pr. year in the price level” be a nominal anchor for the price development.

#### *Justification for the price policy*

As far as I can judge this is the justification for Norway's price policy.

It is more difficult for businesses to get a clear picture of what is happening if the inflation is changing than it is when it remains constant. This is the justification for using a nominal anchor.

According to certain theories a country will be best served by having an inflation that is positive, but small. This is the justification for using 2.5 % per year as the nominal anchor.

#### *Implication of the price policy*

Norway's central bank is called Bank of Norway. It is delegated to that bank to try to make the prices increase 2.5% per year. The bank uses its influence on domestic rates of interest to try to get that price increase.

But accepting that Bank of Norway uses its influence on the domestic rates of interest to make prices increase by 2.5% per year, the government and the parliament have delegated their influence on domestic interest rates to the bank.

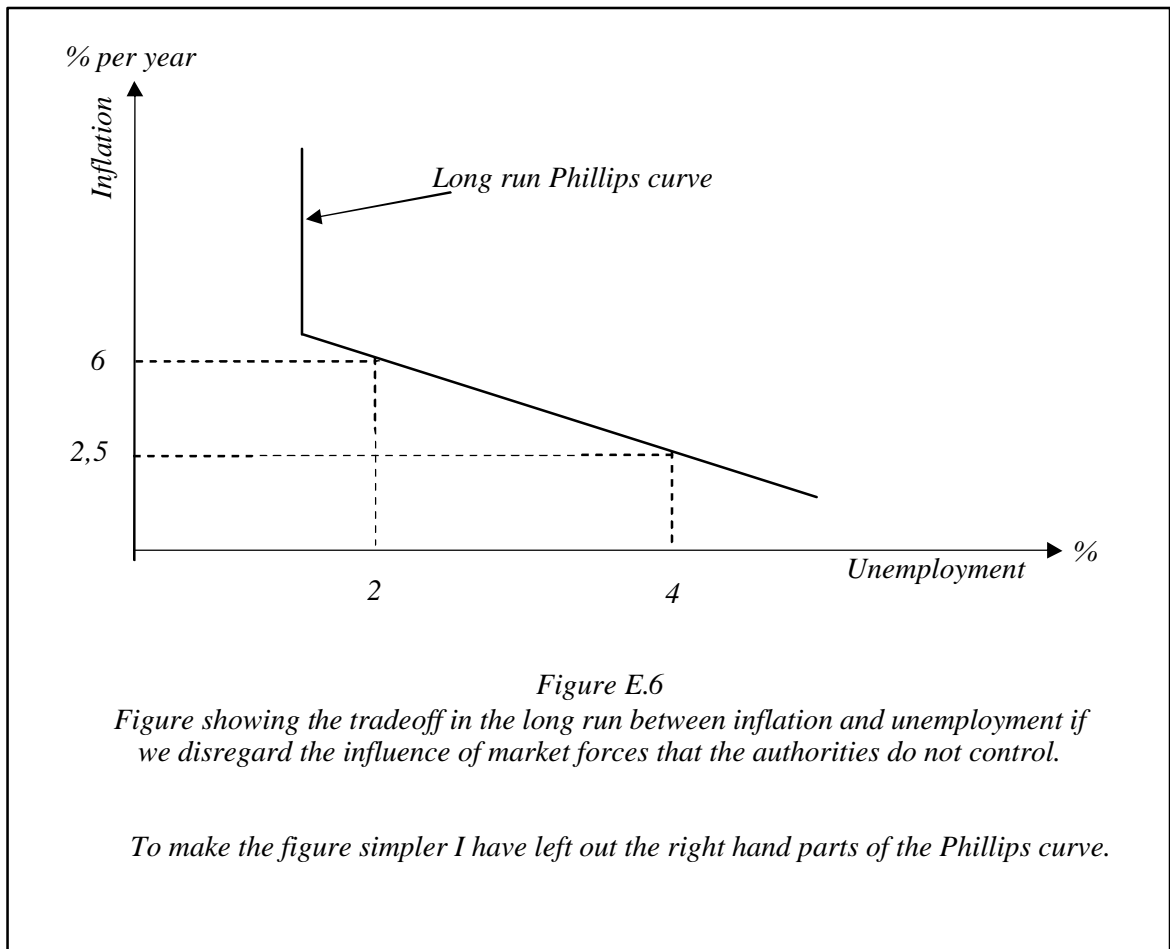
If the theory presented by figure E.6 is regarded as a true description of reality, then it can be reasoned as follows:

