" A STUDY ON THE ECONOMIC CRISIS OF 1970'S AND PROPOSALS "
-AN ECLECTIC ANALYSIS-

by
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C O N T E N T S

LIST OF FIGURES AND TABLES

"INFLATION SURELY HELPED TO MAKE MR. EDWARD HEATH PRIME MINISTER IN 1970 AND, EVEN MORE SURELY EX-PRIME MINISTER IN 1974. THE POPULARITY OF JAPAN'S PRIME MINISTER, MR. K. TANAKA, IS AT AN ALL TIME LOW BECAUSE OF INFLATION. PRESIDENT ALLENDE OF CHILE LOST HIS LIFE AT LEAST PARTLY BECAUSE OF INFLATION. THROUGHOUT THE WORLD, INFLATION IS A MAJOR SOURCE OF POLITICAL UNREST."

FRIEDMAN, 1974

AND AS FOR THE UNEMPLOYMENT...,

CHAPTER 1

INTRODUCTION

Two major economic problems, inflation and unemployment which are so important that even causing the collapse of the democracies, have been the main headache of the governments regardless of the status of the nation, underdeveloped, developing or industrialized.

Up to 1970', to deal with only one of these problems was enough. There was either inflation or unemployment. But 1970's brought a new and unforeseen era to the world. As the inflation was going up due to the traditional causes unemployment was also growing due to the lack of investments, and were causing great difficulties to the governing bodies trying to take precautions.

Yes, unemployment was the biggest problem of 1930's. When everybody was looking for a solution to this problem, John Maynard Keynes of England had came out with the proposal to increase the government spending, and if there was no need to do so, to dig holes on the roads just to have them reclosed in order to create demand and make the investments attractive to prevent the unemployment. His proposal made him one of the most famous and important economist of all time. He then proved, in what is called his 'Keynesian Theory', that inflation could only appear after the full employment. After the 1970's, the world especially Western Europe has observed that inflation and unemployment could increase at the same time, and wages could also increase independently from the unemployment.

What was the fact that brought forward the stagflation in 1970's,i.e. inflation and unemployment increasing at the same time, which unvalidated the Keynesian Theory? Because, not just for Keynes, but also on the Phillips Curve, as the unemployment decreased the inflation would have increased or vice versa.

$I= f(U)$ and $f'\ 0$

where U= unemployment, I= inflation.

Is there a solution to solve these problems jointly, and if there is, what could be the alternative macro economic policies?

This report prepared to answer these questions, include four çhapters. Chapter 1, presenting some statistics pertaining to inflation and unemployment, is devoted to analyse the crisis arisen after 1970's. Chapter 2 discuss the main causes of both problems in EEC countries, Japan, U.S.A. and Turkey. In the third chapter, two different economic models, liberal and social democratic approaches are outlined and their main aims, targets, tools, problems and solutions are explained in detail. In chapter 4, proposing some measures which may be taken to fight the crisis, I present my conclusions.

In this first chapter I want to lay emphasis on the trend of the inflation in different countries and economies, which accelerated after 1970's. Therefore I clasified the countries in five categories.

1) Countries with low income level: Countries with $ 360 or lower GNP per capita.
2) Countries with medium income level: Countries with per capita GNP of between $ 360-$ 3470.
3) Industrialized countries: With per capita GNP of higher than $ 3470.
4) Oil exporting countries with capital surplus.
5) Countries with central authority planning.

In this last category the state dictates the market prices with long intervals;therefore it is difficult to give an exact inflation rate. Since the price is fixed by an external institution instead of free market operations such as existing supply and demand schedule,rate of inflation can not be seen in the form of increasing prices, but in the framework of growing queues and waiting lists. In cases where supply can not meet demand, huge waiting lists are created and to gain such a product it is not a rare situation to wait for a couple of years. Hence we don't have numerical evidence of this fact we will omit countries of this category.

Looking at the data given in the following table, with the exception of Chile, we can conclude that the inflation rates in different countries are similar and around 4%. After 1970 inflation became a major problem and the figures increased sharply. I will try to explaie this inflation and its origins by particularly exemining the cases of EEC countries. Japan and Turkey.

	GNP per capita	Average Annual Inflation Rate 1960-1970	1970-1978 (1)
COUNTRIES WITH LOW INCOME			
Bangladesh	90	3.7	17.9
Burma	150	2.7	13.7
Uganda	280	3.0	27.3
Indonesia	360	-	20.0
COUNTRIES WITH MEDIUM INCOME			
Ghana	390	7.6	35.9
Bolivia	510	3.5	22.7
Turkey	1200	5.6	21.5
Chile	1410	32.9	242.6
Greece	3250	3.2	13.8
INDUSTRIALIZED COUNTRIES			
Italy	3850	4.4	14.0
United Kingdom	5030	4.1	14.1
Japan	7280	4.8	9.6
France	8260	4.1	9.3
West Germany	9580	3.2	5.9
U.S.A.	9590	2.8	6.8
PETROLEUM EXPORTING COUNTRIES			
Libya	6910	5.2	20.7
Saudi Arabia	7690	-	28.4
Kuwait	14890	0.6	19.8

(1) Banque Mondiale. Rapport sur le développement dans le monde, 1980, p. 130-131.

Another universal problem we face along with inflation is unemployment. Again a study on EEC countries, U.S.A., Japan and Turkey will be illuminating. The problem of unemployment which became a major social phenomenon emerged during 1973 and maturated in the following decades. Some statistics proving the fact are as follows:

EEC Countries (2)

	1961-70	1971-80	1981-83	1984-86 (foracast)
	Average Annual Variation as %			
Active Population	0.2	0.6	0.4	0.7
Created Employment	0.2	0.2	-1.3	0.1
	Final Levels			
Active Population	109.2	116.2	117.6	120.1
Employment	107.1	109.1	104.9	105.2
Unemployed Population	2.1	7.1	12.7	14.9
Rate of Unemployment	2.0	6.1	10.8	12.4

In the following table we will give upon a comparison of unemployment rates among EEC countries, U.S.A. and Japan.

(3) Rate of Unemployment (% of Total Working Population

	ECC	U.S.A.	JAPAN
Average of 1961-70	2.0	4.6	1.2
1973	2.4	4.5	1.3
1975	4.1	8.0	1.9
1978	5.2	5.7	2.2
1980	6.1	6.7	2.0
1983	10.8	10.1	2.4

(2) ALBERT,M. and BALL,J. EEC Report, 1983, pp.11
(3) _____, Ibid, pp.23a

On the other hand unemployment enigma in Turkey reached more serious dimensions and starting from 1970 growing rapidly on a day by day basis, reached a total unemployed population size of 3.5 million people in 1984. With a proportion of 20% of the total population, the problem is unfortunately not only an economic problem, but also a social phenomenon that can yield a most undesirable structural disorder.

	Unemployed population	Rate of unemployment (4) (%)
1970	1.066.000	3.7
1971	1.026.000	3.2
1972	1.465.000	4.1
1973	1.235.000	3.6
1974	1.358.000	3.8
1975	1.605.000	5.4
1976	2.172.000	6.3
1977	2.367.000	7.0
1978	1.767.000	6.0
1979	1.962.000	10.0
1980	2.162.000	13.7
1981	3.360.000	20.0
1982	3.139.000	20.2
1983	3.536.000	21.0

In the following chapters, I will try to explain the reasons of unemployment along with the reasons of inflation.

(4) State Institute of Statistics. 1984.

CHAPTER 2

CAUSES OF INFLATION :

Inflation is probably best defined as a persistent tendency for the general level of prices to rise. It is not a product of modern times as many of us would think, but was also experienced in ancient times.[5] Several economic disputes have lead us to two major approaches in defining the inflation

a. Demand pull inflation;
b. Cost push inflation

The rise of market prices, according to Neo-Keynesians, is a result of insufficient production level that cannot saturate the demand in the country, thus creating a difference between supply and demand, which is named "inflationary gap". This concept is the core of demand pull inflation.

On the other hand ,the supporters of cost push inflation approach said that the rise in prices is a result of cost pressure. According to their approach, the rising prices of the inputs, ~~especially~~ the wage increases introduced by trade-unions are the main reasons of the high priced final product.

It is not accurate to define and handle demand pull and cost push inflations as two separate economic processes, because in practice, the process becomes a vicious circle:i.e. low supply not meeting the high demand results in demand pull inflation and the prices the inputs go up causing a cost push inflation; wage, rent and profit margin increases on the other hand result in increasing demand.

Monetarists in early 1960's brought forwards ideas not similar to those produced by Neo-Keynesians and added a new dimension to demand pull inflation. According to Friedman, inflation wherever and whenever it has emerged has flourished in a purely monetaristic sense. He devoted the continuosity in inflation to the increase in money supply; the main reason being the increase in money supply larger than the increase in production, In general,this theory has been approved and the relation between increase in money stock and inflation emphasized.

