

Conference of CESifo and Center on Capitalism and Society
Venice, 21-22 July 2006

Introductory Remarks: Perspectives on the Performance of the Continent's Economies

Edmund S. Phelps*

I greet you on behalf of the Center on Capitalism and Society. In a moment Hans-Werner Sinn will welcome you on behalf of CESifo.

I want to take a couple of minutes to set out very simply what I believe the economic difficulty experienced in western continental Europe – its economic under-performance.

In the past ten years, hourly productivity in the U.S. was growing considerably faster than it had in the two previous decades and then sped up early in the present decade. In the same period, deep slowdowns in hourly productivity began in the Netherlands, next Germany, then Spain and finally Italy and France. Now, *relative* productivity in some of these countries is pulling out of its nose dive, but a cumulative gap has opened up – at least if purchasing-power-parity exchange rates are used. The corresponding gap between total hourly compensation, including social charges and other taxes, has likewise widened.

In addition, unemployment rates are again noticeably higher than those in the U.S., although not as high as in the first half of the 1990s.

Finally, reported job satisfaction tends to run lower in the Continent's Big 3 than in Canada, the U.S. and the U.K.

Most thoughtful observers regard these data as signs of under-performance and large enough to be a serious problem. There is reportedly a large out-migration of young people from France to Ireland, Britain and the U.S.

We have come here to present our differing views on the causes of the under-performance in continental Europe. Is the main cause some deficiency in their *economic* system? Or some by-product of their *welfare* systems of social insurance and assistance? Or adverse market prospects in the

* Director, Center on Capitalism and Society, Columbia University. The Center's website is at www.earth.columbia/ccs This website contains a mission statement, a short history of capitalism theory, the Center's Working Paper series and our electronic journal *Capitalism and Society*.

Continental economies, such as the Continent's challenging demographics?

A great many economists observe that the Continent has few industrial or commercial sectors, if any, that are as innovative as those in the U.S. or Canada or, for that matter, South Korea or Ireland. In my terminology, the Continent has been lacking in *dynamism*, by which I mean innovativeness that is commercially successful. What, though, are the roots of this deficiency of dynamism?

In the perspective of neoclassical theorists, the notion of a faulty "economic system" is an alien concept. Some neoclassicals do not see the social system as faulty either. They suppose that nationals on the Continent have their reasons for their large social insurance and social assistance entitlements. They suggest that *homo Continentus* has an outside need for "security," which the welfare state is well designed to provide, thus a low tolerance for risk and change. The result is that few producers and investors are willing to engage in high-risk projects, even if they have known risk characteristics, and few consumers are willing to try new products, even if they too are free of genuine uncertainty. Thus innovation is shunned on the Continent.

Some other neoclassicals suppose that nationals on the Continent have the same tastes and risk preferences as do those in the comparator countries. Yet the political system has given them a larger welfare state than they would have liked, thus a higher rate of tax and, therefore – or so it is supposed – a lower level of labor-force participation and employment.

In the perspective of what may be called *modern* theory, the task is to find the faults in the *economic* system – the under-developed economic institutions or the malformations in the economic culture – that impede or obstruct entrepreneurs from developing innovations or from succeeding with them, once developed.

A few decades ago, one might have thought that the productivity lead in the world would alternate between the Continent and the United States in view of the comparable technological sophistication of the two regions. But evidently productivity – not to mention the satisfactions of career and the workplace – is not simply "technology."

I have become particularly interested in the idea of economic culture. Of course, any program to explain inter-country differences by appeal to differences in cultural traits and attitudes would be incomprehensible from the stand-point of neoclassical theory. It follows that a rationale for cultural effects, if found, must go outside the neoclassical paradigm to recognize the Hayekian entrepreneur, managers with strategic vision, firms with employee engagement, works seeking learning and personal growth, team players,

consumers with curiosity and Bhidesque venturesomeness – thus Knightian uncertainty and creativity as well as imperfect information. In an economy where entrepreneurial activity is important, the culture of the people available for work is analogous also to their “know-how”: just as a stage and a hall will not “work” if the assembled players have not acquired the ability to act and interact, so the plant and hardware of an entrepreneurial company will not “work” if the personnel is unwilling or unhappy to be organized and to organize themselves as a team.)

A distinctive feature of this conference is that it will seek to discover effects of several cultural values, attitudes, etc. on some of the main dimensions of economic performance.