By using its influence on domestic rates of interest rates Bank of Norway can decide how fast the inflation rate shall rise. Here is an example:

Suppose that inflation is 6% and that Bank of Norway wants it to become 2.5% and to stay at that level.

Suppose also that Bank of Norway conducts an interest policy which makes unemployment larger than 4%. Since the unemployment is that large, inflation decreases. When it has become 2.5%, the bank switches to an interest policy that makes the unemployment equal to 4%. As long as this policy is conducted, inflation will be 2.5%.

By conducting an interest policy making unemployment less than the current unemployment, the authorities can in corresponding manner increase inflation.



*What can Bank of Norway learn from its observations of unemployment and inflation?*

Figure E.6 shows that the bank will then observe only one point on the long-run Phillips curve, i.e. the point where inflation is 2.5% and where unemployment is 4%. Thus it will be impossible for the bank on the basis of its observations to say anything about what will happen if it ties inflation to a nominal anchor that is different from 2.5%, for instance 6 %.

## E.7 DESCRIPTIONS AND COMMENTS BASED ON THE FACT THAT WHAT HAPPENS IN UNCONTROLLED MARKETS INFLUENCE UNEMPLOYMENT AND INFLATION

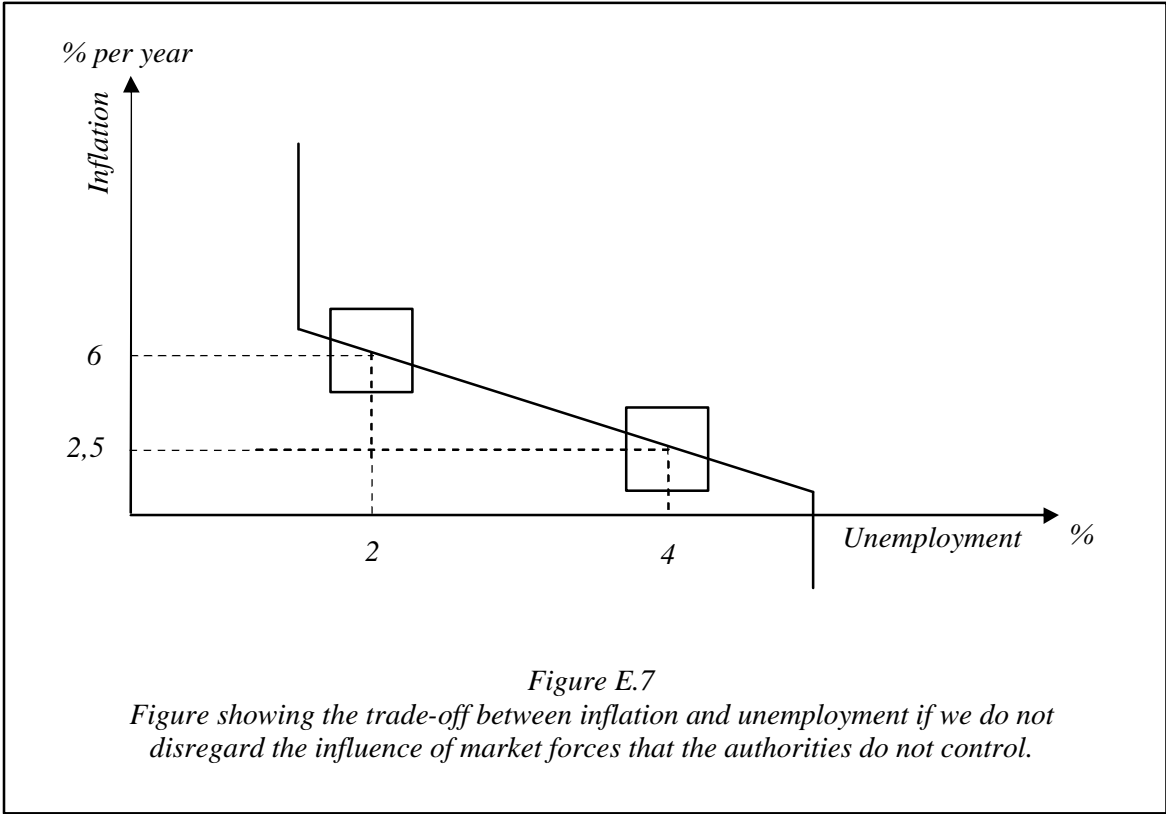
In what follows I shall assume that the figure E.7 gives a true description of the conditions in Norway.