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(5) TREVITHICK,J.A. and MULVEY,C. The Economics of Inflation p.1

As I mentioned earlier, the causes of inflation are not uniform; nevertheless whatever these causes may be, they have created rapid price increases almost in every part of the world after 1970. Herebelow, I will attempt to explain the causes of inflation in a more detailed manner:

- <u>EEC, U.S.A., JAPAN</u>

The main reasons of inflation on the world- particularly in Europe- are as follows:

1. Petroleum crises in 1974 and 1978

The petroleum prices were increased 300-400% after the first crisis took place and 150% following the second one.
As a consequence, petroleum which used to be a cheap source of energy for the production process, became a cost rising input and petroleum using industries went through sharp price increases following a cost push inflation. This was only the beginning of an overall price increase. The secondary products evaluated by petroleum using processes were inputs of other products; so indirectly, sectors using petroleum products as inputs faced high prices resulting increase in end product costs and this evaluation went on with continuously rising prices. Another cost rising factor, transportation cost has also been a considerable motivator of the inflation.
What were the precautions taken by European economies after facing the first petroleum shock? It is doubtful to give a positive answer to this question. As a matter of fact to be least harmed by another price increase, which was not very difficult to forecast, serious studies were necessary, most important of them being increasing the substitution elasticity of petroleum. One way of this is increasing the oil production in the country, which is impossible for many of them. So, there was only one choice left :switching to subsitution goods of petroleum. These may be either sources like coal, hydroelectric energy or limitless sources like solar and wind energy. Instead, the tendency was towards cutting down production and lowering the petroleum demand.

Consequently, growth rates were diminished.

Industrialised Countries (6)	Rate of Growth (% in GNP) 1960-1970	1970-1980
Italy	5.3	2.8
United Kingdom	2.9	2.1
Japan	10.5	5.0
France	5.7	3.7
West Germany	4.4	2.4
U.S.A.	4.3	3.0

Increase in industrial production(1975=100) (7)

	1976	1977	1978	1979	1980	1981	1982	1982-76 Average Annual rate of increase(%)
Belgium	109	111	116	116	115	112	112	0.48
France	109	111	112	117	117	114	112	0.48
Germany	106	111	112	118	118	116	114	0.94
Greece	111	113	121	129	130	129	123	1.81
Ireland	106	115	126	135	136	137	138	4.57
Italy	112	114	116	124	130	127	125	1.90
Japan	111	116	123	131	137	139	139	3.85
Netherland	108	108	109	112	112	110	110	0.32
Sweden	100	94	92	98	98	96	95	-0.78
Switzerland	101	106	106	109	114	114	109	1.33
U.Kingdom	103	108	103	107	100	96	98	-0.72
U.S.A.	117	117	124	129	125	128	118	0.25

We can easily draw the conclusion that the rate of industrial production and the rate of growth were decreased in order to get the least harm possible and adapt the economies to the petroleum crisis. Since oil is a highly income elastic good, the decrease in real GNP rates resulted in a cut down in oil demand and the European countries reached their prospected target. Nevertheless, it was not unrealistic to expect a negative indication of this policy. The shrinked GNP reduced the investments; lower investments prevented creation of new jobs and in turn a second big problem, unemployment flourished.

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(6) Banque Mondiale. Rapport sur le Développement dans le Monde,1980. pp.132-133.

(7) United Nations. Statistical Monthly Yearbook,1984.

2. Europe, U.S.A. and Japan have choosen diminishing GNP as a remedy to petroleum shock. Europe, unfortunately, went one step further and tried to expand the purchasing power of the consumer. The increase in wages (2.5%) granted to the workers was bigger than the increase in GNP (2.3%). This policy was a matter of social choice, the ultimate aim being a welfare state, where people have a higher well being by expanded purchasing power at a higher income level. The outcome was an adverse one. How was it ever possible to give a higher wage rate even though diminishing GNP was being experienced in the overall economy? One way is to expand foreign debts, another was to push the companies to give one portion of their profits to the workers. Consequently, the capacity of the companies to invest was cut down. Finally, this policy boosted unemployment on one hand, and slowed down the production growth pace on the other. The result was ambiguous: Higher purchasing power gained by higher wages on one side and insufficient supply on the contrary. The gap between demand and supply is the "inflationary gap" defined in the Neo-Keynesian theory leading to a demand pull inflation.
3. Since the upheaval of 1974, the huge increase in public sector expenditures was another inflationary pressure. In Europe, in 1982, the share of public expenditure in GDP exceeded 50% whereas in the U.S.A. and Japan it was approximately 35%.

Public Sector Expenditure (8)
(as a % of GDP)

	1960	1967	1973	1980	1981	1982
U.S.A.	27.8	31.2	31.2	33.2	33.5	35.5
Japan	20.7	22.7	22.1	32.7	33.3	34.8
EEC (total)	32.1	37.5	39.9	47.1	49.8	50.8
France	34.6	39.0	38.5	46.2	50.8	51.9
F.R.G.	32.0	38.2	40.5	46.9	49.3	49.7
U.K.	32.6	38.5	41.1	44.3	45.3	46.2
Italy	30.1	33.7	37.8	45.6	53.0	54.9

(8) ALBERT,M. and BALL,J. EEC Report, 1983, p.15.

What are the main reasons of this increase?
- Corporations, in the same way as income earners, endeavoured to maintain the increase in their purchasing power by demanding some sort of compensation from public finances.
As a result, between 1973 and 1982, public authority current expenditure as a share of GDP increased by a third.
- The second reason for the loss of control over public finances, namely the dramatic increase in social security expenditure, is even more important.
From 1974, public sector deficits literally soared in the EEC. Whereas between 1968 and 1973 they represented on average only 0.6% of GDP, this share increased sixfold to 3.7% between 1974-78 and ninefold to more than 5% in the years 1981 to 1983.
These deficits have to be covered either by loans, which further inflate interest rates, thereby curbing company investment, or by increasing the money supply. As can be seen in the following table, increasing money supply proving Friedman's ~~theory of positive~~ relationship between money stock and inflation rate, has been another reason of inflation.

Money Supply Statistics (9)

	1974	1975	1976	1977	1978	1979	1980	1981	1982	82-74 Annual average rate of increase
FF)	373	425	457	508	564	631	671	778	862	10.88
DM)	150	172	177	199	228	234	243	240	257	7.11
Drahmi)	112	131	160	187	228	265	309	377	459	19.31
lira)	59162	67120	79776	96880	122675	151751	171323	188084	219617	17.95
Yen)	44950	49948	56179	60786	68928	71019	69572	76507	80898	7.76
DS Gulden)	39	47	51	58	60	62	66	64	70	7.79

(9) United Nations, Statistical Monthly Yearbook, 1984.

	1974	1975	1976	1977	1978	1979	1980	1981	1982*	1982-74 (Annual avera rate of incr ase)
UM ion BF)	553	639	684	741	784	804	866			7.83
N ion Kron)	38	43	45	50	58	67	79	86	94	11.77
ERLAND ionSF)	48	50	56	56	70	68	68	64	69	5.03
ND ion Pounds)	624	748	875	1072	1367	1479	1686	1743	1900	15.08
D KINGDOM ion pounds)	14739	17483	19467	23659	27535	30046	31131	36620	38274	12.84
. ion dollars)	285	301	319	345	373	402	425	448		6.68
Y ion TL)	91	119	152	210	289	457	720	969	1343	40.39

TURKEY

The rate of inflation which has shown a growing tendency of increase since 1970s and has played a major role in bringing Turkey to verge of 12th September 1980 has several causes. I herebelow list forthcoming items of these in details.

1. Relation of money stock and inflation rate.
   This relation has been well proven in Turkey. In reasoning the relation between money stock and latest budget deficits and its inflationary effects have gained importance.
   The foremost cause of increase in money stock has been the budget deficits. The major reason of this increase in budget deficits which has made itself felt by T.C.Central Bank issued of banknotes against open budget financing can be explained as follows.
   - Pricing strategy of State Economic Enterprises (SEE)
   Following 1970's, despite SEE's authority of self-autonomy in establishing pricing criterion the price of basic goods and services was handed over to governmental authorities;

and, in the case of losses the difference in between was decided to be met from the budget. The scope of basic goods and services is extended to broad dimensions. As a result, this pricing strategy which is even incapable of meeting costs has stretched the loss of SEE's to considerable limit.