I shall also assume that it is a goal of Norway that the inflation shall be 2.5% and that Bank of Norway conducts a policy intended to achieve that goal. This policy creates a tendency for the inflation to be close to 2.5%, and unemployment to be close to 4%.

But inflation and unemployment are not only influenced by economic policy, but also by what happens in markets that the bank does not control. This influence creates a tendency for inflation and unemployment to differ from what the bank wants them to be.

In figure E.7 it is assumed that the combination of these two tendencies makes unemployment and inflation be in a “box” around that point on the long-run Phillips curve where inflation is 2.5% and unemployment is 4%. One consequence of this is that Bank of Norway has only observations of inflation and unemployment which are within this box. If I have understood the bank correctly, it asserts that there is no co-variation between unemployment and inflation in *those* observations. I shall not question that assertion. But if I have understood the bank correctly, it also asserts that this implies that in the long-run there is no co-variation between unemployment and inflation. This is not correct, as can be seen in this way:

Let us for a moment assume that it had been a goal for Bank of Norway that inflation should be 6%. According to figure E.7, the inflation and the unemployment would then have been in a box around that point on the long-run Philips curve where inflation is 6% and unemployment is 2%.



If we compare the two boxes in figure E.7 we see that the unemployment is smaller in the box associated with a 6% price level increase than it is in the box associated with a 2.5% price level increase

We get similar results whenever we compare boxes associated with different price level increases. From this we can conclude

In the long-run, there is a trade-off between inflation and unemployment. The higher the inflation we are willing to accept, the lower the unemployment will tend to be. The policy for achieving the most important goal for the monetary policy

## E.8 BANK OF NORWAY'S DESCRIPTION OF AND COMMENTS ON ITS INTEREST POLICY

The head of Bank of Norway's division for monetary policy, Jan F. Qvigstad, writes in an article:

"In both economic theory and in practical economic policy, it was gradually recognised that there is no trade-off between inflation and unemployment in the long-run. (. . .)

Attention was again focused on the need to restore the nominal anchor. After Paul Volcker was appointed president of the Federal Reserve in the US, monetary policy was gradually oriented towards combating inflation. The monetary anchor was to be restored. A shift in policy took place in 1982, while in Norway this occurred somewhat later - in 1996. (. . .)

Throughout the 1990s, the nominal anchor was restored in many countries and direct inflation targeting became the most common objective of monetary policy. (. . .)

But the monetary policy of today arises from the recognition, based on historical experience, of what the monetary policy in fact can achieve. Inflation targeting in this sense is not new, but in fact a way of operating monetary policy with a view of making the best possible contribution to economic growth. A nominal anchor expressed in terms of low and stable inflation is a formalisation of what has actually been the norm. (, , .)