	Loss of SEE's	Loss/turnover ratios (1
1970	693	3.2
1971	517	1.8
1972	863	2.5
1973	1725	3.8
1974	5157	7.2
1975	6918	7.4
1976	10435	8.2
1977	20111	10.9
1978	38785	15.1

Turnover/Cost ratios of some SEE's (11)

	1970	1971	1972	1973	1974	1975	1976	1977	1978
Steel Ind.	1.34	1.36	1.30	1.14	1,54	1.32	1.16	1.08	0.9
Petr.P.ship	1.92	2.21	1.75	1.30	1,15	1.08	1.06	0.97	1.03
ght Assoc.	1.02	0.99	0.83	0.93	0,91	0.92	0.91	0.83	0.65
Maritime B.	1.01	1.09	1.03	1.05	0,86	0.96	0.86	0.91	0.72
ilways Assoc.	0.59	0.70	0.73	0.81	0,68	0.83	0.95	0.85	0.78

Unrealistic pricing and price adjustments with poor timing has basically two kinds of inflationary impacts. One is budget deficits arising from losses leading to a money stock enlargement, thus giving rise to a demand pull inflation and a general increase in market prices. The other influence of delayed price adjustments (rises in our case) is that it evaluates a bigger price difference between the old and new price and gives access to a second general upward price jump.

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(10) ERTUĞRUL,A. Kamu Açıkları, Para Stoku ve Enflasyon 1982, p.85

(11) _____, Ibid,p.86

- Support Purchasing:

Support purchasing is a fundamental simulator of the market price level and thus public deficits. Support purchases influence the prices through three basic ways:

First, support purchases paid by government are financed by Turkish Central Bank credits. These credits partly supplied by an increase in money stock which further rises the aggregate demand, thus increasing the rate of demand pull inflation.

Second, support purchasing prices are fixed at a political level, where the market economy plays a minor role.

Prices, higher than optimum, have impact on the general prices both directly and indirectly. Direct impact is the increase in prices of the supported products and indirect impact is the cost increase in production where these supported prices are used as inputs.

A third effect created by support purchasing prices is the transfer done to support products production areas with high consumption tendency, whereby the aggregate demand is pushed up and prices start to go up.

- Wages and Employment:

Another factor that has influence on public sector budget deficits is the wage level. The public sector wage rate increased in a higher pace in comparison with the general and private sector wage increases between the years 1970-1980. Meanwhile the rising amount of employment together these increasing wages resulted in an ever growing payrell expenses within the overall expenses of the institutions. The table below shows very clearly that the higher growth in productivity resulted in enlargening deficits in public sector. These deficits were tried to be removed by an expanded money stock, but this in turn boosted the demand.

	Payroll expenses	Production	P.ex.(12) / production
1974	19	71.2	0.26
1975	28.3	92.3	0.30
1976	42.1	104.7	0.40
1977	61.3	142.2	0.42
1978	102.8	197.9	0.51
1979	134.2	311.2	0.44

(12) _____, Ibid, p.99

2. Cost-Push Inflation:

The leading type of cost push inflation comes with imported goods, the so-called "imported inflation". It generally can be shown with the formula

$$F(i) = F(k) + F(d).r$$

where F(i) : inflation rate originating from imports
F(k) : increase percentage of the prices of imported goods in the origin country.
F(d) : percentage change in exchange rates
r : ratio of imports /GNP

In such a state, the imported goods get high prices because of two reasons, it carries the weight of the inflation in the country where it is produced and the rapid drop of TL's exchange rate. When this good is used as an input in production process the cost increases; when it is marketed as a final product, it directly increases the price and when it is imported for investment reasons this will result in increasing the product prices through effecting the fixed investment costs.

On the other hand, cost inflation, not a major variable though, is also effected by the rising wages. The high rates in various sectors, especially in the public sector accompanied by the slower rising production rate, falling productivity in other words have caused a rise in per unit costs leading to a price increase. Meanwhile a protective economic policy has abondoned competition in the market and gave access to the addition of unrealistic profit margin to the cost.

It is certain that the first and second oil crises which are the most important elements of the inflation in Europe in 1970's have well-seen impacts on Turkey as well.

The portion of the oil imports in the total imports figure which used to be 16% in 1960 jumped up to 79% in 1977, which is an unbelievable phenomenon. The size of the reflections in the economy were also beyond imagination;

. A big budget deficit
. Enormous price increases in the industry, where petroleum is used as input.
. Large cost increase in the transportation sector.

The government choosed to subsidize the petrolium prices instead of a price increase; as a result the budget deficit grew ever larger and the government tried to finance the budget by enlarging the money stock by foreign loans. Especially during the first crisis foreign loans were an influential tool. Thanks to the international finance instutions' brillant operations petro-dollars were introduced into circulation with low interest rates and the first shock was extinguished without leaving deep traces.

The following crisis went on in a state, where interest rates were also rising rapidly. As a result foreign loans were not a feasible solution for the countries suffering from high oil prices. Consequently enormous increases of rates of inflation emerged.

3) Demand Pull Inflation

After 70's ever growing oil bills resulted in continous deficit in balance of payments in Turkey. Following thes deficit the Central Bank could no more finance the imports of import goods that are necessary for the production in Turkey (Specially secondary goods). In sufficient funds for import of import material on the one hand and the high petrolium price remaining an energy crisis leaded to a growth of the idle capacity, that was already present and finally production and supply dropped. Within the same period the deficits of the SEE's and support purchases were backed by the budget. Financing the budget by enlarging the money stock resulted a growth in monetary measures. Unfailingly the consequence was a boosed in agreegate demand and an unbalanced supply-demand schedule. The gap between low supply and high demand, named "inflationary gap" by Neo-Keynesians became the major reason of the demand pull inflation in Turkey.

4) Expectations

Another reason for inflation is expectation and this played an important role in Turkey. Inflation is a fact that has a continuity in the country. This influences the people psychologically and some people choosed to buy goods that are not really necessary at the present but on which they expect price increases in the future and they may need this commodity in the future. This procedure increases demand and creates a price increase, whereas these price changes produced and at certainity to further price increases leading to a vicious circle.

The most recent example showing the expectation's roles in the demand is the V.A.T. incindence in Turkey. The consumers expecting a 10 % price increase in Jan. 85 demanded in the month of Dec. 84 half of the amount of goods, that they demanded throughout the year of '84. This jump in demand centered on durable goods, where biggest price increase was expected. This is purely a result of expectation, not an incident.

5) Structural problems

I will hereunder refer to the structural problems leading to inflation.

Industrial structure of the country: The governments during 1970's thought that the development of the industry can rapidly be reached by protection consequences of such a competition lacking metod were low quality-high price products. The high profit margins and continuing low wage/product ratio have played a cost increasing role, whereas the industry also imported cost increasing effect by its dependency on imported role materials and investment goods.

Monopolization ratio in the economy: Since competition was lacking and the trend was towards protection of the industry, monopolization was a highly exercised phenomenon. Certainly the prices were effected directly by the monopolies in a rising direction.

In sufficiency of the infrastructure:The scarcity of the infrastructure,especially the energy shortcoming resulted in bottlenecks and rise of the idle capacity, which starts the production decrease. This was the reason for increasingunit costs and growing demand leading to price increases.

Deficiencies in the taxation structure: Many taxspayers as a result of the deficiencies in the tax system could manage in not paying their taxes and the state, therefore, could not collect its entire income and lacked its money need problem through money stock financing, so money stock increased and inflation went up.

These were the major structural problems. Beyond these following factors can also be mentioned:
- The high ratio of the agricultural products in the total exports and the inelastic foreign demand for these goods.
- Presence of an unorganized stock market.
- Poorly operating banking system.
- Interest rates.
- Foreign exchange rates.
- Workers' and employers' trade unions.

CAUSES OF UNEMPLOYMENT:

"Some degree of unemployment, or at least some risk of unemployment for individuals may be an essential part of economic health for the community. A society in which every individual was absolutely sure of never losing his job, would be a society without any change at all, a dead body, not a live one "says Mr.W.H.Beweridge,author of "Causes and cures of Unemployment". He surely does not mean by this that unless individuals were afraid of unemployment, there would be no progress, that fear is the only mother of invention. He does mean only that progress implies change, and that change may result in displacing men from their chosen careers.

- EEC COUNTRIES, U.S.A., JAPAN-

Nobody can deny that the unemployment is ~~a real disease of~~ society once it reaches to a some degree. Especially, after seventies, the high rate of unemployment became the main source of the crisis taken place in Europe while two main competitors of Europe, Japan and U.S.A. are showing better performance. In Japan, nowadays, the rate of unemployment is at the level of beginning 1970, and in U.S.A. the unemployment which has always existed and mainly affects minorities, is below the level of 1975-1976. U.S. has created 12 million new employment between 1974-80 whereas Europe has created only 120 thousands of it.
So, in Europe unemployment is not only placing a heavy burden on its economy, but it has become a kind of cancer.
What were the main causes of unemployment in Europe and the differences in favor of Japan and U.S.A.?

- In order to fight against inflation, European countries decided to decrease the rate of increase of GNP. As a result of this policy, the rate of growth of the EEC's economy fell from 4.6% per annum between 1960-73 to 2.3% between 1973 and 1980.