The historical knowledge we now have gathered gives us an insight into what inflation really is, why prices increase or fall and we have also learned something about how the monetary system ought to be organised in order to meet different disturbances in the best possible way. An important advantage of controlling inflation as a goal for monetary policy, in addition to explicitly giving the economy a monetary anchor, is that the system also gives the central bank and other market participants clear instructions about how the monetary policy can and should be when disturbances occur. Also here our insight into our own history has been an important point of departure."

Qvigstad's article is published in Bank of Norway's Staff Memo 2005/7 with the title "500 years of price history. Price stability is the norm. What distinguishes the abnormal?".

### *Comments on Qvigstad's article*

1. It has often happened that economic theories that were widely accepted for some time later were dismissed, because they were not regarded as good enough descriptions of reality. The theory of the 1960s on the relation between unemployment and inflation is an example of such a theory.

I would have expected that Qvigstad would have regarded it as possible that the same could happen to the theory that he uses. But this is not the case. He seems to be convinced that this theory is the one and only true theory about the relation between inflation and unemployment in the long-run (cf. that he writes: "In both economic theory and in practical economic policy, it was gradually *recognised* that there is no trade-off between inflation and unemployment in the long-run." (my italics).

2. In contrast to what Qvigstad asserts there is a trade-off between inflation and unemployment not only in the short run, but also in the long run (cf. section E.8).

## APPENDIX F

### EXCERPT FROM ØYVIND ØSTERUD'S ARTICLE "NATIONAL DEMOCRACY AND GLOBAL CAPITALISM"

#### **Introduction**

Many people will reject the idea presented in Chapter 7 of a federation of industrialized countries unless a federation such as this can be as democratic to more or less the same degree as the countries of Western Europe are now.

In this appendix I shall cite a considerable part from an article by Professor Øyvind Østerud<sup>18</sup>. In this excerpt, Østerud discusses the desirability of transferring decision-making power from national to international bodies.

#### **Excerpt from the article**

Østerud writes:

"What then of a radical solution transcending national borders, with democracy based on supranational structures? This is called democracy's third stage, after the first stage in the Hellenic City State and the second stage in the nation states' representative form of government. Regionally this is expressed in the idea of federalizing the EU, with a common parliament existing as the legislative and budgetary authority at the expense of the national assemblies. Globally this is expressed in the idea of a cosmopolitan democracy founded in the UN, in the non-governmental organizations and in the beginnings of a worldwide civil society. This idea of a supranational democracy requires serious consideration; it is supported in broad political and intellectual circles. This solution does, however, have three fundamental weaknesses which so far no one has managed to get round.

First, the supranational level lacks the political infrastructure which affords the democracy content. It lacks a unifying public arena with common fora for debate, discussion, exchanging opinions, hammering out compromises; it lacks parties and organizations which can channel the interests and views of broad groups of people; it lacks a common language and common frames of reference which integrate the population and stabilize institutions. Lacking a political structure such as this and a unifying political arena makes democracy but an empty shell, where the distance between the elite and the masses is on the increase.

Second, the supranational level lacks the fundamental prerequisite of liberal democracy – an overlapping consensus, transcending opposing interests and differences in opinions. This means agree on the rules of play, institutions and the placing of decision-making competence so that decisions can have legitimacy through citizens having a minimum of mutual confidence and common overall values.

Third, supranational constellations lack agreement on "how wealth should be distributed" in the sense that as the political fellowship is too weak to get significant transferrals of welfare accepted. Agreement on the distribution of wealth requires solidarity and social integration. It also requires confidence in central taxation, ensuring that regional and social transfers are used as intended, without corruption and without benefiting strategically placed elite groups. There

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<sup>18</sup> Nasjonalt demokrati og global kapitalisme. Main paper at the conference "*Hva skjer med demokratiet (What is happening to democracy)?*" Gamle Logen, 20 September 1999. See also list of references.

are many individual states which also lack such fundamentals for social integration, often accompanied by unstable democracy.

Currently these three prerequisites for democracy do not exist at a higher level than that of the nation state. It was a laborious and long drawn-out historical process which established democracy on that level, and many states still lack these prerequisites. These prerequisites show the structural barriers to supranational democracies capable of survival. The problem in the EU is acute. This is shown in the tug-of-war between the member states' national assemblies and ministers on the one hand, and more federalized institutions and programmes on the other. (...) Nevertheless, these problems are but limited in the EU in relation to the unforeseeable problems at the global level.

Anchoring democracy formally at a supranational level, with reduced decision-making powers for national assemblies, blurs the difference between democracy and non-democracy. Democracy's "third stage" may thus accentuate democratic problems under the illusion of solving them.

Behind this view is also an assumption concerning certain empirical relationships. This assumption is based on the idea that dismantling a national democracy's borders leads to the accentuation of differences between ethnic groups (...) more private fortifications, broader protest movements, more militant political reaction, deeper crises of legitimacy. There is no basis for assuming that reducing national borders will lead to a borderless world."

## APPENDIX G

# THE THEORY THAT THE DEVELOPMENT WILL BE THE SAME IN ALL COUNTRIES

### **The theory**

Many accept the following theory:

Development will be roughly the same in all countries. Developing countries have not come as far in this development as the industrial countries. This is the most important reason why there are great differences between these two groups of countries. In other words: the theory is that developing countries and industrial countries are “running in the same race” but that the developing countries are just some distance behind the industrial countries.

In his version of this theory, Walt Whitman Rostow used a comparison with a plane starting to move on an airport. To begin with, the plane has such a low speed that it stays on the ground. But at a certain point in time its speed has become so high that it lifts off the ground and it takes off. Rostow believes that sooner or later any country will enter a phase where it takes off, in the sense that its production will start increasing. (See Rostow 1960).

Before the Industrial Revolution there was a great deal of starvation and poverty in Europe. Some people who believe development will occur in roughly the same way everywhere claim that the European countries at that time were in the phase of development the typical developing countries are in now.

### **Objections to the theory**

Many people disagree both with the assertion that development will be the same in all countries and the assertion that the conditions in these countries are the same as the conditions in the industrial countries before they became industrialised.

They argue in this way:

Before Europe’s industrialisation, trade between the European countries was small compared to the total production of these countries. Each of them produced mainly goods and services for domestic use.

Industrialisation started in England and spread little by little to other European countries. Apart from England, who led the way, countries started industrialising by copying production techniques already in use abroad. The techniques used were simple. Therefore it did not take long before a country could produce the machines it needed.

At first, the production was less efficient in a new industrial country than in the countries that had been industrialised for some time. However, transportation costs were much higher than now, compared to other costs. Thus, domestic businesses could compete with foreign businesses on domestic markets. In addition, many governments through protectionism, i.e. by customs and restrictions on imports, protected domestic businesses against foreign competition.

Most of the typical developing countries are members of the WTO (the World Trade Organisation). As members they shall not use customs or quantity restrictions on the import of industrial goods. However, the WTO gives the poorest developing countries special treatment by permitting them to use 12% customs duties on the import of such goods. The possibility for



the developing countries to use a protectionist policy is nevertheless much smaller than it was for the European countries when they became industrialised.

“Production mainly for domestic consumption”, “ability to make the machines used at that time”, “high transportation costs” and “protectionism” were important conditions in the European countries during the period just before they became industrialised.

The first two conditions do not exist in typical developing countries today. Modern industrial machines are complicated. Hence, the typical developing countries are not capable of copying them. Transport has undergone great developments and transport costs are not usually effective protection against foreign competition.

The third, the possibility for using protectionism, are much smaller in the typical developing countries than they were in the European countries when they became industrialised.

### **My view**

I accept the criticism quoted above. This is my view:

Some people use a theory, which says that “what the free flow of products and capital has meant for countries that are industrialised now” tells us what will happen if this occurs: the typical developing countries become integrated into a worldwide economic community where there is the free flow of products and capital.

I shall not use that theory. The differences between “the conditions in the industrial countries when they became industrialised” and “the current conditions in typical developing countries” are too large to make this reasonable

However, what is said above does not prevent me from believing this:

If a small developing country is to escape poverty then it must have considerable foreign trade<sup>19</sup>.