This drastical slowdown in the last years caused that Europe has been the only area of the world to have failed to create jobs since 1973. Between 1973 and 1983 employment in the EEC decreased by 3 million, while in the U.S.A. it increased by 15 million. Lack of investments influenced by the decrease in GNP absolutely affected the rate of unemployment.

- Since 1973, the rate has only doubled in U.S.A. whereas it has increased five times in Europe. Japan on the other hand may be seen as a country of full-employment. In Europe after the first oil price shock, in spite of the slowdown in growth, all countries attempted to maintain the increase in the purchasing powers of wage-earners. The increases in personel incomes have been above the rate of growth while were below in U.S.A. and Japan. Therefore, European firms lost their competitive ability againsts American and Japanese firms. Moreover, the ability to invest of European firms is limited. Thus, the increase in individual incomes, which is excessive in comparison to the wealth produced, reduced investments, increased unemployment and compromised present and future growth.
- High level of wage costs, being an important input in production, affected the costs negatively. Therefore, companies are attracted more by investments which save labour than by investments which create jobs, which increases unemployment level effectively.
- When overall growth falls, there are two ways of maintaining increases in purchasing power of wage-earners. Increasing the external debt or reducing company profits are the policies pursued by the Europeans who preferred to take these decisions as a social choice. Few years later, these policies affected negatively the investment capacity of the European firm.

<u>Profitability of the hundred largest industrial groups (1980)</u> (13)

	%net profit on the sales	Excluded oil companies
EEC	1.4	-0.1
U.S.A.	4.8	11.6
JAPAN	2.4	13.8

(13) ALBERT,M. and BALL,J. EEC Report, 1983, p.14

This virtual disappearance of profit is particularly serious for investment since the risk premiums have considerably increased and the return on capital has decreased. Lacking investment capacities, many European companies were loosing their competitiveness and, at the same time their ability to create jobs. This largely explains the collapse of manufacturing sector in Europe.

- Corporation of every description endeavoured to maintain the increase in their purchasing power by demanding some sort of compensation from public finance, expecting the state to continue to maintain the increase in collective consumption and in payments to households. Increase in social security expenditure also, has been even more important in the loss of control over public finances. An inevitable consequence of this choice was that public authority current expenditure as a share of GDP increased by a third between 1973 and 1982 (from 35% to 47%). Over the same period, public authority investment as a share of GDP fell by a third (from 4.1% to 2.9%).Decrease in public investments, effecting negatively employment level, increased the unemployed people.[14]
- In order to be able to fight against unemployment, Europe should have given priority to increase its investments. But it couldn't be possible since the slowdown in growth and the resulting scarcity of savings made difficult to finance them. The only solution was the urgent creation of a genuine common capital market. But the Member States preferred to maintain and practice their own separate policies and arrangements. This had a result. In the 1960's, the European prosperity attracted direct U.S. investment to Europe. But, as a result of lack of common capital market, there has been dramatical reverse. Therefore, the Europeans went to U.S. to invest. European savings invested in U.S. increased the employments in U.S. while decreasing it in Europe.

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(14) _____, Ibid,p.15

- Europe is "missing out" on the third industrial revolution, and for the first time since the 18th century the major formative initiatives of an industrial revolution are not originating in Europe. In spite of still it is the world's major exporter of products with a high technology content its trade is indisputably declining

External Trade in high-technology products
Specialisation figures 1963-81 (OECD Average=1.00) (15)

	1963	1970	1978	1981
EEC	1.01	0.90	0.88	0.87
U.S.A.	1.27	1.18	1.27	1.19
JAPAN	0.72	1.07	1.27	1.37

Europe in losing ground on most of the product markets of the future, those which represent a source of growth.
It is absolutely vital for the European economy to respond to the electronics challenge. But, actually, the opposite is happening and the number of jobs lost due to the application of electronics is multiplying in Europe while corresponding jobs are increasingly being created in Japan and America.
This is one of the crucial causes why the rate of unemployment is much higher in Europe compared to its competitors.

IN TURKEY-
Everbody knows that Turkey has a very large capacity of manpower, and is a country where there is and has been always excess of labor. Even in the years between 1963-1973 when the rate of growth was increased by 6% per annum, migration of more than 1 million selected manpower did not create bottlenecks in the production.
During last five years, unemployment became a very important social problem. With a 20% of rate of unemployment, Turkey actually is leading all OECD countries.
The main reasons are:
- Independently from Europe, unemployment in Turkey has the main characteristics of all developping countries.

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(15) _____,Ibid,p.30a

One of the most important causes is the high rate of increase in population.

Annual rate of increase of Active population(%) (16)

	1960-1970	1970-80	1980-2000(projected)
TURKEY	1.4	2.2	2.1
U.K.	0.6	0.3	0.4
BELGIUM	0.3	0.7	0.3
IRLANDE	-	1.0	1.6
ITALIE	-0.1	0.7	0.4
FRANCE	0.6	1.1	0.6
NETHERLANDS	1.6	1.3	0.5
GERMANY	0.2	0.7	-
GREECE	-	0.6	0.5
SWEDEN	1.0	0.3	0.2
SWITZERLAND	1.9	0.4	0.2
U.S.A.	1.7	1.5	0.9
JAPAN	1.8	1.3	0.7

As can be seen on the abovementioned figures, the annual rate of increase of the active population has been 2.2 in Turkey between 1970-80, while, in EEC countries, the average was 0.7. Investments of 1 million TL/per worker have to be done in Turkey to create productive employment in modern sector to employ the excess of labor supply created by this high rate of increase in population. To achieve this level, rate of growth should increase more than 7% per year. Whereas in Turkey, this rate has only achieved the level of 4% between 1960-78.
On the other hand, the high rate of urbanisation (4.6% in 1970-80 compared to 1.06% in EEC countries) has been the other cause of unemployment. Unless there was such a high rate of urbanisation, it would probably be excess demand for labor.

(16) Banque Mondiale. Rapport sur le Developpement dans le monde,1980,pp.166-167.

- Scarcity of energy and sharp price increases in petroleum have been major causes of lacking investment. In 1978,petroleum bill reached to 80% of all the export amount. The high level of petroleum bill has been financed by external debts. Thus, increasing balance of payments deficit gave rise to the limitations of imports.Difficulties in importing petroleum, other raw materials and semi-finished products used input in production process, have arisen Accordingly there has been bottlenecks in production of goods, and the idle capacities of existing investments increased extraordinarly.
  Because of the bottlenecks in imports and energy, new investments are neglected which causes furthermore the increase of the unemployment level in the Turkish economy.
- Between 1970-80, since the SEE's deficits, agricultural support purchases are financed from the government budget, arisen budget deficits brought about an increase in public expenditure. Hence,the public investments are sacrificed to the public expenditure. As a result of this policy decreasing public investments increased the unemployment level.
- In order to fight against inflation, after 1980, tight monetary policies are practiced. During this period, rate of growht is stagnated; the rate of increase in GNP has decreased which further reduced investments. On the other hand, banks have increased credit interest rates. As there were no capital accumulation in entrepreneurs, increasing rate of interest and stagnating rate of growth affected investments negatively.
  Moreover, the expectations of inflation has been major reason of the high level of marginal propensity to consume. Due to the very low level of aggregate savings, stagnated growth and high interest rates,level of investments slowed down drastically which further increases unemployments.

CHAPTER 3

THEORETICAL APPROACHES

So far, we have spoken two main problems arisen in the world during last decade with special attention to EEC countries, Japan, U.S.A. and Turkey. These were high rate of inflation and even more important high rate of unemployment. We analysed in details the main causes of it. In this part I will try to study two principal economic approaches, their aims, their targets, their policies to fight against the crisis and the problems which may occur and prevent the performances of these policies.

The main purpose of every economic theory is to rise macroeconomic performance. One may define an economic policy as the coordination of supply and demand to attain to the highest level of social welfare. Therefore, any economic policy has two principal tasks: First is to establish the supply and demand equilibrium and the second is tha this equilibrium should be the best.

From another point of view, economic policy may be interpreted as to orientate economic behaviours which are consumers' and producers' behaviours.
Another explanation says that the task of an economic policy is to organise the prices of labor, savings, capital exchange rates and consumer and investment goods that is to organise the relative price structure restoring equilibrium between supply and demand and increasing social welfare to the highest possible level.

The traditional approach of macroeconomics is to assume that fiscal measures are by far the most effective means of controlling the level of economic activity. Monetarists on the other hand, reject this assertion. It is a central

tenet of the modern monetarist position that, in the medium and longer terms, variation in nominal income are best explained not by variations in the level of 'autonomous expenditure' but by variations in the rate of monetary expansion.
Let me first explain the liberal economic approach.

LIBERAL APPROACH

A liberal political party must have a liberal approach to economic issues, whereby the most important requirement of a liberal economic policy is believing and giving emphasis to free market economy.
In market economies where competitive factors ~~are in~~ possession, the main feature of the competitiveness is the variety in alternatives.The liberal parties not showing such an activity will either loose the power or their liberal ideology.
According to a liberal economic theory, all tasks of the economic policy mentioned above are undertaken by the market itself. There is one further very important task which can be considered within the framework of the liberal macroeconomic policy and to be fulfilled by the state: To establish and protect the institutional structure of market economy.
We can summarize the major points of such an institutional structure as follows:

- Property rights
- Money-credit, fiscal and external trade
- Free competition
- Management

Once the specifications are set up suitably to the free market conditions, the responsabilit of the state is to defend the system against the develo ments which tend to damage the free market conditions. I this content, it is argued that a durable crisis in the market economy cannot exist or the roots of such a crisis is explored elsewhere than the market mechanism. For example, the reason can be found in the areas like law and institutions that are not open to competition principles. By the way theorists beli-eving in liberal doctrine do not reject that there may be minor crises in the market, but they presume these are ori-ginating from the faults of economic agents. When these fa-ults are corrected, they add, crises can be easily overcome, because market economy includes the dynamics that will re-move in stability arising from its own faults by itself. This approach, in short, argues that disorders in the eco-nomy occur as a result of an overpowered state that has too much authority on economic decisions and suggests a small state in terms of production of goods and services and a passive one in terms of conjuncture policy.

Aim, Targets, Tools, Problems, Solutions

As we have pointed out in the preceding sections inflation and unemployment, major problems that gather the focus of the governements' economical efforts, are two separate issues with different sets of causes.

In searching a solution, this nature brings forward the need of separate policies to these two, even though they relate somewhat indirectly. The precautions that are implemented to solve unemployment problem may catalyse the rise of the inflation problem or vice versa. To be more specific we can say that the most effective remedy for unemployment is economic growth, but it is also an effective inflation booster on the other hand. This dilemma leaves a very limited space of maneuver to the policy maker. The pre-cautions to both problems can not be displayed at the same time. Either first the inflation problem will be tackled and then unemployment or first new work areas will be created and then inflation will be stabilized. The essence of the policies that are used to reach the preset aim must be consistent and consciously taken. The frequent interpretation of todays liberal governments includes primarily the solution of inflation; only then the unemployment will be a matter of action. In this direction they step towards taking the money stock under their control and intend to leave the proceeding stabilization processes to the market itself. The most recent example is the policy of Mrs. Margaret Thatcher of the United Kingdom, whereas she points out that the welfare will only appear after financial straits and takes measures towards a control money stock and wait for the free market operations results.

One prerequisite of success is consistency of the measures within themselves. A liberal political party, therefore, must first set its aims and targets and then find out policy tools to reach these targets. It is natural if some impracticabilities occur during the interpretations in the market; the most effective method of dealing with these problems is either to foresee these or to grasp the problem at the particular moment of its flourishment and to take immediate steps towards a solution.

Herebelow I will display the tools of liberal economies towards reaching their aims and targets:

1.) Decreasing the aggregate demand

If the economy is facing an exess demand inflation, and if this demand can be pulled down, this decrease in the internal demand will create a supply surplus and a negative trend on prices will be observed. The decrease of the demand necessitates a strict monetary policy interpretation.

One important factor that must not be omitted is that a strict monetary policy does not end up in a constant money volume in the economy, but it yields a price stabilization through money volume adjustments. The main implement of tight monetary policy is the control over the rate of domestic credit expansion. This recommendation must by definition form the core of any monetarist solution to the problem of inflation. A liberal government has to control the supply of money arising from domestic sources in order to be able to make a start in its battle with inflation. This may not be an easy decision to make for a wide variety of political reasons. For example, a government may be discouraged by the prospect of the increase in unemployment which would ensue from the policy of demand restraint which is implicit in the above proposal: The solution to this problem is that the required reduction in the rate of monetary expansion should be undertaken gradually so as to avoid subjecting the economy to a violent change in direction. The economy should be given the opportunity to acclimatize itself to a changing monetary environment.
Apart from that, in industrialised countries where there is a surplus in balance of payments, this surplus acts as an injection to the economy and plays a role in increasing the demand and makes an inflationary pressure. For that reason the government should float the currency if the country wishes to isolate itself from the inflation occuring elsewhere in the world.

2.) Encouragement of the companies towards increasing their potential profits

Keeping the money stock under control by means of strict monetary policy as a tool against inflation usually drops the rate of growth; that slows down investments which give evidence to unemployment. To prevent this bottleneck, savings have to be inspired. Herewith the production will be eased, savings have to be directed towards production in a way to decrease the production costs, so the companies will increase their profits and will seek for the new investments. Unemployment, first, will develop but with these new investments new opportunities will flourish for active population and the rate of unemployment will drop. Here, I must stress that encouragement and increase of the savings does not mean anything unless they are directed to the right direction. An approach that tightens the savings of companies and augment the savings in a macro sense or presents the macro level savings to the firms with a very high price is not a liberal one in essence. A healthy operating money banking system and capital stock market are an alternative to the problem of expensive savings transfer or high loan interests to the companies.In order to minimize the loan interests the banks must operate more rational and let the interest rates to float in the free market. On the other hand regulations that back-up high loan interests, must be removed within a period of time. Furthermore, the monetary system should prevent the deterioration in the relative price structure by finding out the optimal money amount in the market and takes care that the monetary system is contented with that optimal amount.

3.) Efficient use of resources

This target of the liberal economics originates from the idea of preventing wasteful expenditure. In this direction, the government, not only, is obliged to follow a passive conjuncture and a systematic growth policy for market orientation but is also liable to help the creation of active markets. This fact in turn necessitates the disciplination of relative price structure in a sound manner. This structure is to be coincided with the supply and demand relationship and the nature of competitive market structure. The most likely problem that may emmerge is that the government may enter the market in some product areas just like an entrepreneur and may sell some products and services with a price that does not fit the market, and will try to impose some tax on them. Under these circumstances besides the supply and demand relationship also other factors play a role in the price structure. To prevent such a dilemma the liberal decision maker, who strictly believes the private sector is far more efficient than the public sector, has to make examptions for goods and services whose prices can not be left to market operations and try to render these only through public sector.

Important Problems

Generally in economies, especially in periods when economic balances are not running well, it is not easy to tackle even one major problem, whereas several problems are waiting for solution. In this connection one of the governments' primary assignments is to explain the citizens that they will go through economically painful period and that everyone has to make some sacrifices in order to reach the desired targets The most depreciating aspect of liberal economic policies is that it takes too much time to reach its aim sometimes. Although the monetarist proposals get right to the heart of the inflation problem, they involve possibly quite considerable social and economic costs extending over a period of years. In the prolonged period of transition from a high to alower rate of monetary expansion, the unemployment rate will rise and the rate of growth of output will fall. To prevent this, low costly transfer of overall savings to the firms may be applied which further decreases costs, increases profit margin and therefore encourages production and investments, create new employment, reduces high rate of unemployment. "On the other hand, in order to soften the blow and shorten the period of transition, widespread adoption of indexation may be used as a means both of reducing the arbitrary inequities and misallocations produced by unanticipated inflation and of speeding up the rate of erosion of inflationary expectations. A completely successful indexation program would reduce inflationary price expectations and the shorter will be the period of low capacity utilization and high unemployment." (17)

The liberal approach explained so far includes aims, targets, policies, problems and solutions according to economies of developed countries except very few items. This model cannot be practiced entirely without facing any resistance in developing countries like Turkey. A number of bottlenecks like capital, savings, technological know-how, lack of experience, infrastructural deficiencies, lack of intersectoral relations and unconsciousity of the consumer are factors of that sort. The termination of such problems are dependent on the attempts of the state to establish influential markets. For this sake it is necessary to prepare plans that point out rational product potentials and establish intersectoral ties among these.

(17) TREVITHICK,J.A. and MULVEY,C. The Economics of Inflation 1975,p.170

SOCIAL DEMOCRATIC VIEW - KEYNESIAN APPROACH

Generally, in pluralist democracies, one of the trends is social democratic approach. This approach flourished after the 1929 great depression, which is, according to Keynesians, an experience that shows an implication of insufficiency of the tools of the market operations which we discussed in the beginning of this chapter.

Keynesian approach developed in direction exhibiting the weaknesses of the market economy in order to grant, in an increasing way, the coordination of the entire market to the government. "Income policies" aiming a direct interference to the categories like wage and pricing are interpreted by pointing out factors that turbulate the credibility of free market economy.
As a result, a system, where the micro units are taking orders from the government started to be used. Consequently, the Keynesian approach found a place for itself in the socialist thought.

Aim, Targets, Tools, Problems, Solutions

In contrary to the liberal approach, social democratic approach promises a relaxation and welfare from the first day on.
In this direction, unemployment becomes first problem to be tackled; inflation follows afterwards. The most recent evidence of such an economic policy is represented by M.François Mitterand in the coalition government of Socialist and Communist Parties in France since 1981.