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<sup>19</sup> Here is one possibility which takes the need of developing countries to protect their own industries against competition from industrial countries into consideration: several developing countries form a block and trade between themselves, while protecting themselves against competition from industrial countries.

## APPENDIX H

### ADVICE IN THE READING OF CHAPTERS 3 AND 4

#### THE PURPOSE OF THIS APPENDIX

Those who read this book can with some simplification be divided into those who think it is easy to read and those who think that part of the book is hard to read.

If you are among those who find the book easy to read, this appendix is of no interest to you.

However, I think there are many who find parts of it hard to read. My basis for this is among other things the following comment from a student that I asked to read a draft for the book:

The book treats the problems in a good way, especially for those who have the endurance to work their way through the introduction and the first four chapters. But a lot of this material is too difficult for many potential readers.

Probably many of those who start reading the book will give up before they are half way through. Parts of chapters 3 and 4 are especially problematic in this respect. From chapter 5, I find the book much easier to read.

The purpose of this appendix is to try to make sure that as few as possible give up before they are half way through the book. I will try to achieve this by pointing out which parts of chapters 3 and 4 should be read thoroughly, and which parts can just be skimmed through. However, before you read these chapters you should read section 1.5 again.

#### CHAPTER 3

##### **What is important that you remember from chapter 3?**

*The demands on an alternative system, and the reasons for these demands*

The demands on an alternative system and the reasons for these demands are presented in section 3.4. Read this section thoroughly.

*What is meant by "the alternative system"*

The alternative system" is described in section 3.4. Read that section thoroughly.

*The important differences between "the alternative system" and the economic systems in North Korea and the former Soviet Union*

The differences between "the alternative system" and the systems in North-Korea and the Soviet Union are described in section 3.7. Make sure that you remember what is pointed out in that section.

This advice is not necessary if you follow the advice of reading section 3.4 thoroughly. But in debates about economic systems, you will probably often see that many take it for granted that "an economic system in which there is not free flow of products and capital across borders between countries" to a great extent has to be similar to North Korea's or the Soviet Union's system. Therefore it is very important that you be able to correct this misunderstanding.

### **What is less important that you remember?**

If you find this convenient in order to be able to concentrate on the most important things in chapter 3, you may just skim through sections 3.3, 3.5 and 3.7. What you will remember from these sections by skimming them will probably be sufficient to prevent that you lose the flow in reading the book.

## **CHAPTER 4**

### **What is important that you remember from chapter 4?**

*What is said in section 4.1 about devaluations*

Devaluations are an indispensable part of "the alternative system". It is therefore very important that you read section 4.1 thoroughly.

*The authorities' need to gain control over the capital transfers to and from other countries*

In section 4.3 it is shown that if Norway is to be able to free itself from "the six requirements" then the authorities must gain control over the capital transfers to and from other countries. This is an important point that you should remember. But it will probably not be difficult to remember this point even if you just skim through section 4.3.

*The justification for the rules for import of services*

A central characteristic of "the alternative system" is that most types of services shall not be imported. It is important that you remember both this and the core of the justification for this, but in order to remember this it will probably be sufficient that you read the first part of section 4.4 thoroughly.

### **What is less important that you remember from chapter 4?**

If you find this convenient in order to be able to concentrate on the most important things in chapter 4, you may just skim through sections 4.5, 4.6 and 4.7. What you will remember after skimming through these sections, will probably be sufficient to prevent that you lose the flow in reading the book.

## References

In this file I list the references that I cite in this book, plus some of the most important references that have been used while working on the book, but which are not cited. Where it is possible, I have given a direct Internet link.

Most of the first version of this book was written in Norwegian and based on Norwegian sources. This explains why there are several references from Norwegian books and articles. In the next version of the book, I shall restrict the number of references from Norwegian sources as much as possible and instead increase the number of references written in English.

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