The next paragraph will display a more detailed examination of the economic policies social democrats use in undertaking two major problems of unemployment and inflation.

1. Meeting supply and demand equilibrium by increasing the supply
Instead of liberalists' demand decreasing policy, social democrats prefer to shift the supply schedule upwards to meet the supply and demand in the country.

Such a controversial approach depends upon their totaly different view on how the inflation grows. The liberalists, as we have examined earlier, believe that the prices tend to move downwards with the decreasing demand in the economy. On the contrary, Keynesians put forward, that in a sector where demand is going down, the entrepreneur will prefer to decrease the quantity, not the price. This controversal reasoning by the two approaches depends on the price and quantity relationship which has a total reverse yielding according to Keynesians and liberelists.

We can explain by this following example:

Let's suppose an economy where X, being a raw material, which has a share of 5% in GNP. According to Keynesian,a 50% increase in petroleum prices will increase the general price level of about 2.5%. But the monetarists argue that this increase in petroleum prices will be balanced with the decreases in the prices of other goods, if the money stock is kept fixed; so, the general price increase will be below 2%.

2. <u>Intensive use of the resources by increasing the effective demand</u>.

In contradiction to the "efficient use of scarce resources" approach of the liberalists, the Keynesians put forward the intensive use of resources and claim that by this method, wasting of them can be prevented. The use of the monetary and fiscal tools in direction of expanding the effective demand will replace the problems of insufficient demand and unemployment. At the same time, the expansion of effective demand will increase the profits of the firms, which consequently will increase production and investments will follow the procedure. New employment areas gained through this process will result in public autonomous investments. The main target of economic approaches is to increase the performance of the macroeconomy. The expectation of this Keynesian approach, i.e.: increasing the economic performance through expanding the effective demand, is to secure a more intensive use of the resources and to reach the supply and demand equilibrium by increasing the production; but an undesired result, the unneccessary expansion of the monetary volume, can also be reached.

This will surely boost the inflation. To handicap such a development we have only one measure in our disposal: backing the public investment with sound financial resources.

Important Problems:

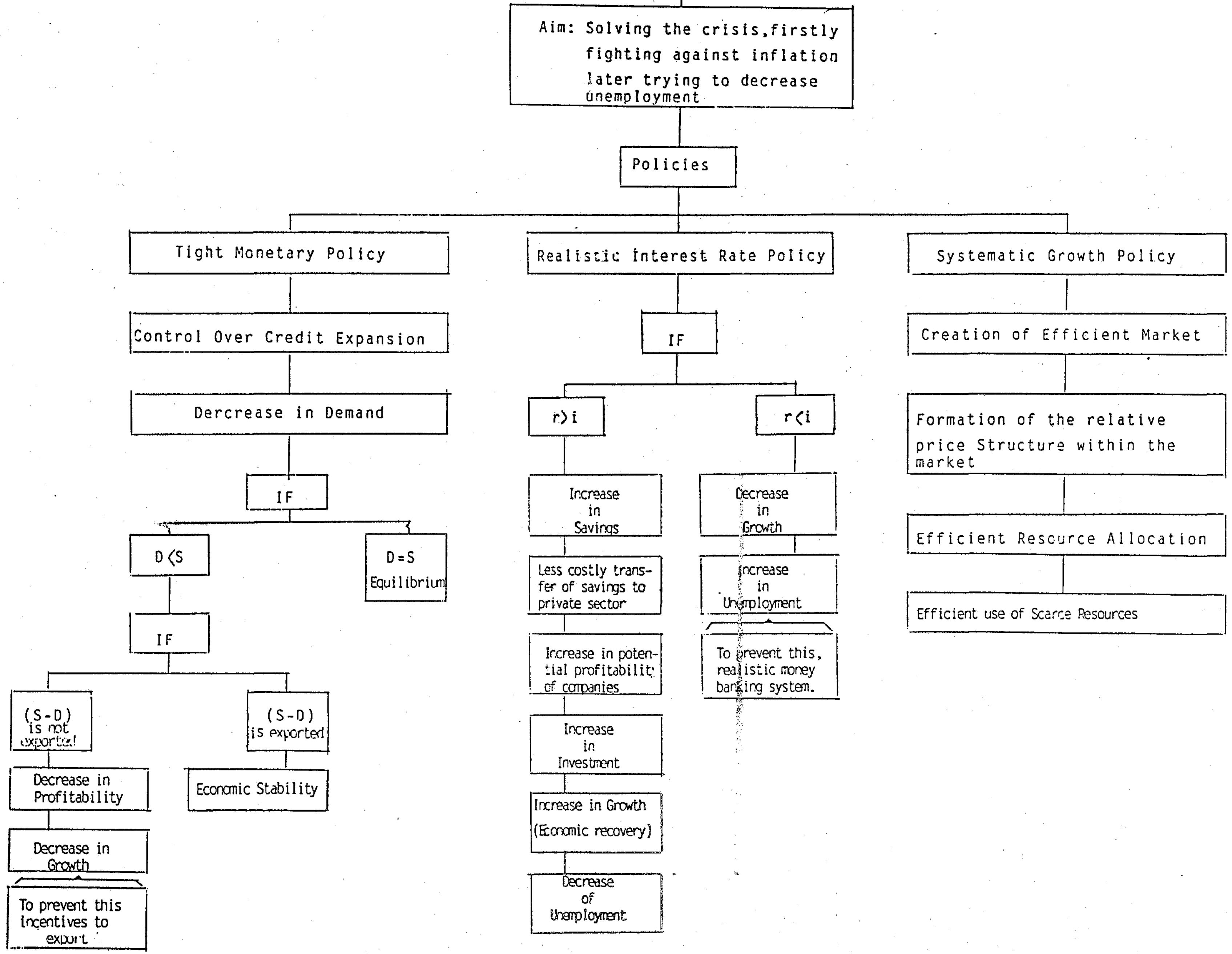
1. The most important bottleneck is in financing the public investments, which have to be done in order to replace the unemployment, because the attempts of distributing welfare from the first day on without waiting to find strong finance resources result in issuing currency and expanding the money stock. This is an accelerator of inflation. Additionally, there is need of foreign currency for the finance of investment goods and for the import of secondary goods which are necessary for the production. For the solution of these problems, income of the state has to be increased by fiscal policy. Furthermore, with the creation and efficient use of funds, the investments have to be based on solid grounds. The foreign currency demand can only be met by placing importance on issues that will increase the foreign currency income.
A serious support policy to increase incoming currency like exports and other services and investments towards this aim will give the desired result.

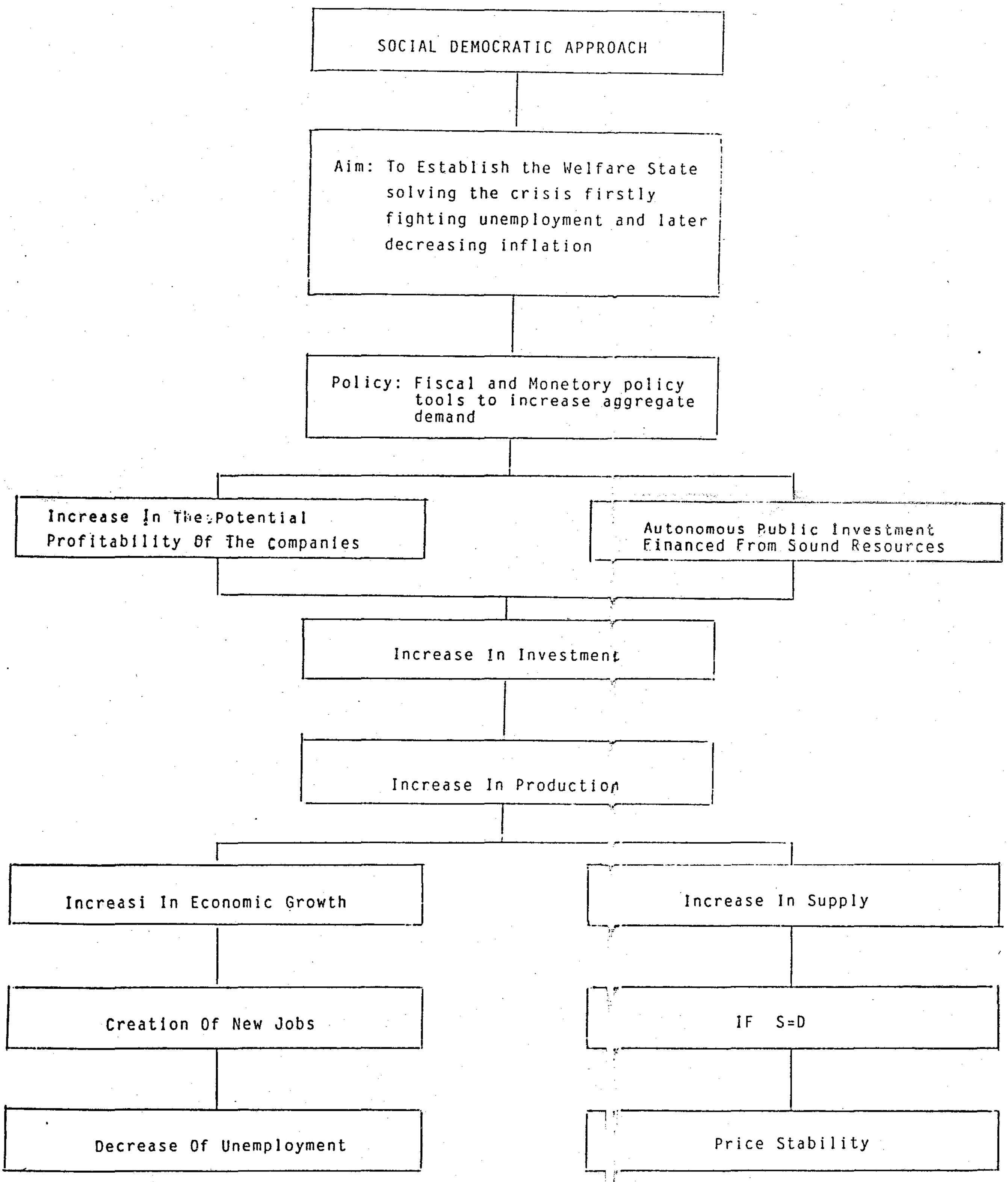
2. Policies of governments show reflections in economic lives of the countries.
With the passing time, governments, doing unefficient expenses partly because of political factors and partly with the negative effect of the bureaucracies, engage in several investments without finding the necessary financial power. The portion that the government takes from GNP grows year by year, whereas the private sector is obliged to pay ever expanding taxes turning into burdens. Consequently, economic structures of the countries form into inequal frameworks and problems like inflation and unemployment can never come to an end. The one and only solution in breaking such a framework includes minimizing the bureucratic handicaps and leaving aside the quarrels for political interests.

We can extract from our discussion that it is not a sure thing to reach a perfect solution to economic problems in neither of the approaches. Always, new problems emerge and hinder a fast and entire solution. Also, we can not say solutions to these newly emerging problems are not available.

What are the basic characteristics of these problems?
The problems in the implementation of liberal policies are basically technical. (e.g.: high loan interests, decreasing effect of the demand drop on economic growth) In the application of social democratic approach on the other hand, problems have often a political interest nature (e.g: insufficient investments) According to me, the latter group of problems are of more consistent nature and the success of the liberals is therefore a closer possibility.

In order to make better comparisons, both approaches are schematically showed in the following pages.


Aim: Solving the crisis, firstly fighting against inflation later trying to decrease unemployment
Policies
Tight Monetary Policy
Realistic Interest Rate Policy
Systematic Growth Policy
Control Over Credit Expansion
Dercrease in Demand
IF
D<S
D=S Equilibrium
IF
(S-D) is not exported
(S-D) is exported
Decrease in Profitability
Economic Stability
Decrease in Growth
To prevent this incentives to export
IF
r>i
r<i
Increase in Savings
Less costly transfer of savings to private sector
Increase in potential profitability of companies
Increase in Investment
Increase in Growth (Economic recovery)
Decrease of Unemployment
Decrease in Growth
Increase in Unemployment
To prevent this, realistic money banking system.
Creation of Efficient Market
Formation of the relative price Structure within the market
Efficient Resource Allocation
Efficient use of Scarce Resources


SOCIAL DEMOCRATIC APPROACH
Aim: To Establish the Welfare State solving the crisis firstly fighting unemployment and later decreasing inflation
Policy: Fiscal and Monetory policy tools to increase aggregate demand
Increase In The Potential Profitability Of The Companies
Autonomous Public Investment Financed From Sound Resources
Increase In Investment
Increase In Production
Increasi In Economic Growth
Increase In Supply
Creation Of New Jobs
IF S=D
Decrease Of Unemployment
Price Stability

CHAPTER 4
CONCLUSIONS AND POLICY RECOMMENDATIONS

The outlook of the world economy vis-a-vis factors such as production, employment, inflation, interest rates, trade, protectionism, foreign deficits may be underlined as follows: Since 1973, developed economic, especially EEC countries experienced high rate of inflation accompanied few years later by increasingly high rate of unemployment. Following 1978 second petroleum shock, industrialized economies generally pursued very tight money and finance policies trying to eliminate the stagflation. These policies are pursued also during 1981 and 1982 and led to spectacular drop in the growth rates. Surely, Turkey also, being a country depending on European economy has been negatively affected from these problems. Therefore, to remove the crisis, different countries tried to run different policies. Two major ones were monetary policy pursued by liberal governments and Keynesian policy pursued by social democratic governments. In the previous chapter, I tried to explain the mechanisms, aims, implements, problems, solutions of both policies.

Nowadays, two EEC countries, France and United Kingdom pursue just opposite policies to fight against the crisis.
The tight monetary policy of Thatcher's liberal government and the Keynesian fiscal policy of Mitterand's socialist France. Which is more succesfull? U.K., with 13.6% rate of unemployment is in the second place after Ireland among EEC countries. On the other hand, France keeps the same level of unemployment but it can not achieve to decrease the rate of inflation.
Therefore, in order to decide which policy to implement, governments should decide which problem is at major importance and which one is at minor one. Once it is fixed, it will be easier to decide; because it is generally accepted and proven that tight monetary policies are more effective to solve the inflation while the Keynesian fiscal policy is effective in solving unemployment.

What has to be done to eliminate the crisis?
To fight against inflation, all EEC countries are performing tight monetary policies in some extent or are controlling the money stocks. For this reason, during last years, inflation is generall under control of governments. But it has a cost. As a result of the transition from a high to a lower rate of monetary expansion the rate of growth of output and consequently investments would fall and the unemployment rate would rise. Therefore, what should be, today, the measures to be taken to achieve the economic recovery in Europe?

EEC countries have surprised the world during the 1950s and 1960s by their ability to grow without inflation but the tables turned during 1970's, which brought inflationary growth followed by inflation without growth. Some ten years ago, zero growth has been fashionable new idea in Europe and many people saw stagnation as a kind of perfect state. Now, it is generally acknowledged that three years of zero growth have been enough to raise the number of unemployed in the ten countries of the community to over 12 million. On the other hand, in zero growth societies no one can improve his situation without worsening someone else's. It is no accident therefore, that the history and geography of democracy and public freedoms coincide with the history and geography of economic growth. The two must be consolidated if it is to restore the growth of the European economy.
- It is up to each individual country to fight inflation because inflation is due principally to three national variables:budgetary policy, monetary policy and the behaviour of prices and incomes. Of these three it is the last which is most important, if the two sides of industry jointly acknowledge that a nominal increase of 5% in incomes will ultimately result in greater purchasing power than a nominal increase of 10%. If not,the only way to a healty economy is through monotary restraint.
- To restore the economic recovery, the sole way is the economic unity of EEC countries because community action has a multiplier effect. It is shown in Table based on the Albert's, Ball's Comet III model on simulations. The principle is simple.

EFFECTS OF AN INCREASE OF PUBLIC INVESTMENT OF 1 % ON GDP AFTER 2 AND 3 YEARS (18)

Effects on	EC-10		D		F		I		UK		NL		B		IRL		DK		GL	
	Year		Year		Year		Year		Year		Year		Year		Year		Year		Year	
	2	3	2	3	2	3	2	3	2	3	2	3	2	3	2	3	2	3	2	3
	Individual action																			
GDP growth	-	-	1,0	0,6	0,4	0,2	0,5	0,4	0,9	1,1	0,4	0,5	0,3	0,3	0,2	0,1	0,3	0,4	0,6	0,8
Trade balance/GDP	-	-	-0,5	-0,4	-1,0	-1,0	-1,0	-0,5	-0,6	-0,5	-0,6	-0,5	-1,3	-1,3	-1,0	-1,0	-0,4	-0,6	-0,1	-0,3
Budget balance/GDP	-	-	-0,6	-0,8	-1,0	-1,1	-2,0	-2,3	-0,9	-1,0	-0,9	-0,9	-1,2	-1,4	-1,2	-1,4	-1,1	-1,1	-1,1	-1,1
	Concerted action																			
GDP growth	1,6	1,5	1,9	1,8	1,3	1,1	1,4	1,5	1,6	1,8	1,3	1,5	1,3	1,4	1,5	1,6	1,1	1,2	2,1	2,3
Trade balance/GDP	-0,4	-0,4	-0,4	-0,5	-0,5	-0,5	-0,4	-0,4	-0,4	-0,3	-0,4	-0,5	-0,4	-0,4	-0,4	-0,4	-0,5	-0,5	-0,1	-0,1
Budget balance/GDP	-0,6	-0,7	-0,2	-0,2	-0,6	-0,7	-1,7	-1,9	-0,5	-0,6	-0,4	-0,5	-0,6	-0,8	-0,4	-0,5	-0,7	-0,7	-0,6	-0,6

(18) ALBERT,M. and BALL,J. EEC Report,1983. p.37a

It is assumed that the EEC countries' public investment during a given year is increased by 1% of GDP. It then examines two hypotheses.

1. That this action is undertaken by each country individually.
2. That the same action is taken at community level in a concerted manner.

The model then calculates, country by country, the effects on growth, external balance of payments and public expenditure over the following two years period. As can be seen on the table, in each case, for various countries and aggregates considered, concerted action is seen to produce better result.

- Real profitability is the main key factor in the provision of future output and employment. An increase in the share of profits is permitted only by restraining the wage growth. What is necessary is to combine an increase in the share of profits sufficient to sustain economic growth with an initial expansion in the level of demand. To achieve this, there should be some aggreement and realisation at a EEC level that real wage moderation is required. The mechanism is that the real wages of those at work should not expand as overall demand, output and employment rise. The increase in the level of demand that is to accompany wage restraint is to be stimulated by additional investments mainly in the fields of energy and new technology. 1% of extra growth each year for three years create three million extra jobs which further decreases the number of unemployed people.

Other measures to achieve a more satisfactory economic environment and encourage the development of a new sound basis for the further growth and prosperity of Europe may be as follows: (19)

. Reducing monetary growth in line with a sustained inflation target in Europe of less than 5%, coupled with a progressive reduction in the budget deficits of member states overall.

. Accelerating early retirement giving aid and provision of training facilities and special job schemes for young people.

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(19) _____, Ibid,p.55

. A reconsideration of capital expenditure programmes by member governments and an encouragement to undertake public capital ventures designed to provide increased services and facilities for private industry.

. Development of an effective energy policy, possibly linked to the suggestion of an import tax on oil.

. Changing work practices in any way which increases the real choices between work and leisure for people, or which increases and facilitates the flexibility of labour market behaviour.

. Facilitate the rationalisation of basic commodity industries within the community and to encourage and support the creation of European companies through mergers acquisitions and joint-ventures, particularly in the high R and D technology and energy fields.

Finally it should be added that expansion in Europe is not synonymous with accelerating monetary growth and rising national fiscal deficits. This is not to say that, over short periods, fiscal and monetary policy in any one country may not be too tight. But it doesn't mean that there should be some major expansionary shift in fiscal and monetary policy. Much will be gained from a continued attempt to achieve a more appropriate long-term balance between monetary growth and the fiscal balance associated with a further reduction both in interest rates and the rate of inflation.

Being a developping country, Turkey has more problems to solve. Turkey has been among the countries most effected from the negative developments in the world economy since 1973; and the inflationist pressure, decrease in investment and failing to expand the employment opportunities led to the continuation of the unemployment as a serious problem.
Unemployment being a very important problem both from political and social point of view, has the nature of a loss and waste from the economic point of view.

On the other hand, continous and high rate of inflation, worsening the income distribution, creates social disequilibrium. Therefore, the most important factor of social peace is the elimination of unemployment and inflation. I personally believe that the elimination of unemployment and expansion of the social security depend on the prevention of inflation and the continuation of a stable economic growth. I have no doubt, in a developping country like Turkey which is experiencing a very high rate of inflation, once the inflation rate is taken under control by tight monetary policy, an eclectic one which includes both monetarist and Keynesian policy tools should be applied to increase the performance of the economy. Therefore, the followings may be proposed to firstly decrease general price level and to eliminate later the unemployment problem, increasing rate of growth.

1) First of all, the following question should be answered. "Who is the responsible of the inflation? The government which causes a deficit in the budget or the Central Bank which finances this deficit with open budget financing". In the industrialized countries, the responsible is sometimes governments, sometimes Central banks. In Turkey, since the Central Bank is only the economic advisor and supporter of all governments, and is depending on it I can easily say that, the responsible of inflation has always been governments.

The major responsability of any political party in power is to create the welfare state for its people. Inflation takes away this welfare. Therefore, to make a start in the battle with inflation, the government has to control the money supply, even though it is forced to cut back on its own expenditure and raise tax revenue. This control over the rate of domestic credit expansion form the core of any monetarist solution to the problem of inflation. Monetarists would also argue that there should be a gradual reduction in the rate of domestic credit expansion because a sudden reorientation of monetary policy could have a very serious repercussions which a gradualist posture would seek to avoid.

Money and credit policy is not an efficient and effective weapon by itself alone. This policy may achieve its aim only if it is utilised in harmony with other leading measures of the economy. A liberal party, practicing tight monetary policy to fight inflation, should and do believe to the free market economy. Prices of all economic concepts should be decided within the market according to demand and supply equilibrium.

. Deposit interest rate should be formed in a most realistic way. From this point of view, the following require more attention.

. Net deposit interest rate (after tax deduction), in any case, must be greater than the rate of inflation.

. Net deposit interest rate given to Turkish Lira(after tax deduction) should be greater than the sum of percentage drop of TL. in comparison to foreign currencies and the rate of interest given to these foreign currencies. Unless this is done, people will keep its saving abroad as foreign currency. Using these foreign currency savings in the domestic investments can not be possible.

. The ruling party should not interfere unless the real interest rate (net deposit interest rate- Inflation rate) is negative or zero.

. Liquidity and repayment capabilities of companies issuing bonds should be controlled but to determine the interest rates applied to these bonds should be let free. This is a very important point and has two important effects. First, if commercial banks determined a interest rate below the realistic one, the saver will prefer to buy bonds and so on, the deposit interest rate will increase to its real value. Secondly, if banks apply a high interest rate to credits, entrepreneurs will tend to issue bonds to finance their activities.

. The points which should be taken into consideration in determining the rates of interest of credits are:

There are two main sources of the big difference between deposit and credit interest rates applied in Turkey today.
The first is that the general expenses of banks are too costly. Second one is the legal arrangements, which increase the cost of credit increase rate. These legal arrangements have to be minimized in a some period of time.
As you can not control the value of a currency by laws, you can not keep itsvalue at the same level, by prohibitions. Or, you can not have equilibriums with a currency which is protected by laws and prohibitions, because any limiting decision taken causes that the other currencies gain value against this specific currency. Therefore, all limitations should be eliminated if the competitiveness in the market has been provided.
Hence, firstly, the competitiveness of the market should be evaluated. According to this evaluation, the deficiencies should be pointed out and the serious decisions should be taken to improve and then the limitations on currency should be removed.
. Measures to transfer less costly the savings to the private sector should be taken in order to increase the profitability of the companies which further rises the output investment, and thus creating new jobs decreasing unemployed people.

2) Indexation :
The transition from a high to a lower rate of monetary expansion has possibly quite considerable social and economic costs.
The unemployment rate will rise and the rate of growth of output will fall. In order to shorten the period of transition, a widespread adoption of indexation may be advisable. Indexation is the means by which all parties to contracts agree to terms which are fixed in real value. A successfull indexation program would reduce expected prices and the shorter will be the period of low capacity utilization and high unemployment.

3) Stabilization Programme:
Together with the effective resource allocation, economic growth also is among the main targets of a stabilization programme.

Turkey has to increase its savings, exports and productivity to achieve the stability. These increases may be attained easier in a growing economy.
There is a big handicap to increase the amounts of savings because of the actual national income level and worsening income distribution. It is not possible to change the propensity to consume of the high income groups and on the other hand, low income groups lost their abilities to save.
Moreover, Turkey has to increase its exports. The most important measure for this is to follow a realistic exchange rate policy. In order to develop the exports, a large content of incentives policy should be continued to apply using realistic financial resources; and also the cooperation between bureaucracy and private sector should be established.
In order to attain international competitiveness and to decrease inflation rate, productivity should be risen. Apart from the no money requiring organizational arrangements, new investments aiming to increase the productivity should be done. Thanks to the existence of investment possibilities to increase particularly the efficiencies of existing capacities, it may be possible to get rapid developments in the investments and the rate of productivity. Therefore, the economic growth is required to have developments in these three concepts necessary for a successfull stabilization programme. Infrastructural and some energy investments done by the government require necessary funds and resources to be financed. Some other measures may be listed. I tried here to explain the most crucial ones.
As can be seen easily, I have tried to write this report as clearly and simply as possible. The first part is analysis, the second the explanation of the two rival theories, while the third puts forward proposals. In theories, it is not too hard to find out problems, to look for the solutions and to give the proposals but in practice, exogenous factors, not been able to foresee in theories, make applying solutions and taking measures harder than they are. Therefore, my proposals are no more Keynesian than monetarist or vice versa. The important factor, I believe, is if they are practicable.

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